LETTERS OF CREDIT

I. DEFINITION/CONCEPT

Q: What is Letter of Credit (LC)?

A: It is any arrangement, however named or described, *whereby a bank* (issuing bank), acting at the request and on the instructions of a *customer* (applicant) or on its own behalf, binds itself to:

1. *Pay* to the order of, or *accept* and *pay drafts drawn by a third party* (Beneficiary), *or*
2. *Authorize* another bank to *pay* or to *accept* and *pay* such drafts, *or*
3. *Authorizes* another bank to *negotiate*, against stipulated document(s),

Provided, the terms and conditions of the credit are complied with. *(Art. 2, Uniform Customs & Practice for Documentary Credits.)*

Note: They are in effect absolute undertakings to pay the money advanced or for the amount for which the credit is given on the faith of the instrument.

Q: What is the duration of LC?

A:
1. Upon the period fixed by the parties; or
2. If none is fixed:
   a. 6 months from its date if used in the Philippines;
   b. 12 months if used abroad *(Art 572, ibid).*

Q: What are the kinds of LC?

A:

COMMERCIAL LETTERS OF CREDIT	STANDBY LETTERS OF CREDIT
Involve contracts of sale.	Involve non-sale transactions.
Payable upon presentation by the seller-beneficiary of documents that show he has *performed* his contract.	Payable upon certification by the beneficiary of the applicant's NON-*performance* of the agreement. *(Transfield v. Luzon Hydro Corp., G.R. No. 146717, Nov. 22, 2004)*

Q: Is irrevocable letter of credit and confirmed letter of credit synonymous?

A: An irrevocable letter of credit is not synonymous with a confirmed letter of credit. In an irrevocable letter of credit, the issuing bank may not, without the consent of the beneficiary and the applicant, revoke its undertaking under the letter, whereas, in a confirmed letter of credit, the correspondent bank gives an absolute assurance to the beneficiary that it will undertake the issuing bank's obligation as its own according to the terms and condition of the credit. *(Prudential Bank and Trust Company v. IAC, G.R. No. 74886, Dec. 8, 1992)*

Q: Can a court order the release to the applicant the proceeds of an irrevocable letter of credit without the consent of the beneficiary?

A: No, such order violates the *irrevocable nature of the letter of credit*. The terms of an irrevocable letter of credit cannot be changed without the consent of the parties, particularly the beneficiary thereof. *(Phil. Virginia Tobacco Administration v. De Los Angeles, G.R. No. L-27829, Aug. 19, 1988)*

II. GOVERNING LAW

Q: What is the law governing letter of credit (LC)?

A: It is the Uniform Customs and Practice (UCP) for documentary Credits for International Chamber of Commerce governs the Letters of credit *(Metropolitan Waterworks vs. Daway, G.R. No. 160723, July 21, 2004).*

Articles 567 to 572 of the Code of Commerce on Letters of Credit are obsolete. However, in the absence of any provision in the Code of Commerce, commercial transaction shall be governed by the usages and customs generally observed. *(Sec. 2, Code of Commerce)*

III. NATURE OF LETTER OF CREDIT

Q: What is the nature and purpose of LC?

A: To ensure certainty of payment. The seller is assured of payment because the bank intervenes and makes the commitment to pay. This addresses problems arising from seller's refusal to part with his goods before being paid and the buyer's refusal to part with his money before acquiring the goods, thus, facilitating commercial transactions.

Q: What are the essential conditions of LC?

A:

1. Issued in favor of a definite person and not to order.

   Note: The Uniform Commercial Practice for Documentary Credits allows letters of credit to be payable to order

2. Limited to a fixed or specified amount, or to one or more amounts, but with a maximum stated limit. *(Article 568, Ibid)*

   Note: If any of these essential conditions is not present, the instrument is merely considered as a letter of recommendation.

Q: In case the buyer was not able to pay its obligation under the letter of credit, can the bank take possession over the goods covered by the said letter of credit?

A: No. The opening of a Letter of Credit did not vest ownership of the goods in the bank in the absence of a trust receipt agreement. A letter of credit is a mere financial device developed by merchants as a convenient and relatively safe mode of dealing with the sales of goods 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. *(Transfield Philippines, Inc. v. Luzon Hydro Corporation, G.R. No. 146717, Nov. 22, 2004)*

IV. PARTIES TO A LETTER OF CREDIT

Q: Who are the parties to a Letter of Credit transaction?

A:

1. *Applicant/Buyer/Importer* – procures the letter of credit, purchases the goods and obliges himself to reimburse the issuing bank upon receipt of the documents title.

2. *Issuing Bank* – One which, whether a paying bank or not, Issues the letter of credit and undertakes to pay the seller upon receipt of the draft and proper documents of title from the seller and to surrender them to the buyer upon reimbursement.

3. *Beneficiary/Seller/Exporter* – In whose favor the instrument is executed. One who delivers the documents of title and draft to the issuing bank to recover payment.

The number of parties may be increased. Modern letters of credit usually involve bank-to-bank transactions. The following additional parties may be:

1. *Advising/notifying bank* – The correspondent bank (agent) of the issuing bank through which it advises the beneficiary of the LC.

2. *Confirming bank* – bank which, upon the request of the beneficiary, confirms the LC issued.

3. *Paying bank* – bank on which the drafts are to be drawn, which may be the issuing bank or another bank not in the city of the beneficiary.

4. *Negotiating bank* – bank in the city of the beneficiary which buys or discounts the drafts contemplated by the LC, if such draft is to be drawn on the opening bank not in the city of the beneficiary.

Q: What are the stages of LC?

A:

1. Contract of sale between the buyer and seller
2. Application for LC by the buyer with the bank
3. Issuance of LC by the bank
4. Shipping of goods by the seller
5. Execution of draft and tender of documents by the seller
6. Redemption of draft (payment) and obtaining of documents by the issuing bank
7. Reimbursement to the bank and obtaining of documents by the buyer

A. RIGHTS AND OBLIGATIONS OF PARTIES

Q: Explain the three (3) distinct but intertwined contract relationships that are indispensable in a letter of credit transaction.

A:

1. *Between the applicant/buyer/importer and the beneficiary/seller/exporter* – The applicant/buyer/importer is the one who procures the letter of credit while the beneficiary/seller/exporter is the one

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who in compliance with the contract of sale ships the goods to the buyer and delivers the documents of title and draft to the issuing bank to recover payment for the goods. Their relationship is governed by the contract of sale.

2. *Between the issuing bank and the beneficiary/seller/exporter* – The issuing bank is the one that issues the letter of credit and undertakes to pay the seller upon receipt of the draft and proper documents of title. On the other hand, the beneficiary/seller/exporter surrenders document of title to the bank in compliance with the terms of the LC. Their relationship is governed by the terms of the LC.

3. *Between the issuing bank and the applicant/buyer/importer* – The applicant/buyer/importer obliges himself to reimburse the issuing bank upon receipt of the documents of title. Their relationship is governed by the terms of the application for the issuance of the letter of credit by the bank. **(2002 Bar Question)**

Q: Is an issuing bank a guarantor?

A: No, the concept of guarantee *vis-a-vis* the concept of irrevocable LC is *inconsistent* with each other. LCs are primary obligations and not security contracts and while they are security arrangements, they are not converted thereby into contracts of guaranty. *(MWSS v. Hon. Daway, G.R. No. 160732, June 21, 2004)*

Q: When is the bank entitled to reimbursement?

A: Once the issuing bank shall have paid the beneficiary after the latter's compliance with the terms of the LC. Presentment for acceptance to the customer/applicant is *not a condition sine qua non* for reimbursement. *(Prudential Bank v. IAC, G.R. No. 74886, Dec. 8, 1992)*

Q: What is the consequence of payment upon an expired LC?

A: An issuing bank which paid the beneficiary of an expired letter of credit can recover the payment from the applicant which obtained the goods from the beneficiary to prevent unjust enrichment. *(Rodzssen Supply Co. v. Far East Bank and Trust Co, G.R. No. 109087, May 9, 2001)*

Q: Should the marginal deposit made by the customer, in possession of the bank be first deducted from the principal indebtedness before computing the interest?

A: Yes, since it is supposed to be returned upon compliance with his obligation. Indeed, it would be onerous to compute interest and other charges on the face value of the letter of credit which the issuing bank issued, without first crediting or setting off the marginal deposit which the importer paid to it. Requiring the importer to pay the interest on the entire letter of credit without deducting first his marginal deposit would be a clear case of unjust enrichment by the bank. *(Abad v. CA, G.R. 42735, Jan. 22, 1990)*

Q: What are the liabilities of correspondent banks?

A:

ROLE	LIABILITY
Notifying/Advising	
Serves as an agent of the issuing bank; Warrants the *apparent* (Appearance to unaided senses) authenticity of the Letter of Credit. *(Bank of America NT & SA v. CA, G.R. No. 105395, Dec. 10, 1993)*	Does not incur any obligation more than just notifying the seller/beneficiary of the opening of the LC after it has determined its apparent authority. (*Bank of America NT & SA v. CA, G.R. No. 105395, Dec. 10, 1993)* Not liable for damages unless the document on its face is manifestly fake.
Confirming	
Lends credence to the LC issued by a lesser-known bank.	Direct obligation, as if it is the one which issued the LC.
Negotiating	
Buys the seller's draft and later on sells the draft to the issuing bank.	Depends on the stage of negotiation, thus: 1. *Before negotiation* – No liability with respect to the seller. Merely suggests its willingness to negotiate. 2. *After negotiation* – A contractual relationship will then arise, making the bank liable.
Paying	
May either be the issuing bank or any other bank in the place of the beneficiary.	Direct obligation.

V. BASIC PRINCIPLES OF LETTER OF CREDIT

A. DOCTRINE OF INDEPENDENCE

Q: What is the independence principle?

A: The relationship of the buyer and the bank is *separate and distinct* from the relationship of the buyer and seller in the main contract; the bank is not required to investigate if the contract underlying the LC has been fulfilled or not because in transactions involving LC, banks deal only with documents and not goods (*BPI v. De Reny Fabric Industries, Inc., L-2481, Oct. 16, 1970).* In effect, the buyer has no course of action against the issuing bank.

Q: What is the effect of the buyer's failure to procure an LC to the main contract?

A: The LC is *independent* from the contract of sale. Failure of the buyer to open the Letter of Credit does not prevent the birth of the Sales Contract. *(Reliance Commodities, Inc. v. Daewoo Industrial Co. Ltd., G.R. No. 100831, Dec. 17, 1993)* The opening of the LC is only a mode of payment. The LC is not an essential requisite to the contract of sale.

Q: In a contract of loan secured by a standby LC, can the partial payments made on the loan be added in computing the issuing bank's liability under its own standby letter of credit?

A: No, although these payments could result in the reduction of the actual amount, which, could ultimately be collected from the issuing bank, the latter's separate undertaking under its letters of credit remain. This is because the letter of credit is an absolute and primary undertaking which is separate and distinct from the contract underlying it. *(Insular Bank of Asia & America v. IAC, Nov. 17, 1988)*

B. FRAUD EXCEPTION PRINCIPLE

Q: What is the exception to the independence principle?

A: The *"Fraud exception rule."* It provides that the untruthfulness of a certificate accompanying a demand for payment under a standby letter of credit may qualify as fraud sufficient to support an injunction against payment. *(Transfield v. Luzon Hydro, G.R. No. 146717, Nov. 22, 2004*)

C. DOCTRINE OF STRICT COMPLIANCE

Q: What is the doctrine of strict compliance?

A: The documents tendered by the seller/beneficiary must *strictly conform* to the terms of the letter of credit. The tender of documents must include all documents required by the letter. Thus, a correspondent bank which departs from what has been stipulated under the LC acts on its own risk and 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 and Trust Company v. CA, G.R. No. 940209, Apr. 30, 1991)*

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WAREHOUSE RECEIPTS LAW (ACT 2137 AS AMENDED)

I. NATURE AND FUNCTIONS OF A WAREHOUSE RECEIPT

Q: What is a warehouse receipt?

A: A written acknowledgment by the warehouseman that he has received and holds certain goods therein described in his warehouse for the person to whom the document is issued. The warehouse receipt has two-fold functions, that is, it is a contract and a receipt. *(Telengtan Bros. & Sons v. CA, G.R. No. L-110581, Sept 21, 1994)*

Q: Distinguish Warehouse Receipts Law from Documents Of Title under Civil Code.

A:

WAREHOUSE RECEIPTS LAW	DOCUMENTS OF TITLE UNDER CIVIL CODE
Warehouse receipts issued by warehouses, whether public or private, bonded or not.	Other receipts of documents issued in bailment contracts other than warehouse receipts (Civil Code 1507-1520)

Q: Who is a warehouseman?

A: A person, natural or juridical, lawfully engaged in the business of storing of goods for profit. *(Sec. 58, WRL)*

Q: What is a warehouse?

A: The building or place where goods are deposited and stored for profit.

Q: Who may issue warehouse receipt?

A:
1. A warehouseman, whether public or private, bonded or not. *(Sec. 1)*
2. A person authorized by a warehouseman.

Q: What is the form of a warehouse receipt and what are its essential terms?

A: It need not be in particular form *but* must embody within its written or printed terms:
1. The location of the warehouse
2. The date of the issue
3. The consecutive number of the receipt
4. A statement whether the goods received will be delivered to bearer, to a specified person or to a specified person or his order
5. Fees
6. A description of the goods
7. The signature of the warehouseman
8. If the receipt is issued for goods of which the warehouseman is the owner, either solely or jointly or in common with others, the fact of such ownership; and
9. A statement of the amount of advances made and of liabilities incurred for which the warehouseman claims a lien. *(Sec. 2)*

Q: What are the *effects of omission* of any of the essential terms?

A:
1. A warehouseman shall be liable to any person injured thereby for all damages caused by the omission
2. Validity of receipt not affected
3. Negotiability of receipts not affected
4. Contract is converted to ordinary deposit. *(Gonzales v. Go Fiong & Luzon Surety Co., G.R. No. 91776, Aug. 30, 1958)*

Q: What is the effect when the goods deposited are incorrectly described?

A: It does not make the receipt ineffective when the identity of the goods is fully established by evidence. Thus, the indorsement and delivery shall constitute sufficient transfer of the title of the goods. *(American Foreign Banking Corp. v. Herridge, G.R. No. L-21005, Dec. 20, 1924)*

GR: Warehouseman shall be liable for damages for non-existence or misdescription of goods at the time of its issue.

XPN: When the goods are described based on:
1. Series or labels upon them
2. Statement that the goods are of certain kind.

Q: What terms may and may not be inserted?

A: A warehouseman may insert in a receipt issued by him any other terms and conditions provided that such terms and conditions shall not be:
1. Contrary to the Warehouse Receipts Law. *(Sec. 3)*

2. Terms reducing the required diligence of the warehouseman. *(Ibid.)*
3. Contrary to law, morals, good customs, public order or public policy.
4. Those exempting the warehouseman from liability for misdelivery or for not giving statutory notice in case of sale of goods.
5. Those exempting the warehouseman from liability for negligence.

A. TO WHOM DELIVERED

Q: To whom should the goods be delivered?

A:
1. To the person lawfully entitled to the possession of the goods, or his agent;
2. To the person entitled to delivery under a non-negotiable instrument or with written authority; or
3. To the lawful order of a negotiable receipt. (person in possession of a negotiable receipt) *(Sec. 9)*

B. KINDS

Q: What are the kinds of warehouse receipt?

A:
1. Negotiable warehouse receipt
2. Non-negotiable warehouse receipt

Q: What is a *negotiable* warehouse receipt?

A: It is a receipt in which it states that the goods received will be delivered to the bearer or to the order of any person named in such receipt (*Sec. 5*). It is negotiated by either delivery or indorsement plus delivery.

Note: No provision shall be inserted in a negotiable receipt that it is non-negotiable. Such provision, if inserted, shall be void. A negotiable warehouse receipt cannot be converted into non-negotiable. (*Sec. 5*)

Q: Who may negotiate?

A:
1. The owner thereof; or
2. 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 order of the person to whom the possession or custody of receipt has been entrusted or in such form that it may be negotiated by delivery. (*Sec. 40*)

Q: What happens if the indorsement is necessary but the negotiable receipt was only delivered?

A:
1. The transferee acquires title against the transferor
2. There is no direct obligation of the warehouseman; and
3. The transferee can compel the transferor to complete the negotiation by indorsing the instrument. Negotiation takes effect as of the time when the indorsement is actually made.

Q: In case the signature of an owner of a negotiable receipt was forged and the forger who now holds the negotiable receipt was able to withdraw the goods from the warehouseman. What are the rights of the owner of the negotiable receipt?

A: If under the terms of the negotiable warehouse receipt, the goods are deliverable to the depositor or to his order, the owner of the said negotiable receipt may proceed against the warehouseman and/or the holder. Without the valid indorsement of the owner to the holder or in blank, the warehouseman is liable to the owner for conversion in the misdelivery. If, however, by the terms of the negotiable warehouse receipt, the goods are deliverable to bearer (either because it is so expressed in the warehouse receipt or because of a blank indorsement by a person to whose order the goods are deliverable) the owner may only proceed against the holder. The warehouseman is not liable for conversion where the goods are delivered to a person in possession of a bearer negotiable instrument.

Q: What is the rule when more than one negotiable receipt is issued for the same goods?

A: A warehouseman shall be liable for all damages caused by his failure to do so to anyone 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 *(Sec. 6).*

Note: The word "duplicate" shall be plainly placed upon the face of every such receipt, except the first one issued. *(Sec. 6.*

Q: What are the warranties on a warehouse receipt?

A: A person who, for value, negotiates or transfers a receipt by indorsement or delivery,

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including one who assigns for value a claim secured by a receipt, unless a contrary intention appears warrants:

1. Receipt is genuine
2. Legal right to negotiate or transfer it
3. No knowledge of defects that may impair the validity or worth of the receipt
4. That he has a right to transfer title to the goods and that the goods are merchantable or fit for a particular purpose whenever such warranties would have been to transfer without a receipt of goods represented thereby. *(Sec. 44)*

Note: The indorsee does not guarantee that the warehouseman will comply with his duties. *(Sec. 45)*

A creditor receiving the warehouse receipt given as a collateral makes no warranty. *(Sec. 46)*

Q: What is a *non-negotiable* warehouse receipt?

A: It is a receipt in which it states that the goods received delivered to the depositor or to any other specified person. *(Sec. 4)*

Q: What is required in a non-negotiable receipt?

A: It shall have plainly placed upon its face by the warehouseman issuing it "non-negotiable," or "not negotiable." *(Sec. 7)*

Note: Failure to mark "non-negotiable" shall make it negotiable (if the holder purchased it for value supposing it to be negotiable).

Q: How is it transferred?

A: A non-negotiable warehouse receipt may be transferred by its delivery to the transferee accompanied by a deed of assignment, donation or other form of transfer.

Q: What is the effect of indorsement?

A: Even if the receipt is indorsed, the transferee acquires no additional right *(Sec. 39)*

C. DISTINCTION BETWEEN A NEGOTIABLE INSTRUMENT AND A NEGOTIABLE WAREHOUSE RECEIPT

Q: Distinguish negotiable instrument from a negotiable warehouse receipt.

A:

NEGOTIABLE INSTRUMENT	NEGOTIABLE WAREHOUSE RECEIPT
Contains an unconditional promise to pay a sum certain in money.	Does not contain an unconditional promise to pay a sum certain in money.
The subject is money.	The subject is merchandise.
The negotiable instrument is the object of value.	The warehouse receipt is not the object of value.
Intermediate parties become secondarily liable.	Intermediate parties are not liable for the warehouse man's failure to deliver the goods.

D. RIGHTS OF A HOLDER OF A NEGOTIABLE WAREHOUSE RECEIPT AS AGAINST A TRANSFEREE OF A NON-NEGOTIABLE WAREHOUSE RECEIPT

Q: Distinguish the rights of a holder of a negotiable warehouse receipt from the rights of a transferee of a non-negotiable warehouse receipt.

A: See Appendix A.

Q: Coco was issued by a warehouseman a negotiable receipt for safekeeping by the latter of his goods. Can the judgment creditor of Coco levy by execution the goods covered by the negotiable receipt?

A: The goods cannot, while in the possession of the warehouseman, be attached by garnishment or otherwise, or be levied upon under an execution *unless* the receipt be first surrendered to the warehouseman, or its negotiation enjoined. The warehouseman cannot be compelled to deliver the actual possession of the goods until the receipt is surrendered to it or impounded by the court.

Q: Assuming that prior to the levy, the receipt was sold to Yoyo on the basis of which he filed a claim with the sheriff. Would Yoyo have better rights to the goods than the creditor? Explain your answer.

A: Yes. Yoyo, as a holder for value of the receipt, has a better right to the goods than the creditor. It is Yoyo that can surrender the receipt which is in its possession and can comply with the other requirements which will oblige the warehouseman to deliver the goods, namely, to sign a receipt for the delivery of the goods, and to pay the warehouseman's liens and fees and other

charges. **(1999 Bar Question)**

Q: Bon took the goods of Angela without her consent and deposited the same with a warehouseman. The latter issued to Bon a negotiable receipt which she indorsed for value to Ryan. Between Angela and Ryan, who has better right over the goods? Why?

A: Ryan has better right to the goods. The goods are covered by a negotiable warehouse receipt which was indorsed to Ryan for value. The negotiation to Ryan was not impaired by the fact that Bon took the goods without the consent of Angela, as Ryan had no notice of such fact. Moreover, Ryan is in possession of the warehouse receipt and only he can surrender it to the warehouseman. *(Sec. 8, WRL)*

Q: What is the proper recourse of the warehouseman if he is uncertain as to who is entitled to the goods? Explain.

A: Since there is a conflicting claim of ownership or title, the warehouseman should file a complaint in interpleader requiring Ryan and Angela to interplead. The matter involves a judicial question as to whose claim is valid. **(2005 Bar Question)**

Q: What is the rule where a warehouse receipt is transferred to secure payment of a loan by way of pledge or mortgage?

A: The pledgee or mortgagee does not automatically become the owner of the goods but 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 for the simple reason that the transaction is *not* a sale but only a mortgage or pledge. Likewise, if the property is lost without the fault or negligence of the mortgagee or pledgee, then said goods are to be regarded as lost on account of the real owner, mortgagor or pledgor. (*PNB v. Sayo, Jr., G.R. No. 129198, July 9, 1998*)

Q: Does the non-payment by the original depositors of the purchase price render the further negotiation of the receipt invalid?

A: No, the negotiation of the warehouse receipt by the buyer of goods purchased from and deposited to the warehouseman is valid even if the warehouseman who issued the negotiable warehouse receipt was not paid by the buyer. The validity of the negotiation cannot be impaired by the fact that the owner/warehouseman was deprived of the possession of the same by fraud, mistake or conversion. (*PNB v. Noah's Ark Sugar Refinery, G.R. No. 107243, Sept. 1, 1993*)

II. DUTIES OF A WAREHOUSEMAN

Q: What are the obligations of a warehouseman?

A:

1. To *take care* of the goods entrusted to his safekeeping

2. To *deliver* them to the holder of the receipt or the depositor provided there is *demand* by the depositor accompanied by either:
   a. An offer to satisfy the warehouseman's lien
   b. An offer to surrender the receipt, if negotiable with such indorsements as would be necessary for the negotiation of the receipts ; or
   c. 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 *(Sec. 8*); and

3. To *keep the goods separate* from the goods of other depositors, except if authorized by agreement or by custom, fungible goods may be mingled with other goods of the same kind and grade.

Q: When is the need for a demand by the depositor not necessary?

A: When the warehouseman has rendered it beyond his power to deliver the goods.

Q: When is refusal to deliver by the warehouseman justified?

A:

1. If the warehouseman's lien is not satisfied by the claimants. (*Sec. 31*)

2. Where the goods have already been sold to satisfy the warehouseman's lien or because of their perishable or hazardous nature. (*Sec. 34*)

3. If the warehouse receipt is negotiated back to him.

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4. When the holder does *not* satisfy the conditions prescribed in Section 8:
    a. Non-satisfaction of warehouseman's lien.
    b. Failure to surrender warehouse receipt.
    c. Refusal to sign the acknowledgement receipt, acknowledging the receipt of the goods from the warehouse.

5. The failure was *not* due to any fault on the part of the warehouseman:
    a. Upon request by or on behalf of the person lawfully entitled. *(Sec. 10)*
    b. If he had information that the delivery about to be made was to one not lawfully entitled. *(Ibid.)*
    c. If several persons claim the goods. *(Sec. 17)*
    d. If the warehouseman needs reasonable time to ascertain the validity of the claim if someone other than the depositor claims title to the goods. *(Sec. 18)*
    e. If the goods are lost, despite ordinary care by the warehouseman.

Q: What if the receipts are lost or destroyed?

A: A court of competent jurisdiction may order the delivery of the goods only:

a. Upon satisfactory proof of the loss or destruction of the receipt; and
b. Upon the giving of a bond with sufficient sureties to be approved by the court. *(Sec. 14)*

Note: The delivery of the goods under an order of the court shall not relieve the warehouseman from liability to a person to whom the negotiable receipt has been or shall be negotiated for value without notice of the proceedings or of the delivery of the goods. (*Sec. 14*)

Q: When does the duty to insure the goods arise?

A:
1. Where the law provides
2. Where it was an inducement for the depositor to enter into the contract;
3. Established practice; or
4. Where the warehouse receipt contains a representation to that effect.

Q: What is conversion?

A: An unathorized 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)*

Q: What are the instances where a warehouseman is liable for conversion?

A:
1. Where the delivery is made to person other than those authorized

2. Even if delivered to persons entitled, he may still be liable for conversion if *prior* to delivery:
    a. He had been requested not to make such delivery; or
    b. He had received notice of the adverse claim or title of a third person.

Q: Give the effects of alteration of the receipt on the liability of the warehouseman.

A:
1. *Alteration immaterial* – whether fraudulent or not, whether authorized or not, the warehouseman is liable on the altered receipt according to its original tenor

2. *Authorized material alteration* – the warehouseman is liable according to the terms of the receipt as altered

3. *Material alteration innocently ma*de – the warehouseman is liable on the altered receipt according to its original receipt

4. *Material alteration fraudulently made* – warehouseman is liable according to the original tenor of the receipt to a purchaser of the receipt for value without notice, and even to the alterer and subsequent purchasers with notice except that as regards to the last two, the warehouseman's liability is limited only to delivery as he is excused from any liability

Q: What are the instances where a warehouseman is criminally liable for his acts?

A:

1. Issuance of receipts for goods *not received. (Sec. 50)*
2. Issuance of receipt containing *false statement. (Sec. 51)*
3. Issuance of duplicate negotiable warehouse receipt *not marked* as such. *(Sec. 52)*
4. Issuance of a negotiable warehouse receipt of which he is an owner *without* stating such fact of ownership. *(Sec. 53)*
5. Delivery of goods *without* obtaining negotiable warehouse receipt. *(Sec. 54)*
6. Negotiation of receipt for *mortgaged* goods. *(Sec. 55)*
7. Issuance of warehouse receipts for good not received. *(Sec. 50)*
8. Commingling of goods. *(Sec. 24)*

Q: What are the other acts for which warehouseman is liable?

A:

1. Failure to stamp "duplicate" on copies of negotiable receipt. (*Sec.6*)
2. Failure to place "non-negotiable" or "not-negotiable" on a non-negotiable receipt. (*Sec. 7*)
3. Misdelivery of goods.(*Sec. 10*)
4. Failure to effect cancellation of a negotiable receipt upon delivery of the goods. (Sec. 11)
5. Issuing receipt for non-existing goods or misdescribed goods. (*Sec.20*)
6. Failure to take care of the goods. (*Sec. 21)*
7. Failure to give notice in case of sale of goods to satisfy lien (*Sec. 33*) or because the goods are perishable or hazardous. (*Sec. 34*)

III. WAREHOUSEMAN'S LIEN

Q: What is covered by the warehouseman's lien over the goods deposited or on the proceeds thereof?

A:

1. Charges for storage and preservation of the goods (insurance and others may be included as long as it is stipulated)

2. Money advanced, interest, insurance, transportation, labor, weighing, coopering and other charges and expenses in relation to such goods

3. Charges and expenses for notice, and advertisements of sale, and for sale of the goods where default had been made in satisfying the warehouseman's lien. *(Sec. 27)*

Q: What are the remedies available to a warehouseman to enforce his warehouseman's lien?

A:

1. By refusing to deliver the goods until the lien is satisfied

2. By causing the extrajudicial sale of the property and applying the proceeds of the value of the lien

   Note: Where the sale was made without the publication required and before the time provided by law, such sale is void and the purchases of the goods acquires no title to them.

3. By filing a civil action for collection of the unpaid charges or by way of counterclaim in an action to recover the property from him or such other remedies allowed by law for the enforcement of a lien against personal property or to a creditor against his debtor, for the collection from the depositor of all the charges which the depositor has bound himself to pay.

Q: Against whose goods may the lien be enforced?

A:

1. Goods belonging to the person who is liable as debtor; and

2. Goods belonging to others which have been deposited at any time by the debtor with authority to make a valid pledge. (*Sec. 28*)

Q: How may the warehouseman lose his lien?

A:

1. By surrendering possession thereof, *or*

2. By refusing to deliver the goods when a demand is made with which he is bound to comply. (*Sec. 29*)

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Note: Where a negotiable receipt is issued, with the exception of the charges for the storage or preservation of goods for which a negotiable receipt has been issued, the lien exists only for other charges expressly enumerated in the receipt so far as they are written although the amount of the said charge isn't stated.

Loss of lien does not mean that the warehouseman does not have any other remedy.

TRUST RECEIPTS LAW (P.D. 115)

I. DEFINITION/CONCEPT OF A TRUST RECEIPT TRANSACTION

Q: What is a trust receipt transaction?

A: It is any transaction between the entruster and entrustee:

1. Whereby the entruster who owns or holds absolute title or security interests over certain specified goods, documents or instrument, *releases* the same to the possession of entrustee upon the latter's execution of a *TR agreement*.

2. Wherein the entrustee binds himself to *hold* the designated goods in trust for the entruster and, in case of default, to sell such goods, documents or instrument with the obligation to turn over to the entruster the proceeds to the extent of the amount owing to it or to turn over the goods, documents or instrument itself if not sold. *(Sec. 4, P.D. 115)*

Q: What is a trust receipt (TR)?

A: It is the written or printed document signed by the entrustee in favor of the entruster containing terms and conditions substantially complying with the provisions of PD 115.

Q: What are the two views regarding TR?

A:

1. As a *commercial document (Sec. 4, P.D. 115)*

2. As a *commercial transaction* – It is a separate and independent security transaction intended to aid in financing importers and retail dealers who do not have sufficient funds. *(Nacu v. CA, G.R. No. 108638, Mar. 11, 1994)*

Q: Are LC and TR negotiable instruments?

A: Letters of credit and trust receipts are not negotiable instrument, but drafts issued in connection with letters of credit are negotiable instruments. Hence, while the presumption of consideration under the negotiable instrument law may not necessarily be applicable to trust receipts and letters of credit, the presumption that the drafts drawn in connection with the letters of credit have sufficient consideration applies. *(Lee v. CA, G.R. No. 117913, Feb. 1, 2002)*

A. LOAN/SECURITY FEATURE

Q: What is the loan and security feature of the trust receipt transaction?

A: A trust receipt arrangement is endowed with its own distinctive features and characteristics. Under that set-up, a bank extends a loan covered by the Letter of Credit, with the trust receipt as a security for the loan. In other words, the transaction involves a loan feature represented by the letter of credit, and a security feature which is in the covering trust receipt. A trust receipt, therefore, is a security agreement, pursuant to which a bank acquires a "security interest" in the goods. It secures an indebtedness and there can be no such thing as security interest that secures no obligation. *(Sps. Vintola vs. Insular Bank of Asia and America, G.R. No. 73271, May 29, 1987)*

B. OWNERSHIP OF THE GOODS, DOCUMENTS, AND INSTRUMENTS UNDER A TRUST RECEIPT

Q: Who is the owner of the articles subject of the TR?

A: The entrustee. A trust receipt has two features, the loan and security features. The loan is brought about by the fact that the entruster financed the importation or purchase of the goods under TR. Until and unless this loan is paid, the obligation to pay subsists. If the entrustee is made to appear as the owner, it was but an artificial expedient, more of legal fiction than fact, for if it were really so, it could dispose of the goods in any manner that it wants, which it cannot do. To consider the entrustee as the true owner from the inception of the transaction would be to disregard the loan feature thereof. *(Rosario Textile Mills Corp. v. Home Bankers Savings and Trust Company, G.R. No. 137232. June 29, 2005)*

II. RIGHTS OF THE ENTRUSTER

Q: Who is an entruster?

A: A lender, financer or creditor. Person holding title over the goods documents or instruments (GDI) subject of a trust receipt transaction; releases possession of the goods upon execution of trust receipt. *(Sec. 3[c])*

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Q: What are the rights of the entruster?

A:

1. To receive the proceeds from the sale of the goods, documents, or instruments to the extent of the amount owing to him

2. To the return of the goods, documents or instruments (GDI) in case of non-sale and enforcement of all other rights conferred to him in the trust receipt

3. May cancel the trust and take possession of the goods, upon default or failure of the entrustee to comply with any of the terms and conditions of the trust receipt. *(Sec. 7, P.D. 115)*

A. VALIDITY OF THE SECURITY INTEREST AS AGAINST THE CREDITORS OF THE ENTRUSTEE/INNOCENT PURCHASERS FOR VALUE

Q: As between the entruster and the creditors of the entrustee, who has a better right over the goods?

A: The entruster. His security interest in goods, documents, or instruments pursuant to the written terms of a trust receipt shall be valid as against all creditors of the entrustee for the duration of the trust receipt agreement. *(Sec. 12, P.D. 115)*

Q: Who can defeat the rights of the entruster over the goods?

A: A purchaser in good faith. He acquires goods, documents or instruments free from the entruster's security interest. *(Sec. 11, P.D. 115)*

III. OBLIGATIONS AND LIABILITY OF THE ENTRUSTEE

Q: Who is an entrustee?

A: A borrower, buyer, importer or debtor. Person to whom the goods are delivered for sale or processing in trust, with the obligation to return the proceeds of sale of the goods or the goods themselves to the entruster.*(Sec. 3[b])*

Q: What are the obligations and liabilitites of the entrustee?

A:

1. To hold good, documents and instruments (GDI) in trust for the entruster and to dispose of them strictly in accordance with the terms of TR;

2. To receive the proceeds of the sale for the entruster *and to turn over* the same to the entruster to the extent of amount owing to the entruster;

3. To insure GDI against loss from fire, theft, pilferage or other casualties.

4. To keep GDI or the proceeds thereof, whether in money or whatever form, separate and capable of identification as property of the entruster;

5. To return GDI to the entruster in case they could not be sold or upon demand of the entruster; and

6. To observe all other conditions of the trust receipts. *(Sec. 9, P.D. 115)*

A. PAYMENT/DELIVERY OF PROCEEDS OF SALE OR DISPOSITION OF GOODS, DOCUMENTS OR INSTRUMENTS

Q: What is the order in the application of proceeds or the TR transactions?

A:

1. Expenses of the sale
2. Expenses derived from storing the goods
3. Principal obligation

Q: Is the entrustee liable for the deficiency?

A: Yes, but any excess shall likewise belong to him. *(Sec. 7, P.D. 115)*

B. RETURN OF GOODS, DOCUMENTS OR INSTRUMENTS IN CASE OF NON-SALE

Q: What is the obligation of the entrustee in case the goods, documents or instruments were not sold?

A: The entrustee should return the goods, documents, or instruments to the entrustor. *(Sec. 4, P.D. 115)*

C. LIABILITY FOR LOSS OF GOODS, DOCUMENTS OR INSTRUMENTS

Q: Who shall bear the loss of goods which are the subject of TR?

A: The entrustee. Loss of goods, documents or instruments which are the subject of a TR, pending their disposition, irrespective of whether or not it was due to the fault or negligence of the entrustee, shall not extinguish his obligation to the entruster for the value thereof. *(Sec. 10, P.D. 115)*

D. PENAL SANCTION IF OFFENDER IS A CORPORATION

Q: What acts or omissions are penalized under the TR Law?

A: The TR Law declares the failure to turn over goods or proceeds realized from sale thereof, as a criminal offense under Art. 315(l)(b) of RPC *(estafa)*. The law is violated whenever the entrustee or person to whom trust receipts were issued fails to: (a) return the goods covered by the trust receipts; or (b) return the proceeds of the sale of said goods. (*Metropolitan Bank v. Tonda, G.R. No. 134436, Aug. 16, 2000)*

Q: Does P.D. 115 violate the prohibition in the Constitution against imprisonment for non-payment of a debt?

A: No. What is being punished is the dishonesty and abuse of confidence in the handling of money or goods to the prejudice of another regardless of whether the latter is the owner or not. 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. *(People v. Nitafan, G.R. No. 81559, Apr 6, 1992)*

Q: Is lack of intent to defraud a bar to the prosecution of these acts or omissions?

A: No. The mere failure to account or return gives rise to the crime which is *malum prohibitum*. There is no requirement to prove intent to defraud (*Ching v. Secretary of Justice, G.R. No. 164317, Feb. 6, 2006; Colinares v. CA, G.R. No. 90828, Sept. 5, 2000; Ong v. CA, G.R. No. 119858, Apr. 29, 2003)* **(2006 Bar Question)**

Q: What is the effect of insufficiency of proof of delivery of goods?

A: *Estafa* cannot lie. *(Ramos v. CA, G.R. No. L-3992-25, Aug. 21, 1987*)

Q: What will happen to the criminal action if the entrustee complied with his obligation under the TR agreement?

A:

1. *If compliance occurred before the criminal charge*- there is no criminal liability.

2. *If compliance occurred after the charge even before conviction*- the criminal action will *not* be extinguished.

Q: What is the penal sanction if offender is a corporation?

A: The Trust Receipts Law recognizes the impossibility of imposing the penalty of imprisonment on a corporation. Hence, if the entrustee is a corporation, the law makes the officers or employees or other persons responsible for the offense liable to suffer the penalty of imprisonment. The reason is obvious, corporations, partnerships, associations and other juridical entities cannot be put to jail. Hence, the criminal liability falls on the human agent responsible for the violation of the Trust Receipts Law. *(Ong vs. CA, G.R. No. 119858, April 29, 2003)*

IV. REMEDIES AVAILABLE

Q: In the event of default by the entrustee on his obligation under the trust receipt agreement, is it absolutely necessary for the entruster to cancel the trust and take possession of the goods to be able to enforce his right thereunder?

A: The law uses the word "may" in granting to the entruster the right to cancel the trust and take possession of the goods. Consequently, the entrustee has the discretion to avail of such right or seek any alternative action, such as a third party claim or a separate civil action which it deems best to protect its right, at any time upon default or failure of the entrustee to comply with any of the terms and conditions of the trust agreement. *(South City Homes, Inc. v. BA Finance Corporation, G.R. No. 135462, Dec. 7, 2001)*

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Q: Can the repossession of the goods by the entruster be considered as payment?

A: No, payment would legally result only after the entruster has foreclosed on the securities, sold the same and applied the proceeds thereof to the entrustee's obligation. Since the trust receipt is a mere security arrangement, the repossession by the entruster cannot be considered payment of the loan/advances given to the entrustee under the letter of credit/trust receipt. *(PNB v. Pineda, G.R. No. 46658, May 13, 1991)*

Q. Earl failed to comply with his undertaking under the trust receipt he issued in favor of ABC bank. The bank filed both criminal and civil cases against Earl. The court proceeded with the civil case independently from the criminal case. Is the court correct in proceeding independently although a criminal case is also instituted?

A: Yes, the complaint against Earl was based on the failure of the latter to comply with his obligation as spelled out in the TR. This breach of obligation 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 Section 13 of the Trust Receipts Law. 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. *(Sarmiento v. CA, G.R. No. 122502, Dec. 27, 2002)*

Q. What is the effect of novation of a trust agreement?

A. Where the entruster and entrustee entered into an agreement which provides for conditions incompatible with the trust receipt agreement, the obligation under the trust receipt is extinguished. Hence, the breach in the subsequent agreement does not give rise to a criminal liability under P.D. 115 but only civil liability. *(Philippine Bank v. Ong, G.R. No. 133176, Aug. 8, 2002)*

Q: What are the defenses to negate criminal liability of the entrustee?

A:

1. Compliance with the terms of the trust receipt either by payment, return of the proceeds or return of the goods.
2. The transaction does not fall under PD 115. (*Colinares v. CA, G.R. No. 90828, Sept. 5, 2000, Consolidated v. CA, G.R. No. 114286, Apr. 19, 2001)*

   Note: In these cases, the execution of a TR was made after the goods covered by it had been purchased, making the buyer the owner thereof. The transaction does not involve a trust receipt but a simple loan even though the parties denominate the transaction as one of a trust receipt.

3. Non-receipt of the goods or where proof of delivery of goods covered by a trust receipt to the accused is insufficient. (*Ramos v. CA, G.R. No. L-3992-25, Aug. 21, 1987*)
4. Cancellation of the trust receipt agreement and taking into possession of the goods by the entruster.

   Note: Mere repossession of the goods will extinguish criminal liability.

5. Compromise by parties before filing of information in court. (*Ong v. CA, G.R. No. 119858, Apr. 29, 2003*)
6. Novation before the filing of the criminal complaint.
7. Loss of goods without fault of the entrustee.
8. Consignment.

Q: Can deposits in a savings account opened by the buyer subsequent to the TR transaction be applied to outstanding obligations under the TR account?

A: No, the receipt of the bank of a sum of money without reference to the trust receipt obligation does not obligate the bank to apply the money received against the trust receipt obligation. Neither does compensation arise because compensation is not proper when one of the debts consists in civil liability arising from criminal. *(Metropolitan Bank and Trust Co. v. Tonda, G.R. No. 134436, Aug. 16, 2000).*

NEGOTIABLE INSTRUMENTS LAW

I. FORMS AND INTERPRETATION

Q: What are the elements of a negotiable instrument?

A:
1. In writing and signed by the maker or drawer
2. Contains an unconditional promise or order to pay a sum certain in money
3. Payable on demand, or at a fixed or determinable future time
4. Payable to order or to bearer (so called badges of negotiability)
5. If addressed to a drawee, he must be named or otherwise indicated with reasonable certainty. *(Sec. 1)*

Note: A negotiable instrument need not follow the exact language of NIL, as long as the terms are sufficient which clearly indicate an intention to conform to the requirements of the law. *(Sec. 10)* No. 5 applies only to bills of exchange. A promissory note has no drawee.

A. REQUISITES OF NEGOTIABILITY

Q: What are the factors to determine the negotiability of the instrument?

A:
1. Words that appear on the face of negotiable instrument
2. Requirements enumerated in Section 1 of NIL
3. Intention of the parties by considering the whole of the instruments

B. KINDS OF NEGOTIABLE INTRUMENTS

Q: What are the two kinds of negotiable instruments under the law?

A:
1. *Promissory notes* (PN) – An 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. *(Sec. 184)*

2. *Bill of exchange* (BOE) – An unconditional order in writing addressed by one person to another signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money to order or to bearer. *(Sec. 126)*

   Note: Checks are special form of BOE.

Q: Distinguish promissory note from a bill of exchange.

A:

	PROMISSORY NOTE	BILL OF EXCHANGE
	Promise to pay	Order to pay
As to number of parties	2 original parties	3 parties
As to liability of parties	Maker is primarily liable	Drawer is secondarily liable
As to number of presentments needed	Only 1 presentment (for payment) is needed	2 presentments (for acceptance and for payment) are generally needed

II. COMPLETION AND DELIVERY

A. INSERTION OF DATE

Q: Is the date essential to make an instrument negotiable?

A: The date is not essential *(Sec. 6 [a])*. If dated, such date is deemed a *prima facie* proof that it is the true date of the making, drawing, acceptance or indorsement of the instrument. *(Sec. 11)*

Q: When is date important?

A: Date is important to determine maturity, as when:
1. Where the instrument is payable within a specified period after date, or after sight.
2. When the instrument is payable on demand, date is necessary to determine whether the instrument was presented within a reasonable time from issue, or from the last negotiation.
3. When the instrument is an interest-bearing one, to determine when the interest starts to run.

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Q: When may date be inserted?

A:

1. Where an instrument expressed to be payable at a fixed period after date is issued undated, or
2. Where the acceptance of an instrument payable at a fixed period after sight is undated

Note: Any holder may insert therein the true date of issue or acceptance, and the instrument shall be payable accordingly. *(Sec.13)*

Q: What is the effect of insertion of wrong date?

A: It does not avoid the instrument in the hands of a subsequent holder in due course. In the hands of a holder in due course, the date inserted, even if wrong, is to be regarded as the true date *(Sec. 13).*

Note: With respect to the person who inserted the wrong date, however, the instrument is avoided. *(Bank of Houston v. Day, 145 Mo. Appl. 410, 122 SW 756)*

B. COMPLETION OF BLANKS

Q: Who has the authority to fill up the blanks in an incomplete but delivered instrument?

A: The holder has a *prima facie* authority to complete it.

A signature on a blank paper delivered by the person making the signature in order that the paper may be converted into a negotiable instrument operates as a prima facie authority to fill it up as such for any amount. *(Sec. 14)*

Q: What is meant by material particular?

A: Any particular proper to be inserted in a negotiable instrument to make it complete.

Q: What are the various situations involving negotiable instruments?

A:

1. Incomplete instrument
   a. Delivered
      i. With forgery and alteration
      ii. Without forgery and alteration
   b. Not delivered
      i. With forgery and alteration
      ii. Without forgery and alteration
2. Complete instrument
   a. Delivered
      i. With forgery and alteration
      ii. Without forgery and alteration
   b. Not delivered
      i. With forgery and alteration
      ii. Without forgery and alteration

C. INCOMPLETE BUT DELIVERED INSTRUMENTS

Q: When is an instrument incomplete?

A: When it is wanting in any material particular. *(Sec. 14)*

Q: When may a prior party be bound by an *incomplete but delivered* instrument?

A: If it is filled up strictly in accordance with the authority given and within a reasonable time. But if any such instrument, after completion, is negotiated to a holder in due course, it is valid and effectual for all purposes in his hands, and he may enforce it as if it had been filled up strictly in accordance with the authority given and within a reasonable time. *(Sec. 14)*

Q: Lorenzo signed several blank checks instructing Nicky, his secretary, to fill them as payment for his obligations. Nicky filled one check with her name as payee, placed P30,000.00 thereon, endorsed and delivered it to Evelyn as payment for goods the latter delivered to the former. When Lorenzo found out about the transaction, he directed the drawee bank to dishonor the check. When Evelyn encashed the check, it was dishonored. Is Lorenzo liable to Evelyn?

A: Yes. This covers the delivery of an incomplete instrument, under Section 14 of the Negotiable Instruments Law, which provides that there was prima facie authority on the part of Nicky to fill-up any of the material particulars thereof. Having done so, and when it is first completed before it is negotiated to a holder in due course like Evelyn, it is valid for all purposes, and she may enforce it within a reasonable time, as if it had been filled up strictly in accordance with the authority given. **(2006 Bar Question)**

D. INCOMPLETE AND UNDELIVERED INSTRUMENTS

Q: What is the rule when an instrument is incomplete and undelivered?

A: Not valid against the party whose signature was placed before delivery, whether the holder is a holder in due course or not. With respect, however, to a holder in due course, non-delivery must be proved because as to him, there is a *prima facie* presumption of delivery.

Reason: Delivery is essential to validity. *(Sec. 15)*

Q: What about the party whose signature was placed after delivery?

A: Valid against the party whose signature was placed after delivery like an indorser because the indorser warrants the instrument to be genuine and in all respect what it purports to be.

Q: Can a Holder in due course hold a maker for instruments which are incomplete and undelivered supposing that the note was stolen, filled-up, and was subsequently negotiated?

A: No. the law is specific that the instrument is not a valid contract in the hands of any holder. The phrase "any holder" includes a holder in due course.

E. COMPLETE BUT UNDELIVERED

Q: What is the effect if an instrument is undelivered?

A: It is incomplete and revocable until delivery of the instrument for the purpose of giving it effect. *(Sec. 16)*

Q: What is delivery?

A: Delivery refers to the transfer of possession, actual or constructive, from one person to another *(Sec. 191),* with the intent to transfer title to payee and recognize him as *holder* thereof.

Q: When is an instrument issued?

A: The instrument is deemed issued the first delivery of the instrument, complete in form, to a person who takes it as holder. *(Sec. 191)*

Q: Can a creditor bank who was the payee in a check fraudulently obtained by a third person who subsequently encashed it sue the drawer-debtor, third person, and drawee bank for the amount of the check?

A: No, the payee of a negotiable instrument acquires no interest with respect thereto until its delivery to him. Without the initial delivery of the instrument from the drawer to the payee, there can be no liability on the instrument. *(Development Bank of Rizal v. Sima Wei, G.R. No. 85419, Mar. 9, 1993)*

Q: What is the effect if the instrument is in the possession of a holder in due course?

A: Valid delivery is conclusively presumed. *(Sec. 16)*

Q: What if the instrument is in the possession of a party other than a holder in due course?
A: Possession of such party constitutes *prima facie* presumption of delivery but subject to rebuttal.

Q: When is delivery made conditional or for a special purpose? Provide examples.

A: It depends upon whom the instrument is delivered. If the instrument lands in the hands of a holder in due course (one who does not know of the conditional delivery or of its special purpose), the instrument will be as if there is no condition.

To a holder not in due course, prior parties are not bound by the instrument.

Note: The law contemplates that the condition is orally or verbally conveyed to the holder upon delivery, because of the rule that the negotiability is determined only upon the face of the instrument.

Q: Who are immediate parties?

A: Persons having knowledge of the conditions or limitations placed upon the delivery of an instrument. It means privity, and not proximity.

Q: Who are remote parties?

A: Persons without knowledge as to the conditions or limitations placed upon the delivery of an instrument, even if he is the next party physically.

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ASST. SUBJECT HEADS: KIMVERLY A. ONG & JOANNA MAY D.G. PEÑADA; MEMBERS: MA. ELISA JONALYN A. BARQUEZ, ANGELI R. CARPIO, ANTONETTE T. COMIA, ALBAN ROBERT LORENZO F. DE ALBAN, JOEBEN T. DE JESUS, CHRIS JARK ACE M. MAÑO, ANNA MARIE P. OBIETA, RUBY ANNE B. PASCUA, FLOR ANGELA T. SABAUPAN, GIAN FRANCES NICOLE C. VILCHES

F. COMPLETE AND DELIVERED INSTRUMENTS

Q: What are the rules when an instrument is complete and delivered?

A:

1. Without forgery and alteration, all parties are bound.

2. With forged indorsement and/or alteration
   a. Order instruments
      i. Order promissory note
         - Prior parties notbound. Forged signature is wholly inoperative (Sec. 23); unless estoppel sets in with regard prior parties (cut-off rule).
         - Subsequent parties bound.

      ii. Order bill of exchange
         - Drawer's account cannot be charged by the Drawee;
         - Drawer has no cause of action against collecting bank, since the duty of the latter is only to payee;
         - Drawee can recover from collecting bank;
         - Drawer not liable to the collecting bank. Collecting bank bears loss (can recover from person it paid)
         - Payee can recover from: Drawer and Collecting bank, but not from Drawee unless with acceptance of the bill;

   b. Bearer instruments
      i. Bearer promissory note
         - Prior parties liable;
         - Forged signatory not liable to party not holder in due course.

      ii. Bearer bill of exchange
         - Drawee bank liable.

III. RULES ON INTERPRETATION

Q: What are the rules of construction in case of ambiguities in a negotiable instrument?

A:

1. Words prevail over figures
2. Interest runs from the date of the instrument, if date from which interest is to run is unspecified; if undated, from the issue
3. If undated, deemed dated on the date of issue
4. Written provisions prevail over printed
5. If there is doubt whether it is a bill or note, the holder may treat it as either at his election
6. When not clear in what capacity it was signed, deemed signed as an indorser
7. If *"I promise to pay"* but signed by two or more persons, jointly and severally liable.

IV. SIGNATURE

Q: Who are the persons liable on an instrument?

A:

GR: Only persons whose signatures appear on an instrument are liable thereon. *(Sec. 18)*

XPN:

1. *Person signs in trade or assumed name (Sec. 18 [2])* – Party who signed must have intended to be bound by his signature.

2. *Principal is liable if a duly authorized agent signs in his own behalf disclosing the name of the principal and adding words to show he is merely signing in a representative capacity. (Sec. 19)* – Authority may be given orally or in writing (SPA, only an evidence of authority of an agent to third parties)

3. In case of forgery *(Sec. 23)*
4. Acceptor makes his acceptance of a bill on a separate paper *(Sec. 134)*
5. Person makes a written promise to accept the bill before it is drawn *(Sec. 135)*

A. SIGNING IN TRADE NAME

Q: Is a person signing in trade name liable?

A: Yes. As a general rule, only persons whose signatures appear on an instrument are liable thereon. But one who signs in a trade or assumed name is liable as if he signed his own name *(Sec. 18 [2])*. It is necessary, however, that the party who signed intended to be bound by his signature.

B. SIGNATURE OF AN AGENT

Q: What are the legal effects of an agent's signature in a negotiable instrument?

A: Provided that the requisites are complied with, the legal effects of an agent's signature in a negotiable instrument are:

1. His signature will bind his principal
2. He will be exempt from personal liability

Q: What are the requisites to exempt an agent from liability?

A:

1. He is duly authorized
2. He adds words to his signature indicating that he signs as agent/representative
3. He discloses the name of his principal.*(Sec. 20)*

Q: What is meant by procuration?

A: Procuration is the act by which a principal gives power to another to act in his place as he could himself *(Fink v. Scott, 143 S.E. 305)*

Q: What is the effect of a signature by procuration?

A: It operates as notice that the agent has but a 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. *(Sec. 21)*

C. INDORSEMENT BY MINOR OR CORPORATION

Q: What are the effects of an infant or corporation's indorsement?

A:

1. Not void. The incapacity of the infant is not a defense which can be availed of by prior parties. However, it does not destroy the right of such an infant indorser to disaffirm under the rules of infancy
2. Passes property therein
3. *Voidable.* Therefore, parties prior to the minor or corporation cannot escape liability by setting up as defense the incapacity of the indorsers.
4. A minor, however, may be held bound by his signature in an instrument where he is guilty of actual fraud committed by specifically stating that he is of age. *(PNB v. CA, G.R. No. L-34404, June 25, 1980)*

D. FORGERY

Q: What is forgery?

A: Forgery is the counterfeit making or fraudulent alteration of any writing.

Q: When is there forgery?

A: Signature is affixed by one who does not claim to act as an agent and who has no authority to bind the person whose signature he has forged.

Q: When is there want of authority?

A: Signature is affixed by one who purports to be an agent but has no authority to bind the alleged principal.

Q: What is the effect when there is forgery?

A:

GR: It does NOT render the instrument void. The signature is wholly inoperative, and no right to retain the instrument, or to give a discharge thereof, or to enforce payment thereof against any party to it, is acquired through or under such signature. *(Cut-off rule)*

XPN:

1. If the party against whom it is sought to enforce such right is precluded from setting up forgery or want of authority. *(Sec. 23)*
2. Where the forged signature is not necessary to the holder's title, in which case, the forgery may be disregarded *(Sec. 48)*

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Q: Can a payee sue the collecting bank for the amount of the checks when it made payment of the same under a forged endorsement in favor of the forger?

A: Yes, since the signature of the payee was forged to make it appear that he had made an indorsement in favor of the forger, such signature should be deemed as inoperative and ineffectual. The collecting bank grossly erred in making payment by virtue of said forged signature. The collecting bank is liable to the payee and must bear the loss because it is its legal duty to ascertain that the payee's endorsement was genuine before cashing the check. *(Westmont Bank v. Ong, G.R. No. 132560, Jan. 30, 2002)*

Q: Who are precluded from setting up the defense of forgery?

A:

1. Those who admit/warrant the genuineness of the signature: indorsers, persons negotiating by delivery and acceptor; *(Sec 56)*
2. Those who by their acts, silence, or negligence, are estopped from claiming forgery;
3. A holder of a bearer instrument who subsequently negotiates such instrument with a prior forged indorsement (forged indorsement is not necessary to his title it being a bearer instrument).

Q: What are the rights of the parties in cases of forged instruments?

A:

1. *Where note payable to order:*
    1. Party whose signature was forged is not liable to a holder, even a HIDC
    2. Indorsement is wholly inoperative.

2. *Where note payable to bearer:*
    a. The party whose indorsement is forged is liable to a HIDC, but not to one who is not a HIDC
       Reason: it can be negotiated by mere delivery
    b. The only defense available is want of delivery but this defense can be raised only against a holder not in due course.

3. *Where bill payable to order:* The party whose indorsement is forged is *not* liable to any holder even a HIDC. The forged indorsement is wholly inoperative.

Q: A client indorsed a check with a forged indorsement. The collecting bank indorsed the check with the drawee bank. What are the liabilities of the parties?

A: The collecting bank is bound by its warranties as an indorser and cannot set up the defense of forgery as against the drawee bank.

The drawee bank is under strict liability to pay the check to the order of the payee. Payment under a forged indorsement is not to the drawer's order. Since the drawee bank did not pay a holder or other person entitled to receive payment, it has no right to reimbursement from the drawer. *(Associated Bank v. CA, G.R. No. 107382, Jan. 31, 1996)*

Q: What is the remedy of the drawee bank?

A: The drawee bank may not debit the account of the drawer but may generally pass liability back through the collection chain to the party who took from the forger and, of course, to the forger himself, if available. If the forgery is that of the payee's or holder's indorsement, the collecting bank is held liable, without prejudice to the latter proceeding against the forger. Since a forged indorsement is inoperative, the collecting bank had no right to be paid by the drawee bank. The former must necessarily return the money paid by the latter because it was paid wrongfully. *(Associated Bank v. CA, G.R. No. 107382, Jan. 31, 1996)*

Q: What is the liability of the drawee bank and the drawer for the amount paid on checks with forged indorsements, if the same was due to the negligence of both the drawee bank and the drawer?

A: The loss occasioned by such negligence should be divided equally between the drawer/depositor and the drawee.

Q: Can a drawer-depositor who entrusted his check books, credit cards, passbooks, bank statements and cancelled checks to his secretary and who had introduced the secretary to the bank for purposes of reconciliation of his accounts hold the drawee bank liable for the

amounts withdrawn by the secretary by forging his signature on the checks?

A: No, he is precluded from setting up the forgery due to his own negligence in entrusting to his secretary his credit cards and check book including the verification of his statements of account. *(Ilusorio v. CA, G.R. No. 139130, Nov. 27, 2002)*

Q: Can a drawer, from whom checks were stolen but failed to report the same to the authorities or the drawee bank, recover the value of the checks paid by the drawee bank on the forged checks which was stolen from the drawer?

A: No, the drawer cannot recover. He is the one which stands to be blamed for its negligence/predicament. *(Security Bank and Trust Company v. Triumph Lumber and Construction Corp., G.R. No. 126696, Jan. 21, 1999)*

Q: How is forgery proven and who has the burden of proof?

A: Forgery, as any other mechanism of fraud must be proven clearly and convincingly, and the burden of proof lies on the party alleging forgery.*(Chiang Yia Min v. CA, G.R. No. 137932, Mar. 28, 2001)*

Q: Discuss the legal consequences when a bank honors a forged check.

A:

1. *When drawer's signature is forged* – Drawee-bank by accepting the check cannot set up the defense of forgery, because by accepting the instrument, the drawee bank admits the genuineness of signature of drawer *(BPI Family Bank v. Buenaventura, G.R. No. 148196, Sept. 30, 2005; Sec. 23, NIL).*

   Unless a forgery is attributable to the fault or negligence of the drawer himself, the remedy of the drawee-bank is against the party responsible for the forgery. Otherwise, drawee-bank bears the loss. A drawee-bank paying on a forged check must be considered as paying out of its funds and cannot charge the amount to the drawer *(Samsung Construction Co. Phils, v. Far East Bank, G.R. No. 129015, Aug. 13, 2004).* If the drawee-bank has charged drawer's account, the latter can recover such amount from the drawee-bank *(Associated Bank v. CA, G.R. No. 107382, Jan. 31, 1996; BPI v. Case Montessori Internationale, G.R. No. 149454, May 28, 2004).*

   However, the drawer may be precluded or estopped from setting up the defense of forgery as against the drawee-bank, when it is shown that the drawer himself had been guilty of gross negligence as to have facilitated the forgery *(Metropolitan Waterworks v. CA, G.R. No. L-62943, July 14, 1986).*

2. *Drawee bank versus collecting bank*– When the signature of the drawer is forged, as between the drawee-bank and collecting bank, the drawee-bank sustains the loss, since the collecting bank does not guarantee the signature of the drawer. The payment of the check by the drawee bank constitutes the proximate negligence since it has the duty to know the signature of its client-drawer. *(Philippine National Bank v. CA, G.R. No. L-26001, Oct. 29, 1968).*

3. *Forged payee's signature* – When drawee-bank pays the 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. In such case, the bank becomes liable since its primary duty is to verify the authenticity of the payee's signature *(Traders Royal Bank v. Radio Philippines Network, G.R. No. 138510, Oct. 10, 2002; Westmont Bank v. Ong, G.R. No. 132560, Jan. 30, 2002).*

4. *Forged endorsement* – Drawer's account cannot be charged, and if charged, he can recover from the drawee-bank *(Associated Bank v. CA, G.R. No. 107382, Jan. 31,1996).*

   Drawer has no cause of action against collecting bank, since the duty of collecting bank is only to the payee *(Manila Lighter Transportation, Inc. v. CA,G.R. No. L-50373 Feb. 15, 1990).* Drawee-bank can recover from the collecting bank *(Great Eastern Life Ins. Co. v. Hongkong & Shanghai Bank, G.R. No. 18657, Aug. 23, 1922)* because even if the indorsement on the check deposited by the bank's client is forged, collecting bank is bound by its

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warranties as an indorser and cannot set up defense of forgery as against drawee bank *(Associated Bank v. CA, G.R. No. 107382, Jan. 31, 1996)*.

Q: What are the kinds of fraud relating to a negotiable instrument?

A:

1. *Fraud in the execution or fraud in factum* – A person, without negligence, has signed an instrument which was in fact a negotiable one, but was deceived as to the character of the instrument and without knowledge of it (real defense).

2. *Fraud in the inducement or simple fraud* – Relates to the quantity, quality, value or character of the consideration of the instrument. Deceit is not in the character of the instrument but in its amount or terms (personal defense).

Q: The drawer's signature was forged. There is, however, a provision in the monthly bank statement that if the drawer's signature was forged, the drawer should report it within 10 days from receipt of the statement to the drawee. The drawer, however failed to do so. What will be its effect insofar as the drawer's right is concerned?

A: The failure of the drawer to report the forgery within ten days from receipt of the monthly bank statement from the drawee bank does not preclude the drawer from questioning the mistake of the drawee bank despite the provision. *(BPI v. CASA Montessor, G.R. No. 149454, May 28, 2004)*

Q: If forgery was committed by an employee of the drawer whose signature was forged, does the relationship amount to estoppel such that the drawer is precluded in recovering from the drawee bank?

A: The bare fact that the forgery was committed by an employee of the party whose signature was forged can not necessarily imply that such party's negligence was the cause of the forgery in the absence of some circumstances raising estoppel against the drawer. *(Samsung Construction Co. v. Far East Bank and Trust Company, G.R. No. 129015, Aug. 13, 2004)*

V. CONSIDERATION

Q: What is consideration?

A: It is an inducement to a contract that is the cause, price or impelling influence, which induces a party to enter into a contract.

Q: What is the presumption recognized by law as to the existence of consideration?

A: Every negotiable instrument is deemed *prima facie* to have been issued for a valuable consideration. *(Sec. 24)*

Q: What constitutes value?

A: It is any consideration sufficient to support a simple contract.

Note: An antecedent or pre-existing debt constitutes value and is deemed such whether the instrument is payable on demand or at a future time. *(Sec. 25)*

Love and affection do not constitute value within the meaning of the law.

Q: Who is a holder for value?

A: One who has given a valuable consideration for the instrument issued or negotiated to him *(Sec. 26)*.

Q: Up to what extent can a holder be considered a holder for value?

A: The holder is deemed as such not only as regards the party to whom the value has been given to by him but also in respect to all those who became parties prior to the time when value was given.

Note: Where the holder has a lien on the instrument arising either from contract or by implication of law, he is deemed a holder for value to the extent of his lien. *(Sec. 27)*

Q: What is the effect of want of consideration?

A: It becomes a matter of defense as against any person *not* a holder in due course (Sec. 28);

Q: What is the effect of partial failure of consideration?

A: Partial failure of consideration is a defense *pro tanto*, whether the failure is an ascertained and liquidated amount or otherwise *(Sec. 28)*

Q: Who has the burden of proving that a negotiable instrument was issued for a consideration?

A: The drawer of a check, not the payee, has the burden of proof to show that the instrument was issued without sufficient consideration. Since a negotiable instrument is presumed to have been issued for a valuable consideration, the mere presentation of a dishonored instrument in evidence entitles the holder to recover from the drawer even if the payee did not establish the accountability of the drawer. *(Travel-On v. CA, G.R. No. L-56169, June 26, 1992)*

Q: Can a logging concessionaire which issued promissory notes in favor of a bank to secure advances in connection to its log exportations raise the defense of want of consideration in a case filed by the bank for the payment of the PN?

A: No, the promissory note appears to be negotiable as they meet the requirements of Sec.1 of the NIL. Such being the case, the notes are *prima facie* deemed to have been issued for consideration. It bears noting that no sufficient evidence was adduced by the logging concessionaire to show otherwise. *(Quirino Gonzales Logging Concessionaire v. CA, G.R. No. 126568, Apr. 30, 2003)*

Q: What is meant by *"failure of consideration"*?

A: Failure of consideration means the failure or refusal of one of the parties to do, perform or comply with the consideration agreed upon.

Q: How is absence or failure of consideration distinguished from inadequacy of consideration?

A: Inadequacy of consideration does not invalidate the instrument, unless there has been fraud, mistake or undue influence *(Art. 1355, NCC).* However, knowledge of inadequacy of consideration would render the holder not a holder in due course. *(Sec. 53)*

VI. ACCOMODATION PARTY

Q: Who is an accommodation party?

A: One who has signed the instrument as maker, drawer, acceptor, or indorser, *without* receiving value therefor, and for the purpose of lending his name to some other person.*(Sec. 29)*

Q: What are the requisites to be an accommodation party?

A:
1. Accommodation party must sign as maker, drawer, acceptor or indorser
2. No value is received by the accommodation party for the accommodated party; and
3. The purpose is to lend the name.

Note: It does not mean, however, that one cannot be an accommodation party merely because he has received some consideration for the use of his name. The phrase "without receiving value therefor" only means that no value has been received for the instrument and not for lending his name.

Q: What are the distinctions between an accommodation party and a regular party?

A:

ACCOMMODATION PARTY	REGULAR PARTY
Signs an instrument without receiving value therefore *(Sec. 29)*	Signs the instrument for value *(Sec. 24)*
Purpose of signing: lend his name to another person *(Sec. 29)*	Not for that purpose
May always show, by parol evidence, that he is only such	Cannot disclaim personal liability by parol evidence
Cannot avail of the defense of absence/failure of consideration against a holder not in due course	May avail
May sue reimbursement after paying the holder/subsequent party	May not sue

Q: Up to what extent is an accommodation party liable?

A:
1. *Right to revoke accommodation* – before the instrument has been negotiated for value.
2. *Right to reimbursement from accommodated party* – the accommodated party is the real debtor. Hence, the cause of action is not on the instrument but on an implied contract of reimbursement.

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3. Right to contribution from other solidary accommodation maker. *(Sadaya v. Sevilla, G.R. No. L-17845, Apr. 27, 1967)*

Q: Can a party who signed on the note as an accommodation party raise the defense of absence or want of consideration?

A: No. An accommodation party who lends his name to enable the accommodated party to obtain credit or raise money is liable on the instrument to a holder for value even if he receives no part of the consideration. He assumes the obligation to the other party and binds himself to pay the note on its due date. By signing the note, the accommodation party thus became liable for the debt even if he had no direct personal interest in the obligation or did not receive any benefit therefrom. *(Dela Rama v. Admiral United Savings Bank, G.R. No. 154740, Apr. 16, 2008)*

Q: Can a corporation be an accommodation party, if so, does the liability of an accommodation party attach to a corporation?

A: No. The issue or indorsement of negotiable paper by a corporation without consideration and for the accommodation of another is *ultra vires.* Hence, one who has taken the instrument with knowledge of the accommodation nature thereof cannot recover against a corporation where it is only an accommodation party. *(Crisologo-Jose v. CA,G.R. No. 80599, Sept. 15, 1989)*

Q: May a holder for value recover from an accommodation party notwithstanding his knowledge of such fact?

A: Yes, a holder for value may recover. This is so because an accommodation party is liable on the instrument to a holder for value, notwithstanding that such holder at the time of taking the instrument knew him to be only an accommodation party. The accommodation party is liable to a holder for value as if the contract was not for accommodation. 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. *(Ang Tiong v. Ting, G.R. No. L-26767, Feb. 22, 1968)*

VII. NEGOTIATION

Q: When is an instrument negotiated?

A: An instrument is negotiated when it is transferred from one person to another in such a manner as to constitute the transferee the *holder* thereof. (*Sec. 30*)

Note: A holder is the payee or indorser of a bill or note, who is in possession of it, or the bearer thereof. *(Sec. 191)*

Q: What are the methods of transferring a negotiable instrument?

A:

1. *Issue* – first delivery of the instrument complete in form to a person who takes it as a holder.
2. *Negotiation* – an instrument is negotiated when it is transferred from one person to another in such a manner as to constitute the transferee the holder thereof.
3. *Assignment* – absent any express prohibition against assignment or transfer written on the face of a non-negotiable instrument, the same may be assigned or transferred.

A. DISTINGIUSHED FROM ASSIGNMENT

Q: What distinguishes negotiation from assignment?

A:

NEGOTIATION	ASSIGNMENT
Only a negotiable instrument may be negotiated	Non-negotiable instrument may be assigned absent of any prohibition against assignment written on its face.
The transferee, if he is a HIDC may acquire better rights than his transferor.	The transferee can have no better rights than his transferor; he merely steps into the shoes of the assignor
The holder can hold the drawer liable and the indorsers liable if the party primarily liable does not pay.	The transferee has no right of recourse for payment against immediate parties.

B. MODES OF NEGOTIATION

Q: What are the methods of negotiation?

A:
1. *If payable to bearer*- it is negotiated by delivery

2. *If payable to order*- it is negotiated by the indorsement of the holder completed by delivery. *(Sec. 30)*

Q: What is the effect, if any, if a bearer instrument is negotiated by indorsement and delivery?

A: A bearer instrument, even when indorsed specially, may nevertheless be further negotiated by delivery, but the person indorsing specially shall be liable as endorser to only such holders as make title through his endorsement (once a bearer instrument, always a bearer instrument). *(Sec. 40)*

Note: This rule does not apply to an instrument originally payable to order but is converted into bearer instrument because the only or last indorsement is an indorsement in blank.

Q: Earl Louie makes a promissory note payable to bearer and delivers the same to Joana. Joana, however, endorses it to Ana in this manner:

"Payable to Ana. Signed: Joana."

Later, Ana, without indorsing the promissory note, transfers and delivers the same to Batista. The note is subsequently dishonored by Earl Louie. May Batista proceed against Earl Louie for the note?

A: Yes. Earl Louie is liable to Batista under the promissory note. The note made by Earl Louie is a bearer instrument. Despite special indorsement made by Joana thereon, the note remained a bearer Instrument and can be negotiated by mere delivery. When Ana delivered and transferred the note to Batista, the latter became a holder thereof. As such holder, Batista can proceed against Earl Louie. **(1998 Bar Question)**

Q: Where indorsement should be placed?

A:
1. On the instrument itself; or
2. On a separate piece of paper attached to the instrument called “allonge”. *(Sec. 31)*

Q: Can there be partial indorsement?

A:

<u>**GR**</u>**:** No. Indorsement must be of the entire instrument. *(Sec. 32)*

<u>**XPN**</u>**:** When there is partial payment.

Q: What is the effect when an order instrument was delivered without indorsement?

A: The transfer operates as an ordinary assignment *(Sec.49).* Without the indorsement, the transferee would not be the holder of the instrument. When indorsement is subsequently obtained, the transfer operates as a negotiation only as of the time the negotiation is actually made.

Note: The transferee has the right to require the transferor to indorse the instrument.

Q: What is the effect when a negotiable instrument is merely assigned?

A: The transferee does not become a holder and he merely steps into the shoes of the transferor. Any defense available against the transferor is available against the transferee. *(Salas v. CA, G.R. No. 76788 Jan. 22, 1990)*

Q: What is an indorsement?

A: Indorsement is the writing of the name of the indorser on the instrument with the intent to transfer title to the same.

Q: What are the different kinds of Indorsement?

A:
1. *Special (Sec. 34)*–Specifies the person to whom *or* to whose order the instrument is to be payable. Also known as specific indorsement or indorsement in full.

2. *Blank (Sec. 34)* –Specifies no indorsee.
   1. Instrument is payable to bearer and may be negotiated by delivery;
   2. May be converted to special indorsement by writing over the signature of the indorser in blank any contract consistent with the character of indorsement*(Sec. 35)*.

3. *Absolute*–The indorser binds himself to pay:

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   a. upon no other condition than failure of prior parties to do so
   b. upon due notice to him of such failure

4. *Conditional* –Right of the indorsee is made to depend on the happening of a contingent event. Party required to pay may disregard the conditions *(Sec. 39)*

5. *Restrictive* –When the instrument:
   a. Prohibits further negotiation of the instrument (it destroys the negotiability of the instrument);
   b. Constitutes the indorsee the agent of the indorser; *(Sec. 36)*
   c. Vests the title in the indorsee in trust for or to the use of some persons. But mere absence of words implying power to negotiate does not make an instrument restrictive.

6. *Qualified(Sec. 34)*– constitutes the indorser a mere assignor of the title to the instrument. It is made by adding to the indorser's signature words like*, without recourse* (serves as an ordinary equitable assignment) *(Sec. 38)*

7. *Joint*–indorsement made payable to 2 or more persons who are not partners. *(Sec. 41)*

   Note: All of them must indorse unless the one indorsing has authority to indorse for the others

6. *Irregular(Sec. 64)*– A person who, not otherwise a party to an instrument, places thereon his signature in blank before delivery.

7. *Facultative* –Indorser waives presentment and notice of dishonor, enlarging his liability and his indorsement.

8. *Successive* – indorsement to two persons in succession.

Note: Any of them can indorse to effect negotiation of the instrument.

Q: What is the effect of a qualified indorsement:

A: A qualified indorsee has limited liability. He is liable only if the instrument is dishonored by non-acceptance or non-payment due to:

1. Forgery;
2. Lack of good title on the part of the indorser;
3. Lack of capacity to indorse on the part of the prior parties; or
4. The fact that at the time of the indorsement, the instrument was valueless or not valid at the time of the indorsement which fact was known to him.

Note: A qualified indorser guarantees only the genuineness of the instrument but does not guarantee its payment.

Q: What are the rights of an indorsee in a restrictive indorsement?

A:
1. To receive payment of the instrument;
2. To bring any action thereon that the indorser could bring; and
3. To transfer his rights as such indorsee, where the form of the indorsement authorizes him to do so. *(Sec. 37)*

Q: What do subsequent indorsees acquire under the restrictive indorsement?

A: All subsequent indorsees acquire only the title of the 1st indorsee. *(Sec. 37)*

Q: When there is a joint indorsement, who must indorse?

A:

GR: All must indorse in order for the transaction to operate as a negotiation. *(Sec. 41)*

XPN:
1. Payees or indorsees are partners; and
2. Payee or indorsee indorsing has authority to indorse for the others.

Q: What are the instances where the indorsements served only as equitable assignment?

A:
1. Indorsement of part of the amount of the instrument. *(Sec. 32)*
2. In cases of qualified indorsement. *(Sec. 38)*
3. Conditional Indorsement. *(Sec. 39)*
4. Transfer of an instrument payable to order by mere delivery. *(Sec. 49)*

Q: When can an indorsement be stricken out?

A: The holder may, at any time, strike out any indorsement which is not necessary to his title. Indorser whose indorsement is struck out, and all indorsers subsequent to him, are relieved from liability on the instrument. *(Sec. 48)*

Q: When can a prior party negotiate an instrument?

A: Where an instrument is negotiated back to him. But, he is not entitled to enforce payment thereof against any intervening party to whom he was personally liable. *(Sec. 50)*

Q: What are the limitations to renegotiation?

A: In the following cases, a prior party cannot further negotiate the instrument:

1. Where it is payable to the order of a third person, and it has been paid by the drawer *(Sec. 121[a])*;
2. Where it was made or accepted for accommodation and has been paid by the party accomodated*(Sec. 121[b])*;
3. In other cases, where the instrument is discharged when acquired by a prior party. *(Sec. 119)*

VII. RIGHTS OF A HOLDER

Q: Who is a holder?

A: The payee or indorsee of a bill or note who is in possession of it or the bearer thereof. *(Sec. 191)*

Q: What are the classes of holders?

A:

1. Holders in general (Simple Holders). *(Sec. 51)*
2. Holders for value. *(Sec. 26)*
3. Holders in due course. *(Secs. 52, 57)*

Q: What are the rights of a holder in general?

A:

1. Right to sue
2. Right to receive payment (*Sec. 51*)

   Note: If the payment is in due course, the instrument is discharged.

A. HOLDER IN DUE COURSE

Q: What constitutes payment in due course?

A: When made:

1. At or after the maturity of the instrument
2. To the holder thereof, in good faith and without notice that his title is defective *(Sec. 88)*

Q: Who is a holder in due course (HIDC)?

A: He who takes a negotiable instrument:

1. That is complete and regular upon its face;

   Note: Absence of the required documentary stamp will not make the instrument incomplete. (It is not a requisite of negotiability under Sec. 1 and it is not a material particular under Sec. 125)

2. Became the holder before it was overdue, and without notice that it has been previously dishonored, if such was the fact;

   Note: if the instruments is payable on demand, the date of maturity is determined by the date of presentment, which must be made within a reasonable time after its issue, if it is a note, or after the last negotiation thereof, if it is a bill of exchange. *(Secs. 71 and 143[a])*

   Where transferee receives notice of any infirmity in the instrument of defect in the title of the person negotiating the same before he had paid the full amount agreed to be paid, he will be deemed a holder in due course only to the extent of the amount paid by him. *(Sec. 54)*

3. Took it in good faith and for value;

4. 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. *(Sec. 52)*

   Note: Knowledge of the agent is constructive knowledge to the principal.

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Q: Who is deemed to be a HIDC?

A:

GR: Every holder is deemed *prima facie* to be a holder in due course;

XPN: When it is shown that the title of any person who has negotiated the instrument was defective. *(Sec.59)*

Q: Can a payee be a HIDC?

A: There can be no doubt that a proper interpretation of NIL as a whole leads to the conclusion that a payee may be a holder in due course under the circumstances in which he meets the requirements of Sec. 52. *(De Ocampo v. Gatchalian, G.R. No. L-15126, Nov. 30, 1961)*

Note: There is a contrary view on the matter, wherein it is contended that under subsection 4 of Sec. 52, the holder in due course must have acquired the instrument through negotiation and an instrument is issued and not negotiated to a payee.

Q: Can a drawee be a HIDC?

A: A drawee does not by paying a bill become a holder in due course since a holder refers to one who has taken the instrument as it passes along in the course of negotiation; whereas a drawee, upon acceptance and payment, strips the instrument of negotiability and reduces it to a mere voucher or proof of payment.

Q: What are the rights of a HIDC?

A:

1. Hold the instrument free from defenses available to parties among themselves
2. Hold the instrument free from any defect of title of prior parties
3. Receive payment
4. Enforce payment of the instrument for the full amount thereof against all parties liable
5. Sue

Q: Who is a holder not in due course (HNIDC)?

A:

1. One who became a holder of an instrument without any of the requisites under Sec. 52

2. One to whom an instrument payable on demand is negotiated after an unreasonable length of time from issue. *(Sec. 53)*

Q: What are the rights of a HNIDC?

A: The rights similar to an assignee. The other rights are:

1. He may receive payment and if the payment is in due course, the instrument is discharged
2. He is entitled to the instrument but holds it subject to the same defenses as if it were non-negotiable
3. He may sue on the instrument in his own name. *(Sec. 5)*

Q: What are the rights of a holder through a HIDC?

A: He has all the rights of a HIDC from whom he derives his title in respect of all parties prior to such holder, provided he is not himself a party to any fraud or illegality affecting the instrument. *(Sec. 58)*

Note: A payee or indorsee whose title is defective cannot better it by selling the instrument to a HIDC and buying it again. Similarly, a HIDC who negotiates the instrument to a holder other that one in due course and then reacquires it will hold the instrument as a holder in due course.

Q: How does the "shelter principle" embodied in the Negotiable Instruments Law operate to give the rights of a HIDC to a holder who does not have the status of a HIDC? Briefly explain.

A: Under the shelter principle, a person who does not qualify as a holder in due course can, nonetheless, acquire the rights and privileges of a holder in due course if he derives his title to the instrument through a holder in due course. However, a person who previously held the instrument cannot improve his position by later reacquiring it from a holder in due course if the former holder was a party to fraud or illegal activity affecting the instrument or had notice of a claim or defense against the instrument. **(2008 Bar Question)**

Q: When is the title of a person (transferor) defective?

A:

1. *In its acquisition* – When he obtained the instrument, or any signature thereto, by fraud, duress, or force and fear, or other unlawful means, or for an illegal consideration.

2. *In the negotiation* – When he negotiates it in breach of faith, or under such circumstances as amount to a fraud. *(Sec. 55)*

Q: What constitutes notice of defect (on the transferee)?

A: The person to whom it is negotiated must have had actual knowledge of such facts or knowledge of other facts that his action in taking the instrument amounted to bad faith. *(Sec. 56)*

Q: What is the effect of notice before the full amount is paid?

A: Transferee will be deemed a holder in due course only to the extent of the amount therefore paid by him. *(Sec. 54)*

Q: The drawer delivered a check to Wilma, an agent, for safekeeping only and for the purpose of evidencing her sincere intention to buy a car owned by RC, who is Wilma's principal. Wilma did not return the check and delivered it as payment for her hospital expenses to MB Clinic. Does the presumption that every holder is presumed to be HIDC apply to MB Clinic?

A: No, the rule that a possessor of the instrument is *prima facie* a HIDC does not apply to MB Clinic because there was a defect in the title of the holder, since the instrument was not payable to WILMA or to bearer, the drawer had no account with the payee, Wilma did not show or tell the payee why she had the check in his possession and why he was using it for the payment of his own account. As holder's title was defective or suspicious, it cannot be stated that the payee acquired the check without knowledge of said defect in holder's title, the presumption that it is a HIDC does not exist. *(De Ocampo& Co. v. Gatchalian, G.R. No. L-15126, Nov. 30, 1961)*

Q: NSW received three post-dated and crossed checks issued on the condition that the drawer on due date would make sufficient deposits to cover the checks. NSW did not wait for the maturity and indorsed the check to an investment house, which deposited the same. The checks bounced. Is the investment house a holder in due course?

A: No, that the checks had been issued subject to the condition that the drawer on due date would make the back up deposit for said check which condition was not made, constitutes a good defense against the holder who is not a HIDC, particularly when the check was crossed. The crossing of a check serves a warning to the holder that the check had been issued for a definite purpose so that he must inquire if received the check pursuant to that purpose, otherwise, he is not a holder in due course. *(State Investment House v. IAC, G.R. No. 72764, July 13, 1989)*

Q: What is the effect of possession of a negotiable instrument after presentment and dishonor?

A: It does not make the possessor a holder for value within the meaning of the law. It gives rise to no liability on the part of the maker or drawer or indorsers. *(STELCO Marketing Corp. vs. CA, G.R. No. 96160, June 17, 1992)*

Q: Is a corporation to which four crossed checks were indorsed by the payee corporation a holder in due course and hence entitled to recover the amount of the checks when the same had been dishonored for the reason of "payment stopped"?

A: The checks were crossed checks and specifically indorsed for deposit to payee's account only. From the beginning, the corporation was aware of the fact that the checks were all for deposit only to payee's account. Clearly then, it could not be considered a HIDC. However, it does not follow as a legal proposition that simply because it was not a HIDC for having taken the instruments in question, w/ notice that the same was for deposit only, that it was altogether precluded from recovering on the instrument. The disadvantage in not being a HIDC is that the negotiable instrument is subject to defenses as if it were non-negotiable. *(Atrium Management Corp. v. CA, G.R. No. 109491, Feb. 28, 2001)*

B. DEFENSES AGAINST THE HOLDER

Q: What are the defenses against the Holder?

A:

1. *Real Defenses* – those that are available against all parties, both immediate and remote, including holders in due course.

2. *Personal Defenses* –defenses which are not available against a holder in due course. Those which grow out of the agreement or conduct of a particular person in regard to the instrument which renders it inequitable or him,

though holding the legal title, to enforce it against the party sought to be made liable.

IX. LIABILITIES OF PARTIES

Q: Who are primarily liable?

A:
1. *Maker* – in a promissory note
2. *Acceptor* – in a bill of exchange

Q: Who are secondarily liable?

A:
1. Drawer
2. Indorser

Q: Distinguish a drawer from a maker.

A:

DRAWER	MAKER
Issues a BOE	Issues a PN
Only secondarily liable	Primarily liable
Can limit his liability by putting "without recourse"	Cannot limit liability

Q: What are the conditions in order for persons secondarily liable in a BOE (drawer and indorsers) to become liable?

A:
1. The bill is presented for acceptance *(Sec. 143)*
2. The bill is dishonored by non-acceptance or non-payment *(Sec. 70);* and
3. The necessary proceedings for dishonor are duly taken. *(Sec. 152)*

Q: To whom should presentment be made?

A:
1. *Promissory note* – maker
2. *Bill of exchange* – drawee/acceptor

Q: What are the liabilities of those secondarily liable?

A: See Appendix B

A. MAKER

Q: What are the liabilities a maker?

A:
1. Engages to pay according to the tenor of the *instrument*; and
2. Admits the existence of the payee and his then capacity to indorse. *(Sec.60)*

Note: Liability of the maker is primary and unconditional.

Q: When is a maker precluded from setting-up these defenses?

A:
1. That payee is a fictitious person
2. That payee was insane, a minor, or a corporation acting *ultra vires*.

Q: What are words which depict the nature of the liability of the makers/drawers?

A: An instrument which begins with "I", or "Either of us" promise to pay, when signed by two or more persons, makes them solidarily liable. Also, the phrase "joint and several" binds the makers jointly and individually to the payee so that all may be sued together for its enforcement, or the creditor may select one or more as the object of the suit. *(Astro Electronics Corp. v. Phil. Export and Foreign Loan Guarantee Corporation, G.R. No. 96073, Dec. 21, 2003)*

Q: On the right bottom margin of a PN appeared the signature of the corporation's president and treasurer above their printed names with the phrase "and in his personal capacity." The corporation failed to pay its obligation. Are the officers liable?

A: Yes, persons who write their names on the face of promissory notes are makers and liable as such. The officers are co-makers and as such, they cannot escape liability arising therefrom. *(Republic Planters Bank v. CA, G.R. No. 93073, Dec. 21, 1992)*

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

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

A: The bank cannot recover the amount paid to B for the check. When the bank honored the check, it became an acceptor. As acceptor, the bank became primarily and directly liable to the payee/holder B.
The recourse of the bank should be against X and its bookkeeper who conspired to make X's ledger show that he has sufficient funds. **(1998 Bar Question)**

B. DRAWER

Q: To whom is the drawer secondarily liable?

A:
1. The holder
2. Any of the indorsers intervening between holder and drawer who is compelled to pay by the holder, the drawer will be liable to that indorser so compelled to pay

C. ACCEPTOR

Q: What are the liabilities of an acceptor?

1. Engages to pay according to the tenor of his *acceptance*
2. Admits the existence of the drawer, the genuineness of his signature and his capacity and authority to draw the instrument
3. Admits the existence of the payee and his then capacity to indorse. *(Sec. 62)*

Note: Drawee does not become liable until he accepts the instrument in which case he becomes an acceptor.

Q: When is an acceptor is precluded from setting-up these defenses?

1. That the drawer is non-existent or fictitious
2. That the drawer’s signature is a forgery
3. That there is no consideration between him and the drawer

D. INDORSER

Q: Who is deemed an indorser?

A: A person placing his signature upon an instrument otherwise than as maker or acceptor, is deemed to be an indorser, unless he clearly indicates by appropriate words his intention to be bound in some other capacity. *(Sec. 63)*

Note: A person who places his indorsement on an instrument negotiable by delivery incurs all liabilities of an indorser. *(Sec. 67)*

Q: Distinguish an irregular indorser from a general indorser.

A: An irregular indorser, not otherwise a party to the instrument, places his signature thereon in blank before delivery to add credit thereto. A general indorser is a regular party to the instrument like a maker, drawer or acceptor and he signs upon delivery of the instrument. While an irregular indorser signs for accommodation, a regular indorser signs for valuable consideration. *(Sec. 64[2])* **(2005 Bar Question)**

Q: Who is a qualified indorser?

A: A qualified indorser is a person who indorses without recourse. *(Sec. 65)*

Q: Does an indorser warrant the solvency of prior parties?

A: A general indorser warrants the solvency of prior parties, while a qualified indorser does not.

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

A: A is liable to F. As the maker of the promissory note, A is directly or primarily liable to F, who is a holder in due course. Despite the presence of the special indorsements on the note, these do not detract from the fact that a bearer instrument is always negotiable by mere delivery, until it is indorsed restrictively “for deposit only.”

B, as a general endorser, is liable to F secondarily, and warrants that the instrument is genuine and in all respects what it purports to be; that he has good title to it; that all prior parties had capacity to contract; that he has no knowledge of any fact which would impair the validity of the instrument or render it valueless; that at the time of his indorsement, the instrument is valid and

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subsisting; and that on due presentment, it shall be accepted or paid, or both, according to its tenor, and that if it be dishonored and the necessary proceedings on dishonor be duly taken, he will pay the amount thereof to the holder, or to any subsequent indorser who may be compelled to pay.

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

Q: Can a collecting bank debit the account of the depositor when the checks indorsed to it (bank) were forged?

A: Yes, because the depositor of a check as indorser warrants that it is genuine and in all respect what it purports to be. Thus, when the checks deposited had forged indorsements and the collecting bank, as a consequence of such forgery, was made to pay the drawee bank, the collecting bank can debit the account of the depositor for his breach of warranty *(Jai-Alai Corporation Of The Philippines v. BPI, G.R. No. L-29432, Aug. 6, 1975).*

Q: Phebean, the drawer issued a check to James. James, subsequently indorsed it to Trude. When Trude is about to encash the check, the drawee Union Bank refused to encash it due to insufficiency of funds. Trude sued James for payment of money. James alleged that the suit should be dismissed because Phebean is an indispensable party. Does James' argument hold water?

A: No. There is no privity between the drawer and the holder. The drawer is merely secondarily liable. As indorser, the buyer warranted that upon due presentment, the checks were to be accepted or paid, or both, according to their tenor, and that in case they were dishonored, she would pay the corresponding amount. After an instrument is dishonored by non-payment, indorsers cease to be merely secondarily liable; they become principal debtors whose liability becomes identical to that of the original obligor. *(Tuazon v. Heirs of Bartolome Ramos, G.R. No. 156262, July 14, 2005)*

Q: Treasury warrants were indorsed by A and B. These were presented for encashment by PNB. Subsequently, these were dishonored by the Insular Treasurer. Because of the dishonor, PNB applied A's deposit in the PNB for payment of the warrant. Is the application of the deposit of A properly enforced?

A: No. The general indorser of a negotiable instrument engages that if it be dishonored and the necessary proceedings of dishonor be duly taken, he will pay the amount thereof to the holder. In this connection, it has been held that notice of dishonor is necessary in order to charge an indorser and that the right of action against him does not accrue until the notice is given *(Gullas v. PNB, G.R. No. L-43191, Nov. 13, 1935)*

Q: What is the order of liability among the indorsers?

A:

1. *Among themselves* – Liable prima facie in the order in which they indorse *(Sec. 68)*

2. *To the holder* – In any order

Note: Every indorser is liable to all indorsers subsequent to him, but not those indorsers prior to him.

Q: Carmelo indorsed a check to Linas. Paolo stole the check from Linas, forged the latter's signature and indorsed it to Johan. Denver Bank encashed the check upon presentment thereof by Johan. Who is the party liable?

A: The bank is the party liable. It is the primary duty of the bank to know that the check was duly indorsed by the original payee and, where it pays the amount of the checks to a third person who has forged the signature of the payee, the loss falls on such bank who cashed the checks. A bank engaged in business is invested with public interest and it is its duty to pretect its clients and all persons who transact businesswith it. *(Traders Royal Bank v. RPN, G.R. No. 138510, Oct. 10, 2002)*

Q: What is the liability of an agent or broker who negotiates an instrument without indorsement?

A: He incurs all the liabilities prescribed to a general indorser unless he discloses the name of his principal and the fact that he is acting only as an agent. *(Sec. 69)*\

Note: Parol evidence is not admissible to relieve an agent or broker whose endorsement brings him within the above liability.

E. WARRANTIES

Q: What are the warranties provided by the person negotiating an instrument?

A:
1. That the instrument is genuine and in all respects what it purports to be
2. That he has good title to it
3. That all prior parties had capacity to contract
4. That he has no knowledge of any fact which would impair the validity of the instrument or render it useless.

X. PRESENTMENT FOR PAYMENT (PP)

Q: What is presentment for payment (PP)?

A: The presentation of an instrument to the person primarily liable for the purpose of demanding and receiving payment.

Q: How should presentment be made?

A:

GR: Instrument must be exhibited to the person from whom payment is demanded; when paid, it must be delivered to person paying it. *(Sec. 74)*

XPN: When exhibition is excused:
1. Debtor does not demand to see the instrument and refuses payment on some other grounds; or
2. Instrument is lost or destroyed.

Q: What is the liability of a bank paying a certificate of deposit payable to bearer without requiring its surrender?

A: The bank remains liable to the holder if it paid the certificate of deposit payable to bearer without requiring its surrender *(Far East Bank & Trust Company v. Querimit, G.R. No. 148582, Jan. 16, 2002).*

Q: Can a payee claim payment for a promissory note which was stolen and as such is not in his possession?

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

A. NECESSITY OF PRESENTMENT FOR PAYMENT

Q: When is PP necessary?

A: PP is only necessary to charge persons secondarily liable (*Sec. 70*). But PP is not necessary in the following instances:

1. As to drawer, where he has no right to expect or require that the drawee or acceptor will pay the instrument *(Sec. 79)*

2. As to 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)*

3. When dispensed with under Sec. 82, such as:
   a. Where, after the exercise of reasonable diligence, presentment cannot be made
   b. Where the drawee is a fictitious person
   c. By waiver of presentment, express or implied
   d. When the instrument has been dishonored by non-acceptance

Q: What is the rule if the instrument is, by its terms, payable at a special place (at a bank or at an office or at a residence but not in an unspecified place like Manila City)?

A: If 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)*

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

A: Yes. The suit will prosper as far as the face value of the note is concerned, but not with respect to the interest due subsequent to the maturity of the note and the costs of collection. RP was ready and willing to pay the note at the

specified place of payment on the specified maturity date, but PN did not show up. PN lost his right to recover the interest due subsequent to the maturity of the note and the costs of collection. **(2000 Bar Question)**

Q: What are the requisites for a sufficient PP?

A:
1. Made by the holder, or his agent
2. At a reasonable hour on a business day
3. At a proper place
4. PP was made to the person primarily liable, or if he is absent or inaccessible, to any person found at the place where the presentment is made *(Sec. 72)*

Note: Where the person/s primarily liable is/are:
1. Dead – payment must be made to his personal representative *(Sec. 76)*
2. Liable as partners and no place of payment specified – payment may be made to any of them though there has been a dissolution of the firm *(Sec. 77)*
3. Several persons, not partners, and no place of payment is specified – payment must be made to all of them *(Sec. 78)*

Q: When must presentment for payment be made?

A:

INSTRUMENT	TIME FOR PRESENTMENT
Payable at a fixed or determinable future time	**GR:** On the day it falls due. *(Sec. 85)* **XPN:** If the due date falls on a Saturday, presentment must be made on the next Monday. **Note:** If presentment for payment is made before maturity; it will not result to a discharge of the instrument *(Sec. 50).*
Promissory note payable on demand	Within a reasonable time after its issue.
Bill of exchange payable on demand	Within a reasonable time after the last negotiation thereof *(Sec.71)*. **Note:** *"Last negotiation"* means the last transfer for value. Subsequent transfers between banks for purposes of collection are not negotiations within Sec. 71.

Note: *Reasonable time* means not more than 6 months from the date of issue. Beyond said period the check becomes stale and valueless and thus, should not be paid.

Q: Is the bank liable to the payee for depositing and encashing the crossed checks to an unauthorized person?

A: Yes. The effects of crossing a check relate to the mode of its presentment for payment. Under Sec. 72 of the NIL, presentment for payment, to be sufficient, must be made by the holder or by some person authorized to receive on his behalf. Who the holder or authorized person depends on the instruction stated on the face of the check. The checks here had been crossed and issued "for payee's account only." This only signifies that the drawers had intended the same for deposit only by the person indicated *(Associated Bank v. CA, G.R. No. 89802, May 7, 1992).*

Q: What is the order of preference with regard to the place of presentment?

A:
1. Specified place in the instrument
2. Address of the person to make the payment if given in the instrument
3. Usual place of business or residence of the person to make the payment
4. Wherever he can be found; or
5. At his Last known place of business or residence *(Sec. 73)*

Q: How must presentment be made where the instrument is payable at a bank?

A: 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)*

B. PARTIES TO WHOM PRESENTMENT FOR PAYMENT SHOULD BE MADE

Q: Who are the parties to whom presentment for payment should be made?

A: Presentment for payment must be made the primary party – to the (1) maker in case of a promissory note, or to the (2) acceptor in case of an accepted bill. If the bill of exchange or check is payable on demand, the presentment must be made to the drawee although he is not liable on the bill.

Note: If the person primarily liable is absent or inaccessible, then presentment must be made to any

person of sufficient discretion at the proper place of presentment.

C. DISPENSATION WITH PRESENTMENT OF PAYMENT

Q: What is the effect when presentment is not made?

A: Drawer and the indorsers are discharged from their secondary liability unless such presentment is excused.

Q: When is the delay in making presentment excused?

A:

3. When caused by circumstances beyond the control of the holder; and
4. Not imputable to his default, misconduct, or negligence *(Sec. 81).*

Note: Only the delay in presentment is excused and not the presentment itself. Hence, as soon as the cause of delay ceases to operate, presentment must be made with reasonable diligence *(Sec. 81).*

D. DISHONOR BY NON-PAYMENT

Q: When is an instrument dishonored by non-payment?

A:

1. Non-payment upon due presentation. Happens when:
   a. The instrument is duly presented for payment to party primarily liable;&
   b. It is either refused or cannot be obtained.

2. Non-payment without presentation. Happens when:
   c. Presentment is excused
   d. the instrument is overdue
   e. it is unpaid

Q: What is the effect of dishonor by non-payment?

A: As to the holder, after an instrument has been dishonored by non-payment, the person secondarily liable becomes the principal debtors and he need not proceed against the person primarily liable.

XI. NOTICE OF DISHONOR

Q: What is notice of dishonor?

A: Given by the holder to the parties secondarily liable, drawer and each indorser, that the instrument was dishonored by non-payment or non-acceptance by the drawee/maker.

Note: Persons primarily liable need not be given notice of dishonor because they are the ones who dishonored the instrument.

Q: What are the purposes for requiring notice of dishonor?

A:

1. To inform parties secondarily liable that the maker or acceptor has failed to meet his engagement.
2. To advise them that they are required to make payment.

Q: When is a PN considered dishonored?

A:

1. If not accepted
2. Not paid when presented; or
3. Where presentment is excused, instrument is overdue and unpaid. *(Sec. 83)*

Q: What is the liability of person secondarily liable when instrument dishonored?

A: After the necessary proceedings for dishonor had been duly taken, an immediate right of recourse to all parties secondarily liable thereon accrues to the holder. *(Sec. 84)*

A. PARTIES TO BE NOTIFIED

Q: To whom must notice be given?

A: Notice of dishonor should be given to:

1. The drawer; or
2. His agent *(Sec. 97)*
3. *Where party is dead* – to a personal representative or sent to the last residence or last place of business of the deceased *(Sec. 98)*
4. *When the parties to be notified are partners* – notice to any one partner though there has been a dissolution *(Sec. 99)*

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5. Notice to joint parties who are not partners must be given to each of them *(Sec. 100)*
6. *Where a party has been adjudged a bankrupt* – to the party himself or to his trustee or assignee *(Sec. 101)*

Q: The instrument was dishonored in the hands of the agent. To whom and when may he give notice?

A:

1. *To the parties secondarily liable* – Within the time fixed by Secs. 102-104, and 107, otherwise, they are discharged

2. *To his principal* – The principal must give notice to parties secondarily liable as if he were the holder. *(Sec. 94)*

B. PARTIES WHO MAY GIVE NOTICE OF DISHONOR

Q: Who gives the notice?

A:

1. Holder
2. Another in behalf of the holder
3. Any party to the instrument who may be compelled to pay and who, upon taking it up, would have a right to reimbursement from the party to whom notice is given. *(Sec. 90)*

C. EFFECT OF NOTICE

Q: What is the effect of notice of dishonor if given by or on behalf of the holder?

A: Notice of dishonor inures to the benefit of:

1. All holders subsequent to the holder who has given notice; and
2. All parties prior to the holder but subsequent to the party to whom notice has been given and against whom they may have a right of recourse. *(Sec. 92)*

Q: What is the effect of notice of dishonor if given by party entitled thereto?

A: Notice of dishonor inures to the benefit of:

1. The holder; and
2. All parties subsequent to the party to whom notice is given (Sec. 93).

D. FORM OF NOTICE

Q: What is the form and contents of a notice of dishonor?

A:

1. Oral; or
2. In writing
3. It may be given by personal delivery, or by mail *(Sec. 96)*
4. Must contain the following:
   a. Description of the instrument;
   b. Statement that it has been presented for payment or for acceptance and that it has been dishonored *(If protest is necessary, notice must also contain a statement that it has been protested).*
   c. Statement that the party giving the notice intends to look for the party addressed for payment.

Note: A written notice need not be signed, and an insufficient notice may be supplemented or validated by verbal communication. A misdescription of the instrument does *not* vitiate the notice *unless* the party to whom the notice is given is in fact misled thereby. *(Sec. 95)*

E. WAIVER

Q: When may waiver of notice be given?

A:

1. Before the time of giving notice has arrived; or
2. After the omission to give due notice. *(Sec. 109)*

Q: What are the ways to give a waiver of notice?

A: It can either be:

1. Express; or
2. Implied (*e.g.* Payment by an indorser after he learns of the default of the maker admission of liability after dishonor). *(Sec. 109)*

Q: Who are affected by the waiver of notice?

A:

1. All parties (if embodied on the face of the instrument); or
2. Particular indorser (if written above the signature of such indorser) *(Sec. 110)*

F. DISPENSATION OF NOTICE

Q: When is notice of dishonor not necessary?

A:

1. Waiver of notice. *(Sec. 109)*
2. Waiver of protest. *(Sec. 111)*
3. When after due diligence, notice cannot be given. *(Sec. 112)*
4. Drawer in cases under Sec. 114
5. Indorser in cases under Sec. 115; and
6. Where due notice of dishonor by non-acceptance has been given (notice of dishonor by non-payment not necessary). *(Sec. 116)*

Q: With regard to the drawer, when can a notice of dishonor be dispensed with?

A:

1. When drawer and drawee is the same person
2. Drawee is fictitious or does not have the capacity to contract
3. Drawer is person to whom the instrument is presented for payment *(he is the one who dishonored the instrument)*
4. Drawer has no right to expect or require that the drawee or acceptor will honor the instrument.
5. Drawer has countermanded the payment (*e.g.* stop payment order) *(Sec.114)*

Q: Juben issued to Y 2 post-dated checks as security for pieces of jewelry to be sold. Y negotiated the check to S. When Juben failed to sell the jewelry he withdrew all his funds from the drawee bank. After dishonor, Juben contends that the holder failed to give her a notice of dishonor. Is notice of dishonor necessary?

A: He was responsible for the dishonor of his checks, hence, there was no need to serve him notice of dishonor. *(State Investment House, Inc. v. CA, G.R. No. 101163, Jan. 11, 1993)*

Q: With regard to the indorser, when is it not necessary to give a notice of dishonor?

A:

1. Drawee is fictitious or has no capacity to contract, and indorser was aware of these facts at the time he indorsed the instrument;
2. Indorser is person to whom the instrument is presented for payment; or
3. Instrument was made or accepted for his accommodation *(Sec. 115)*

G. EFFECT OF FAILURE TO GIVE NOTICE

Q: What is the effect of omission of a previous holder to give notice of dishonor by non-acceptance?

A: It does not prejudice the rights of a holder in due course subsequent to the omission to present the instrument to the drawee for acceptance and notify the drawer and indorsers if acceptance is refused. *(Sec. 117)*

Q: When should the notice be given?

A:

1. **GR:** As soon as instrument was dishonored *(Sec. 102)* – Party is allowed one entire day for the purpose of giving notice.

   XPN: Delay is excused *(Sec. 113)*

   Note: An instrument cannot be dishonored by non-payment until after the maturity

2. Parties reside in the same place
   a. Place of business – Before close of business hours on the day following
   b. Residence – Before the usual hours of rest on the day following
   c. By mail – Deposited in the post office in time to reach him in the usual course on the day following *(Sec. 103)*

3. Parties reside in *different places*
   a. By mail – Deposited in the post office in time to go by mail (actual departure in the course of mail from the post office in which the notice was deposited) the day following the day of dishonor.
   b. If no mail – At a convenient hour (of the sender) on that day, by the next mail thereafter
   c. Other than by post office (*e.g.* personal messenger) – Within the time that notice would have been received in due course of mail, if it has been deposited in the post

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office within the time specified in (a) *(Sec. 104)*

4. Time of notice to antecedent parties – Same time for giving notice that the holder has after the dishonor *(Sec. 107)*

Note: Actual receipt of the party within the time specified by law is sufficient though not sent in the places specified above. *(Sec. 108)*

Q: What is the effect of failure to give notice of dishonor?

A:

GR: Any person to whom such notice is not given is discharged, but he will still be liable for breach of warranties pertaining to the instrument.

XPN:
1. Waiver. *(Sec. 109)*
2. Notice is dispensed with. *(Sec. 112)*
3. Not necessary to drawer. *(Sec. 114)*
4. Not necessary to indorser. *(Sec. 115)*

Q: What is the effect of lack of notice of dishonor on the instrument which is payable in installments?

A:
1. *No acceleration clause* – Failure to give notice of dishonor on a previous installment does not discharge drawers and indorsers as to succeeding installments.

2. *With acceleration clause* – It depends upon whether the clause is automatic or optional.
   a. Automatic – failure to give notice of dishonor as to a previous installment will discharge the persons secondarily liable as to the succeeding installments;
   b. Optional – if not exercised, the rule would be the same as if there is no acceleration clause. If exercised, the rule would be the same as if the installment contains an automatic acceleration clause. *(Town Savings Bank v. CA, G.R. No. 106011, June 17, 1993)*

XII. DISCHARGE

A. DISCHARGE OF NEGOTIABLE INSTRUMENT

Q: What is discharge?

A: It is the release of all parties, whether primary or secondary, from the obligations arising thereunder. It renders the instrument without force and effect, and consequently, it can no longer be negotiated.

Q: What are the methods for discharge of instrument?

A:
1. Payment by principal debtor:
   a. By or on behalf of principal debtor
   b. At or after its maturity
   c. To the holder thereof
   d. In good faith and without notice that the holder's title is defective
2. Payment by accommodated party
3. Intentional cancellation of instrument by the holder (by expressly stating it in the instrument or when the instrument is torn up, burned or destroyed)
4. Any act which discharges a simple contract for the payment of money under Art. 1231 of the NCC specifically remission, novation, and merger.

   Note: Loss of the negotiable instrument will not extinguish liability; compensation is not available so long as an obligation is evidenced by a negotiable instrument. *(Commercial Law Review, Villanueva, 2009ed)*

5. Reacquisition by principal debtor in his own right. Reacquisition must be:
   a. By the principal debtor
   b. In his own right
   c. At or after date of maturity (instrument is discharged; if made before, it may be renegotiated) *(Sec. 119)*

B. DISCHARGE OF PARTIES SECONDARILY LIABLE

Q: What are the methods of discharge of secondary parties?

A:
1. Any act which discharges the instrument;
2. Intentional cancellation of his signature by the holder

3. Discharge of prior party which may be made when signature is stricken out
4. Valid tender of payment by a prior party;
5. Release of the principal debtor, unless holder expressly reserves his right of recourse against the said subsequent parties
6. Extension of time of payment, unless:
   a. Extension is consented to by such party
   b. Holder expressly reserves his right of recourse against such party. *(Sec. 120)*

Q: What are the effects of payment by persons secondarily liable?

A:
1. Instrument is not discharged
2. It only cancels his own liability and that of the parties subsequent to him
3. **GR:** Instrument may be renegotiated

   XPN:
   a. Where it is payable to the order of a third person, and has been paid by the drawer; and
   b. Where it is paid by the accommodated party

   Note: (a) and (b) has the same effect as payment by the party primarily liable.

4. Person paying is remitted to his former rights (as regards prior parties) and he may strike out his own and all subsequent indorsements. *(Sec. 121)*

C. RIGHT OF A PARTY WHO DISCHARGED INSTRUMENT

Q: What are the rights of a party who discharged the instrument?

A:

GR: The party so discharging the instrument is remitted to his former rights as regards all prior parties, and he may strike out his own and all subsequent indorsements, and again negotiate the instrument.

XPN:
1. Where it is payable to the order of a third person, and has been paid by the drawee; &
2. It was made or accepted for accommodation, and has been paid by the party accommodated.

D. RENUNCIATION

Q: What is renunciation?

A: The act of surrendering a claim or right with or without recompense (a personal defense).

Q: How is renunciation by holder made?

A:
1. Must be written
2. If oral, the instrument must be *surrendered* to the person primarily liable. *(Sec. 122)*

Q: What are the effects of renunciation?

A:
1. *Made in favor of principal debtor made at or after the maturity (made absolutely and unconditionally) of the instrument* – discharges the instrument *(Sec. 122)*

2. *Made in favor of a secondary party may be made by the holder before, at or after maturity* – discharges only the secondary parties and all subsequent to him *(Sec. 122)*

3. Renunciation does not affect the rights of a holder in due course without notice. *(Sec. 120)*

Q: What is the rule regarding cancellation of an instrument?

A: It is presumed intentional**.** It is inoperative if unintentional, or under a mistake or without the authority of the holder. But where an instrument or any signature appears to have been cancelled, burden of proof lies on the party who alleges that the cancellation was made unintentionally, or under a mistake or without authority. *(Sec. 123)*

XIII. MATERIAL ALTERATION

A. CONCEPT

Q: What is a material alteration?

A: Any change in the instrument which affects or changes the liability of the parties in any way.

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Q: What constitutes a material alteration?

A: Any alteration which changes the:

1. Date
2. Sum payable, either principal or interest;
3. Time or place of payment
4. Number or relations of the parties
5. Medium or currency in which payment is to be made; or
6. Adds a place of payment when no place of payment is specified, or any other change or addition which alters the effect of the instrument in any respect. *(Sec. 125)*

Note: The change in the date of indorsement is not material where the date is not necessary to fix the maturity of the instrument.

B. EFFECT OF MATERIAL ALTERATION

Q: What is the effect of material alteration which is not apparent?

A:

1. Avoids the instrument *except* against:
   a. A party who has made the alteration;
   b. A party who authorized or assented to the alteration; or
   c. The indorsers who indorsed *subsequent* to the alteration (because of their warranties)

2. If negotiated to a HIDC, he may enforce the payment thereof according to its original tenor against the party prior to the alteration. He may also enforce payment thereof against the party responsible for the alteration for the altered amount.

3. If negotiated to a NHIDC, he cannot enforce payment against the party prior to the alteration. He may however enforce payment according to the altered tenor from the person who caused the alteration and from the indorsers. *(Sec. 124)*

Q: Is there material alteration when the serial number of a check had been altered?

A: No. An alteration is said to be material if it alters the effect of the instrument. It means 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. The alteration of the serial number of a check did not change the relations between the parties nor the effect of the instrument. Hence, the alteration on the serial number of a check is not a material alteration. *(International Corporate Bank vs. CA, G.R. No. 141968, Feb. 12, 2001)*

XIV. ACCEPTANCE

A. DEFINITON

Q: What is acceptance of a bill?

A: A signification by the drawee of his assent to the order of the drawer *(Sec. 132)*.

Q: What is the effect of acceptance?

A: Upon acceptance, the bill, in effect becomes a note. The drawee who thereby becomes an acceptor assumes the liability of the maker (which is primary liability) and the drawer, that of the first indorser.

B. MANNER

Q: What are the requisites for acceptance?

A:

1. In writing, except constructive acceptance and to a foreign bill payable in another state (unless the other state requires for written acceptance)
2. Signed by the drawee (without it, he is not liable)
3. Must express a promise to pay money (not goods)
4. Delivered to the holder (before delivery or notification, acceptor may revoke or cancel his acceptance).

Q: What are the kinds of acceptance?

A:

1. *General* – Assents without qualification to the order of the drawer *(Sec. 139).*

   Note: A holder may refuse to accept a qualified acceptance and if he does not obtain an unqualified acceptance, he may treat the bill as dishonored by non-acceptance.

   a. Qualified – An acceptance which in express terms varies the effect of the bill as drawn *(Sec. 139).*

b. Conditional – makes payment by the acceptor dependent on the fulfillment of a condition therein stated.
c. Partial – an acceptance to pay part only of the amount for which the bill is drawn.
d. Local – an acceptance to pay only at a particular place.
e. Qualified as to time
f. The acceptance of some one or more of the drawees but not of all. *(Sec. 141)*

2. *Constructive/implied*
   a. Drawee to whom the bill is delivered for acceptance destroys it; or
   b. Drawee refuses, within 24 hours after such delivery, or within such time as is given him, to return the bill accepted or non-accepted

3. *Extrinsic* – the acceptance is written on a paper other than the bill itself. To be binding upon the acceptor:
   a. Acceptance must be shown to the person to whom the instrument is negotiated; and
   b. Such person must take the bill for value on the faith of such acceptance *(Sec. 134).*

4. *Virtual* – conditions:
   a. Unconditional promise in writing to accept a bill
   b. Promise made before it is drawn
   c. Any person who, upon faith thereof, received the bill for value. *(Sec. 135)*

C. TIME FOR ACCEPTANCE

Q: What is the time allowed for the drawee to make the acceptance?

A: The drawer has *24 hours* after presentment to decide whether or not he will accept the bill. The acceptance, if given, dates as of the day of presentation. *(Sec. 136)*

Note: Drawee bank is not entitled to 24 hours to decide whether or not to pay a check since a check is presented for payment, not acceptance.

D. RULES GOVERNING ACCEPTANCE

Q: What is the effect of accepting an instrument with a qualified acceptance?

A:

GR: When the holder takes a qualified acceptance the drawer and indorsers are discharged from liability on the bill.

XPN:
1. When they have expressly or impliedly authorized the holder to take a qualified acceptance, or
2. Subsequently assent thereto
3. Implied assent (when they did not express their dissent to the holder within a reasonable time when they received a notice of qualified acceptance). *(Sec. 142)*

Q: When may an incomplete bill be accepted?

A: Acceptance may be made before the bill has been signed by the drawer or while otherwise incomplete, or after it is overdue, or even after it has been dishonored by non-acceptance or non-payment. *(Sec. 138)*

Q: What is the effect of the certification by the drawee bank?

A: Certification implies that the check is drawn upon sufficient funds in the hand 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. Where a check is certified by the bank on which it is drawn, the certification is equivalent to acceptance *(New Pacific Timber v. Seneris, G.R. No. L-41764, Dec. 19, 1980).*

XV. PRESENTMENT FOR ACCEPTANCE

Q: What is presentment for acceptance (PA)?

A: Production or exhibition of a bill of exchange to the drawee for his acceptance or payment (also includes presentment for payment).

Q: What are the rules as to PA?

A:

GR: PA is *not* necessary to render any party to the bill liable. *(par.2, Sec. 143)*

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XPN:

1. Payable after sight, or when it is necessary in order to fix the maturity of the instrument
2. Expressly stipulated that it shall be presented for acceptance; or
3. Where the bill is drawn payable elsewhere than at the residence or place of business of the drawee. *(Sec. 143)*

Note: The holder must either present it for acceptance or negotiate it within a reasonable time, otherwise, the drawer and all indorsers are discharged. *(Sec. 144)*

A. TIME/PLACE/MANNER OF PRESENTMENT

Q: How must PA be made?

A:

1. By or on behalf of the holder
2. At a reasonable hour on a business day
3. Before the bill is overdue; and
4. To the drawee or some person authorized to accept or refuse to accept on his behalf. When:

   a. *Addressed to 2 or more drawees not partners* – To all (except when one was given authority)
   b. *Drawee is dead* – To his personal representative

      Note: Where drawee is dead, PA is not required.

   c. Drawee is bankrupt or insolvent or has made an assignment for the benefit of creditors – To him or to his trustee or assignee. *(Sec. 145)*

B. EFFECT OF FAILURE TO MAKE PRESENTMENT

Q: What is the effect of failure to make presentment?

A: Failure to make such presentment will discharge the drawer from liability or to the extent of the loss caused by the delay *(Republic of the Philippines vs. PNB, G.R. No. L-16106, December 30, 1961).*

Q: When may delay in making PA be excused?

A:

1. Bill drawn payable elsewhere than at the place of business or the residence of the drawee; and
2. Holder has no time, with the exercise of reasonable diligence, to present the bill for acceptance before presenting it for payment on the day that it falls due. *(Sec. 147)*

Q: When is presentment excused?

A:

1. Drawee is dead, or has absconded, or is a fictitious person not having capacity to contract by bill
2. After exercise of reasonable diligence, presentment cannot be made; or
3. Although presentment has been irregular, acceptance has been refused on some other ground. *(Sec. 148)*

C. DISHONOR BY NON-ACCEPTENCE

Q: When is a bill dishonored by non-acceptance?

A:

1. When it is duly presented for acceptance and such an acceptance is refused or cannot be obtained; or
2. When presentment for acceptance is excused, and the bill is not accepted. *(Sec. 149)*

Q: What is the duty of the holder where bill is not accepted?

A: The person presenting it must treat the bill as dishonored by non-acceptance or he loses the right of recourse against the drawer and indorsers. *(Sec. 150)*

Q: What are the rules when a bill is dishonored by non-acceptance?

A:

1. Right of recourse against all secondary party accrues to the holder
2. No presentment for payment is necessary since dishonor of the instrument by non-payment is to be expected
3. If the instrument is accepted after it has been dishonored by non-acceptance presentment for payment is necessary upon maturity; and
4. In case of non-payment, holder must give the corresponding notice of dishonor; otherwise, secondary parties are discharged.

XVI. PROMISSORY NOTES

Q: What is a promissory note?

A: An 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. *(Sec. 184 NIL)*

Q: What are the special types of promissory notes?

A:

1. *Certificate of deposit* – a written acknowledgment by a bank of the receipt of money on deposit on which the bank promises to pay to the depositor or to him or his order or to some other person or to him or his order, or to a specified person or bearer, on demand or on a fixed date, often with interest.

2. *Bonds* – A promise, under seal, to pay money.
   a. *Registered bond* – one payable only to the person whose name appears on the face of the certificate.
   b. *Coupon bond* – one to which are attached coupons which entitle the holder to interest when due.

3. *Bank Note* – PN of issuing bank payable to bearer on demand and intended to circulate as money.

4. *Due Bill* - An instrument where one person acknowledges his indebtedness to another

5. *Mortgage Note* – an instrument secured by either a real or personal property.

6. *Title-retaining Note* – an instrument used to secure the purchase price of goods

7. *Collateral Note* – it is used when the maker pledges securities to the payee to secure the payment of the amount of the note

8. *Judgment Note* – this is a note to which a power of attorney is added enabling the payee to take judgment against the maker without the formality of a trial if the note is not paid on its due date.

XVII. CHECKS

A. DEFINITION

Q: What is a check?

A: It is a bill of exchange drawn on a bank and payable on demand *(Sec. 185).* It must be presented for payment within a reasonable time after its issue or the drawer shall be discharged from liability thereon to the extent of the loss caused by the delay. *(Sec. 186)*

B. KINDS

Q: What are the different kinds of checks?

A:

1. *Cashier’s or manager’s check* – Drawn by the bank’s cashier or manager, as the case may be, upon the bank itself and deemed accepted by the act of issuance.

2. *Traveler’s check* – Upon which the holder’s signature must appear twice, one to be affixed by him at the time it is issued and the second counter-signature, to be affixed by him in the presence of the payee before it is paid, otherwise, it is incomplete.

3. *Certified check* – Bears upon its face an agreement by the drawee bank that the check will be paid on presentation.

4. *Memorandum check* – “Memo” is written across its face, signifying that drawer will pay holder absolutely without need of presentment.

Q: What is a crossed check? What are the effects of crossing a check? Explain.

A: A crossed check is a check with two (2) parallel lines, written diagonally on the upper right corner thereof. It is a warning to the drawee bank that payment must be made to the right party; otherwise the bank has no authority to use the drawer's funds deposited with the bank. To be assured that it will avoid any mistake in paying to the wrong party, banks adopted the policy that crossed checks must be deposited in the payee's account. When withdrawal is made, the banks can be sure that they are paying to the right party. The crossing becomes a warning also to

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whoever deals with the said instrument to inquire as to the purpose of its issuance. Otherwise, if something wrong happens to the payment thereof, that person cannot claim to be a holder in due course. Hence, he is subject to the personal defense on the part of the drawer that there is breach of trust committed by the payee in not complying with the drawer's instruction. **(2005 Bar Question)**

Q: What is a stale check?

A: A check which has not been presented for payment within a reasonable time after its issue. It is valueless and thus, should not be paid. A check becomes stale 6 months from date of issue.

Q: What is the effect of a stale check?

A: The drawer and all indorsers are discharged from liability thereon. *(Sec. 188)*

Q: What is a memorandum check?

A: A memorandum check is an evidence of debt against the drawer and although may not be intended to be presented, has the same effect as an ordinary check and if passed on to a third person, will be valid in his hands like any other check. *(People v. Nitafan, G.R. No. 75954, Oct. 22, 1992)*

C. PRESENTMENT FOR PAYMENT

Q: Within what time must a check be presented?

A: Within a reasonable time after its issue or the drawer will be discharged from liability thereon to the extent of the loss caused by the delay *(Sec. 186).*

Q: What is the effect of delay to make presentment for payment?

A: The indorser shall be discharged from liability. *(PNB vs. Seeto, G.R. No. L-4388, August 13, 1952)*

Note: See also Sec. 186 and above.

Q: A check was dishonored due to material alteration. Creditor filed an action against drawee bank for the amount. Is the creditor entitled?

A: No. If a bank refuses to pay a check (notwithstanding the sufficiency of funds), the payee-holder cannot, as provided under Sections 185 and 189 of the NIL, sue the bank. The payee should instead sue the drawer who might in turn sue the bank. This is so because no privity of contract exists between the drawee-bank and the payee *(Villanueva v. Nite, G.R. No. 148211, July 25, 2006).*

Q: When will the delivery of a check produce the effect of payment even if the same had not been encashed?

A: If the debtor was prejudiced by the creditor's unreasonable delay in presentment. Acceptance of a check implies an undertaking of due diligence in presenting it for payment. If no such presentment was made, the drawer cannot be held liable irrespective of loss or injury sustained by the payee. Payment will be deemed effected and the obligation for which the check was given as conditional payment will be discharged. *(Pio Barretto Realty Corp. v. CA, G.R. No. 132362, June 28, 2001).*

INSURANCE CODE

I. CONCEPT OF INSURANCE

Q: What laws govern insurance?

A:
1. Insurance Code of 1978 *(P.D. 1460)*
2. New Civil Code
3. Special Laws

Q: What is a contract of insurance?

A: It is an agreement whereby one undertakes for a consideration to indemnify another against the loss, damage or liability arising from an unknown or contingent event*. (Sec. 2[1], Insurance Code)*

Note: A contract of insurance is still a contract, thus it must have all the essential elements of a valid contract as enumerated in Art. 1318 of the New Civil Code

Q: What is *Uberrimae Fides* Contract?

A. The contract of insurance is one of *Perfect Good Faith* not for the insured alone, but equally so far the insurer. It requires the parties to the contract to disclose conditions affecting the risk of which He ought to know.

II. ELEMENTS OF CONTRACT OF INSURANCE

Q: What are the elements of a contract of insurance?

A: SPEAR
1. ***S****cheme to distribute losses* – Such assumption of risk is part of a general scheme to *distribute actual losses* among a large group or substantial number of persons bearing a similar risk.

2. ***P****ayment of premium* – As consideration for the insurer's promise, the insured makes a *ratable contribution* called "premium," to a general insurance fund

3. ***E****xistence of insurable interest* – The insured possesses an interest of some kind *susceptible of pecuniary estimation*, known as *"insurable interest."*

   In general (*except in life insurance policies),* a person is deemed 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 from its destruction or injury by the happening of the event insured against.

4. ***A****ssumption of Risk* – The insurer assumes that risk of loss for a consideration.

5. ***R****isk of loss* – The insured is subject to a risk of loss through the *destruction* or *impairment* of that interest by the happening of designated peril.

   Note: Because of the first element, an insurance contract therefore is a *risk-distributing device***.**

Q: What is moral hazard?

A: An undesirable side effect in the transfer of risk. It is a phenomenon on which the existence of insurance could have the *perverse effect* of the probability of loss.

III. CHARACTERSITICS AND NATURE OF AN INSURANCE CONTRACT

Q: What are the nature and characteristics of an insurance contract?

A:
1. *Consensual* – Acceptance of the offer perfects the contract of insurance.

   Note: Insurance contracts through correspondence follow the "cognition theory" wherein an acceptance made by letter shall not bind the person making the offer except from the time it came to his knowledge *(Enriquez v. Sun Life Assurance Co. of Canada, GR No. L-15774, Nov. 29, 1920)*.

2. *Voluntary* – The parties may *incorporate* such terms and conditions as they may deem convenient *Provided* they *do not* contravene any provision of law and are *not* opposed to public policy, law morals, good customs, or public order.

   GR: The taking out of an insurance contract is *not* compulsory.

   XPN: Liability insurance may be *required* by law in certain instances (E.g. compulsory motor vehicle liability

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insurance, or employees under Labor Code, or as a condition to granting a license to conduct a business or calling affecting the public safety or welfare).

3. *Aleatory* – Liability of the insurer depends upon some contingent event.

   Note: An aleatory contract is a contract where one or both of the parties reciprocally bind themselves to give or do upon the happening of an event which is uncertain, or which is to occur at an indeterminate time *(Art. 2010, NCC).*

4. *Unilateral* – It imposes legal duties *only on insurer* who promises to indemnify in case of loss.

5. *Conditional* – It is subject to conditions the principal one of which is the *happening* of the event insured against.

6. *Contract of indemnity* –

   GR: The insurer promises to make good only the *loss* of the insured.

   XPN: A life insurance is *not* a contract of indemnity. It is not applicable to life insurance policies because life is not capable of pecuniary estimation. The only situation where the principle of indemnity is applicable to life insurance is if the *amount in the policy is fixed.* An example would be in a case where a creditor insures the life of his debtor to the extent of the latter's debt to the former.

7. *Personal* – Each party having in view the character, credit and conduct of the other.

8. *Property* – Since insurance is a *contract*, it is property in legal contemplation.

9. *Risk distributing device* – Insurance serves to distribute the risk of economic loss among as many as possible of those who are subject to the same kind of loss.

10. *Onerous* – there is a valuable consideration called the premium

IV. CLASSES OF INSURANCE

Q: What are the 3 classes of insurance?

A:

1. *Life insurance* – dependent upon human life.
   a. Individual life
   b. Group life
   c. Industrial life

2. *Non-Life Insurance*
   a. Marine
   b. Fire
   c. Casualty

3. *Contracts of suretyship or bonding.* (*De Leon, The Insurance Code Annotated, 2006*)

A. MARINE INSURANCE

Q: What is marine insurance?

A: 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 fixed period of time.

Q: What vessels are contemplated in marine insurance?

A: Those used, or at least, intended for navigation. *E.g.,* one for shipping, chartering, voyage and the like. Vessels which are used as museums or those that are stationary are not entitled to be insured under this a marine insurance.

Q: What does marine insurance include?

A: Marine insurance includes:

1. Insurance against loss or damage to:
   a. Vessels, goods, freight, cargo, merchandise, profits, money, valuable papers, bottomry and respondentia, and interest in respect to all risks or perils of navigation;
   b. Persons or property in connection with marine insurance;
   c. Precious stones, jewels, jewelry and precious metals whether in the course of transportation or otherwise; and

d. Bridges, tunnels, piers, docks and other aids to navigation and transportation *(Sec. 99)*

Note: Cargo can be the subject of marine insurance, and once it is entered into, the implied warranty of seaworthiness immediately attaches to whoever is insuring the cargo, whether he be the ship owner or not. *(Roque v. IAC, G.R. No. L-66935, Nov. 11, 1985)*

2. *"Marine protection and Indemnity insurance"* which means 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. *(Sec. 99)*

   Measure of indemnity:
   a. *Valued policy* – the parties are bound by the valuation, if the insured had some interest at risk and there is no fraud (Sec. 156)
   b. *Open policy* – the following rules shall apply in estimating a loss:
      i. value of the ship- value at the beginning of the risk
      ii. value of the cargo- actual cost when laden on board or market value at the time and place of lading
      iii. value of freightage- gross freightage exclusive of primage
      iv. cost of insurance – in each case to be added to the estimated value *(Sec. 161)*

Q: What are the two major divisions of Marine insurance?

A:
1. *Ocean marine insurance* – covers primarily sea perils of ships and cargoes. *Scope:* **GELS**
   a. **G**oods or cargoes
   b. **E**arnings such as freight, passage money
   c. **L**iability incurred by reason of maritime perils
   d. **S**hips or hulls

2. *Inland marine insurance* – covers primarily the land or over the land (but sometimes water) transportation perils of property shipped by railroads, motor trucks, airplanes, and other means of transportation. It also covers risks of lake, river, or the other inland waterway transportation and other waterborne perils outside of those risks that fall definitely within the ocean marine category. *Classes:* **Pt-BFF**

   a. ***P**roperty in **T**ransit* – Provides protection to the property frequently exposed to loss while it is being transported from one location to another.

   b. ***B**ailee liability* – Insurance for those who have temporary custody of the goods.

   c. ***F**ixed transportation property* – They are so insured because they are held to be an essential part of transportation system such as bridges, tunnels, etc.

   d. ***F**loater* – Provides insurance to follow the insured property wherever it may be located subject always to the territorial limits of the contract.

Q: What does the phrase *"perils of the sea or perils of navigation"* mean?

A: It includes only those casualties due to the unusual violence or extraordinary action of wind and wave, or to other extraordinary causes connected with navigation.

Q: What does *"perils of the ship"* mean?

A: It is a loss which, in the ordinary course of events, results from:
1. The natural and inevitable action of the sea
2. The ordinary wear and tear of the ship
3. The negligent failure of the ship's owner to provide the vessel with proper

equipment to convey the cargo under ordinary conditions.

Q: Does an insurer undertake to insure against "perils of the ship"?

A:

<u>**GR:**</u> No.

<u>**XPN**</u>**:** In the absence of any stipulation to the contrary, the insurer does not undertake to insure against perils of the ship. The purpose of an ocean marine policy is to secure an indemnity against accidents which may happen not against event which must happen.

Q: A marine insurance policy on a cargo states that "the insurer shall be liable for losses incident to perils of the sea." During the voyage, seawater entered the compartment where the cargo was stored due to the defective drainpipe of the ship. The insured filed an action on the policy for recovery of the damages caused to the cargo. May the insured recover damages?

A: No. The proximate cause of the damage to the cargo insured was the defective drainpipe of the ship. This is peril of the ship, and not peril of the sea. The defect in the drainpipe was the result of the ordinary use of the ship. To recover under a marine insurance policy, the proximate cause of the loss or damage must be peril of the sea. **(1998 Bar Question)**

Q: What is an "all risks" marine insurance policy?

A:

<u>**GR**</u>**:** It is that which insures against *all* causes of conceivable loss or damage.

<u>**XPN**</u>**:**

1. As otherwise excluded in the policy; or
2. Due to fraud or intentional misconduct on the part of the insured. *(Choa Tiek v. CA, G.R. No. 84507, Mar. 15, 1990)* This type of policy grants greater protection than that afforded by the "perils clause."

Q: Who has the burden of proof in an "all risks" marine insurance policy?

A: The insured under an "all risks insurance policy" has the initial burden of proving that the cargo was in good condition when the policy attached and 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.

Q: What is the extent of the insurable interest of the following?

A:

1. *Shipowner*
   a. Over the vessel to the extent of its value, except that if chartered, the insurance is only up to the amount not recoverable from the charterer. *(Sec. 100)*
   b. If hypothecated by a bottomry loan, the insurable interest is only up to the excess of the values of the vessel over the loan. *(Sec. 101)*
   c. He also has an insurable interest on expected freightage. *(Sec. 103)*

2. *Cargo owner* – over the cargo and expected profits. *(Sec. 105)*

3. *Charterer* – over the amount he is liable to the ship owner, if the ship is lost or damaged during the voyage *(Sec. 106).*

4. *Creditor/lender* – amount of the loan

Q: What is the risk insured against in marine insurance?

A:

<u>**GR**</u>**:** Only *perils of the sea* is insured against.

<u>**XPN:**</u> *Unless* perils of the ship are covered by an *all-risks policy.*

Q: What are the distinctions between perils of the sea and perils of the ship?

A:

PERILS OF THE SEA	PERILS OF THE SHIP
Includes only those casualties due to the: 1. Unusual violence; or 2. Extraordinary action of wind and wave; or 3. Other extraordinary causes connected with navigation.	A loss which in the ordinary course of events, results from the: 1. Natural and inevitable action of the sea; 2. Ordinary wear and tear of the ship; or 3. Negligent failure of the ship's owner to provide the vessel with proper equipment to convey the cargo under ordinary conditions.

Q: What is a loan on bottomry?

A: It is one which is payable only if the vessel given as security for the loan completes in safety the contemplated voyage.

Q: What is freightage?

A: It is the benefit which is to accrue to the owner of the vessel from its use in the voyage contemplated or benefit derived from the employment of the ship.

Q: Where is freightage derived from?

A:

1. The chartering of the ship
2. Its employment for the carriage of his own goods
3. Its employment for the carriage of goods of others. (*Sec.* 102)

Q: When does insurable interest in expected freightage in a charter party exist?

A: It exists when the insured has an *inchoate right to freight,* that is, he must be in such position with regard to freight that nothing could prevent him from ultimately having a perfect right to it but the intervention of the perils insured against.

Q: When does inchoate right to freight exists?

A:

1. Where freight is the price to be paid for the hire of the ship under a charter party, the ship owner has an inchoate right to freight as soon as there is an inception of performance by the ship under the charter party.

2. As soon as the goods are actually put on board and where part of the goods has been loaded and the balance is ready, there is an insurable interest in the whole freight.

3. Where the ship owner has made a binding contract for freight and the ship is in readiness to receive the goods, he has an insurable interest.

Q: When is insurable interest in expected freightage in a charter party non-existent?

A:

1. Where there is no contract and no part of the goods expected to be carried are on board, there is no insurable interest in freight although there are goods ready for shipment or the master is provided with funds for the purpose of purchasing a cargo.

2. Where the vessel is a mere *"seeking ship"* or a vessel looking for cargo to be transported, the owner has no insurable interest in freight to be earned on goods not loaded.

Q: What are special marine insurance contracts and clauses?

A:

1. *All-risks policy* – insurance against all causes of conceivable loss or damage, *except:*
   a. Excluded risk stipulated in the policy, or
   b. due to fraud or intentional misconduct on the part of the insured *(Chao Tiek Seng v. CA, GR. No. 84507, Mar. 15, 1990)*

   The insured has the initial burden of proving that the cargo was in good condition when the policy attached and that the cargo was damaged when unloaded from the vessel; thereafter, the burden shifts to the insurer to show the exception to the coverage.

2. *Barratry clause* – a clause which provides that there can be no recovery on the policy in case of any willful misconduct 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 owner's interest. It requires an intentional and willful act in its commission. No honest error or judgment or mere negligence, unless criminally gross, can be barratry. *(Roque v. IAC, G.R. No. L- 66935, Nov. 11, 1985)*

3. *Inchamaree clause* – a clause which makes the insurer liable for loss or damage to the hull or machinery arising from the:
   a. Negligence of the captain, engineers, etc.
   b. Explosion, breakage of shafts; and
   c. Latent defect of machinery or hull. *(Thames and Mersey Marine*

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Insurance Co v. Hamilton Fraser and Co [1887] 12 AC 484)

4. *Sue and labor clause* – a clause under which the insurer may become liable to pay the insured in addition to the loss actually suffered, such expenses as he may have incurred in his efforts to protect the property against a peril for which the insurer would have been liable *(Sec. 163)*

Note: Such clause constitutes an exception to the principle that an insurance contract is one of indemnity *(where the insurer promises* to make good only the loss of the insured) since the insurer is liable to pay additional expenses for the protection of the property against an insured peril.

Q: What is concealment in marine insurance?

A: It 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.

Q: Is information of the belief or expectation of a third person, in reference to a material fact, material?

A: Yes. Thus, there is concealment where the insured at the time of application for insurance did not disclose the *opinion of marine experts* who inspected the vessel insured that it was unseaworthy. *(Sec. 108)*

Q: When is the insured presumed to have knowledge of a prior loss in marine insurance?

A: The insured is presumed to have knowledge of a prior loss at the time of insuring, if the information might possibly have reached him in the usual mode of transmission and at the usual rate of communication. *(Sec. 109)*

Q: What matters, when concealed, do not vitiate the entire insurance contract, but merely exonerates the insurer from a loss resulting from the risk concealed?

A:

1. National character of the insured
2. The liability of the thing insured to capture and detention
3. The liability to seizure from breach of foreign laws of trade
4. The want of necessary documents
5. The use of false and simulated papers. *(Sec. 110)*

Q: What are the distinctions on concealment in marine insurance and other property insurance?

A:

MARINE INSURANCE	OTHER PROPERTY INSURANCE
The information or the belief or expectation of 3rd persons in reference to a material fact is material and must be communicated.	The information or belief of a 3rd party is not material and need not be communicated, unless it proceeds from an agent of the insured whose duty is to give information.
The concealment of any fact in relation to any of the matters stated in Sec. 110 does not vitiate the entire contract but merely exonerates the insurer from a risk resulting from the fact concealed.	Concealment of any material fact will vitiate the entire contract, whether or not the loss results from the risk concealed.

Q: What is the effect of false representation by the insured?

A: Any misrepresentation of a material fact made with fraudulent intent avoids the policy. If the misrepresentation is *not* intentional or fraudulent but the fact misrepresented is material to the risk, the insurer may rescind the contract from the time representation becomes false. *(Sec. 111)*

Q: What is the distinction between promissory representation and representation of expectation?

A:

PROMISSORY REPRESENTATION	REPRESENTATION OF EXPECTATION
It 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	It is a statement 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 intentions or expectations merely.

Q: What is the effect of falsity as to expectation?

A: Representations of expectation or intention, unless *made with fraudulent intent*, their failure

of fulfillment is not ground for rescission. *(Sec. 112)*

Q: What is warranty in marine insurance?

A: It is a stipulation, either express or implied, forming part of the policy as to some fact, condition or circumstance relating to the risk.

Q: What are the implied warranties in marine insurance?

A:

1. Seaworthiness. *(Sec. 113)*
2. Non-deviation from the agreed voyage. *(Secs. 123, 124, 125)*
3. Non-engagement from illegal venture.
4. Warranty of neutrality - the ship will carry neutrality of the ship or cargo where such nationality or neutrality is expressly warranted. *(Sec. 120)*
5. Presence of insurable interest

Q: What is seaworthiness?

A: It is a relative term depending upon the nature of the ship, voyage, service and goods denoting in general, a ship's fitness to perform the service and to encounter the ordinary perils of the voyage, contemplated by the parties to the policy. *(Sec. 114)*

Q: When is the warranty of seaworthiness complied with?

A:

GR: The warranty of seaworthiness is complied with if the ship be seaworthy *at the time of the commencement of the risk. (Sec. 115)* There is no implied warranty that the vessel will remain in seaworthy condition throughout the life of the policy.

XPN:

1. *In the case of time policy*- the ship must be seaworthy at the commencement of every voyage she may undertake. *(Sec. 115 [a])*

2. *In the case of cargo policy*- each vessel upon which cargo is shipped or transshipped must be seaworthy at the commencement of each particular voyage. *(Sec. 115 [b])*

3. *In the case of voyage policy contemplating a voyage in different stages*- the ship must be seaworthy at the commencement of each portion. *(Sec. 117)*

Q: What is the effect of the admission of seaworthiness by the insurer?

A: If the policy provides that the seaworthiness of the vessel as between insured and insurer is admitted, the issue of seaworthiness cannot be raised by the insurer without showing concealment or misrepresentation by the insured. *(Phil. American General Insurance Co. v. CA, G.R. No. 116940, June 11, 1997)*

Q: What does the admission of seaworthiness by the insurer mean?

A: It 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. (*Philippine American General Insurance Co., Inc. v CA, GR No. 116940. June 11, 1997)*

Q: What is the effect if unseaworthiness is unknown to the owner of the cargo?

A: It is immaterial in ordinary marine insurance and may not be used by him as a defense in order to recover on the marine insurance policy. It becomes the obligation of a cargo owner to look for a reliable common carrier, which keeps its vessels in seaworthy conditions. The shipper may have no control over the vessel but he has control in the choice of the common carrier that will transport his goods. *(Roque v. IAC, G.R. No. L-66935, Nov. 11, 1985)*

Q: What is the scope of the seaworthiness of a vessel?

A: 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 and sails, food, water, fuel and lights, and other necessary or proper stores and implements for the voyage. *(Sec. 116)*

Q: What are the two kinds of total loss?

A:

1. Actual total loss
2. Constructive total loss

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Q: What are the distinctions between the two?

A:

ACTUAL TOTAL LOSS	CONSTRUCTIVE TOTAL LOSS
It exists when the subject matter of the insurance is wholly destroyed or lost or when it is so damaged as no longer to exist in its original character.	It is one which the loss, although not actually total, is of such a character that the insured is entitled, if he thinks fit, to treat it as total by abandonment. *(Sec. 131)*
The right of the insured to claim the whole insurance is absolute. No need to give notice of abandonment. *(Sec. 135)*	Abandonment by the insured is necessary in order to recover for a total loss *(Sec. 138)* in the absence of any provision to the contrary in the policy.

Q: What constitutes actual total loss?

A:

1. A total destruction of the thing insured
2. The irretrievable loss of the thing by sinking, or by being broken up
3. Any damage to the thing which renders it valueless to the owner for the purpose for which he held it; or
4. Any other event which effectively deprives the owner of the possession, at the port of destination, of the thing insured. *(Sec. 130)*

Note: Complete physical destruction is *not* essential to constitute actual total loss.

Q: What is constructive total loss?

A:

1. Actual loss of more than ¾ of the value of the object
2. Damage reducing value by more than ¾ of the value of the vessel and of cargo; and
3. Expense of transshipment exceeds ¾ of the value of the cargo. *(Sec. 131)*

Q: When is actual loss presumed?

A: It may be presumed from the continued absence of a ship without being heard of. The length of time which is sufficient to raise his presumption depends on the circumstances of the case. *(Sec. 132)*

Q: In an insurance upon cargo, what is the liability of the insurer in case of reshipment?

A: If the original ship be disabled, and the master, acting with a wise discretion, as the agent of the merchant and the ship owners, forwards the cargo in another ship, such necessary and justifiable change of ship will not discharge the underwriter on the goods from liability for any loss which may take place on goods subsequently to such reshipment. *(Sec. 133)* The insurer may, however, require additional premium if the hazard be increased by his extension of liability.

Q. What is deviation in marine insurance policy?

A: Deviation is a departure of the vessel from the course of the voyage, or an unreasonable delay in pursuing the voyage, or the commencement of an entirely new voyage. *(Sec. 123)*

Q: What are the four cases of deviation in marine insurance?

A:

1. Departure from the course of sailing fixed by mercantile usage between the places of beginning and ending specified in the policy. *(Sec. 121)*

2. Departure from the most natural, direct, and advantageous route between the places specified if the course of sailing is not fixed by mercantile usage. *(Sec. 122)*

3. Unreasonable delay in pursuing the voyage. *(Sec. 123)*

4. The commencement of an entirely different voyage.

Q: What are the two kinds of deviation?

A:

1. *Proper* – This will not vitiate a policy of marine insurance because deviation is considered justified or caused by actual necessity which is equal in importance to such deviation. *(Sec. 124)*

2. *Improper* – The insurer becomes immediately absolved from further liability under the policy for losses occurring subsequent to the deviation because deviation is considered to be without just cause. Every deviation *not* specified in *Sec.124* is improper. *(Sec. 125)*

Q: What is the additional liability of the insurer of goods referred to in the reshipment of cargo?

A: The marine insurer is bound for:
1. Damages
2. Expenses of discharging
3. Storage
4. Shipment
5. Extra freightage
6. All other expenses incurred in saving cargo reshipped. (*Sec. 134)*

Note: The liability of the insurer cannot exceed the amount of the insurance.

Q: What is abandonment?

A: It is the act of the insured by which, after a constructive total loss he declared the relinquishment to the insurer of his interest in the thing insured.

Q: What are the requisites for the validity of abandonment?

A:
1. There must be an actual relinquishment by the person insured of his interest in the thing insured. *(Sec. 138)*

2. There must be a constructive total loss. *(Sec. 139)*

3. The abandonment must neither be partial nor conditional. *(Sec. 140)*

4. It must be made within a reasonable time after receipt of reliable information of the *los.s (Sec. 141)*

5. It must be factual. *(Sec. 142)*

6. It must be made by giving notice thereof to the insurer which may be done orally or in writing. *(Sec. 143)*

7. The notice of abandonment must be explicit and must specify the particular cause of abandonment. *(Sec. 144)*

Q: What is the form of notice of abandonment?

A: Abandonment 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 7 days from such oral notice. *(Sec. 143)*

Q: What is the effect of a valid abandonment?

A: It is equivalent *to a transfer by the insured of his interest, to the insurer*, with all the chances of recovery and indemnity. The insurer becomes entitled to all the rights which the insured possessed in the thing insured. *(Sec. 146)*

Q: What are the forms of acceptance of abandonment?

A:
1. Express
2. Implied from the conduct of the insurer
3. Mere silence of the insurer for unreasonable length of time after notice. *(Sec. 150)*

Q: When may the insured, by a contract of marine insurance, abandon the thing insured?

A:
1. If more than three-fourths thereof in value is actually lost, or would have to be expended to recover it from the peril

2. If it is injured to such an extent as to reduce its value more than three-fourths

3. 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

4. If the thing insured is 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*. (Sec. 139)*

Note: Freightage cannot in any case be abandoned, unless the ship is also abandoned.

Q: What is the three-fourth rule?

A: What is contemplated as ¾ under the law must be more than ¾. When what was lost was exactly ¾, the rule cannot be applied.

Q: An insurance company issued a marine insurance policy covering a shipment by sea

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from Mindoro to Batangas of 1,000 pieces of Mindoro garden stones against "total loss only." The stones were loaded in two lighters, the first with 600 pieces and the second with 400 pieces. Because of rough seas, damage was caused the second lighter resulting in the loss of 325 out of the 400 pieces. The owner of the shipment filed claims against the insurance company on the ground of constructive total loss inasmuch as more than ¾ of the value of the stones had been lost in one of the lighters. Is the insurance company liable under its policy? Why?

A: The insurance company is not liable under its policy covering against "total loss only" the shipment of 1,000 pieces of Mindoro garden stones. There is no constructive total loss that can be claimed since the ¾ rule is to be computed on the total 1,000 pieces of Mindoro garden stones covered by the single policy coverage. **(1992 Bar Question)**

Q: What are the effects of acceptance of abandonment?

A:

1. The insurer becomes at once liable for the whole amount of the insurance and also becomes entitled to all rights which insured possessed in the thing insured. *(Sec. 146)*

2. It fixes the rights of the parties; whether express or implied, is conclusive upon them, and irrevocable. *(Sec. 152)*

3. It stops the insurer to rely on any insufficiency in the form, time, or right, of abandonment. Whether the insured has a right to abandon is immaterial where the abandonment is accepted and there is no fraud.

4. On accepted abandonment of a ship, the freightage earned subsequent to the loss belongs to the insurer of the ship. But freightage earned previously belongs to the insurer of said freightage who is subrogated to the rights of the insured up to the time of the loss. *(Sec. 153)*

<u>**XPN:**</u> Where the ground upon which it was made proves to be unfounded. *(Sec. 152)* Under Sec. 145, abandonment can be sustained only upon the ground specified in the notice thereof.

Q: What is the effect of the insurer's refusal to accept a valid abandonment?

A: If the insurer declines to accept a *proper* abandonment, he is liable as upon an actual total loss less any proceeds the insured may have received on account of the damaged property as when the insured succeeds in selling the property as damaged *(Sec. 154).* If the abandonment was *improper*, the insured may nevertheless recover to the extent of the damage proved.

Q: What is the effect of insured's failure to make abandonment?

A: The insured has an election to abandon or not, and cannot be compelled to abandon although abandonment is proper. If the insured fails to abandon, he may nevertheless recover his *actual loss (Sec. 155).*

Q: When does co-insurance exist?

A: There is co-insurance if the value of the insured's interest exceeds the amount of 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.

A marine insurer is liable upon a partial loss only for such proportion of the amount insured by him as the loss bears to the value of the whole interest of the insured in the property insured *(Sec. 157).*

Note: Co-insurance applies only to marine insurance. Logically, there cannot be co-insurance in life insurance. But co-insurance applies in fire insurance only when expressly stipulated by the parties.

Q: What are the requisites for co-insurance?

A: There is co-insurance when the following *requisites concur:*

1. The amount of insurance is less than the insured's insurable interest;
2. The loss is partial.

Q: What is the *Formula* to determine the amount recoverable?

A:

$$\frac{\text{(Partial) Loss}}{\text{Value of thing Insured}} \times \text{Amount of Insurance} = \text{Amount of recovery}$$

Illustration:
If a vessel valued at P1M is insured for only P800, 000 and is damaged to the extent of P400, 000, the insurer will be required to pay only 80% of the loss suffered, or P320,000; the other 20% or P80,000 being borne by the insured himself.

$$\frac{P400,000 \text{ or } 2/5 \times P800,000}{P1M} = P320,000$$

The insured is considered a co-insurer as to the uninsured portion of P200,000.

Note: If the loss is total, the insurer is liable for the full amount of P800,000. On the other hand, if the property is insured to its full value, the insured is entitled to recover the full amount of the partial loss of P400,000.

Q: In case of loss, what is the insured entitled to recover if profits to be realized are separately insured?

A: If 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. *(Sec. 158)*

Q: When is the loss of profits conclusively presumed?

A: 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 were expected to arise, and the valuation fixes their amount. *(Sec. 160)*

Q: What are the rules for estimating loss under an open policy of marine insurance?

A:

1. *Value of the ship* – In ascertaining the value of the vessel, the value is to be taken as of the commencement of the risk and not its value at the time she was built;

2. *Value of cargo* – The value of the cargo is its actual cost to the insured, when laden on board, or where that cost cannot be ascertained, its market value at the time and place of lading it on board, but without reference to any loss incurred in raising money for its purchase, 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;

3. *Value of freightage* – the gross freightage, exclusive of primage, without reference to the cost of earning;

   Note: Primage is a compensation paid to the captain after a successful voyage.

4. *Cost of insurance* – It is always added in calculating the value of the ship, cargo, or freightage or other subject matter in an open policy. *(Sec. 161)*

Q: What does the phrase *"port of refuge expenses"* mean?

A: These are the additional expenses incurred in repairing the damages suffered by a vessel because of the perils insured against as well as those incurred for saving the vessel from such perils, such as the expense of launching or raising the vessel or of towing or navigating it into port for her safety. These are items to be borne by the insurer in addition to a total loss if that afterwards takes place. *(Sec. 163)*

Q: What are the rights of the insured in case of general average?

A:

GR: The insurer is liable for any general average loss *(Sec. 136)* where it is payable or has been paid by the insured in consequence of a peril insured against.

The insured may either hold the insurer directly liable for the whole of the insured value of the property sacrificed for the general benefit, subrogating him to his own right of contribution or demand contribution from the other interested parties as soon as the vessel arrives at her destination *(Sec. 135).*

XPN: There can be no recovery for general average loss against the insurer:

1. After the separation of the interests liable to contribution, that is to say, after the cargo liable for contribution has been removed from the vessel; or

2. When the insured has neglected or waived his right to contribution.

Note: General average is a principle of law whereby, when it is decided by the master

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of a vessel, acting for all the interest concerned to sacrifice a part of a venture exposed to a common and imminent peril in order to save the rest, the interests so saved are compelled to contribute ratably or proportionately to the owner of the interest sacrificed, so that the cost of the sacrifice shall fall equally upon all. *(Hector S. De Leon, The Law on Insurance, 2003)*

Q: What is Free From Particular Average Clause (FPA Clause)?

A: A clause agreed upon in a policy of marine insurance in which it is stated that the insurer shall not be liable for a particular average.

The insurer is liable only for general average and not for particular average unless such particular average loss as the effect of depriving the insured of the possession at the port of destination of the whole of the thing insured. *(Sec. 136)*

Q: What is the limit as to liability of insurer?

A: The liability of the insurer for any general average loss is limited to the proportion of contribution attaching to his policy value where this is less than the contributing value of the thing insured. *(Sec. 164)*

B. FIRE INSURANCE

Q: What is fire insurance?

A: It is a contract of indemnity by which the insurer, for a consideration, agrees to indemnify the insured against loss of or damage 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. *(Sec. 167)*

Note: The liability of an insurer is to pay for direct loss only. The insurer may be liable to pay for consequential losses if covered by extension to such fire policies or insured under separate policy

Q: When does alteration in the thing insured entitle the insurer to rescind?

A: In order that the insurer may rescind a contract of fire insurance for any alteration made in the use or condition of the thing insured, the following requisites must be present:

1. The use or condition of the thing is specially 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; and
5. The alteration increases the risk.

Note: 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 the loss. *(Sec. 170)*

Q: What are the distinctions of ocean marine and fire policies?

A:

OCEAN MARINE	FIRE INSURANCE
A policy of insurance on a vessel engaged in *navigation* is a contract of marine insurance although it insures against fire risks only.	Where the hazard is fire alone and the subject is an unfinished vessel, never afloat for a voyage, the contract to insure is a fire risk, especially in the absence of an express agreement that it shall have the incidents of marine policy, or where it insures materials in a shipyard for use in constructing vessels. Also where a policy insures against fire, a vessel while moored and in use as a hospital

Q: Why is the distinction between marine and fire insurance important?

A:

1. In marine insurance, the rules on constructive total loss *(Secs. 131, 139)* and abandonment *(Sec. 138)* apply but *not* in fire insurance;
2. In case of partial loss of a thing insured for less than its actual value, the insured in a marine policy is a co-insurer of the uninsured portion *(Sec. 157)*, while the insured may only become a co-insurer in fire insurance if expressly agreed upon by the parties. *(Sec. 172)*

Q: What is the measure of indemnity in open and valued policies in fire insurance?

A:

OPEN POLICIES	VALUED POLICIES
The expense necessary to replace the thing lost or injured in the condition it was at the time of the injury.	The parties are bound by the valuation, in the absence of fraud.

Q: What is a co-insurance clause?

A: It is that which requires the insured to maintain insurance to an amount equal to the value or specified percentage of the value of the insured property under penalty of becoming co-insurer to the extent of such deficiency.

Note: The insured is *not* a co-insurer under fire policies in the absence of stipulation.

Q: What is a fall of building clause?

A: It is that which provides, in a fire insurance policy, that if the building or any part thereof falls, *except* as a *result of fire,* all insurance by the policy shall immediately cease.

Q: What is an option to rebuild clause?

A: It gives the insurer the option to rebuild the destroyed property instead of paying the indemnity. This clause serves to protect the insurer against unfair appraisals friendly to the insured. *(Sec. 172)*

C. CASUALTY INSURANCE

Q: What is casualty insurance?

A: It is that which covers loss or liability arising from accident or mishap, excluding those falling under types of insurance as fire or marine. *(Sec. 174)*

Q: What are the two divisions of casualty insurance?

A:

1. *Accident or health insurance* – Insurance against specified perils which may affect the person and/or property of the insured.

   E.g. personal accident, robbery/theft insurance

2. *Third party liability insurance* – Insurance against specified perils which may give rise to liability on the part of the insured of claims for injuries or damage to property of others.

Q: What are some rules on "third party liability insurance"?

A:

1. Insurable interest is based on the interest of the insured in the safety of the persons, and their property, who may maintain an action against him in case of their injury or destruction respectively.

2. In a third party liability (TPL) insurance contract, the insurer assumes the obligation by paying the injured third party to whom the insured is liable. Prior payment by the insured to the third person is not necessary in order that the obligation may arise. The moment the insured becomes liable to third persons, the insured acquires an interest in the insurance contract which may be garnished like any other credit.

3. In burglary, robbery and theft insurance, the opportunity to defraud the insurer (moral hazard) is so great that insurer have found it necessary to fill up the policies with many restrictions designed to reduce the hazard. Persons frequently excluded are those in the insured's service and employment. The purpose of the exception is to guard against liability should theft be committed by one having unrestricted access to the property.

4. Right of third party injured to sue the insurer of party at fault depends on whether the contract of insurance is intended to benefit third persons also or only the insured

Q: When does the injured person have the right to sue insurer of the party at fault?

A:

1. *Indemnity against third party liability* – injured third party can directly sue the insurer.

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Purpose: To protect injured person against the insolvency of the insured who causes such injury.

2. *Indemnity against actual loss or payment* – third party has no cause of action against the insurer. The third person's recourse is limited to the insured alone. The contract is solely for the insurer to reimburse the insured for liability actually satisfied by him.

Note: The insurer is *not* solidarily liable with the insured. The insurer's liability is based on contract; that of the insured is based on torts. Furthermore, the insurer's liability is limited by the amount of the insurance coverage.

Q: Chirs, a boxer, is a holder of an accident insurance policy. In a boxing match, de died after being knocked out by the opponent. Can his father who is a beneficiary under said insurance policy successfully claim indemnity from the insurance company?

A: Yes. Clearly, the proximate cause of death was the boxing contest. Death sustained in a boxing contest is an accident. *(De la Cruz v. Capital Insurance & Surety Co., G.R. No. L-21574, June 30, 1966)* **(1990 Bar Question)**

Q: Sun-Moon Insurance issued a Personal Accident Policy to Henry Dy with a face value of P500,000. A provision in the policy states that "the company shall not be liable in respect of "bodily injury' consequent upon the insured person attempting to commit suicide or willfully exposing himself to needless peril except in an attempt to save human life." Six months later Henry Dy died of a bullet wound in his head. Investigation showed that one evening Henry was in a happy mood although he was not drunk.

He was playing with his handgun from which he had previously removed its magazine. He pointed the gun at his sister who got scared. He assured her it was not loaded. He then pointed the gun at his temple and pulled the trigger. The gun fired and Henry slumped on the floor.

Henry's wife Beverly, as the designated beneficiary, sought to collect under the policy. Sun-Moon Insurance rejected her claim on the ground that the death of Henry was not accidental. Beverly sued the insurer. Decide and Discuss fully.

A: Beverly can recover the proceeds of the policy from the insurer. The death of the insured was not due to suicide or willful exposure to needless peril which are excepted risks. The insured's act was purely an act of negligence which is covered by the policy and for which the insured got the insurance for his protection. In fact, he removed the magazine from the gun and when he pointed the gun to his temple he did so because he thought that it was safe for him to do so. He did so to assure his sister that the gun was harmless. There is none in the policy that would relieve the insurer of liability for the death of the insured since the death was an accident. **(1995 Bar Question)**

Q: What is liability insurance?

A: It has been said to be a contract of indemnity for the benefit of the insured and those in privity with him, or those to whom the law upon the grounds of public policy extends the indemnity against liability.

Q: What's the difference between the liability of the insurer and that of the insured in case for indemnity against third person liability?

A:

INSURER	INSURED
The liability is direct but the insurer cannot be held solidarily liable with the insured and other parties at fault.	Liability is direct and can be held liable with all the parties at fault.
Liability is based on contract	Liability is based on tort.
The third-party liability is only up to the extent of the insurance policy and that required by law	The liability extends to the amount of actual and other damages. *(Heirs of George Y. Poe v. Malayan Insurance Company, Inc. G.R. No. 156302, Apr. 7, 2009)*

Q: In liability insurance, is the insured's liability must first be determined by the court before the third party liability insurer could be sued?

A: No, the contention of the insurer is not correct. There is no need to wait for the decision of the court determining insured's liability with finality before the third party liability insurer could be sued. The occurrence of the injury to a third person immediately gave rise to the liability of the insurer under its policy. In other words, where an insurance policy insures directly against liability, the insurer's liability accrues immediately upon the occurrence of the injury or event upon

which the liability depends. The insurer cannot be held solidarily liable with the insured. The liability of the insurer is based on contract while that of the insured is based on tort. If the insurer was solidarily liable with the insured, it could be made to pay more than the amount stated in the policy. This would, however, be contrary to the principles underlying insurance contracts. On the other hand, if the insurer was solidarily liable and it is made to pay only up to the amount stated in the insurance policy, the principles underlying solidary obligations would be violated. **(1996 Bar Question)**

Q: What is a *"no action"* clause?

A: It is a requirement in a policy of liability insurance which provides that suit and final judgment be first obtained against the insured, that only thereafter can the person injured recover on the policy. *(Guingon v. Del Monte, G.R. No. L-21806, Aug. 17, 1967)*

Note: A "*no action*" clause must yield to the provisions of the Rules of Court regarding multiplicity of suits. *(Shafter v. RTC, G.R. No. 78848, Nov. 14, 1988)*

D. SURETYSHIP

Q: What is suretyship?

A: It is an agreement whereby the surety guarantees the performance by another of an undertaking or an obligation in favor of a third party. *(Sec. 175)*

Q: What is the nature of liability of surety?

A:

1. Solidary with the bond obligor
2. Limited to the amount in the bond (it cannot be extended by implication)
3. It is determined strictly by the terms of the contract of suretyship in relation to the principal contract between the obligor and the oblige

Q: What are the rules in the payment of premiums in suretyship?

A:

1. The premium becomes a debt as soon as the contract of suretyship or bond is perfected and delivered to the obligor *(Sec. 77)*
2. The contract of suretyship or bonding shall not be valid and binding unless and until the premium therefore has been paid
3. Where the obligee has accepted the bond, it shall be valid and enforceable notwithstanding that the premium has not been paid; *(Philippine Pryce Assurance Corp. v. CA, G.R. No. 107062, Feb. 21, 1994)*
4. If the contract of suretyship or bond is not accepted by, or filed with the obligee, the surety shall collect only a reasonable amount;
5. If the non-acceptance of the bond be due to the fault or negligence of the surety, no service fee, stamps, or taxes imposed shall be collected by the surety; and
6. In the case of continuing bond (for a term longer than one year or with no fixed expiration date), the obligor shall pay the subsequent annual premium as it falls due until the contract is cancelled. *(Sec. 177)*

Q: What are the types of surety bonds?

A:

1. *Contract bonds* – These are connected with construction and supply contracts. They are for the protection of the owner against a possible default by the contractor or his possible failure to pay materialmen, laborers and sub-contractors.

   The position of surety, therefore, is to answer for a failure of the principal to perform in accordance with the terms and specifications of the contract.

   There may be two bonds:

   a. *Performance bond* – One covering the faithful performance of the contract; and
   b. *Payment bond* – One covering the payment of laborers and material men.

2. *Fidelity bonds* – They pay an employer for loss growing out of a dishonest act of his employee.

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For the purposes of underwriting, they are classified as:

a. *Industrial bond* – One required by private employers to cover loss through dishonesty of employees; and
b. *Public official bond* – One required of public officers for the faithful performances of their duties and as a condition of entertaining upon the duties of their offices.

3. *Judicial bonds* – They are those which are required in connection with judicial proceedings.

Q: What are the distinctions between suretyship and property insurance?

A:

SURETYSHIP	PROPERTY INSURANCE
It is an accessory contract.	The principal contract itself.
There are three parties: the surety, obligor/debtor, and the obligee/creditor.	There are only two parties: insurer and insured
More of a credit accommodation with the surety assuming primary liability	A contract of indemnity
Surety is entitled to reimbursement from the principal and his guarantors for the loss it may suffer under the contract.	No right of recovery for the loss the insurer may sustain except when the insurer is entitled to subrogation.
A bond may be cancelled by or with the consent of the obligee or by the commissioner or by the court.	May be cancelled unilaterally either by the insured or by the insurer on grounds provided by law.
Requires acceptance of the obligee before it becomes valid and enforceable.	Does not need acceptance of any third party.
A risk-shifting device, the premium paid being in the nature of a service fee.	A risk-distributing device, the premium paid being considered a ratable contribution to a common fund.

E. LIFE INSURANCE

Q: What is life insurance?

A: It is that which is payable on the death of a person or on his surviving a specified period, or otherwise contingently on the continuance of cessation of life *(Sec. 180).* It is 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.

Q: What are the distinctions between life insurance and fire/marine insurance?

A: See Appendix C

Q: What are the kinds of life insurance policies?

A:

1. *Ordinary life, general life or old line policy* – Insured pays a premium every year until he dies. Surrender value after 3 years.

2. *Limited payment* – Insured pays premium for a limited period. It is payable only at the death of the insured.

3. *Endowment* – Insured pays a premium for a specified period. If he outlives the period, the face value of the policy is paid to him; if not, his beneficiaries receive benefit.

4. *Term insurance* – Insured pays once only, and he is insured for a specified period. If he dies within the period, his beneficiaries benefit. If he outlives the period, no person benefits from the insurance. Also known as temporary insurance.

5. *Industrial life* – Life insurance entitling the insured to pay premiums weekly, or where premiums are payable monthly or oftener

6. *Variable contract* – Any policy or contract on either a group or individual basis issued by an insurance company providing for benefits or other contractual payments or values thereunder to vary so as to reflect investment results of any segregated *portfolio* of investment.

Q: What is the effect if the beneficiary will fully bring about the death of the insured?

A:

GR: The interest of a beneficiary in a life insurance policy shall be forfeited when the beneficiary is the principal, accomplice; 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. *(Sec. 12)*

XPN:
1. The beneficiary acted in self-defense;
2. The insured's death was not intentionally caused (*e.g.,* thru accident);
3. Insanity of the beneficiary at the time he killed the insured.

Q: When is the insurer liable in case of suicide?

A:
1. The suicide is committed after the policy has been in force for a period of 2 years from the date of its issue or of its last reinstatement.
2. The suicide is committed after a shorter period provided in the policy although within the 2 year period
3. The suicide is committed in the state of insanity regardless of the date of commission, unless suicide is an excepted risk. *(Sec. 180-A)*

Note: The policy cannot provide a period longer than 2 years. If the policy provides for a longer period and the suicide is committed within said period but after 2 years, the insurer is liable.

The insurer is not liable if it can show that the policy was obtained with the intention to commit suicide even in the absence of any suicide exclusion in the policy.

Q: What is the measure of indemnity under a policy of insurance upon life or health?

A: 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. *(Sec. 183)*

F. COMPULSORY MOTOR VEHICLE LIABILITY INSURANCE

Q: What is motor vehicle liability insurance?

A: It is a protection coverage that will answer for legal liability for losses and damages for bodily injuries or property damage that may be sustained by another arising from the use and operation of a motor vehicle by its owner.

Q: What is the purpose of motor vehicle liability insurance?

A: To give immediate financial assistance to victims of motor vehicle accidents and/or their dependents, especially if they are poor regardless of financial capability of motor vehicle owners of operators responsible for the accident sustained. *(First Integrated Bonding Insurance Co., Inc. v. Hernando, G.R. No. L-51221, July 31, 1991)*

Q: Who is a passenger?

A: Any fare paying person being transported and conveyed in and by a motor vehicle for transportation of passengers for compensation, including persons expressly authorized by law or by the vehicle's operator or his agents to ride without fare. *(Sec. 373 [b])*

Q: Who is a third-party?

A: Any person other than a passenger as defined in this section and shall also exclude a member of the household, or a member of the family within the second degree of consanguinity or affinity, of a motor vehicle owner or land transportation operator, as likewise defined herein, or his employee in respect of death, bodily injury, or damage to property arising out of and in the course of employment. *(Sec. 373, [c])*

Q: What is the meaning of a *"motor vehicle owner"*?

A: It means the actual legal owner of a motor vehicle, whose name such vehicle is duly registered with the Land Transportation Office. *(Sec. 373, [d])*

Q: What is the meaning of *"land transportation operator"*?

A: It means the owner or owners of motor vehicles for transportation of a passenger for compensation, including school buses. *(Sec. 373, [e])*

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Q: What is a no fault indemnity clause?

A: It is a clause where the insurer is required to pay a third party injured or killed in an accident without the necessity of proving fault or negligence on the part of the insured. There is a stipulated maximum amount to be recovered. **(1994 Bar Question)**

Q: What are the rules under the *"no fault clause"*??

A:

1. The total indemnity in respect of any one person shall not exceed P15,000 for all motor vehicles *(Insurance Memorandum Circular No. 4-2006) (Sec. 378)*

2. Proof of loss:
   a. Police report of accident
   b. Death certificate and evidence sufficient to establish proper payee
   c. Medical report and evidence of medical or hospital disbursement. *(Sec. 378 [ii])*

3. Claim may be made against one motor vehicle only

4. In case of an occupant of a vehicle, the claim shall lie against the insurer of the vehicle in which the occupant is riding, mounting or dismounting from

5. In any other case, claim shall lie against the insurer of the directly offending vehicle

6. In all cases, the right of the party paying the claim to recover against the owner of the vehicle responsible for the accident shall be maintained

Note: The claimant is not free to choose from which insurer he will claim the "no fault indemnity," as the law, by using the word "shall", makes it mandatory that the claim be made against the insurer of the vehicle in which the occupant is riding, mounting or dismounting from. That said vehicle might not be the one that caused the accident is of no moment since the law itself provides that the party paying may recover against the owner of the vehicle responsible for the accident. *(Perla Compania de Seguros, Inc. v. Ancheta, G.R. No. L-49599, Aug. 8, 1988)*

This no-fault claim does *not* apply to property damage. If the total indemnity claim exceeds P15, 000 and there is controversy in respect thereto, the finding of fault may be availed of by the insurer only as to the excess. The first P15, 000 shall be paid without regard to the fault.

Q: What is the authorized driver clause?

A: It indemnifies the insured owner against loss or damage to the car but limits the use of the insured vehicle to:

1. The insured himself; or
2. Any person who drives on his order or with his permission. *(Villacorta v. Insurance Commissioner, G.R. No. 54171, Oct. 28, 1980)*

Q: What is the main purpose of an authorized driver clause?

A: Its main purpose is to require a person other than the insured, who drives the car on the insured's order, such as, his regular driver, or with his permission, such as a friend or member of the family or the employees of a car service or repair shop to be duly licensed drivers and have no disqualification to drive a motor vehicle. (*Villacorta v. Insurance Commission, G.R. No. L-54171, Oct. 28, 1980*)

Q: What is the theft clause?

A: It is that which includes theft as among the risks insured against. Where a car is unlawfully and wrongfully taken without the knowledge and consent of the owner, such taking constitutes "theft" and it is the theft clause, not the authorized driver clause which should apply. *(Palermo v. Pyramid Inc., G.R. No. L-36480, May 31, 1988)*

Q: What is a cooperation clause?

A: It is that which provides that the insured shall give all such information and assistance as the insurer may require, usually including attendance at trials or hearings.

Q: When a passenger jeepney, insured but with an authorized driver's clause and was driven by a driver who only holds a Traffic Violation report (TVR) because his license was confiscated, met an accident, may the owner of the jeepney claim from the insurance company?

***A*:** Yes. The fact that the driver was merely holding a TVR does *not* violate the condition that the driver should have a valid and existing driver's

license. Besides, such a condition should be disregarded because what is involved is a *passenger jeepney*, and what is involved here is *not* own damage insurance but *third party liability* where the injured party is a third party *not* privy to the contract of insurance. **(2003 Bar Question)**

Q: Anna insured her brand new car with Vilches Ins. Co. for comprehensive coverage wherein the insurance company undertook to indemnify him against loss or damage to the car a) by accidental collision b) by fire, external explosion, burglary, or theft, and c) malicious act. The car was carnapped and at that time, Anna's license was already expired. Anna filed a claim with the insurance company but it denied the claim because of "authorized driver clause." May the insurance company be held liable to indemnify Anna for the loss of the insured vehicle?

A: Yes. The car was lost due to theft. What applies in this case is the "theft" clause, and not the "authorized driver" clause. It is immaterial that Anna was driving the car with an expired driver's license at the time it was carnapped. **(1993 Bar Question)**

Q: Who are the persons subject to the compulsory motor vehicle liability insurance requirement?

A:

1. Motor vehicle owner (MVO) or one who is the actual legal owner of a motor vehicle in whose name such vehicle is registered with the LTO; or

2. Land transportation operator (LTO) or one who is the owner of a motor vehicle or vehicles being used for conveying passengers for compensation including school buses.

Q: What are the substitutes for a compulsory motor vehicle liability insurance policy?

A: MVOs or LTOs, instead of a CMLVI policy, may either:

1. Post a surety bond with the Insurance Commissioner who shall be made the obligee or creditor in the bond in such amount or amounts required as limits of indemnity to answer for the same losses sought to be covered by a CMLVI policy; or

2. Make a cash deposit with the Insurance Commission in such amount or amounts required as limits of indemnity for the same purpose.

V. INSURABLE INTEREST

Q: What is an insurable interest?

A:

GR: A person is deemed 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* from its destruction or injury by the happening of the event insured against.

XPN: The term has a somewhat broader meaning in connection with life insurance. To have an insurable interest in the life of a person, the expectation of benefit from the continued life of that person need *not* necessarily be of pecuniary nature.

Q: Differentiate insurable interest in life insurance and insurable interest in property insurance.

A: Insurable interest in life exists when there is reasonable ground founded on the relation of the parties, either pecuniary or contractual or by blood or affinity, to *expect some benefit* or *advantage* from the *continuance* of the life of the insured.

On the other hand, 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. *(Sec. 13)*

Q: What are the reasons for the requirement of an insurable interest?

A:

1. As *deterrence* to the insured – The requirement of an insurable interest to support a contract of insurance is based upon considerations of public policy which render wager policies invalid. A wager policy is obviously contrary to public interest.

2. As a *measure of limit* of recovery – If and to the extent that any particular insurance contract is a contract to pay indemnity, the insurable interest of the insured will be the measure of the

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upper limit of his provable loss under the contract.

A. IN LIFE/ HEALTH

Q: What are the two general classes of life policies?

A:

1. *Insurance upon one's life* – are those taken out by the insured upon his own life *(Section 10[a])* for the benefit of himself, or of his estate, in case it matures only at his death, for the benefit of third person who may be designated as beneficiary.

   The question of insurable interest is immaterial where the policy is procured by the person whose life is insured. A person who insures his own life can designate any person as his beneficiary, whether or not the beneficiary has an insurable interest in the life of the insured subject to the limits under Article 739 and 2012 of the NCC.

   Note: An application for insurance on one's own life does not usually present an insurable interest question.

2. *Insurance upon life of another* – are those taken out by the insured upon the life of another. *(Sec. 10 [a], [b], [c] and [d])*

   Where a person names himself beneficiary in a policy he takes on the life of another, he must have insurable interest in the life of the latter.

Q: For whose life and health does a person have an insurable interest?

A: Of himself, of his spouse and of his children *(Sec. 10 [a])*

Q: Is the insured beneficiary required to prove insurable interest?

A: No, because he is presumed to have an insurable interest on the life of his spouse or his children.

The husband and wife as well as parent and child do have some pecuniary interest in each other's life since they are legally obliged to support each other.

a. *Of any person on whom he depends wholly or in part for education or support, or in whom he has a pecuniary interest; (Section 10, [b])*

   Mere blood relationship or mere relationship by affinity does *not* constitute an insurable interest; there must be a *risk of monetary loss* from the insured's death.

b. *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 performance*; (*Sec. 10, [c])*

c. *Of any person upon whose life any estate or interest vested in him depends. (Sec. 10, [d])*

Q: Who are the persons under Sec. 10, (c) who have an insurable interest on the life and health of a person?

A: A creditor may name himself as beneficiary in a policy he takes on the life of his debtor. The death of the debtor may either prevent payment if his estate is not sufficient to pay his debts or delay such payment if an administrator has to be appointed to settle his estate. Except *Section 10, (a) of the Insurance Code*, an insurance contract partakes the nature of a contract of indemnity.

Q: What is the extent of the creditor's recovery upon the death of the debtor?

A:

GR: Limited to the amount of his interest (the amount owing to him).

XPN: If the debtor is the insured and the creditor is named beneficiary, the creditor will be entitled to the whole proceeds of the policy upon the debtor's death, though his credit may be much less.

Note: The debtor was the one who applied for the insurance, to insure his own life.

XPN to XPN:

1. If debtor applied for insurance and designated creditor in compliance with creditor's requirement that debtor will take insurance to insure creditor's interest.

2. A person may take a policy on the life of his business partner because the latter's death may result in an interruption of business operations which can be in turn cause financial loss.
3. A business firm can take out a policy on the life of its officers or employees whose services proved valuable to the business. The proceeds are not taxable income but constitute indemnity to the employer for the loss which the business suffers because of the death of a valued officer or employee.

Q: Is the consent of the person insured essential to the validity of the policy?

A: No. So long as it could be proved that the insured has an *insurable interest* at the *inception of the policy*, the insurance is valid even without such consent.

Q: When must insurable interest exist?

A:

1. *Life or health insurance*

   GR: Insurable interest in life or health must exist when the insurance takes effect, bur need not exist thereafter or when the loss occurs. *(Sec. 19)*

   XPN:
   a. When the insurance is taken by the creditor on the life of the debtor, the creditor is required to have an insurable interest not only at the time of the contract but also at the time of the debtor's death because in this case, it is considered as a contract of indemnity.
   b. When the insurance is taken by the employer on the life of the employee.

3. *Property Insurance* – When the insurance takes effect and when the loss occurs, but need *not* exist in the meantime. *(Sec. 19)*

B. IN PROPERTY

Q: What may consist an insurable interest in property?

A:

1. An *existing interest* – The existing interest in the property may be legal or equitable title.

   Examples of insurable interest arising from legal title:
   a. Trustee, as in the case of the seller of property not yet delivered;
   b. Mortgagor of the property mortgaged;
   c. Lessor of the property leased

   Examples of insurable interest arising from equitable title:
   a. Purchaser of property before delivery or before he has performed the conditions of the sale
   b. Mortgagee of property mortgaged;
   c. Mortgagor, after foreclosure but before the expiration of the period within which redemption is allowed

2. An *inchoate interest* founded on an existing interest

   Example: A stockholder has an inchoate interest in the property of the corporation of which he is a stockholder, which is founded on an existing interest arising from his ownership of shares in the corporation

3. An *expectancy* coupled with an existing interest in that out of which the expectancy arises.

   Note: Expectancy to be insurable must be coupled with an existing interest or founded on an actual right to the thing or upon any valid contract for it. *(Sec. 16)*

Q: If the owner sold the property subject of insurance and was destroyed by a fire before he was able to redeem the same, is the insurer liable?

A: No. At the time of the loss, he was no longer the owner of the property insured as he failed to redeem the property. The law requires in property insurance that a person can recover the proceeds of the policy if he has insurable interest at the time of the issuance of the policy and also at the time when the loss occurs. At the time of fire, the owner no longer had insurable interest in the property insured.

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Q: Angela, owner of a condominium unit, insured the same against fire with the ELM Insurance Co., and made the loss payable to his sister, Antonette. In case of loss by fire of the said condominium unit, who may recover on the fire insurance policy?

A: Angela can recover on the fire insurance policy for the loss of said condominium unit. He has the insurable interest as owner-insured. As beneficiary in the fire insurance policy, Antonette cannot recover on the fire insurance policy. For the beneficiary to recover on the fire or property insurance policy, it is required that she must have insurable interest in the property insured. In this case, Antonette does not have insurable interest in the condominium unit. **(2001 Bar Question)**

Q: A piece of machinery was shipped to Joeben on the basis of C&F Manila. Pablo insured said machinery with the Talaga Merchants Ins. Co. (Tamic) for loss or damage during the voyage. The vessel sank en route to Manila. Joeben then filed a claim with Tamic which was denied for the reason that prior to the delivery, Joeben had no insurable interest. Decide the case.

A: Jeoben had an existing insurable interest on the piece of machinery he bought. The purchase of goods under a perfected contract of sale already vests *equitable interest* on the property in favor of the buyer even while it is pending delivery. **(1991 Bar Question)**

Q: If the owner sold the property subject of insurance and was destroyed by a fire before he was able to redeem the same, is the insurer liable?

A: No. At the time of the loss, he was no longer the owner of the property insured as he failed to redeem the property. The law requires in property insurance that a person can recover the proceeds of the policy if he has insurable interest at the time of the issuance of the policy and also at the time when the loss occurs. At the time of fire, the owner no longer had insurable interest in the property insured.

Q: What is the measure of insurable interest in property?

A: The extent to which the insured might be damnified by loss or injury thereof. *(Sec. 17).* Insurable interest in property does not necessarily imply a property interest in, or lien upon, or possession of, the subject matter of the insurance, and neither title nor a beneficial interest is requisite to the existence thereof. It is sufficient that the insured is so situated with reference to the property that would be liable to loss should it be injured or destroyed by the peril against which it is insured. Anyone has an insurable interest in property who derives a benefit from its existence or would suffer loss from its destruction. *(Gaisano Cagayan, Inc. v. Insurance Company of North America, G.R. No. 147839, June 8, 2006)*

Q: What is the extent of insurable interest of a common carrier or depository in a thing held by him?

A: To the extent of his liability but not to exceed the value thereof *(Sec. 15).* This is so because the loss of the thing by the carrier or depository may cause liability against him to the extent of its value.

C. DOUBLE INSURANCE AND OVER INSURANCE

Q: What are the distinctions between double insurance and over insurance?

A:

DOUBLE INSURANCE	OVER INSURANCE
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.	When the amount of the insurance is beyond the value of the insured's insurable interest.
Two or more insurers.	There may be only one insurer, with whom the insured takes insurance beyond the value of his insurable interest.
Not prohibited by law, unless there is a stipulation to the contrary.	Prohibited by law because it is a wagering contract and no longer a contract of indemnity.

Q: When does double insurance exist?

A: Double insurance exists where the same person is insured by several insurers separately, in respect to the same subject and interest. *(Sec. 93)*

Q: Give the requisites of double insurance.

A: STRIP

1. Person insured is the same

2. **T**wo or more insurers insuring separately
3. **S**ubject matter is the same
4. **I**nterest insured is the same
5. **R**isk or peril insured against is the same

Q: What is the purpose of the rule on double insurance?

A: To prevent over-insurance and thus avert the perpetration of fraud. The public, as well as the insurer, is interested in preventing the situation in which a loss would be profitable to the insured *(Pioneer Insurance and Surety Corp v. Yap, G.R. No. L-36232, Dec. 19, 1974)*

Q: Is double insurance prohibited by law?

A: No. A person may therefore procure two or more insurances to cover his property. What is prohibited by law is over insurance.

Q: The building worth P70 Million was totally razed by fire. If the owner decides to claim from Eastern Insurance Corp. only P50 Million, will the claim prosper? Explain.

A: Yes, the claim will prosper if the owner decides to claim from Eastern Insurance Corporation only P50 Million because the amount sought to be claimed does not exceed the value of his insurable interest. Eastern Insurance Corporation, however, can recover from Northern Insurance Corporation and Southern Insurance Corporation their proportionate share of the amount it paid to the owner**. (2008 Bar Question)**

Q: Can an insurer provide that the insured may not procure additional insurance?

A: Yes, the insurer may insert an *"other insurance clause"* which will prohibit double insurance. The rationale is to prevent the danger that the insured will over insure his property.

Q: What is additional or other insurance clause?

A: A condition in the policy requiring the insured to inform the insurer of any other insurance coverage of the property insured. It is lawful and specifically allowed under Sec. 75 which provides that *"a policy may declare that a violation or a specified provision thereof shall avoid it, otherwise the breach of an immaterial provision does not avoid it.*

Q: What are its purposes?

A:
1. To prevent an increase in the moral hazard
2. To prevent over-insurance and fraud

Q: What is the effect of non-disclosure of the existence of other insurances covering the subject matter of the insurance being applied for, if the applicant is required to do so?

A: The insured cannot recover from the insurance because he is guilty of violation of warranty/ condition.

Q: What are the rules where the insured is over-insured by double insurance?

A:

1. The insured, unless the policy otherwise provides, may claim payment from the insurers in such order as he may select, up to the amount which the insurers are severally liable under their respective contracts.

2. 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.

3. 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 policy.

4. Where the insured receives any sum in excess of the valuation in the case of valued policies, or of 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.

5. Each insurer and the other insurers, to contribute ratably to the loss in proportion to the amount for which he is liable under his contract. (*Sec. 94*)

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

A: In double insurance, the insurers are considered as co-insurers. Each one is bound to contribute ratably to the loss in proportion to the

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amount for which he is liable under his contract. This is known as the *"principle of contribution"* or *"contribution clause." (Sec. 94 [e])* **(2005 Bar Question)**

D. MULTIPLE OR SEVERAL INTERESTS ON SAME PROPERTY

Q: What are the instances where more than one insurable interest may exist in the same property?

A:

1. In trust, both trustor and trustee have insurable interest over the property in trust.
2. In a corporation, both the corporation and its stockholders have insurable interest over the assets.
3. In partnership both the firm and partners has insurable interest over its assets.
4. In assignment both the assignor and assignee has insurable interest over the property assigned.
5. In lease, the lessor, lessee and sub-lessees have insurable interest over the property in lease.
6. In mortgage, both the mortgagor and mortgagee have insurable interest over the property mortgaged.

Q: Is the insurable interest of mortgagor and mortgagee in case of a mortgaged property the same?

A: Each has an insurable interest in the property mortgaged and this interest is separate and distinct from the other. Therefore, insurance taken by one in his name only and in his favor alone does not inure to the benefit of the other. The same is not open to objection that there is double insurance. *(Sec. 8)*

Q: What is the extent of insurable interest of mortgagor and mortgagee?

A:

1. *Mortgagor* – To the extent of its *value* as owner of the property. The loss or destruction of the property insured will not extinguish the mortgage debt. The exception is in marine insurance.

2. *Mortgagee* – To the extent of the *debt*. Such interest continues until the mortgage debt is extinguished. The property relied on as mortgaged is only a security. In insuring the property, he is not insuring the property itself but his interest or lien thereon.

Note: In case of an insurance taken by the *mortgagee alone and for his benefit*, the mortgagee, after recovery from the insurer, is not allowed to retain his claim against the mortgagor but it passes by subrogation to the insurer to the extent of the insurance money paid.

VI. PERFECTION OF A CONTRACT

Q: What is a policy of insurance?

A: It is the written instrument in which *the contract of insurance is set forth (Sec. 49).* It is the *written document* embodying the terms and stipulations of the contract of insurance between the insured and insurer. It is *not* necessary for the perfection of the contract.

Q: What is the form of an insurance contract?

A: May be verbal or in writing, or partly in writing and partly verbal. However, the law provides that no policy of insurance shall be issued or delivered unless in the form previously approved by the Insurance Commission.

Q: When is the insurance contract perfected?

A: When the assent or consent is manifested by the meeting of the offer and the acceptance upon the thing and the cause which are to constitute the contract. Mere offer or proposal is not contemplated*. (De Lim v. Sun Life Assurance Co., G.R. No. L-15774, Nov. 29, 1920)*

A. OFFER AND ACCEPTANCE IN INSURANCE CONTRACT

Q. How offer is made in property and liability insurance?

A. It is the insured who makes an offer to the insurer, who accepts the offer, rejects it, or makes a counter-offer. The offer is usually accepted by an insurance agent on behalf of the insurer**.**

Q. How offer is made in Life and Health Insurance?

A. it depends upon whether the insured pays the premium at the time he applies for insurance.

1. If he does not pay the premium, his application is considered an invitation to the insurer to make an offer, which

he must then accept before the contract goes into effect.
2. If he pays the premium with his application, his application will be considered an offer.

Q. When is there an acceptance?

A. Where the application for insurance constitutes an offer by the insured, a policy is issued strictly in accordance with the offer is an acceptance of the offer that perfects the contract.

Q. When can there be an issuance of policy without acceptance?

A. If the issued policy does not conform to the insured's application, it is an offer to the insured which he may accept or reject.

Q. What is the effect of delay?

A. Unreasonable delay in returning the premium raises the presumption of acceptance of the insurance application. *(Gloria v. Philippine American Life Ins. Co., [CA}73 O.G. [No.37] 8660)*

Q: When does the policy become binding?

A:
1. When all the conditions precedent stated in the offer have been satisfied; and
2. When delivered

Q: What are the requisites for a valid delivery?

A:
1. Intention of the insurer to give legal effect as a completed instrument;
2. Word or act by insurer putting the instrument beyond his legal, though not necessarily physical control;
3. Insured must acquiesce in this intention.

Note: Possession of the policy by the insured raises the presumption of delivery, while the possession by the insurer is prima facie evidence of no delivery.

Q: What are the 2 types of delivery?

A:
1. *Actual* – delivery to the person of the insured.
2. *Constructive*
   a. *By mail* – If policy was mailed already and premium was paid and nothing is left to be done by the insured, the policy is considered constructively delivered if insured died before receiving the policy.
   b. *By agent* – If delivered to the agent of the insurer, whose duty is ministerial, or delivered to the agent of the insured, the policy is considered constructively delivered.

Q: What is the importance of delivery?

A:
1. It becomes the evidence of the making of a contract and of its terms;
2. It is considered as communication of the insurer's acceptance of the insured's offer;
3. It becomes the determination of policy period;
4. It marks the end of insurer's opportunity to decline coverage.

B. PREMIUM PAYMENT

Q: What is premium?

A: It is an agreed price for assuming and carrying the risk – that is, the consideration paid an insurer for undertaking to indemnify the insured against a specified peril.

Q: What is the difference between premium and assessment?

A: Premium is levied and paid to meet anticipated losses, while assessment are collected to meet actual losses. Also, while premium is not a debt, assessment properly levied, unless otherwise expressly agreed, is a debt.

Q: When does payment of premium become a debt or obligation?

A:
1. In *fire, casualty and marine insurance,* the premium payable becomes a debt as soon as the risk attaches.
2. In *life insurance,* the premium becomes a debt only when, in the case of the *first premium,* the contract has become binding, and in the case of *subsequent premiums,* when the insurer has continued the insurance after maturity of the premium, in consideration of the insured's express or implied promise to pay.

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Q: Does non-payment of balance of premiums cancel the policy?

A: No, a contrary rule would place exclusively in the hands of the insured the right to decide whether the contract should stand or not. *(Philippine Phoenix Surety & Insurance, Co., Inc., v. Woodworks, Inc., G.R. No. L-22684, Aug. 31, 1967)*

Q: What are the effects of non-payment of premiums?

A: Non-payment of the *first premium* unless waived, prevents the contract from becoming binding notwithstanding the acceptance of the application or the issuance of the policy.

Non-payment of the *subsequent premiums* does not affect the validity of the contracts unless, by express stipulation, it is provided that the policy shall in that event be suspended or shall lapse.

Q: Is the fire insurance policy a binding one even if the premium stated in the policy is not paid?

A: No, insurance is a contract whereby one undertakes for a consideration to indemnify another against loss, damage or liability arising from an unknown contingent event.

The consideration is the premium. The premium must be paid at the time and in the way and manner specified in the policy, and if not, the policy will lapse and be forfeited by its own terms.

The non-payment of consideration constitutes inability of the agreement *(Philippine Surety and Insurance Company v. Woodwork, Inc., G.R. No. L-25317, Aug. 6, 1979)*

Q: If the applicant failed to pay premium and instead execute a promissory note in favor of the insurer payable within 30 days which was accepted by the latter, is the insurer liable in case of loss?

A: Yes, the insurer is liable because there has been a perfected insurance contract. The insurer accepted the promise of the applicant to pay the insurance premium within thirty 30 days from the effective date of policy. By so doing, it has implicitly agreed to modify the tenor of the insurance policy and in effect, waived any provision therein that it would only pay for the loss or damage in case the same occurs after the payment of the premium. Considering that the insurance policy is silent as to the mode of payment, insurer is deemed to have accepted the promissory note in payment of the premium. This rendered the policy immediately operative on the date it was delivered. *(Capital Insurance & Surety Co. Inc. v. Plastic Era Co., Inc. G.R. No. L-22375, July 18, 1975)*

Q: Can fortuitous event excuse the insured from not paying the premiums?

A:

GR: No, non-payment of premiums does not merely suspend but put an end to an insurance contract since the time of the payment is peculiarly of the essence of the contract.

XPN:

1. The insurer has become insolvent and has suspended business, or has refused without justification a valid tender of premiums. *(Gonzales v. Asia Life Ins. Co., G.R. No. L-5188, Oct. 29, 1952)*
2. Failure to pay was due to the wrongful conduct of the insurer.
3. The insurer has waived his right to demand payment.

Q: What is the effect of acceptance of premium?

A: Acceptance of premium within the stipulated period for payment thereof, including the agreed grace period, merely assures continued effectivity of the insurance policy in accordance with its terms. *(Stoke v. Malayan Insurance Co., Inc., G.R. No. L-34768, Feb. 28, 1984)*

Where an insurer authorizes an insurance agent or broker to deliver a policy to the insured, it is deemed to have authorized said agent to receive the premium in its behalf. The insurer is bound by its agent's acknowledgment of the receipt of payment of premium.

Q: What is the effect of payment of premium by post-dated check?

A: Delivery of a promissory note or a check will *not* be sufficient to make the policy binding *until* the said note or check has been converted into cash. This is consistent with Article 1249 of the Civil Code.

Note: Payment by means of a check or note, accepted by the insurer, bearing a date prior to the loss, assuming availability of the funds thereof, would be sufficient even if it remains unencashed at the time of the loss. The subsequent effects of

encashment would retroact to the date of the instrument and its acceptance by the creditor.

Q: What if there was no premium paid, may the insurer recover the unpaid premium from the insured?

A: No, the continuance of the insurer's obligation is conditioned upon the payment of the premium, so that no recovery can be had upon a lapsed policy, the contractual relation between the parties having ceased. If the peril insured against had occurred, the insurer would have had a valid defense against recovery under the policy.

Q: What is the "cash and carry" rule?

A:

GR: No policy or contract of insurance issued by an insurance company is valid and binding unless and until the premium thereof has been paid. Any agreement to the contrary is void. **(2003 Bar Question)**

XPN: A policy is valid and binding even when there is non-payment of premium:

1. In case of *life or industrial life policy* whenever the grace period provision applies.

2. When there is *acknowledgment in a policy of a receipt of premium,* which the law declares to be conclusive evidence of payment, even if there is stipulation therein that it shall not be binding until the premium is actually paid. This is without prejudice however to right of insurer to collect corresponding premium. *(Sec. 77)*

3. When there is an agreement allowing the insured to pay the premium in installments and partial payment has been made at the time of loss (*Makati Tuscany Condominium Corp. v. CA, G.R. No. 95546, Nov. 6, 1992).*

4. When there is an agreement to grant the insured credit extension for the payment of the premium. (Art. 1306, NCC), and loss occurs before the expiration of the credit term. (*UCPB General Insurance v. Masagana Telemart, G.R. No. 137172, Apr. 4, 2001*).

5. When estoppel bars the insurer to invoke non-recovery on the policy.

6. When the public interest so requires, as determined by the Insurance Commissioner

   E.g.: In compulsory motor vehicle insurance, if the policy was issued without payment of premium by the vehicle owner, the insurer will still be held liable. To rule otherwise would prejudice the 3rd party victim.

Q: What is the effect of acknowledgment of receipt of premium in policy?

A: Conclusive evidence of its payment, *in so far as to make the policy binding*, notwithstanding any stipulation therein that it shall not be binding until the premium is actually paid (*Sec. 78*).

When the policy contains such written acknowledgment, it is presumed that the insurer has waived the condition of prepayment. It hereby creates a legal fiction of payment. The presumption is however, extended only to the question of the binding effect of the policy.

As far as the payment of the premium itself is concerned, the acknowledgment is only a prima facie evidence of the fact of such payment. The insurer may still dispute its acknowledgment but only for the purpose of recovering the premium due and unpaid. Whether payment was indeed made is a question of fact.

Q: Is the insurance company liable when a car, bought on installment basis, met an accident but the car is not yet fully paid?

A: Yes, when insured and insurer have agreed to the payment of premium by installments and partial payment has been made at the time of loss, then the insurer becomes liable. When the car loss happened on the 5th month, the six months agreed period of payment had not yet elapsed. The owner may recover from Peninsula Insurance Company, but the latter has the right to deduct the amount of unpaid premium from the insurance proceeds. **(2006 Bar Question)**

C. NON-DEFAULT OPTIONS IN LIFE INSURANCE

Q: What are the devices used to prevent the forfeiture of a life insurance after the payment of the first premium?

A:

1. *Grace period* – After the payment of the first premium, the insured is entitled to a grace period of 30 days within which

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to pay the succeeding premiums. *(Sec. 227,(a)).*

2. *Cash surrender value* – The amount the insurer agrees to pay to the holder of the policy if he surrenders it and releases his claim upon it. *(Cyclopedia Law Dictionary, 3rd ed., 1077)*

3. *Extended insurance* – It is where the insured is given a right, upon default, after payment of at least three full annual premiums *(see Sec. 227 [f])* 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. *(De Leon, The Insurance Code of the Philippines Annotated, 2006)*

4. *Paid up Insurance* – The insured is given a right, upon default, after the payment of at least three annual premiums to have the policy continued in force from the date of default for the whole period of the insurance without further payment of premiums.(ibid.) It results to a reduction of the original amount of insurance, but for the same period originally stipulated.*(6 Couch 2d., 355; 37 C.J.S. 364)*

5. *Automatic Loan Clause* – A stipulation in the policy providing that upon default in payment of premium, the same shall be paid from the loan value of the policy until that value is consumed. In such a case, the policy is continued in force as fully and effectively as though the premiums had been paid by the insured from funds derived from other sources.*(6 Couch 2d., 383)*

6. *Reinstatement* – Provision that the holder of the policy shall be entitled to reinstatement of the contract at anytime within 3 years from the date of default in the payment of premium, unless the cash surrender value has been paid, or the extension period expired, upon production of evidence of insurability satisfactory to the company and the payment of all overdue premiums and any indebtedness to the company upon said policy. *(Sec. 227, (j)).*

D. REINSTATEMENT OF A LAPSED POLICY

Q. What is purpose of the Reinstatement Provision?

A. The purpose of the provision is to clarify the requirements for restoring a policy to premium-paying status after it has been permitted to lapsed.

Q. Within what period shall the holder of the policy be entitled to reinstatement of the contract?

A. The law requires that the policy owner be permitted to reinstate the policy, subject to the violations specified, any time within three (3) years from the date of default of premium payment. A longer period, being more favorable to the insured, may be used.

Q. Is reinstatement of a lapsed policy an absolute right of the insured?

A. Reinstatement is not an absolute right of the insured, but discretionary on the part of the insurer, which has the right to deny reinstatement if it were not satisfied as to the insurability of the insured, and if the latter did not pay all overdue premiums and other indebtedness to the insurer. *(McGuire vs. Manufacturer's Life Ins. Co., 87 Phil. 370).*

Q. What does Evidence of Insurability includes?

A. Evidence of Insurability is broader phrase than "Evidence of Good Health" and includes such other factors as the insured's occupation, habits, financial condition, and other risk selection factors.

Q. A life insurance policy lapsed. The insured applied for reinstatement of the policy and paid only a part of the overdue premiums. Subsequently, the insured died. Was the insurer liable?

A. The insurer is was not liable as the policy was not reinstated. The failure to pay the balance of the overdue premiums prevented reinstatement and recovery of the face value of the policy. *(Andres vs. Crown Life Ins. Co., 55 O.G. 3483).*

E. REFUND OF PREMIUMS

Q: When is the insured entitled to recover premiums already paid or a portion thereof?

A:

1. *Whole:*
    a. When *no* part of the thing insured has been exposed to any of the perils insured against *(Sec. 79)*
    b. When the contract is *voidable* because of the fraud or misrepresentations of the insurer of his agent *(Sec.81).*
    c. When the insurance is *voidable* because of the existence of facts of which the insured was ignorant without his fault *(Sec.81).*
    d. When the insurer *never* incurred any liability under the policy because of the default of the insured other than actual fraud *(Sec. 81).*
    e. When *rescission* is granted due to insurer's breach of contract *(Sec. 74).*

2. *Pro rata:*
    a. When the insurance is for a definite period and the insured surrenders his policy *before the termination thereof*; *(Sec. 79 [b]);* except:
        i. Policy not made for a definite period of time;
        ii. Short period rate is agreed upon;
        iii. Life insurance policy.

    b. When there is over-insurance. The premiums to be returned shall be proportioned to the amount by which the aggregate sum insured in all the policies exceeds the insurable value of the thing at risk. *(Sec. 82)*
        i. In case of over-insurance by double insurance, the insurer is not liable for the total amount of the insurance taken, his liability being limited to the property insured. Hence, the insurer is not entitled to that portion of the premium corresponding to the excess of the insurance over the insurable interest of the insured.
        ii. In case of over-insurance by several insurers, the insured is entitled to a ratable return of the premium, proportioned to the amount by which the aggregate sum insured in all the policies exceeds the insurable value of the thing insured (*Sec. 82*).

            E.g. Where there is a total over insurance of P500,000.00 in an aggregate P2,000,000.00 policy (P1,500,000.00 is only the insurable value), 25% (proportion of P500k to P2M) of the premiums paid to the several insurers should be returned.

Q: When insured not entitled to return of premiums paid?

A:

1. The risk has already attached and the risk is entire and indivisible;
2. In life policies;
3. If contract is void *ab initio* because of fraud by the insured;
4. If contract is illegal and the parties are in *pari delicto.*

VII. RESCISSION OF INSURANCE CONTRACTS

Q. What are the instances wherein a contract of insurance may be rescinded?

A.

1. Concealment
2. Misrepresentation/ omission
3. Breach of warranties

A. CONCEALMENT

Q: What is concealment?

A: Concealment is a *neglect* to communicate that which a party knows *and* ought to communicate. *(Sec. 26)*

Q: What are the requisites in concealment?

A:

1. A party knows a fact which he neglects to communicate or disclose to the other party
2. Such party concealing is duty bound to disclose such fact to the other

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3. Such party concealing makes no warranty as to the fact concealed
4. The other party has no means of ascertaining the fact concealed
5. The fact must be material

Q: What is the test of materiality?

A: It is 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 advantages of the proposed contract, or in making his inquiries. *(Sec. 31)*

Q: What is the presumption when the insured failed to convey the nature of the facts to the insurer?

A:

GR: The failure of the insured to communicate is intentional rather than inadvertent.

XPN: In the absence of evidence of the uninsurability of a person afflicted with chronic cough, concealment thereof is *no ground* for annulment of the policy.

Note: As long as the facts concealed are material. Sec. 27 states concealment, whether intentional or not.

Q: How does it differ from materiality in marine insurance?

A: Rules on concealment are stricter since the insurer would have to depend almost entirely on the matters communicated by the insured. Thus, in addition to material facts, each party must disclose all the information he possesses which are material to the information of the belief or expectation of a third person, in reference to a material fact. But a concealment in a marine insurance in any of the following matters enumerated under Section 110, Insurance Code does not vitiate the entire contract, but merely exonerates the insurer from a loss resulting from the risk concealed.

Q: What is the test in ascertaining the existence of concealment?

A: If the applicant is *aware* of the existence of some circumstances which he knows would influence the insurer in acting upon his application, good faith requires him to disclose that circumstance, though unasked.

Q: What are the matters that need *not* be disclosed?

A:

GR: The parties are *not* bound to communicate information of the following matters:

1. Those which the other knows
2. 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
3. Those of which the other waives communication
4. Those which prove or tend to prove the existence of a risk excluded by a warranty, and which are not otherwise material
5. Those which relate to a risk excepted from the policy and which are not otherwise material;
6. The nature or amount of the interest of one insured (except if he is not the owner of the property insured, Sec. 34).

XPN: In answer to inquiries of the other. *(Sec. 30)*

Note: Neither party is bound to communicate, even upon inquiry*, information of his own judgment,* because such would add nothing to the appraisal of the application.

The parties are bound to know *all the general causes* which are *open to his inquiry*, equally with the other, and *all general usages of trade*.

Q: What are the matters that must be disclosed even in the absence of inquiry?

A:

1. Those material to the contract
2. Those which the other has no means of ascertaining
3. Those as to which the party with the duty to communicate makes no warranty

Note: Matters relating to the *health of the insured* are *material* and relevant to the approval of the issuance of the life insurance policy as these definitely affect the insurer's action to the application. It is well-settled that the insured need not die of the disease he had failed to disclose to the insurer, as it is sufficient that his non-disclosure misled the insurer in forming his estimates of the risks of the proposed insurance policy or in making inquiries *(Sunlife Assurance Company of Canada v. CA, G.R. No. 105135, June 22, 1995).*

Information as to the nature of interest need not be disclosed except In property insurance, if the insured is not the owner. If somebody is insuring properties of which he is not the owner, he must disclose why he has insurable interest that would entitle him to ensure it.

Q: May the right to information of material facts be waived?

A: Yes.

1. By the terms of the contract
2. By the failure to make an inquiry as to such facts, where they are distinctly implied in other facts from which information is communicated. *(Sec. 33)*

Q: What are the effects of concealment?

A:

1. If there is concealment under Section 27, the remedy of the insurer is rescission since concealment vitiates the contract of insurance.
2. The party claiming the existence of concealment must prove that there was knowledge of the fact concealed on the part of the party charged with concealment.
3. Good faith is *not* a defense in concealment. Concealment, whether intentional or unintentional entitles the injured party to rescind the contract of insurance. *(Sec. 27)*
4. The matter concealed need not be the cause of loss.
5. To be guilty of concealment, a party must have knowledge of the fact concealed at the time of the effectivity of the policy.

Q: When should concealment take place in order that the policy may be avoided?

A: At the time the contract is entered into and not afterwards. The duty of disclosure ends with the completion of the contract. Waiver of medical examination in a non-medical insurance contract renders even more material the information required of the applicant concerning previous condition of health and diseases suffered, for such information necessarily constitutes an important factor which the insurer takes into consideration in deciding whether to issue the policy or not. Failure to communicate information acquired after the effectivity of the policy will *not* be a ground to rescind the contract.

Reason: Information is no longer material as it will no longer influence the other party to enter into such contract.

Q: Joanna applied for a non-medical life insurance. The Joanna did not inform the insurer that one week prior to her application for insurance, he was examined and confined at St. Luke's Hospital where she was diagnosed for lung cancer. The insured soon thereafter died in a plane crash. Is the insurer liable considering that the fact concealed had no bearing with the cause of death of the insured? Why?

A: No. The concealed fact is material to the approval and issuance of the insurance policy. It is well settled that the insured need not die of the disease she failed to disclose to the insurer. It is sufficient that his nondisclosure misled the insurer in forming his estimate of the risks of the proposed insurance policy or in making inquiries. **(2001 Bar Question)**

Q: What are the instances whereby concealment made by an *agent procuring the insurance binds the principal?*

A.

1. Where it was the duty of the agent to acquire and communicate information of the facts in question;
2. Where it was possible for the agent, in the exercise of reasonable diligence to have made of the insurance contract.

Note: Failure on the part of the insured to disclose such facts known to his agent, or wholly due to the fault of the agent, will avoid the policy, despite the good faith of the insured.

B. MISREPRESENTATION/OMMISON

Q: What is representation?

A: An oral or written statement of a fact or condition affecting the risk made by the insured to the insurance company, tending to induce the insurer to assume the risk.

Q: What are the kinds of representation?

A:

1. Oral or written; *(Sec. 36)*
2. Affirmative; *(Sec. 39) or*
3. Promissory. *(Sec. 42)*

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Q: What is an affirmative representation?

A: Any allegation as to the existence or non-existence of a fact when the contract begins. (*e.g.* the statement of the insured that the house to be insured is used only for residential purposes is an affirmative representation).

Q: What is a promissory representation?

A: 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.

Q: When should representation be made?

A: At the time of, or before, issuance of the policy. *(Sec. 37)*

Q: What is misrepresentation?

A: It is an affirmative defense. To avoid liability, the insurer has the duty to establish such a defense by satisfactory and convincing evidence. *(Ng Gan Zee v. Asian Crusader Life Assn. Corp., G.R. No. L- 30685, May 30, 1983)*

Note: In the absence of evidence that the insured has sufficient medical knowledge to enable him to do distinguish between "peptic ulcer" and "tumor", the statement of deceased that said tumor was "associated with ulcer of the stomach" should be considered an expression in good faith. *Fraudulent intent of insured must be established to entitle insurer to rescind the insurance contract.* Misrepresentation, as a defense of insurer, is an affirmative defense which must be proved. *(Ng Gan Zee v. Asian Crusader Life Assn. Corp., G.R. No. L-30685, May 30, 1983)*

Q: What are the requisites of a false representation (misrepresentation)?

A:

1. The insured stated a fact which is *untrue*;
2. Such fact was stated with *knowledge* that it is untrue and with intent to deceive or which he states positively as true without knowing it to be true and which has a tendency to mislead;
3. Such fact in either case is *material to the risk.*

Note: A representation cannot qualify an express provision in a contract of insurance but it may qualify an implied warranty. A representation as to the future is to be deemed a promise unless it appears that it was merely a statement of belief or an expectation that is susceptible to present, actual knowledge. The statement of an erroneous opinion, belief or information, or of an unfulfilled intention, will not avoid the contract of insurance, unless fraudulent.

Q: What is the test of materiality?

A: It 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 representation is made, in forming his estimates of the disadvantages of the proposed contract or in making his inquiries (similar with concealment). *(Sec. 46)*

Q: What are the effects of misrepresentation?

A:

1. It renders the insurance contract voidable at the option of the insurer, although the policy is not thereby rendered void ab initio. The injured party entitled to rescind from the time when the representation becomes false;
2. When the insurer accepted the payment of premium with the knowledge of the ground for rescission, there is waiver of such right;
3. There is no waiver of the right of rescission if the insurer had no knowledge of the ground therefore at the time of acceptance of premium payment.

Q: What is the effect of collusion between the insurer's agent and the insured?

A: It *vitiates the policy* even though the agent is acting within the apparent scope of his authority. The agent ceases to represent his principal. He, thus, represents himself; so the insurer is not estopped from avoiding the policy.

Q: What are the characteristics of representation?

A:

1. Not a part of the contract but merely a collateral inducement to it
2. Oral or written
3. Made at the time of, or before issuing the policy and not after
4. Altered or withdrawn before the insurance is effected but not afterwards
5. Must be presumed to refer to the date the contract goes into effect. *(Sec. 42)*

Q: What are the similarities of concealment and representation?

A:

1. Refer to the same subject matter and both take place before the contract is entered.
2. Concealment or representation prior to loss or death gives rise to the same remedy; that is rescission or cancellation.
3. The test of materiality is the same. *(Secs. 31, 46)*
4. The rules of concealment and representation are the same with life and non-life insurance.
5. Whether intentional or not, the injured party is entitled to rescind a contract of insurance on ground of concealment or false representation.
6. Since the contract of insurance is said to be one of utmost good faith on the part of both parties to the agreement, the rules on concealment and representation apply likewise to the insurer.

Q: How does concealment differ from misrepresentation?

A: In *concealment*, the insured withholds the information of material facts from the insurer, whereas in *misrepresentation*, the insured makes erroneous statements of facts with the intent of inducing the insurer to enter into the insurance contract.

Q: How is concealment and misrepresentation applied in case of loss or death?

A:

GR: If the concealment or misrepresentation is discovered before loss or death, the insurer can cancel the policy. If the discovery is after loss or death, the insurer can refuse to pay.

XPN: The incontestability clause under paragraph 2 of Section 48.

XPN to XPN:

1. Non-payment of premiums. (*Secs. 77, 22 [b], 228 [b], 203 [b])*
2. Violation of condition. *(Secs. 227 [b], 228 [b])*
3. No insurable interest
4. Cause of death was excepted or not covered
5. Fraud of a vicious type
6. Proof of death was not given. *(Sec. 242)*
7. That the conditions of the policy relating to military or naval service. *(Secs. 227 [b], 228 [b])*
8. That the action was not bought within the time specified. *(Sec. 62)*

Q: What is the remedy of the injured party in case of misrepresentation?

A: If there is misrepresentation, the injured party is entitled to rescind from the time when the representation becomes false.

Q: When should the right to rescind the contract be exercised?

A: The right to rescind must be exercised previous to the commencement of an action on the contract. (the action referred to is that to collect a claim on the contract)

Q. What is Omission?

A. The failure to communicate information of matters proving or tending to prove the falsity of warranty.

Q. What is the effect of Omission?

A. The contract of insurance may be rescinded.

Q. In case of Omission, who is entitled to rescind the contract?

A. The insurer is entitled to rescind the contract.

C. BREACH OF WARRANTIES

Q: What are warranties?

A: Statements or promises by the insured 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 render the policy voidable by the insurer.

Q: What is the purpose of warranties?

A: To eliminate potentially increasing moral or physical hazards which may either be due to the acts of the insured or to the change of the condition of the property.

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Q: What is the basis of warranties?

A: The insurer took into consideration the condition of the property at the time of effectivity of the policy.

Q: What are the kinds of warranties?

A:

1. *Express* – an agreement contained in the policy or clearly incorporated therein as part thereof 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* – It is deemed included in the contract although not expressly mentioned.

   Peculiar only to marine insurance, and therefore is deemed included in the contract, although not expressly mentioned:

   a. That the ship will not deviate from the agreed voyage unless deviation is proper
   b. That the ship will not engage in illegal venture
   c. Warranty of neutrality, that the ship will carry the requisite documents of nationality or neutrality where such nationality or neutrality is warranted
   d. Presence of insurable interest
   e. That the ship is seaworthy at the time of the commencement of the insurance contract.

Q: What are the distinctions between warranty and representation?

A:

WARRANTY	REPRESENTATION
Considered parts of the contract.	Collateral inducement to the contract.
Always written on the face of the policy, actually or by reference.	May be written in a totally disconnected paper or may be oral.
Must be strictly complied with.	Only substantial proof is required.
Its falsity or non-fulfillment operates as a breach of contract.	Its falsity renders the policy void on the ground of fraud.
Presumed material.	Insurer must show its materiality in order to defeat an action on the policy.

Q: What are the effects of breach of warranty?

A:

1. *Material*

   GR: Violation of material warranty or of material provision of a policy will entitle the other party to rescind the contract.

   XPN:
   a. Loss occurs before the time of performance of the warranty;
   b. The performance becomes unlawful at the place of the contract; and
   c. Performance becomes impossible.

2. *Immaterial*

   GR: It will not avoid the policy.

   XPN: When the policy expressly provides or declares that a violation thereof will avoid it.

   For instance, an "Other Insurance Clause" which is a condition in the policy requiring the insured to inform the insurer of any other insurance coverage of the property. A violation of the clause by the insured will not constitute a breach unless there is an additional provision stating that the violation thereof will avoid the policy. *(Sec. 75)*

Q: What is the effect of a breach of warranty without fraud?

A: The policy is *avoided only from the time of breach (Sec. 76) and* the *insured is entitled:*

1. To the *return of the premium paid* at a *pro rata* from the time of breach if it occurs after the inception of the contract; or
2. To *all premiums* if it is broken during the inception of the contract.

VIII. CLAIMS SETTLEMENT AND SUBROGATION

A. NOTICE AND PROOF OF LOSS

Q: What is loss in insurance?

A: The injury, damage or liability sustained by the insured in consequence of the happening of one or more of the perils against which the insurer, in consideration of the premium, has undertaken to indemnify the insured. It may be total, partial, or constructive in Marine Insurance.

Q: What is notice of loss?

A: It is the more or less formal notice given the insurer by the insured or claimant under a policy of the occurrence of the loss insured against.

Q: What are the conditions before the insured may recover on the policy after the loss?

A:

1. The insured or some person entitled to the benefit of the insurance, without unnecessary delay, must give *notice* to the insurer; (*Sec. 88)*
2. When required by the policy, insured must present a *preliminary proof loss* which is the best evidence he has in his power at the time. *(Sec. 89)*

Q: What are the purposes of notice of loss?

A:

1. To give insurer information by which he may determine the extent of his liability;
2. To afford the insurer a means of detecting any fraud that may have been practiced upon him; and
3. To operate as a check upon extravagant claims.

Q: What is the effect of failure to give notice of loss?

A:

FIRE INSURANCE	OTHER TYPES OF INSURANCE
Failure to give notice defeats the right of the insured to recover.	Failure to give notice will *not* exonerate the insurer, unless there is a stipulation in the policy requiring the insured to do so.

Q: What are the instances when the defects in the notice or proof of loss are considered waived?

A: When the insurer: **MaJoR-DeW**

1. **W**rites to the insured that he considers the policy null and void as the furnishing of notice or proof of loss would be useless;
2. **R**ecognizes his liability to pay the claim;
3. **De**nies all liability under the policy
4. **Jo**ins in the proceedings for determining the amount of the loss by arbitration, making no objections on account of notice and preliminary proof; or
5. **Ma**kes Objection on any ground other than the formal defect in the preliminary proof.

Q: When is delay in the presentation of notice or proof of loss deemed waived?

A: If caused by:

1. Any act of the insurer; and
2. By failure to take objection promptly and specifically upon that ground. *(Sec. 91)*

Q: What is proof of loss?

A: It is the more or less formal evidence given the company by the insured or claimant under a policy of the occurrence of the loss, the particulars thereof and the data necessary to enable the company to determine its liability and the amount thereof.

Q: What is the time for payment of claims?

LIFE POLICIES	NON-LIFE POLICIES
1*Maturing upon the expiration of the term* – the proceeds are immediately payable to the insured, except if proceeds are payable in installments or annuities which shall be paid as they become due 2. *Maturing at the death of the insured, occurring prior to the expiration of the term stipulated* – the proceeds are payable to the beneficiaries within 60 days after presentation of claim and filing of proof of death *(Sec. 242)*	The proceeds shall be paid within 30 days after the receipt by the insurer of proof of loss and ascertainment of the loss or damage by agreement of the parties or by arbitration but not later than 90 days from such receipt of proof of loss, whether or not ascertainment is had or made. *(Sec. 243)*

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B. GUIDELINES ON CLAIMS SETTLEMENT

Q. What is Claim Settlement?

A. Claim settlement is the indemnification of the suffered by the insured. The claimant may be the insured or reinsured, the insurer who is entitled to subrogation, or a third party who has a claim against the insured.

Q. What are the rules in Claim Settlement?

A.

1. No insurance company doing business in the Philippines shall refuse, without justifiable cause, to pay or settle claims arising under coverages provided by its policies, nor shall any such company engage in unfair claim settlement practices.

2. Evidence as to 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 *(Sec. 241)*

Q. What is the purpose of the rule?

A. To eliminate unfair claim settlement practices.

Q. What are the acts which constitute unfair claim settlement practices?

A.

1. Knowingly misrepresenting to claimants pertinent facts or policy provisions relating to coverages at issue.

2. Failing to acknowledge with reasonable promptness pertinent communications with respect to claims arising under its policies.

3. Failing to adopt and implement reasonable standards for the prompt investigation of claims arising under its policies.

4. Not attempting in good faith to effectuate prompt, fair and equitable settlement of calims submitted in which liability has become reasonably clear; or

5. 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. *(Sec. 241, Par.1)*

Q. What is the sanction for the insurance companies which engaged to unfair settlement practices?

A. Sec. 241 enumerates the grounds which shall be considered as sufficient as sufficient cause of the suspension or revocation of an insurance company's certificate of authority.

Q. What is the obligation of the insurer with regard to the insured's decision to compromise third party claim?

A. Where a policy gives the insurer a control of the decision to settle claim or to litigate it, the insurer nevertheless is required to observe a certain measure of consideration for the interest of the insured. The rule has come to be generally accepted that while the express terms of the policy do not impose of the insurer the duty to claim settle the claim at all costs, there is an implied duty on his part to give due consideration to the interest of the insured in its exercise of the option to reject a compromise settlement and proceed with litigation. In insurance contracts, the law requires strict observance of the standards of good faith and fair dealing on the part of the insurer.

Q: What is the effect of refusal or failure to pay the claim within the time prescribed?

A: Secs. 242, 243 and 244 provide that the insurer shall be liable to pay interest twice the ceiling prescribed by the Monetary Board which means twice 12% per annum (legal rate of interest prescribed in CB No. 416) or 24% per annum interest on the proceeds of the insurance from the date following the time prescribed in Secs. 242 or 243 until the claim is fully satisfied *(Prudential Guarantee and Assurance, Inc. v. Trans-Asia Shipping Lines, Inc. G. R. No. 151890, June 20, 2006)*

Note: Refusal or failure to pay the loss or damage will entitle the assured to collect interest UNLESS such refusal or failure to pay is based on the ground that the claim is fraudulent.

Q: What are the rules on the prescriptive period?

A:

1. The parties to a contract of insurance may validly agree that an action on the policy should be brought within a limited period of time, provided such period is not less than 1 year from the time the cause of action accrues. If the period agreed upon is less than 1 year from the time the cause of action accrues, such agreement is void. *(Sec. 63)*

   a. The stipulated prescriptive period shall begin to run from the date of the insurer's rejection of the claim filed by the insured or beneficiary and not from the time of loss.
   b. In case the claim was denied by the insurer but the insured filed a petition for reconsideration, the prescriptive period should be counted from the date the claim was denied at the first instance and not from the denial of the reconsideration *(Sun Life Office, Ltd. vs. CA, GR. No. 89741, Mar 13, 1991)*

2. If there is no stipulation or the stipulation is void, the insured may bring the action within 10 years in case the contract is written.

3. In a comprehensive motor vehicle liability insurance (CMVLI), the written notice of claim must be filed within 6 months from the date of the accident; otherwise, the claim is deemed waived even if the same is brought within 1 year from its rejection. *(Vda. De Gabriel vs. CA, GR No. 103883, Nov 14, 1996)*

4. The suit for damages, either with the proper court or with the Insurance Commissioner, should be filed within 1 year from the date of the denial of the claim by the insurer, otherwise, claimant's right of action shall prescribe. *(Sec. 384)*

Q: What is the prescriptive period in commencing an action?

A: Within one year from time cause of action accrues.

Q. From what time shall the period of prescription be computed in case the insured asked for reconsideration of the denial of claim?

A. In case the claim was denied by the insurer but the insured file a petition for reconsideration, the prescriptive period should be counted from the date the claim was denied at the first instance and not from the denial of the reconsideration. To rule otherwise would give the insured a scheme or devise to waste time until any evidence which may be considered against him is destroyed. *(Sun life Office, Ltd. vs. CA, 195 SCRA 193; Asked, V [a}, 1996 Bar Exams.).*

Q. What is the prescriptive period of prescription in motor vehicle insurance?

A. It is one year from denial of the claim and not from the date of the accident.

Q. What is the Principle of Subrogation?

A. 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 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. (*Art. 2207, NCC*)

Q: Should there be a contract before the insurer be subrogated?

A: The principle of subrogation inures to the insurer *without* any formal assignment or any express stipulation to that effect in the policy. Said right is *not* dependent upon nor does it grow out of any private contract. Payment to the insured makes the insurer a subrogee *in equity*. (*Malayan Insurance Co., Inc. v. CA, G.R. No. L-36413, Sept. 26, 1988)*

Note: Incapacity of the insured will *not* affect the capacity of the subrogee because capacity is personal to the holder *(Lorenzo Shipping v. Chub and Sons, Inc., G.R. No. 147724, June 8, 2004).*

Q: What are the rules on indemnity?

A:

1. Applies *only* to property insurance except when the creditor insures the life of his debtor

2. Insurance contracts are *not* wagering contracts or gambling contracts.

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Note: Wagering contracts are those where the parties contemplate gain through mere chance.

Q: What are the purposes of subrogation?

A:

1. To make the person who caused the loss legally responsible for it

2. To prevent the insured from receiving double recovery from the wrongdoer and the insurer

3. To prevent the tortfeasors from being free from liability and is thus founded on consideration of public policy

Q: What are the rules on subrogation?

A:

1. *Applicable only to property insurance* – the value of human life is regarded as unlimited and therefore, no recovery from a third party can be deemed adequate to compensate the insured's beneficiary.

2. The right of insurer against a third party is limited to the amount recoverable from latter by the insured.

Q: What if the amount paid by the insurance company does *not* fully cover the injury or loss?

A: The aggrieved party shall be entitled to recover the deficiency from the person causing the loss or injury. *(Art. 2207, NCC)*

Q: What are the instances where the right of subrogation *does not* apply?

A:

1. Where the insured by his own act *releases* the wrongdoer or third party liable for loss or damage from liability

2. The insurer *loses* his rights against the wrongdoer since the insurer can only be subrogated to only such rights as the insured may have

3. Where the insurer pays the insured the value of the loss *without* notifying the carrier who has in good faith settled the insured claim for loss

4. Where the insurer pays the insured for a loss or risk *not* covered by the policy

5. Life insurance

6. For recovery of loss in *excess* of insurance coverage.

TRANSPORTATION LAW

I. COMMON CARRIERS

Q: What are common carriers?

A: PeBuLaCoPu

1. Must be a **Pe**rson, corporation, firm or association
2. Must be engaged in the **Bu**siness of carrying or transporting passengers or goods or both
3. The carriage or transport must either be by **La**nd, water or air
4. The service is for **Co**mpensation
5. The service is offered to the **Pu**blic.

A. DILIGENCE REQUIRED

Q: What is the diligence required?

A: Extraordinary diligence.

Q: What is meant by extraordinary diligence?

A: It is that extreme measure of care and caution which persons of unusual prudence and circumspection use for securing and preserving their own property or rights. The law requires common carriers to render service with the greatest skill and utmost foresight.

Q: What are the requirements of extraordinary diligence in carriage by sea?

A:

1. Warranty of shipworthiness (*Trans-Asia Shipping vs. CA, GR No. 118126, March 4, 1996)*

2. No Overloading. *(Negros Navigation vs. CA, GR No. 110398, November 7, 1997)*

Q: What are the requirements of extraordinary diligence in carriage by land?

A:

1. Good condition of the vehicle
2. Compliance with traffic rules

Q: What is the reason for requiring common carriers to observe extraordinary diligence?

A: The nature of the business of common carriers and the exigencies of public policy demand that they observe extraordinary diligence.

B. LIABILITIES OF COMMON CARRIER

Q: When does liability of the common carrier commence in connection to the transfer of goods?

A: It begins with the actual delivery of the goods for transportation, and not merely with the formal execution of a receipt or bill of lading; the issuance of a bill of lading is not necessary to complete delivery and acceptance. *(Compania Maritima v. Insurance Co. of North America, G.R. No. L-18965, Oct. 30, 1964)*

Q: When does the duty to exercise extraordinary diligence commence and cease with respect to transport of passengers?

A: The duty of the common carrier commence from the moment the person who purchases the ticket from the carrier presents himself at the proper place and in a proper manner to be transported.

The relation of carrier and passenger continues until the passenger has been landed at the port of destination and has left the vessel owner's dock or premises. Once created, the relationship will not ordinarily terminate until the passenger has, after reaching his destination, safely alighted from the carrier's conveyance or had a reasonable opportunity to leave the carrier's premises. *(Aboitiz Shipping Corp. v. CA, G.R. No. 84458, Nov. 6, 1989)*

Q: What are the liabilities of a common carrier in case of breach of contract of carriage?

A:

1. *Culpa contractual* – negligence based on contract; filed against the common carrier wherein he is a passenger.

2. *Culpa aquiliana* – negligence based on tort; filed against the drivers of both vehicles and the owners thereof.

3. *Culpa criminal* – negligence based on a crime; filed against the driver at fault if his act amounts to a crime.

Q: What are the defenses available in *culpa contractual*?

A:

1. Exercise of extraordinary due diligence
2. Due diligence in the selection and supervision of employees

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3. Fortuitous event
4. *Contributory negligence of passengers* – it does not bar recovery of damages for death or injury if the proximate cause is the negligence of the common carrier but the amount of damages shall be equitably reduced. *(Art. 1762)*

Q: What are the kinds of damages that may be recovered in case of death of a passenger *(culpa contractual)?*

A:

1. An indemnity for the death of the victim
2. An indemnity for loss of earning capacity of the deceased
3. Moral damages
4. Exemplary damages

   Note: Carrier is not liable for exemplary damages where there is no proof that it acted in a wanton, fraudulent, reckless, oppressive or malevolent manner

5. Attorney's fees and expenses of litigation
6. Interest in proper cases. *(Briñas v. People, G.R. No. L-30309, Nov. 25, 1983)*

Q: What are the distinctions between an action to enforce liability of the employer of the negligent driver under Art. 103 of the RPC, and an action based on quasi-delict?

A:

ART. 103, RPC	ART. 2180, NCC (QUASI-DELICT)
Employer is only subsidiarily liable.	Liability is primary and direct.
There must be a judgment of conviction against the negligent driver otherwise the action against the employer would be premature.	Action may proceed independently from the criminal action.
The defense of due diligence in selection and supervision of employees cannot be invoked.	The defense of due diligence in selection and supervision of employees may be invoked.

Q: What is the liability with regard to moral damages?

A:

GR: Moral damages are not recoverable for breach of contract of carriage in view of Art. 2219-20 of the Civil Code.

XPN:

1. Where the mishap results in the death of the passenger
2. Where it is proved that the common carrier was guilty of fraud or bad faith, even if death does not result.

II. VIGILANCE OVER GOODS

A. EXEMPTING CAUSES

Q: What is the presumption on the loss, destruction, or deterioration of goods?

A:

GR: The common carrier is presumed to have been at fault or to have acted negligently when the goods transported are lost, destroyed or deteriorated.

Note: The presumption of fault or negligence against the carrier is only a disputable presumption. The law, in creating such a presumption merely relieves the owner of the goods, for the time being, from introducing evidence to fasten the negligence on the former, because the presumption stands in the place of evidence.

XPN: When the same is due to any of the following causes only:

1. *Caso Fortuito* (Flood, storm, earthquake, lightning or other natural disaster or calamity). Provided, the following conditions are present:
   a. Natural disaster was the proximate and only cause;
   b. Carrier exercised diligence to prevent or minimize loss before, during and after the occurrence of the natural disaster; and
   c. The common carrier has not negligently incurred delay in transporting the goods. *(Art. 1740, NCC)*

2. Act of the public enemy in war, whether international or civil, provided:
   a. Act was the proximate and only cause;
   b. Carrier exercised diligence to prevent or minimize loss before, during and after the act; and
   c. No delay. *(Art. 1740, NCC)*

3. Act or omission of the shipper or owner of the goods, provided:

a. *If proximate and only cause-* exempting;
b. *If contributory negligence-* mitigating

4. The character of the goods or defects in the packing or in the containers. Provided, carrier exercised due diligence to forestall or prevent loss *(Art 1742).*

   Note: If the fact of improper packing is known to the carrier or its servants, or apparent upon ordinary observation, but it accepts the goods notwithstanding such condition, it is not relieved from responsibility for loss or injury resulting therefrom. *(Southern Lines Inc., v. CA, G.R. No. L-16629, Jan. 31, 1962)*

5. Order or act of competent authority. Provided, the authority is with power to issue order *(Art. 1743).* If the officer acts without legal process, the common carrier will be held liable *(Ganzon vs. CA, GR No. L-48757, May 30, 1988).*

Note: In all cases other than those enumerated above, there is presumption of negligence even if there is an agreement limiting the liability of the common carrier in the vigilance over the goods.

Q: Are mechanical defects considered fortuitous events? Give illustrations.

A: No. Mechanical defects in the carrier are not considered a *caso fortuito* that exempts the carrier from responsibility. *(Sweet Lines, Inc. v. CA, G.R. No. L-46340, Apr. 29, 1983)*

1. Tire blowout of a jeep is not a fortuitous event where there exists a specific act of negligence by the carrier consisting of the fact that the jeepney was overloaded and speeding at the time of the incident. *(Juntilla v. Fontanar, G.R. No. L-45637, May 31, 1985)*

2. Defective brakes cannot be considered fortuitous in character. *(Vergara v. CA, G.R. No. 77679, Sept. 30, 1987)*

Q: Is fire considered a natural disaster?

A: No. This must be so as it arises almost invariably from some act of man or by human means. It does not fall within the category of an act of God unless caused by lightning or by other natural disaster or calamity. It may even be caused by the actual fault or privity of the carrier *(Eastern Shipping Lines v. IAC, G.R. No. L-69044, May 29, 1987).*

Note: In case that the goods have been already deposited in the warehouse of Bureau of Customs then the goods was destroyed by fire, the carrier is not anymore liable *(Sevando vs. Philippine Steam Navigation, G.R. No. L-36481-2, October 23, 1982).*

Q: Is the occurrence of a typhoon a fortuitous event?

A:

GR: Yes, if all the elements of a natural disaster or calamity concur. This holds true especially if the vessel was seaworthy at the time it undertook that fateful voyage and that it was confirmed with the Coast Guard that the weather condition would permit safe travel of the vessel to its destination. *(Philippine American General Insurance Co., Inc. v. MGG Marine Services, Inc., G.R. No. 135645, Mar. 8, 2002)*

XPN: If a vessel sank due to a typhoon, and there was failure to ascertain the direction of the storm and the weather condition of the path they would be traversing, it constitutes lack of foresight and minimum vigilance over its cargoes taking into account the surrounding circumstances of the case. Thus, the common carrier will still be liable. *(Arada v. CA, G.R. No. 98243, July 1, 1992)*

Q: Is a common carrier liable for the acts of strangers or criminals?

A: Yes. A common carrier is liable even for acts of strangers like thieves or robbers.

XPN: where such thieves or robbers acted "with grave or irresistible threat, violence or force." The common carrier is not liable for the value of the undelivered merchandise which was lost because of an event that is beyond his control. *(De Guzman v. CA, G.R. No. L-47822, Dec. 22, 1988)*

Q: Could a hijacking of a common carrier guarded by 4 persons be considered force majeure if only 1 of the 2 hijackers was armed with bladed weapon?

A: No. The hijacking in this case cannot be considered force majeure. The hijackers did not act with grave or irresistible threat, violence or force. **(1995 Bar Question)**

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Q: What are the requisites of absence of negligence?

A:
1. The cause of the breach of obligation must be independent of the will of the debtor
2. The event must be unforeseen or unavoidable
3. The event must be such as to render it impossible for the debtor to fulfil his obligation in a normal manner
4. The debtor must be free from nay participation in or aggravation of the injury to the creditor.

Q: What is the importance of absence of delay?

A: The absence of delay is important in case of natural disaster because if a common carrier incurs in delay in transporting the goods, such disaster shall not free such carriers from responsibility. *(Art. 1740 NCC)*

Q: What are the rules regarding the time of delivery of goods and delay?

A:
1. *If there is an agreement as to time of delivery* – delivery must be within the time stipulated in the contract or bill of lading

2. *If there is no agreement* – delivery must be within a reasonable time. *(Saludo, Jr. v. CA, G.R. No. 95536, Mar. 23, 1992)*

Q: If there is delay in the delivery of goods, what is the liability of the carrier?

A: The carrier shall be liable for damages immediately and proximately resulting from such neglect of duty. *(Saludo, Jr. v. CA, GR No. 95536, Mar. 23, 1992)*

Q: What are the Civil Code provisions regarding delay in the transportation of goods?

A:
1. Those who in the performance of their obligations are guilty of fraud, negligence, or delay, and those who in any manner contravene the tenor thereof, are liable for damages; *(Art. 1170)*

2. If the common carrier negligently incurs in delay in transporting the goods, a natural disaster shall not free such carrier from responsibility; *(Art. 1740)*

3. If the common carrier, without just cause, delays the transportation of the goods or changes the stipulated or usual route, the contract limiting the common carrier's liability cannot be availed of in case of the loss, destruction, or deterioration of the goods; *(Art. 1747)*
4. An agreement limiting the common carrier's liability for delay on account of strikes or riots is valid. *(Art. 1748)*

Q: What are the defenses available to any common carrier to limit or exempt it from liability?

A:
1. Observance of extraordinary diligence; or

2. Proximate cause of the incident mentioned in Art. 1734. **(2001 Bar Question)**

A. CONTRIBUTORY NEGLIGENCE

Q: What is the rule if there is contributory negligence on the part of the shipper?

GR: If the shipper or owner merely contributed to the loss, destruction or deterioration of the goods, the proximate cause thereof being the negligence of the common carrier, the latter shall be liable for damages, which however, shall be equitably reduced. *(Art. 1741)*

XPN: In a collision case and allision cases, the parties are liable for their own damages.

B. DURATION OF LIABILITY

Q: When does the duty to exercise extraordinary diligence start and end with respect to carriage of goods?

A: It lasts from the time the goods are unconditionally placed in the possession of, and received by the carrier for transportation until the same are delivered, actually or constructively, by the carrier to the consignee or to the person who has a right to receive them. *(Art. 1736)*

Q: To whom should delivery be made?

A: It must be delivered, actually or constructively, to the consignee or to the person who has a right to receive them.

Note: Delivery of the cargo to the customs authorities is not delivery to the consignee, or to the person who has a right to receive them. *(Lu Do & Lu Ym Corp. v. Binamira, G.R. No. L-9840, Apr. 22, 1957)*

Q: What is constructive delivery?

A: It is a delivery of a representation of property (as a written instrument) or means of possession (as a key) that is construed by a court as sufficient to show the transferor's intent or to put the property under the transferee's control

Q: What is the right of stoppage *in transitu*?

A: It is the right exercised by the seller by stopping the delivery of the goods to a certain buyer or consignee (because of insolvency) when such goods are already in transit.

Q: What is the rule as to unloading, storage and stoppage *in transitu?*

A:

GR: The common carrier's duty to observe extraordinary diligence in the vigilance over the goods remains in full force and effect even when they are temporarily unloaded or stored in transit.

XPN: When the shipper or owner has made use of the right of stoppage *in transitu.*

Q: What is the diligence required in exercising the right of stoppage *in transitu*?

A: Ordinary diligence because of the following:
1. It is holding the goods in the capacity of an ordinary bailee or warehouseman and not as a carrier;
2. There is a change of contract from a contract of carriage to a contract of deposit;

Note: If the seller instructs to deliver it somewhere else, a new contract of carriage is formed and the carrier must be paid accordingly.

C. STIPULATION FOR LIMITATION OF LIABILITY

Q: Are stipulations limiting the carrier's liability valid?

A: Yes, 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
3. Reasonable, just and not contrary to public policy. *(Art. 1744)*

Q: May a stipulation limiting the common carrier's liability be annulled by the shipper or owner?

A: Yes, if the common carrier refused to carry the goods unless the shipper or owner agreed to such stipulation. However, under this provision, annulment of the agreement limiting the carrier's liability is still necessary. *(Art. 1746)*
Note: There is no need to annull, if the common carrier without just cause:

1. Delays the transportation of the goods; or
2. Changes the stipulated or usual route, the contract limiting the common carrier's liability cannot be availed of in case of loss, destruction, or deterioration of the goods. *(Art. 1747)*

Q: What are some stipulations limiting the liability of common carriers which may be valid?

A:
1. An agreement limiting the common carrier's liability for delay on account of strikes or riots. *(Art. 1748)*

2. A stipulation that the common carrier's liability is limited to the value of the goods appearing in the bill of lading, unless the shipper or owner declares a greater value and pays corresponding freight. *(Art. 1749)*

3. A contract fixing the sum that may be recovered for the loss, destruction, and deterioration of goods is binding provided that it is just and reasonable under the circumstances and it has been fairly and freely agreed upon. *(Art. 1750)*

4. When a passenger is carried gratuitously, a stipulation limiting the common carrier's liability for negligence

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is valid, but not for willful acts or gross negligence. However, the reduction of fare does not justify any limitation of the common carrier's liability. *(Art. 1758)*

Q: What are void stipulations in a contract of carriage of goods?

A:

1. That the goods are transported at the risk of the owner or shipper
2. That the common carrier will not be liable for any loss, destruction, or deterioration of the goods
3. That the common carrier need not observe any diligence in the custody of the goods
4. That the common carrier shall exercise a degree of diligence less than that of a good father of a family, or a man of ordinary prudence in the vigilance over the movables transported
5. That the common carrier shall not be responsible for the acts or omissions of his or its employees
6. That the common carrier's liability for acts committed by thieves, or of robbers who do not act with grave or irresistible threat, violence or force, is dispensed with or diminished
7. That the common carrier is not responsible for the loss, destruction or deterioration of goods on account of the defective condition of the car, vehicle, ship, airplane or other equipment used in the contract of carriage
8. Any similar stipulation that is unreasonable, unjust and contrary to public policy. *(Art. 1745)*

Q: What is the effect of the agreement on limiting the liability to the presumption of negligence of the carrier?

A: Even if there is an agreement limiting the liability of the common carrier in the vigilance over the goods, the common carrier is still disputably presumed to have been negligent in case of its loss, destruction or deterioration. *(Art. 1752)*

Q: When is the limitation of the amount of liability valid?

A: When it is reasonable and just under the circumstances, and has been freely and fairly agreed upon. *(Art.1750)*

Q: Is the liability limited to the value of the goods appearing in the bill of lading when stipulated?

A:

GR: A stipulation that the common carrier's liability is limited to the value of the goods appearing in the bill of lading is binding.

XPN: the shipper or owner declares a greater value and pays corresponding freight. *(Art. 1749).*

D. LIABILITY FOR BAGGAGE OF PASSENGERS

Q: What rule will apply on checked-in baggage of passengers?

A: The provisions of Articles 1733 to 1753 of the Civil Code shall apply.

Q: What rule will apply when the baggage is in the personal custody of the passengers of their employees?

A:

1. The common carrier shall be responsible for shipper's baggage as depositaries, provided that notice was given to them, or to their employees, of the effects brought by the guests and that, on the part of the shipper, they take the precautions which said common carriers or their substitutes advised relative to the care and vigilance of their effects. *(Art. 1998, NCC)*
2. The responsibility shall include the loss of, or injury to the personal property of the shipper caused by the employees of the common carrier as well as strangers; but not that which may proceed from any force majeure. *(Art. 2000, NCC)*
3. The act of a thief or robber, who has entered the carrier is not deemed force

majeure, unless it is done with the use of arms or through an irresistible force. *(Art. 2001, NCC)*

4. The common carrier is not liable for compensation if the loss is due to the acts of the shipper, his family, or servants, or if the loss arises from the character of the things brought into the carrier. *(Art. 2002, NCC)*

5. The common carrier cannot free himself from responsibility by posting notices to the effect that he is not liable for the articles brought by the passenger. Any stipulation between the common carrier and the shipper whereby the responsibility of the former as set forth in Articles 1998 to 2001 is suppressed or diminished shall be void. *(Art. 2003, NCC)*

Q: Could a common carrier be held liable for the loss of a valuable item stolen by other passenger when the victim told the driver that he has valuable item?

A: Yes. Ordinarily, the common carrier is not liable for acts of other passengers. But the common carrier cannot relieve itself from liability if the common carrier's employees could have prevented the act or omission by exercising due diligence. In this case, the passenger asked the driver to keep an eye on the bag which was placed beside the driver's seat. If the driver exercised due diligence, he could have prevented the loss of the bag. **(1997 Bar Question)**

III. SAFETY OF PASSENGERS

A. VOID STIPULATIONS

Q: Are stipulations limiting the common carrier's responsibility for the safety of passengers valid?

A: No. The responsibility of a common carrier for the safety of passengers as required in Articles 1733 and 1755 cannot be dispensed with or lessened by stipulation, by posting of notices, by statements on tickets, or otherwise. *(Art. 1757)*

Q: What is the rule in case of non-paying passengers or if the fare is reduced?

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

However, the reduction of fare does not justify any limitation of the common carrier's liability. *(Art. 1758)*

B. DURATION OF LIABILITY

Q: When does this duty begin to exist?

A: The duty exists from the moment the person offers to be transported places himself in the care and control of the common carrier who accepts him as such passenger. The duty continues until the passenger has, after reaching his destination, safely alighted from the carrier's conveyance or has had a reasonable opportunity to leave the carrier's premises and to look after his baggage and prepare for his departure.

Q: When a Public Utility Vehicle is not in motion, is there a necessity for a person who wants to ride the same to signal his intention to board?

A: No. When the bus is not in motion there is no necessity for a person who wants to ride the same to signal his intention to board. A public utility bus, once it stops, is in effect making a continuous offer to bus riders. Hence, it becomes the duty of the driver and the conductor, every time the bus stops, to do no act that would have the effect of increasing the peril to a passenger while he was attempting to board the same. The premature acceleration of the bus in this case was a breach of such duty. *(Dangwa vs. CA, G.R. No. 95582, October 7, 1991)*

Q: If the bus started moving slowly when the passenger is boarding the same, is the passenger negligent?

A: No. Further, even assuming that the bus was moving, the act of the victim in boarding the same cannot be considered negligent under the circumstances. As clearly explained in the testimony of the aforestated witness for petitioners, Virginia Abalos, the bus had "just started" and "was still in slow motion" at the point where the victim had boarded and was on its platform. *(Dangwa vs. CA, G.R. No. 95582, October 7, 1991)*

Q: What is the duty of the common carriers in boarding of passengers?

A: It is the duty of common carriers of passengers, including common carriers by railroad train, streetcar, or motorbus, to stop their conveyances a reasonable length of time in order

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to afford passengers an opportunity to board and enter, and they are liable for injuries suffered by boarding passengers resulting from the sudden starting up or jerking of their conveyances while they are doing so (Dangwa vs. CA, G.R. No. 95582, October 7, 1991).

Q: Is a person mere stepping on the platform of a bus already considered a passenger?

A: Yes. The person, by stepping and standing on the platform of the bus, is already considered a passenger and is entitled all the rights and protection pertaining to such a contractual relation. Hence, it has been held that the duty which the carrier owes to its patrons extends to persons boarding cars as well as to those alighting therefrom *(Dangwa vs. CA, G.R. No. 95582, October 7, 1991).*

Q: Robert De Alban and his family rode a bus owned by Joeben Bus Company. Upon reaching their desired destination, they alighted from the bus but Robert returned to get their baggage. However, his youngest daughter followed him without his knowledge. When he stepped into the bus again, the bus accelerated that resulting to Robert's daughter death. The bus ran over her. Is the bus company liable?

A: Yes. The relation of carrier and passenger does not cease at the moment the passenger alights from the carrier's vehicle at a place selected by the carrier at the point of destination, but continues until the passenger has had a reasonable time or reasonable opportunity to leave the current premises (*La Mallorca vs. CA, GR L-20761*, *27 July 1966*).

C. LIABILITY FOR ACTS OF OTHERS

Q: Are common carriers liable for acts of its employees?

A: Common carriers are liable for the death of or injuries to passengers through the negligence or willful acts of the former's employees, although such employees may have acted beyond the scope of their authority or in violation of the orders of the common carriers.
The liability of the common carriers does not cease upon proof that they exercised all the diligence of a good father of a family in the selection and supervision of their employees. *(Art. 1759)*

Q: What is the rationale behind this principle?

A: The basis of the carrier's liability for assaults on passengers committed by its drivers rests on the principle that it is the carrier's implied duty to transport the passenger safely. As between the carrier and the passenger, the former must bear the risk of wrongful acts or negligence of the carrier's employees against passengers, since it, and not the passengers, has power to select and remove them. *(Maranan v. Perez, G.R. No. L-22272, June 26, 1967)*

Q: What is the extent of liability of common carriers for acts of co-passengers or strangers?

A: A common carrier is responsible for injuries suffered by a passenger on account of the willful acts or negligence of other passengers or of strangers, if the carrier's employees through the exercise of the diligence of a good father of a family would have prevented or stopped the act or omission. (Art. 1763)

Q: In a jeepney, Angela, a passenger, was injured because of the flammable material brought by Antonette, another passenger. Antonette denied his baggage to be inspected invoking her right to privacy. Should the jeepney operator be held liable for damages?

A: No. The operator is not liable for damages. In overland transportation, the common carrier is not bound nor empowered to make an examination on the contents of packages or bags, particularly those handcarried by passengers. *(Nocum v. Laguna Tayabas Bus Company, G.R. No. L-23733, Oct. 31, 1969)*

Q: In the question above, if it were an airline company involved, would your answer be the same?

A: No. The common carrier should be made liable. In case of air carriers, it is unlawful to carry flammable materials in passenger aircrafts, and airline companies may open and investigate suspicious packages and cargoes pursuant to R.A. 6235. **(1992 Bar Question)**

Q: A passenger was injured because a bystander outside the bus hurled a stone. Is the bus company liable?

A: No. There is no showing that any such incident previously happened so as to impose an obligation on the part of the personnel of the bus company to warn the passengers and to take the necessary precaution. Such hurling of a stone

constitutes fortuitous event in this case. The bus company is not an insurer of the absolute safety of its passengers. *(Pilapil v. CA, G.R. No. 52159, Dec. 22, 1989)* **(1994 Bar Question)**

D. EXTENT OF LIABILITY FOR DAMAGES

Q: Who are not considered passengers?

A:

1. One who remains on a carrier for an unreasonable length of time after he has been afforded every safe opportunity to alight
2. One who has boarded by fraud, stealth, or deceit
3. One who attempts to board a moving vehicle, although he has a ticket, unless the attempt be with the knowledge and consent of the carrier
4. One who has boarded a wrong vehicle, has been properly informed of such fact, and on alighting, is injured by the carrier
5. Invited guests and accommodation passengers

Note: The carrier is thus not obliged to exercise extraordinary diligence but only ordinary diligence in these instances.

Q: May a common carrier be held liable to a passenger who was injured and eventually died while trying to board the vehicle?

A: Yes. It is the duty of common carriers of passengers to afford passengers an opportunity to board and enter, and they are liable for injuries suffered by boarding passengers resulting from the sudden starting up or jerking of their conveyances while they are doing so. The victim, by stepping and standing on the platform of the bus, is already considered a passenger and is entitled all the rights and protection pertaining to such a contractual relation. *(Dangwa Transportation Co., Inc. v. CA, G.R. No. 95582, Oct. 7, 1991)*

Q: Is the victim's presence in a vessel after 1 hour from his disembarkation was no longer reasonable and he consequently ceased to be a passenger?

A: No. Carrier-passenger relationship continues until the passenger has been landed at the port of destination and has left the vessel-owner's premises *(Aboitiz Shipping Corporation vs. CA, GR No. 84458, November 6, 1989)*

Q: What is the rule in case of non-paying passengers or if the fare is reduced?

A: When a passenger is carried gratuitously, a stipulation limiting the common carrier's liability for negligence is valid, but not for willful acts or gross negligence. However, the reduction of fare does not justify any limitation of the common carrier's liability *(Art. 1758).*

Q: What is assumption of risk on the part of passengers?

A: Passengers must take such risks incident to the mode of travel.

Note: Carriers are not insurers of any and all risks to passengers and goods. It merely undertakes to perform certain duties to the public as the law imposes, and holds itself liable for any breach thereof. *(Pilapil v. CA, G.R. No. 52159, Dec. 22, 1989)*

Q: Is a carrier liable to its passengers for damages caused by mechanical defects of equipments or appliances installed in the carrier?

A: Yes, whenever it appears that the defect would have been discovered by the carrier if it had exercised the degree of care which under the circumstances was incumbent upon it, with regard to inspection and application of the necessary tests. The manufacturer is considered as being in law the agent or servant of the carrier, as far as regards the work of constructing the appliance. The good repute of the manufacturer will not relieve the carrier from liability.

The rationale of the carrier's liability is the fact that the passenger has neither choice nor control over the carrier in the selection and use of the equipment and appliances in use by the carrier. Having no privity whatever with the manufacturer or vendor of the defective equipment, the passenger has no remedy against him, while the carrier usually has. It is but logical, therefore, that the carrier, while not in insurer of the safety of his passengers, should nevertheless be held to answer for the flaws of his equipment if such flaws were at all discoverable. *(Necesito v. Paras, G.R. No. L-10605, June 30, 1958)*

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Q: Should the diligence of the passenger be considered in determining liability in case of injury?

A: Yes. The passenger must observe the diligence of a good father of a family or ordinary diligence to avoid injury to himself *(Art. 1761)*. This means that if the proximate cause of the passenger's injury is his negligence, the common carrier is not liable.

Q: Who has the burden of proof in cases of contributory negligence?

A: The common carrier since it will benefit from such mitigated liability.

Q: May the registered owner of the vehicle be held liable for damages suffered by a third person in the course of the operation of the vehicle?

A: Yes. The registered owner of a public service vehicle is responsible for damages that may arise from consequences incident to its operation or that may be caused to any of the passengers therein *(Gelisan v. Alday, G.R. No. L-30212, Sept 30, 1987).* Also, the liability of the registered owner of a public service vehicle for damages arising from the tortious acts of the driver is primary, direct, and joint and several or solidary with the driver. *(Philtranco Service Enterprises, Inc. v. CA, G.R. No. 120553)*

IV. BILL OF LADING

Q: What is a bill of lading?

A: It is a written acknowledgement of receipt of goods and agreement to transport them to a specific place and to a named person or to his order.

Q: What is the two-fold character of a bill of lading?

A: A bill of lading operates both as a receipt and as a contract. It is a receipt for the goods shipped and a contract to transport and deliver the same as therein stipulated. As a receipt, it recites the date and place of shipment, describes the goods as to quantity, weight, dimensions, identification marks and condition, quality, and value. As a contract, it names the contracting parties, which include the consignee, fixes the route, destination, and freight rate or charges, and stipulates the rights and obligations assumed by the parties. *(Phoenix Assurance Co., Ltd. v. United States Lines, G.R. No. L-24033, Feb. 22, 1968)*

Q: What are the three functions of Bill of Lading?

A:

1. It is a receipt for the goods shipped
2. It is a contract by which the three parties namely the shipper, carrier and consignee undertake specific responsibilities and assume stipulated obligations; and
3. It is a legal evidence of the contract between the shipper and the carrier. As evidence, its contents shall decide all disputes which may arise with regard to their execution and fulfillment.

NOTE: In the absence of a bill of lading, their respective claims may be determined by legal proofs which each of the contracting parties may present in conformity with law.

Q: What are the two types of bill of lading?

A:

1. *Negotiable* – If issued to the bearer or to the order of any person named in such bill.
2. *Non-negotiable* – If issued to a specific person named in such bill.

Q: What is the period of delivery of goods?

A: If a period has been fixed for the delivery of the goods, it must be made within such time, and, for failure to do so, the carrier shall pay the indemnity stipulated in the bill of lading, neither the shipper nor the consignee being entitled to anything else (Art. 370, Code of Commerce).

Q: If indemnity is not stipulated, how will it be determined?

A: If no indemnity has been stipulated and the delay exceeds the time fixed in the bill of lading, the carrier shall be liable for the damages which the delay may have caused. (*Art. 370, Code of Commerce)*

Q: What is the duty of the carrier if there is no period of time fixed for the delivery of goods?

A: The carrier shall be under the obligation to forward them with the first shipment of the same or similar merchandise he may make to the point where he must deliver them, and should he not do so, the damages occasioned by the delay shall be suffered by him. *(Art. 358)*

Q: Is the surrender of the bill of lading necessary upon delivery of the goods?

A: Yes. If the carrier fails to require such surrender:

1. *If non-negotiable* – Action against the carrier does not lie.

2. *If negotiable* – Action by the shipper may lie against the carrier

Q: When could a consignee refuse to take delivery of goods?

A:
1. When a part of the goods transported are delivered and the consignee is able to prove that he cannot make use of the part without the others; *(Art. 365)*
2. If the goods are damaged and such damage renders the goods useless for the particular purpose for which there are to be used; *(Art. 365)*
3. When there is delay on account of the fault of the carrier; *(Art. 371)* or
4. If the cargo consists of liquids and they have leaked out, nothing remaining in the containers but one-fourth (¼) of their contents, on account of inherent defect of cargo. *(Art. 687)*

Note: In all cases, the shipper may exercise the right of abandonment by notifying the carrier. Ownership over damaged goods passes to the carrier and carrier must pay shipper the market value of the goods at point of destination.

Q: What is the period for filling claims?

A:
1. *Immediately after delivery* – if the damage is apparent; or
2. *Within 24 hours from delivery* – If the damage is not apparent. (Art. 366, Code of Commerce)

Q: When does Article 366 of the Code of Commerce apply?

A: It applies in case of domestic transportation (inter-island) where there is damage to the goods transported.

Q: What are the requisites before claim for damages under Art. 366 may be demanded?

A:
1. Consignment of goods through a common carrier, by a consignor in one place to a consignee in another place; and
2. The delivery of the merchandise by the carrier to the consignee at the place of destination *(New Zealand Ins. Co., Ltd. v. Choa Joy, G.R. No. L-7311, Sept. 30, 1955).*

Q: What is the effect of paying the transportation charges in the filing of an action on account of damages to goods?

A:
1. *If paid before checking the goods* – The right to file a claim is not waived.

2. *If paid after the goods were checked* – The right to file a claim is already waived *(Southern Lines, Inc. v. CA, G.R. No. L-16629, Jan. 31, 1962).*

Note: The filing of claim is a condition precedent for recovery of damages.

Q: What is the doctrine of Combined or Connecting Services?

A: The carrier which delivered the goods to the consignee shall assume the obligations, rights and actions of those who preceded him in the conveyance of the goods.

The shipper or consignee should proceed against the one who executed the contract or against the others who received the goods without reservation. But even if there is reservation, they are not exempted from liabilities that they may have incurred by reason of their own acts *(Art. 373, Code of Commerce).*

The carrier may then file a third-party complaint against the one who is really responsible. The carrier is an indispensible party. But the shipper or consignee may sue all of them as alternative defendants.

Q: What is the period for filing actions?

A: It shall prescribe eight days after the delivery has been made, and once prescribed, the carrier shall have no other action than that corresponding to him as an ordinary creditor (Art. 375, Code of Commerce).

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V. MARITIME COMMERCE

A. CHARTER PARTIES

Q: What is a charter party contract?

A: A contract whereby the whole or part of the ship is let by the owner to a merchant or other person for a specified time or use for the conveyance of goods, in consideration of the payment of freight. *(Caltex v. Sulpicio Lines, G.R. No. 131166, Sept. 30, 1999)*

Q: What are the classes of charter party?

A:

1. *Bareboat or demise* – the ship owner gives possession of the entire vessel to the charterer. In turn, the charterer supplies, equips, and mans the vessel. The charterer is the owner *pro hac vice*.

2. *Contract of affreightment* – the owner of the vessel leases a part or all of its space to haul goods for others. It can either be:

   a. *Time charter* – Vessel is chartered for a particular time or duration. While the ship owner still retains possession and control of the vessel, the charterer has the right to use all vessel's facilities. The charterer may likewise designate vessel's destination.

   b. *Voyage charter* – Vessel is chartered for a particular voyage or series of voyages.

Q: What is a voyage charter?

A: A voyage charter is a contract wherein the ship was leased for a single voyage for the conveyance of goods, in consideration of the payment of freight. The shipowner retains the possession, command and navigation of the ship, the charterer merely having use of the space in the vessel in return for his payment of freight. An owner who retains possession of the ship remains liable as carrier and must answer for loss or non-delivery of the goods received for transportation. *(Cebu Salvage Corp. vs. Philippine Home Assurance Corp., G.R. No. 150403, Jan. 25, 2007)*

Note: The same concept applies to a time charter.

Q: What are the distinctions between a bareboat or demise charter party from contracts of affreightment?

A:

BAREBOAT/DEMISE CHARTER CONTRACT	CONTRACT OF AFFREIGHTMENT
Negligence of the charterer gives rise to its liability to others.	Ship owner remains liable and carrier must answer for any breach of duty.
Charterer is regarded as owner *pro hac vice*. Ship owner temporarily relinquishes possession and ownership of the vessel.	Charterer is not regarded as owner. Ship owner retains ownership over the vessel. *(Coastwise Lighterage v. CA, G.R. No. 114167, July 12, 1995)*

Q: What is meant by owner *pro hac vice*?

A: The charterer is considered the owner of the vessel for the voyage or service stipulated. The charterer and not theowner of the vessel is liable for vessel's expenses, including seaman's wages.

Q: What are the instances when a charter party may be rescinded?

A:

1. At the request of the charterer:
   a. By abandoning the charter and paying half the price
   b. Error in tonnage or flag
   c. Failure to place vessel at charterer's disposal
   d. Return the vessel due to pirates, enemies, and bad weather
   e. *Arrival at port for repairs* - if repairs take less than 30 days, pay full freightage; if more than, freightage in proportion to the distance covered.

2. At the request of the ship owner:
   a. If extra lay days terminate without the cargo being placed alongside vessel; and
   b. Sale by the owner of the vessel before loading by the charterer.

3. Due to fortuitous event:
   a. *War* – There is a governmental prohibition of commercial intercourse, intended to bring about an entire cessation for the time being of all trade whatever

b. *Blockade* – A sort of circumvallation around a place by which all foreign connection and correspondence is, as far as human power can effect it, to be cut off

c. Prohibition to receive cargo at port of destination

d. *Embargo* – A proclamation or order of State, usually issued in times of war or threatened hostilities, prohibiting the departure of ships or goods from some or all the ports of such State until further order; or

e. Inability of the vessel to navigate. *(Art. 640)*

B. LIABILITY OF SHIPOWNERS AND SHIPPING AGENTS

Q: What is the three-fold character of the captain?

A:

1. General agent of the ship owner
2. Vessel's technical director
3. Government representative of the flag he navigates under

Q: What are the inherent powers of the ship captain?

A:

1. To appoint or make contracts with the crew in the ship agent's absence, and to propose said crew, should said agent be present; but the ship agent may not 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 ship agent

3. To impose correctional punishment:
   a. Upon those who fail to comply with orders; or
   b. Those wanting in discipline

4. To make contracts for the charter of the vessel in the absence of the ship agent or of its consignee

5. To adopt all proper measures to keep the vessel well supplied and equipped, purchasing all that may be necessary for the purpose, provided there is no time to request instruction from the ship agent

6. To order, in similar urgent cases while on a voyage, the repairs on the hull and engines of the vessel and in its rigging and equipment, which are absolutely necessary to enable it to continue and finish its voyage. *(Art. 610)*

Q: What are the obligations of the captain?

A:

1. Inventory of equipment
2. Keep a copy of Code of Commerce on board
3. Have a log book, freight book, accounting book
4. Conduct a marine survey of vessel before loading
5. Remain on board while loading
6. Demand pilot on departure and on arrival at each port
7. Be on deck when sighting land
8. Arrivals under stress: to file marine protest in 24 hours
9. Record bottomry loan with Bureau of Customs
10. Keep papers and properties of crew members who might die
11. Conduct himself according to the instuctions of the ship agent
12. Report to ship agent on arrival
13. Observe rules on the situation of lights and maneuvers to prevent collisions
14. Remain on board until the last hope to save the vessel is lost and to abide by the decision of the majority whether to abandon or not
15. In case of shipwreck: file marine protest, within 24 hours
16. Comply with rules and regulation on navigation. *(Art. 612)*

Q: In what cases shall the ship owner/agent be liable to the damages caused by the captain?

A:

1. Damages suffered by the vessel and its cargo by reason of want of skill or negligence on his part
2. Thefts committed by the crew, reserving his right of action against the guilty parties;

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3. Losses, fines, and confiscations imposed an account of violation of customs, police, health, and navigation laws and regulations;
4. 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 timely use of all his authority to prevent or avoid them;
5. Those caused by the misuse of the powers;
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. No exceptions whatsoever shall exempt him from this obligation;
7. For those arising by reason of his voluntarily entering a port other than that of his destination, outside of the cases or without the formalities referred to in Article 612; and
8. For those arising by reason of non-observance of the provisions contained in the regulations on situation of lights and manoeuvres for the purpose of preventing collisions *(Art. 618).*

Note: Ship owner/agent is not liable for the obligations contracted by the captain if the latter exceeds his powers and privileges inherent in his position of those which may have been conferred upon him by the former. However, if the amount claimed were used for the benefit of the vessel, the ship owner or ship agent is liable.

Q: In what causes shall the captain be not liable for loss or injury to persons or cargo?

A:
1. *Force majeure*
2. Obligations contracted for the vessel's benefit, except when the captain expressly agrees to be liable.

Q: May the captain have himself substituted by another?

A: No, in the absence of consent from the ship agent, and should he do so he shall be liable for all the acts of the substitute. *(Art. 615)*

Q: When may the captain and crew members rescind their contractual employment?

A: In case of:
1. War
2. Change of destination
3. Outbreak of disease
4. New owner of vessel. *(Art. 647)*

Q: Who is the shipowner of a vessel?

A: The person in possession, management, control over the vessel, and the right to direct her navigation. While in their possession, the ship owners also receive freight earned and paid.

Q: Who is a ship agent?

A: The person entrusted with provisioning or representing the vessel in the port in which it may be found. Hence, whether acting as agent of the owner of the vessel or as agent of the charterer, he will be considered as the ship agent and may be held liable as such, as long as he is the one that provisions or represents the vessel. *(Macondray & Co., Inc. v. Provident Insurance Corp, G.R. No. 154305, Dec. 9, 2004)*

Q: What are the civil liabilities of ship owners and agents?

A:
1. Damages suffered by a 3rd person for tort committed by the captain;
2. Contracts entered for provisioning and repair of vessel;
3. Indemnities in favor of 3rd persons arising from the conduct of the captain from the care of goods; and
4. Damages in case of collision due to fault or negligence or want of skill of the captain.

Q: What are the powers, functions, and liabilities of ship agents?

A:
1. Indemnity for expenses incurred for ship's benefit.
2. Discharge of captain and/or crew members. The following are the rules observed by the ship agent:
    a. Captain and/or crew member's contract not for a definite period or voyage:

        i. *Before vessel sets out to sea:* Ship agent at his discretion may discharge the captain and members of the crew. Ship agent must pay captain and/or

crew members salaries earned according to their contracts, and without any indemnity whatsoever, unless there is an expressed agreement;

ii. *During voyage:* Captain and/or crew member shall receive salary until return to the port where contract was made. Article 637 of the Code of Commerce enumerates the just causes for discharge.

b. Where captain and members of the crew's contracts with ship agent be for a definite period or voyage:

i. Captain and/or crew members may not be discharged until after the fulfillment of their contracts, *except* by reason of insubordination in serious matters, robbery, theft, habitual drunkenness, or damage caused to the vessel or to its cargo through malice or manifest or proven negligence. *(Art. 605, Code of Commerce)*

ii. If the captain should be the vessel's co-owner, he may not be discharged unless ship agent returns his amount of interest therein. In the absence of agreement between the parties, interest shall be appraised by experts appointed in the manner established by civil procedure.

Q: What is the *Doctrine of Limited Liability*?

A: Also called the "no vessel, no liability doctrine," it provides that liability of ship owner is limited to ship owner's interest over the vessel. Consequently, in case of loss, the ship owner's liability is also extinguished. Limited liability likewise extends to ship's appurtenances, equipment, freightage, and insurance proceeds. The ship owner's or agent's liability is merely co-extensive with his interest in the vessel, such that a total loss of the vessel results in the liability's extinction. The vessel's total destruction extinguishes maritime liens because there is no longer any *res* to which they can attach. *(Monarch Insurance v. CA, G.R. No. 92735, June 8, 2000)*

Q: What is the rationale of this doctrine?

A: To offset against innumerable hazards and perils in sea voyage and to encourage ship building and maritime commerce. By abandonment, the ship owner and ship agent exempt themselves from liability, thus avoiding the possibility of risking his whole fortune in the business *(Real and hypothecary nature of Maritime Law)*

Q: What are the cases in which the doctrine of limited liability is allowed?

A:

1. Civil liability of the ship agent or shipowner for the indemnities in favor of third persons; *(Art. 587)*
2. Civil liability of the co-owners of the vessel for the results of the acts of the captain; *(Art. 590)*
3. If the vessel and her cargo be totally lost, by reason of capture or shipwreck, all the rights shall be extinguished, both as regards the right of the crew to demand wages and the right of the ship agent to recover the advances made; *(Art. 643) or*
4. Extinction of civil liability incurred by the shipowner or agent in cases of maritime collisions. *(Art. 837)*

Q: What are the exceptions to the doctrine of limited liability?

A:

1. Repairs and provisioning of the vessel before the loss of the vessel; *(Art. 586)*

2. Insurance proceeds. If the vessel is insured, the proceeds will go to the persons entitled to claim from the shipowner; *(Vasquez v. CA, G.R. No. L-42926, Sept. 13, 1985)*

3. Workmen's Compensation cases (now Employees' Compensation under the Labor Code); *(Oching v. San Diego, G.R. No. 775, Dec. 17, 1946)*

4. When the shipowner is guilty of fault or negligence;

   Note: But if the captain is the one who is guilty, doctrine may still be invoked, hence, abandonment is still an option.

5. Private carrier; or

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6. Voyage is not maritime in character.

Q: If a vessel was insured, may the claimants go after the insurance proceeds?

A. Yes. In case of a lost vessel, the claimants may go after the proceeds of the insurance covering the vessel. **(1999 Bar Question)**

Q: Does the total destruction of the vessel affect the liability of the ship owner for repairs on the vessel completed before its loss?

A: No. **(2000 Bar Question)**

C. ACCIDENTS AND DAMAGES IN MARITIME COMMERCE

Q: What are the accidents in maritime commerce?

A:

1. Averages
2. Arrival under stress
3. Collision
4. Shipwreck

Q: What are averages?

A: All extraordinary or accidental expenses which may be incurred during the voyage for the preservation of the vessel or cargo or both.

Q: What are the kinds of averages?

A:

1. *General average* – Damages or expenses deliberately caused in order to save the vessel, its cargo or both from real and known risk.

2. *Particular average* – Damages or expenses caused to the vessel or cargo that did not inure to the common benefit, and borne by respective owners.

Q: What are the requisites for general average?

A:

1. Common danger present;
2. Deliberate sacrifice of part of the vessel or cargo;
3. Successful saving of vessel and/or cargo; and
4. Proper procedure and legal steps.

Q: Who shall be liable for the amount of the general averages?

A: All persons having an interest in the vessel and cargo therein at the time of the occurrence of the average shall contribute. *(Art. 812)*

Q: Who shall be liable for the amount of the particular averages?

A: The owner of the things which gave rise to the expenses or suffered the damage shall bear the simple or particular averages *(Art. 810).*

Q: What are the distinctions between general average and particular average?

A:

GENERAL AVERAGE	PARTICULAR AVERAGE
Both the ship and cargo are subject to the same danger	No common danger to both the vessel and the cargo
There is a deliberate sacrifice of part of the vessel, cargo, or both	Expenses and damages are not deliberately made
Damage or expenses incurred to the vessel, its cargo, or both, redounded to the benefit of the respective owners.	Did not inure to common benefit and profit of all persons interested in the vessel and her cargo.
All those who have benefited shall satisfy the average.	Only the owner of the goods benefiting from the damage shall bear the expense of average.

Q: What are goods not covered by general average even if not sacrificed?

A:

1. Goods not recorded in the books or records of the vessel *(Art. 855[2])*

2. Fuel for the vessel if there is more than sufficient fuel for the voyage *(Rule IX, York-Antwerp Rule)*

Q: What is jettison?

A: Act of throwing overboard part of a vessel's cargo or hull in hopes of saving a ship from sinking.

Q: What is the order of goods to be cast overboard in case of jettison?

A:

1. Those on deck, preferring the bigger bulk with least value**.**

2. Those below upper deck, beginning with the heaviest with least utility.

Q: Distinguish between overseas and inter-island trade regarding reimbursement and payment of general averages on jettisoned deck cargo.

A:

1. In case of overseas trade, the York-Antwerp Rules prohibit the loading of cargo on deck. In case such cargo is jettisoned, the owner will not be entitled to reimbursement in view of the violation. If the cargo were saved, the owner must contribute to general average.
2. In case of interisland trade, the York-Antwerp Rules allow deck cargo. If the cargo loaded on deck is jettisoned as a result of which the vessel was saved, the cargo owner is entitled to reimbursement. If the cargo is saved, the cargo owner must contribute to the general average.

Reason: In interisland trade, voyages are usually short and there are intervening islands and the seas are generally not rough. In overseas trade, the vessel is exposed for many days to the peril of the sea making deck cargo is dangerous to navigation.

Q: What is collision?

A: It is the impact of two moving vessels.

Q: What is allision?

A: It is the impact between a moving vessel and a stationary one.

Q: What are the zones of time in the collision of vessel?

A:

1. *First zone* – all time up to the moment when risk of collision begins.

   Note: One vessel is a privileged vessel and the other is a vessel required to take action to avoid collision.

2. *Second zone* – time between moment when risk of collision begins and moment it becomes practically a certainty.

   Note: In this zone, the conduct of the vessels are primordial. It is in this zone that vessels must observe nautical rules, unless a departure therefrom becomes necessary to avoid imminent danger. The vessel which does not make such strict observance is liable.

3. *Third Zone* – time when collision is certain and up to the time of impact.
   Note: An error at this point no longer bears any consequence.

Q: What is an *error in extremis*?

A: The sudden movement made by a faultless vessel during the third zone of collision with another vessel which is at fault under the second zone. Even if sudden movement is wrong, no responsibility will fall on the faultless vessel.

Q: What are the rules governing liabilities of parties in case of collision?

A:

1. *One vessel at fault* – The ship owner of such vessel shall be liable for all resulting damages.

2. *Both vessels at fault* – Each vessel shall suffer their respective losses but as regards the owners of the cargoes, both vessels shall be jointly and severally liable.

3. *Vessel at fault not known* – Each vessel shall suffer its own losses and both shall be solidarily liable for loses or damages on the cargo. (Doctrine of Inscrutable Fault).

4. *Fortuitous event* – Each shall bear its own damage.

5. *Third vessel at fault* – The third vessel shall be liable for losses and damages sustained.

Q: What is the role of a "protest" with respect to collisions?

A: The action for recovery of damages arising from collisions cannot be admitted if a protest or declaration is not presented within twenty-four hours before the competent authority of the point where the collision took place, or that of the first port of arrival of the vessel, if in Philippine territory, and to the Filipino consul if it occurred in a foreign country *(Art. 835).*

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Note: Failure to make a protest is not an impediment to the maintenance of a civil action based on quasi-delict.

Q: When is a protest required?

A:

1. Arrival under stress; *(Art. 612 [8])*
2. Shipwreck; *(Arts. 601 [15], 843)*
3. If the vessel has gone through a hurricane or where the captain believes that the cargo has suffered damages or averages; *(Art. 642)* and
4. Maritime collision. *(Art. 835)*

Q: Who can file a maritime protest?

A:

1. In case of maritime collision, the passenger or other persons interested who may be on board the vessel or who were in a condition who can make known their wishes *(Arts. 835-836)* or the captain himself. *(Verzosa and Ruiz v. Lim*, G.R. *No. 20145, Nov. 15, 1923)*

2. The captain in cases of:
   a. Arrival under stress
   b. Shipwreck; or
   c. If the vessel has gone through a hurricane or where the captain believes that the cargo has suffered damages or averages.

Q: Two vessels figured in a collision resulting in considerable loss of cargo. The damaged vessels were safely conducted to a port. Kim, a passenger and Ruby, a shipper who suffered damage to his cargo, did not file maritime protest. Can Kim and Ruby successfully maintain an action to recover losses and damages arising from the collision?

A: Ruby, the shipper can successfully maintain an action to recover losses and damages arising from the collision notwithstanding his failure to file a maritime protest since the filing thereof is required only on the part of Kim, who, being a passenger of the vessel at the time of the collision, was expected to know the circumstances of the collision. Kim's failure to file a maritime protest will therefore prevent him from successfully maintaining an action to recover his losses and damages. *(Art 836)*.**(2007 Bar Question)**

Q: During a typhoon, vessel SS Anna collided with M/V Joanna. The collision would be avoided if the captain of SS Anna was not drunk and the captain of SS Joanna was not asleep. Who should bear the damages to the vessels and their cargoes?

A: The ship owners of SS Anna and M/V Joanna shall each bear their respective loss of vessels. For the losses and damages suffered by their cargoes, both ship owners are solidarily liable. **(1998 Bar Question)**

Q: What is a shipwreck?

A: The loss of the vessel at sea as a consequence of its grounding, or running against an object in sea or on the coast. If the wreck was due to malice, negligence, or lack of skill of the captain, the owner of the vessel may demand indemnity from said captain.

Q: Who shall bear the losses in shipwreck?

A:

GR: The loss of a ship and her cargo shall fall upon their respective owners. *(Art. 840)*

XPN: If the wreck was due to malice, negligence, or lack of skill of the captain, or because the vessel put to sea was insufficiently repaired and equipped, the ship agent or the shippers may demand indemnity from the captain for the damage caused to the vessel or to the cargo by the accident. *(Art. 841)*

Q: What is arrival under stress?

A: It is the arrival of a vessel at the nearest and most convenient port, if during the voyage the vessel cannot continue the trip 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 it to navigate. *(Art. 819)*

Note: In arrival under stress, the captain must file a Protest which is merely a disclaimer for the shipowner not to be liable.

Q: When is arrival under stress unlawful?

A:

1. Lack of provisions is due to negligence to carry according to usage and customs
2. Risk of enemy not well known of manifest
3. Defect of vessel is due to improper repair; or
4. Malice, negligence, lack of foresight or skill of captain. *(Art. 820)*

D. CARRIAGE OF GOODS BY SEA ACT

Q: When will COGSA apply?

A: It will only be applied in terms of loss or damage of goods transported to and from Philippine ports in foreign trade. It may also apply to domestic trade when there is a paramount clause in the contract.

Q: What cases are covered under the COGSA?

A: It applies only in case of loss or damage, and not to misdelivery or conversion of goods. *(Ang v. American Steamship Agencies, Inc., G.R. No. L-22491, Jan. 27, 2967)*

Also, the deterioration of goods due to delay in their transportation constitutes "loss" or "damage" within the meaning of Sec. 3(6) of COGSA. *(Mitsui O.S.K. Lines Ltd. v. CA, G.R. No. 119571, Mar. 11, 1998)*

Q: When should notice be filed in case of damage to goods under the COGSA?

A:

1. If the *damage is apparent* – Notice must be immediately given. The notice may either be in writing or orally.

2. If the *damage is not apparent* – Notice must be given within 3 days after delivery.

Q: What is the consequence if no notice was filed?

A: There is no consequence on the right to bring suit if no notice is filed unlike under the Code of Commerce. It only gives rise to a presumption that the goods are delivered in the same condition as they are shipped.

There is also no consequence if the transportation charges and expenses are paid unlike under the Code of Commerce.

Q: Clause 18 of the bill of lading provides that the owner should not be liable for loss or damage of cargo unless written notice thereof was given to the carrier within 30 days after receipt of the goods. However, Section 3 of the Carriage of Goods by Sea Act provides that even if a notice of loss or damage is not given as required, "that fact shall not affect or prejudice the right of the shipper to bring suit within one year after the delivery of the goods." Which of these two provisions should prevail?

A: Clause 18 must of necessity yield to the provisions of the Carriage of Goods by Sea Act in view of the proviso contained in the same Act which says: "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 or lessening such liability otherwise than as provided in this Act, shall be null and void and of no effect." *(Sec. 3)* This means that a carrier cannot limit its liability in a manner contrary to what is provided for in said Act, and so clause 18 of the bill of lading must of necessity be null and void. *(E. E. Elser, Inc. v. CA, G.R. No. L-6517, Nov. 29, 1954)*

Q: When should suits for loss or damage of cargo be brought?

A: The suit should be brought within one year from:

1. Delivery of the goods, in case of damage; or
2. The date when the goods should have been delivered, in case of loss.

Q: To whom should such delivery be made as basis of the computation of the one-year period?

A: The one-year period is computed from the delivery of goods to the operator and not to the consignee.

Q: What instances do the one-year period apply?

A:

1. Amendment of pleadings for lack of jurisdiction
2. Filing of third party complaint
3. Loss or damage to cargo, excluding delay or misdelivery
4. Subrogation. *(Art 2207, NCC)*

Q: When is the one year period in the COGSA interrupted?

A:

1. When an action is filed in court; or
2. When there's a contrary agreement between the parties

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Q: Is Art. 1155 of the Civil Code providing that the prescription of actions is interrupted by the making of an extrajudicial written demand by the creditor applicable also to actions brought under the COGSA?

A: No, written claims does not toll the running of the one-year prescriptive period under the COGSA. *(Dole Philippines, Inc. v. Maritime Company of the Philippines*, *G.R. No. L-61352, Feb. 27, 1987)*

Q: Who are the persons who can give notice to, and bring suit against the carrier?

A:

1. The shipper
2. The consignee; or
3. Any legal holder of the bill of lading like the indorsee, subrogee, or the insurer of the goods. *(Kuy v. Everett Steamship Corporation*, *G.R. No. L-5554, May 27, 1953)*

Q: Does the one-year prescriptive period within which to file a case against the carrier also apply to a claim filed by an insurer who stands as a subrogee to the insured?

A: Yes, it includes the insurer of goods. Also, whether the insurer files a third party complaint or maintains an independent action is of no moment *(Filipino Merchants Insurance Co., Inc. v. Alejandro, G.R. No. L-54140, Oct. 14, 1986).*

Note*:* The ruling in the above-cited case should apply only to suits against the carrier filed either by the shipper, the consignee or the insurer, not to suits by the insured against the insurer. The basis of the insurer's liability is the insurance contract and such claim prescribes in 10 years, in accordance with Art. 1144 of the Civil Code. *(Mayer Steel Pipe Corporation v. CA, G.R. No. 124050, June 19, 1997)*

Q: What is the prescriptive period in case of misdelivery and conversion of goods?

A: In case of misdelivery or conversion, the proper periods are:

1. If there is a written contract – 10 years *(Art. 1144, Civil Code)*
2. Oral contract – 6 years *(Art. 1145)*
3. For quasi-delict – 4 years *(Art. 1146)*

Q: What is the amount of the carrier's liability under the COGSA?

A:

1. The liability limit is set at $500 per package or customary freight unless the nature and value of such goods is declared by the shipper.
2. Shipper and carrier may agree on another maximum amount, but not more than amount of damage actually sustained.

Note: When the packages are shipped in a container supplied by carrier and the number of such units is stated in the bill of lading, each unit and not the container constitute the "package".

Q: What are the instances where there is no liability under COGSA?

A:

1. if the nature or value of goods knowingly and fraudulently misstated by shipper
2. if damage resulted from dangerous nature of shipment loaded without consent of carrier
3. if unseaworthiness not due to negligence
4. if deviation was to save life or property at sea.

VI. PUBLIC SERVICE ACT

A. DEFINITION OF PUBLIC UTILITY

Q: What is a public utility?

A: A business or service engaged in regularly supplying the public with some commodity or service of public consequence sush as electricity, gas, water, transportation, telephone or telegraph service.

Q: What is a public service?

A: Every person that may own, operate, manage, control in the Philippines, for hire/compensation, with general/limited clientele whether permanent, occasional or accidental, and done for general business purposes, any common carrier, railroad, street railway, traction railway, subway motor vehicle, steamboat, or steamship line, ferries and watercraft, shipyard, ice-plant, electric light, heat and power or any other public utility.

B. NECESSITY FOR CERTIFICATE OF PUBLIC CONVENIENCE

Q: What is a Certificate of Public Convenience (CPC)?

A: An authorization issued for the operation of public services for which no franchise, either municipal or legislative, is required by law, such as a common carrier.

Under the Public Service Law, a certificate of public convenience can be sold by the holder thereof because it has considerable material value and is considered a valuable asset *(Raymundo v. Luneta Motor Co., G.R. No. 39902, Nov. 29, 1933).*

Q: What is a certificate of public convenience and necessity (CPCN)?

A: A certificate issued by the appropriate government agency for the operation of a public service for which prior franchise is required by law.

Note: There is no more distinction between a CPC and a CPCN. Unless otherwise exempt, no public service shall operate without having been issued a CPC or a CPCN.

Q: Chris was granted a Certificate of Public Convenience (CPC) in 1986 to operate a ferry between Mindoro and Batangas using the motor vessel "MV Gela." He stopped operations in 1988 due to unserviceability of the vessel. In 1989, Nicole was granted a CPC for the same route. After a few months, she discovered that Elisa was operating on her route under Chris' CPC. Because Nicole filed a complaint for illegal operations with the Maritime Industry Authority, Chris and Elisa jointly filed an application for sale and transfer of Chris' CPC and substitution of the vessel "MV Gela" with another owned by Elisa. Should Chris' and Elisa's joint application be approved?

A: No. The joint application of Chris and Elisa for the sale and transfer of Chris' CPC and substitution of the vessel MV Gela with another vessel owned by the transferee should not be approved. The certificate of public convenience and MV Gela are inseparable. The unserviceability of the vessel covered by the certificate had likewise rendered ineffective the certificate itself, and the holder thereof may not legally transfer the same to another. *(Cohon v. CA, G.R. No. 82558, Aug 20, 1990)* **(1992 Bar Question)**

Q: Does the CPC confer upon the holder any proprietary right or interest in the route covered thereby?

A: No. *(Luque v. Villegas, G.R. No. L-22545, Nov. 28, 1969).* However, with respect to other persons and other public utilities, a certificate of public convenience as property, which represents the right and authority to operate its facilities for public service, cannot be taken or interfered with without due process of law. Appropriate actions may be maintained in courts by the holder of the certificate against those who have not been authorized to operate in competition with the former and those who invade the rights which the former has pursuant to the authority granted by the Public Service Commission *(A.L. Animen Transportation Co. v. Golingco, G.R. No. 17151, Apr. 6, 1922)*

Q: What are the requirements for the grant of certificate of public convenience?

A:

1. Applicant must be a citizen of the Philippines. If the applicant is a Corporation, 60% of its capital must be owned by Filipinos
2. Applicant must prove public necessity
3. Applicant must prove the operation of proposed public service will promote public interest in a proper and suitable manner; and
4. Applicant must have sufficient financial capability to undertake proposed services and meeting responsibilities incidental to its operation. *(Kilusang Mayo Uno v. Garcia G.R. No. 108584, Dec. 22, 1994)*

Q: Cite instances where a certificate of public convenience is not necessary?

A:

1. Warehouses
2. Animal-drawn vehicles or *banca* powered by oar or by sail; tug boats and lighters
3. Airships except as to fixing rates
4. Radio companies, except as to fixing of rates
5. Ice plants
6. Public market
7. Public utilities operated by the national government or political subdivision except as to rates.

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Q: What are the grounds that oppositors may raise to the application for a certificate of public convenience?

A:
1. The area has already a well-established operator – prior operator rule.
2. Interpose an objection stating that the grant of the application would result to a ruinous competition.
3. Attack the citizenship of the applicant *(Sec. 11, Art. XII of the 1987 Constitution prohibits the granting of franchise or certificate for the operation of public utility in favor of non-Filipino citizens)*; or
4. The applicant does not have the necessary financial capacity.

Q: What is the prior operator rule?

A: Provides existing franchise operator preferential right within authorized territory as long as said operator renders satisfactory and economical service. This rule subordinates the prior applicant rule which gives first applicant priority only if things and circumstances are equal. A prior operator must be given the opportunity to extend its transportation services before permitting a new operator to operate in the territory of said prior operator.

Q: What are the exceptions of prior operator rule?

A: Where public interest would be better served by the new operator:

1. Where the old operator failed to make an offer to meet the increase in traffic;
2. Where the CPC granted to the new operator s a maiden certificate;
3. When the application of the rule would be conducive to monopoly.

Q: What is the *Prior Applicant Rule?*

A: Applies to situations wherein two applicants are applying for a certificate of public convenience over a given territory. Where both applicants are similarly situated, the prior applicant shall have the certificate over the other.

Q: What is the *Third Operator Rule?*

A: Where two operators are more than serving the public there is no reason to permit a third operator to engage in competition with them. The fact that it is only one trip and of little consequence is not sufficient reason to grant the application. *(Yangco v. Esteban, G.R. No. 38586, Aug. 18, 1933)*

Q: What is the *Protection of Investment Rule?*

A: The law contemplates that the first licensee will be protected in his investment and will not be subjected to a ruinous competition.

So long as an operator under a prior license complies with its terms and conditions and the reasonable rules and regulations for its operation, and meets the reasonable demands of the public, it will be protected rather than destroy its investment by the granting of the second license to another person for the same thing over the same route of travel.

Note: The "prior operator" and "protection of investment" rules cannot take precedence over the convenience of the public. *(Martires Ereno Co. v. Public Service Commission*, *G.R. No. L-25962, Sept. 30, 1975)*

C. FIXING OF RATES

Q: Who has the power to fix rates?

A: Public Service Commision

Q: What is the extent of power by the Commission to fix rates?

A: The Public Service Commission has the power to fix and determine the following which shall be imposed observed and followed thereafter by any public service:
1. Individual or joint rates
2. Tolls
3. Charges
4. Classifications
5. Schedules
6. Commutation
7. Mileage
8. Kilometrage
9. Other special rates. *(Sec 16)*

Q: May the Commission approve rates proposed by public services?

A: Yes. 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. 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. *(Sec 16)*

Q: Cite examples of public utilities which certificate of public convenience is not necessary except as to fixing of rated.

1. Airships
2. Radio companies
3. Public utilities operated by the national government or political subdivision

Q: In determining the just and reasonable rates to be charged by a public utility, what are the three major factors that should be considered by the regulating agency?

A:

1. Rate of return
2. Rate base and
3. The return itself or the computed revenue to be earned by the public utility based on the rate of return and rate base *(Republic vs Meralco, GR No. 141314, November 15, 2002).*

   Note: The rate of return of a public utility is not prescribed by administrative and judicial pronouncements. The Supreme Court has consistently adopted a 12% rate of return for public utilities *(Ibid).*

Q: Are proceeds from public utilities excluded from gross income for tax purposes?

A: Yes *(Sec. 32 [B] NIRC).*

D. UNLAWFUL ARRANGEMENTS

Q: What is the so-called *"kabit system"*?

A: It is an arrangement whereby a person who has been granted the certificate allows other persons who own motor vehicles to operate under his license, sometimes for a fee or percentage of the earnings. **(2005 Bar Question)**

Note: Although not outrightly penalized as a criminal offense, the kabit system is invariably recognized as being contrary to public policy and therefore, void and inexistent under Art. 1409 of the New Civil Code. It is a fundamental principle that the court will not aid either party to enforce an illegal contract, but will leave them both where it finds them. *(Lita Enterprises, Inc. v. IAC, G.R. No. 64693, Apr. 27, 1984)*

Q: May the registered owner of the vehicle be allowed to prove that there is already a transfer of ownership to another person under the kabit system?

A: No. One of the primary factors considered in the granting of a certificate of public convenience for the business of public transportation is the financial capacity of the holder of the license, so that liabilities arising from accidents may be duly compensated. The *kabit* system renders illusory such purpose and, worse, may still be availed of by the grantee to escape civil liability caused by a negligent use of a vehicle owned by another and operated under his license.

If a registered owner is allowed to escape liability by proving who the supposed owner of the vehicle is, it would be easy for him to transfer the subject vehicle to another who possesses no property with which to respond financially for the damage done. *(Lim v. CA, G.R. No. 125817, Jan. 16, 2002)*

Q: What is the reason behind the proscription against the *kabit* system?

A: The thrust of the law in enjoining the *kabit* system is not so much as to penalize the parties but to identify the person upon whom responsibility may be fixed in case of an accident with the end view of protecting the riding public. The policy therefore loses its force if the public at large is not deceived, much less involved. *(Lim v. CA, G.R. No. 125817, Jan. 16, 2002)*

Q: What is the so-called *"boundary system"*?

A: Under this system the driver is engaged to drive the owner/operator's unit and pays the latter a fee commonly called boundary for the use of the unit. Whatever he earned in excess of that amount is his income. *(Paguio Transport Corp. v. NLRC, G.R. No. 119500, Aug. 28, 1998)*

Q: What kind of relationship exists between the owner of the vehicle and the driver under a "boundary system" arrangement?

A: The relationship between jeepney owners/operators on one hand and jeepney drivers on the other under the boundary system is that of employer-employee and not of lessor-lessee. *(Martinez v. NLRC, G.R. No. 117495, May 29, 1997)*

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The features which characterize, the "boundary system" – namely, the fact that the driver does not receive a fixed wage but gets only the excess of the amount of fares collected by him over the amount he pays to the jeep-owner, and that the gasoline consumed by the jeep is for the account of the driver – are not sufficient to withdraw, the relationship between them from that of the employer and employee. *(National Labor Union v. Dinglasan, G.R. No. L-14183, Nov. 4, 1993)*

E. APPROVAL OF SALE, ENCUMBRANCE OR LEASE OF PROPERTY

Q: What are the guidelines to eliminate the sale and transfer of expired and/or dead CPCs?

A:

1. No approval of sale and transfer of a CPC shall be accepted where the validity of CPC being conveyed is less than 6 months on the date of its filing with the LTFRB.
2. No application for approval of sale and transfer of a CPC shall be accepted unless the units authorized therein are registered with the LTO for the current year.
3. Where the authorized units under the CPC conveyed have all not been registered with the LTO for the current year, the application for the approval of sale and transfer will be accepted and processed only for the actual number of registered units corresponding to the CPC conveyed.
4. No application for approval of sale and transfer of a CPC shall be accepted, unless all fees/dues have been fully paid to the LTO and LTFRB, and taxes to the BIR *(DOTC Order 2010-34).*

Q: Is the approval by the Public Utility Commission of the sale, encumbrance or lease of property is a condition precedent to the validity of a contract?

A: No. While in the old law the sale without the approval of the Public Utility Commission was declared null and void, under Commonwealth Act 146, the new law, the sale may not only be negotiated but completed before said approval. In other words, the approval by the Commission is not a condition precedent to the validity of the contract. The approval is only necessary to protect public interest *(Darang vs. Belizar, G.R. No. L-19487, January 31, 1967).*

VII. THE WARSAW CONVENTION

A. APPLICABILITY

Q: When is this law applicable?

A: This Convention applies to all international carriage of persons, luggage or goods performed by aircraft for reward. It applies equally to gratuitous carriage by aircraft performed by an air transport undertaking. *(Art. 1[1])*

Q: What is an international transportation?

A: Any carriage in which, according to the contract made by the parties, the place of departure and the place of destination, whether or not there be a break in the carriage or a transshipment, are situated either:

1. Within the territories of two High Contracting Parties; or
2. Within the territory of a single High Contracting Party, if there is an agreed stopping place within a territory subject to the sovereignty, suzerainty, mandate or authority of another Power, even though that Power is not a party to the Convention. *(Art. 1[2])*

Note: A High Contracting Party is one of the original parties to the convention.

B. LIMITATION OF LIABILITY

Q: What are the limitations to the liability of air carriers?

A:

1. *In the carriage of persons* – 250,000 francs for each passenger. Nevertheless, by special contract, the carrier and the passenger may agree to a higher limit of liability.

2. *In the carriage of registered baggage and of cargo* – Two hundred and fifty (250) francs per kilogramme, unless the passenger or consignor has made, at the time when the package was handed over to the carrier, a special declaration of interest in delivery at destination and has paid a supplementary sum if the case so requires.

   Note: In the case of loss, damage or delay of part of registered baggage or cargo, or of any object contained therein, the weight to be taken into consideration in determining the amount to which the

carrier's liability is limited shall be only the total weight of the package or packages concerned. Nevertheless, when the loss, damage or delay of a part of the registered baggage or cargo, or of an object contained therein, affects the value of other packages covered by the same baggage check or the same air waybill, the total weight of such package or packages shall also be taken into consideration in determining the limit of liability.

3. *As regards objects of which the passenger takes charge himself* – Five thousand (5,000) francs per passenger. *(Art. 22)*

   Note: Carrier is not entitled to the foregoing limit if the damage is caused by willful misconduct or default on its part *(Art. 25)*

Q: Is a stipulation relieving the carrier from or limiting its liability valid?

A: No. 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 such provision does not involve the nullity of the whole contract. *(Art. 23[1])*

Q: What are the exceptions to these limitations?

A:
1. Willful misconduct
2. Default amounting to willful misconduct
3. Accepting passengers without ticket
4. Accepting goods without airway bill or baggage without baggage check

Q: When will one's right to damages be extinguished?

A: 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.

Note: Despite the express mandate that an action for damages should be filed within 2 years from the arrival at the place of destination, such rule shall not be applied where delaying tactics were employed by airline itself in a case where a passenger wishes to settle his complaint out-of-court but the airline gave him the runaround, answering the passenger's letters but not giving in to his demands, hence, giving the passenger no time to institute the complaint within the reglamentary period. *(United Airlines v. Uy, G.R. No. 127768, Nov. 19, 1999)*

Q: Could a person recover a claim covered by Warsaw Convention after the lapse two years?

A: No. A claim covered by the Warsaw Convention can no longer be recovered under local law, if the statute of limitations of two years has already lapsed. *(PAL. v. Savillo, 557 SCRA 66)*

B. WILLFULL MISCONDUCT

Q: What constitutes willful misconduct?

A: The definition of "willful misconduct" depends in some measure on which court is deciding the issue. Some common factors that courts will consider are:

1. Knowledge that an action will probably result in injury or damage
2. Reckless disregard of the consequences of an action, or
3. Deliberately failing to discharge a duty related to safety. Courts may also consider other factors

Q: Is the failure of the carrier to deliver the passenger's luggage at the designated time and place ipso facto constitutes wilful misconduct?

A: No. 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 *(Luna vs. CA, GR No. 100374-75, November 27, 1992).*

Q: Is the carrier's guessing of which luggage contained the firearms constitutes willful misconduct?

A: Yes. The guessing of which luggage contained the firearms amounted to willful misconduct under Section 25(1) of the Warsaw Convention. *(Northwest Airlines vs. CA, GR No. 120334, January 20, 1998)*

Q: Is the allegation of willful misconduct resulting in a tort is insufficient to exclude the case from the realm of Warsaw Convention?

A: Yes. A cause of action based on tort did not bring the case outside the sphere of the Warsaw Convention. *(Lhuiller vs. British Airways, GR No. 171092, March 15, 2010).*

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CORPORATION LAW

Q: What are the distinctions between partnership and corporation?

A: See Appendix D

A. CORPORATION DEFINED

Q: What is a corporation?

A: An artificial being created by operation of law having the right of succession, and the powers, attributes and properties expressly authorized by law and incident to its existence. *(Sec. 2)*

Q: May a corporation enter into a contract of partnership?

A:

GR: Corporations have no power to enter into partnership.

Reason: Public policy. In a partnership, the corporation would be bound by the acts of the persons who are not its duly appointed and authorized agents and officers, which would be entirely inconsistent with the policy of the law that the corporation shall manage its own affairs separately and exclusively.

XPN: The SEC allowed corporations to enter into partnerships with other corporations and individuals provided:

1. The authority to enter into partnership relation is expressly conferred by the Charter or the AOI and the nature of the business venture to be undertaken by the partnership is in line with the business authorized by the charter or the AOI. *(SEC Opinions, Feb. 29, 1980, Dec. 1, 1993, and Feb. 23, 1994.)*

2. The partnership must be a limited partnership and the corporation must be a limited partner

3. If it is a foreign corporation, it must obtain a license to transact business in the country.

Q: Does a defective incorporation result into a partnership?

A: The answer depends on whether or not there is a clear intent to participate in the management of the business affairs on the part of the investor. Parties who intends to participate or has actually participated in the business affairs of the proposed corporation would be considered as partners under a *de facto* partnership. On the other hand, parties who took no part notwithstanding their subscriptions do not become partners with other subscribers. *(Pioneer Insurance v. CA, G.R. No. 84197, July 28, 1989)*

Q: May a corporation enter into a joint venture?

A: Yes. It may enter into a joint venture with another where the nature of that venture is in line with the business authorized by its charter. *(Aurbach v. Sanitary Wares Manufacturing Corporation, G.R. No. 75875, Dec. 15, 1989)*

Q: What are the distinctions between joint account and partnership?

A:

JOINT ACCOUNT	PARTNERSHIP
Has no firm name and is conducted In the name of the ostensible partner.	Has a firm name.
Has no juridical personality and can sue or be sued only in the name of the ostensible partner.	Has juridical personality and may sue or be sued under its firm name
Has no common fund.	Has a common fund.
The ostensible partner manages its business operations.	All general partners have the right of management.
Liquidation thereof can only be done by the ostensible partner.	Liquidation may, by agreement, be entrusted to a partner or partners.

Q: What are the attributes of a corporation?

A:

1. It is an artificial being
2. It is created by operation of law
3. It enjoys the right of succession
4. It has the powers, attributes and properties expressly authorized by law or incident to its existence

Q: What are the theories on the formation of a corporation?

A:

1. *Concession theory or fiat theory* – Means that a corporation was conceived as an artificial person owing existence through creation by a foreign power. It has without any existence until it has received the imprimatur of the state acting according to law, through the SEC. *(Tayag v. Benguet*

Consolidated, Inc., G.R. No. L-23276, Nov. 29, 1968)

Note: Philippine jurisprudence adopted this theory as the underlying basis for the existence and powers of corporate entities.

2. *Theory of corporate enterprise or economic unit* – The corporation is not merely an artificial being, but more of an aggregation of persons doing business, or an underlying business unit. (However, this doctrine is being used in support of other doctrines)

   Note: Recognizes the existence of a business enterprise as the bases of several contracts and transactions apart from the issue of whether there was duly constituted a juridical person.

3. *Genossenschaft theory* – Treats a corporation as "the reality of the group as a social and legal entity, independent of State recognition and concession". *(Tayag v. Benguet Consolidated, Inc., G.R. No. L-23276, Nov 29, 1968)*

Q: What are the two kinds of franchise?

A:

1. *Corporate or primary/general franchise* – grant given to exist as a corporation;

2. *Special or secondary franchise* – certain rights and privileges conferred upon existing as a corporation *(e.g. right to use the streets of a municipality to lay pipes of tracks, erect poles, or string wires).*

B. CLASSIFICATION OF CORPORATIONS

Q: What are the classifications of corporation?

A:

1. As to Corporation Code:
   a. *STOCK CORPORATION*- one which have capital stock divided into shares and are authorized to distribute to the holders of such shares dividends or allotments or the surplus profits on the basis of the shares held. (Sec 3)

   b. *NON- STOCK CORPORATION*- is one which do not issue shares and are created not for profit but for public good and welfare and where no part of its income is distributable as dividends to its members, trustees, or officers. (Sec 87)

2. As to the number of persons who compose them:
   a. *Corporation aggregate*- corporation consisting of more than one member or corporator;

   b. *Corporation Sole*- religious corporation which consists of one member or corporator only and his successor.

3. As to whether they are for religious purpose or not:
   a. *Ecclesiastical corporation*- one organized for religious purpose

   b. *Lay corporation*- one organized for a purpose other than for religion.

4. As to whether they are for charitable purpose or not:
   a. *Eleemosynary*- one established for religious purposes

   b. *Civil*- one established for business or profit

5. As to state or country under or by whose laws they have been created:
   a. *Domestic*- one incorporated under the laws of the Philippines

   b. *Foreign*- 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. *(Sec 123)*

6. As to their legal right to corporate existence:
   a. *De jure*- one existing both in fact and in law

   b. *De facto*- one existing in fact but not in law

7. As to whether they are open to the public or not:
   a. *Close*- one which is limited to selected persons or members of the family. *(Sec 96- 105)*

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b. Open- one which is open to any person who may which to become a stockholder or member thereto

8. As to their relation to another corporation
   a. *Parent or Holding*- one which is related to another corporation that it has the power either, directly or indirectly to, elect the majority of the director of such other corporation

   b. *Subsidiary*- one which is so related to another corporation that the majority of its directors can be elected either, directly or indirectly, by such other corporation

9. As to whether they are corporations in a true sense or only in a limited sense:
   a. *True*- one which exists by statutory authority

   b. *Quasi*- one which exist without formal legislative grant.

      i. *Corporation by prescription*- one which has exercised corporate powers for an indefinite period without interference on the part of the sovereign power and which by fiction of law, is given the status of a corporation;

      ii. *Corporation by estoppel*- one which in reality is not a corporation, either de jure or de facto, because it is so defectively formed, but is considered a corporations in relation to those only who, by reason of theirs acts or admissions, are precluded from asserting that it is not a corporation.

10. As to whether they are for public (government) or private purpose:
   a. Public- one formed or organized for the government or a portion of the State

   b. one formed for some provate purpose, benefit or end

Q: What are the requisites of a *de facto* corporation?

A:
1. Organized under a valid law.

2. Attempt in good faith to form a corporation according to the requirements of the law.

   Note: The Supreme Court requires that Articles of Incorporation have already been filed with the SEC and the corresponding certificate of incorporation is obtained.

3. *Use of corporate powers.*

   Note: The corporation must have performed the acts which are peculiar to a corporation like entering into a subscription agreement, adopting by-laws, and electing directors.

Q: How is the status of a *de facto* corporation attacked?

A: The existence of a *de facto* corporation shall not be inquired into collaterally in any private suit to which such corporation may be a party. Such inquiry may be made by the Solicitor General in a *quo warranto* proceeding. *(Sec. 20)*

Note: However, as long as it exists, a *de facto* corporation enjoys all attributes of a corporation until the State questions its existence.

In comparison with a corporation by estoppel where the stockholders are liable as general partners, stockholders in a *de facto* corporation are liable as a *de jure* corporation. Hence, up to the extent of their share holdings.

Q: Distinguish de facto corporation from corporation by *estoppel*.

A:

DE FACTO CORPORATION	CORPORATION BY ESTOPPEL
There is existence in law	There is *no* existence in law
The dealings among the parties on a corporate basis is *not* required	The dealings among the parties on a corporate basis is required
When requisites are lacking, it can be corporation by estoppel	It will be considered a corporation in any shape or form

C. NATIONALITY OF CORPORATIONS

Q: What are the tests in determining the nationality of corporations?

A:

1. *Incorporation test* – Determined by the state of incorporation, regardless of the nationality of the stockholders.
2. *Domiciliary test* – Determined by the principal place of business of the corporation.
3. *Control test* – Determined by the nationality of the controlling stockholders or members. This test is applied in times of war.
4. *Grandfather rule* – Nationality is attributed to the percentage of equity in the corporation used in nationalized or partly nationalized area.

Q: What are the requisites of the control test?

A:

1. Control, not mere majority or complete stock control, but complete domination, not only of finances but of policy and business practice in respect to the transaction attacked such that the corporate entity as to this transaction had at that time no separate mind, will or existence of its own
2. Such control must have been used by the defendant to commit fraud or wrong, to perpetuate the violation of a statutory or other positive legal duty, or dishonest or unjust act in contravention of plaintiffs legal right; and
3. The control and breach of duty must proximately cause the injury or unjust loss complained of. *(Velarde v. Lopez, Inc., G.R. No. 153886, Jan. 14, 2004; Heirs of Ramon Durano, Sr. v. Uy, G.R. No. 136456, Oct. 24, 2000)*

Q: Who are considered "Philippine Nationals" under Foreign Investment Act of 1991 (R.A. No. 7042)?

A:

1. Corporations organized under Philippine laws of which 60% of the capital stock outstanding and entitled to vote is owned and held by Filipino citizens
2. Corporations organized abroad and registered as doing business in the Philippines under the Corporation Code of which 100% of the capital stock entitled to vote belong to Filipinos.

Note: However, it provides that where a corporation and its non-Filipino stockholders own stocks in a SEC-registered enterprise, at least 60% of the capital stock outstanding and entitled to vote of both corporations and at least 60% of the members of the board of directors of both corporations must be Filipino citizens (DOUBLE 60% RULE).

Q: What is the nationality of a corporation organized and incorporated under the laws of a foreign country, but owned 100% by Filipinos?

A: Under the control test of corporate nationality, this foreign corporation is of Filipino nationality. Where there are grounds for piercing the veil of corporate entity, that is, disregarding the fiction, the corporation will follow the nationality of the controlling members or stockholders, since the corporation will then be considered as one and the same. **(1998 Bar Question)**

D. CORPORATE JURIDICAL PERSONALITY

Q: What is the doctrine of separate (legal) personality?

A: It is a well-settled doctrine that a corporation has a personality distinct and separate from its individual stockholders or members *(Cruz vs. Dalisay, A.M. No. R-181-P, July 31, 1987).*

Q: What are the significances of the doctrine of separate personality?

A:

1. *Liability for acts or contracts* – the acts of the stockholders do not bind the corporation unless they are properly authorized. The obligations incurred by a corporation, acting through its authorized agents are its sole liabilities. The obligations of the corporation are not the obligations of its shareholders and members and vice-versa. *(Cease v. CA,G.R. No. L-33172, Oct. 18, 1979)*
2. *Right to bring actions* – may bring civil and criminal actions in its own name in

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the same manner as natural persons. *(Art. 46, Civil Code)*

3. *Right to acquire and possess property* – property conveyed to or acquired by the corporation is in law the property of the corporation itself as a distinct legal entity and not that of the stockholders or members. *(Art. 44[3], Civil Code)*

   Note: The interest of the shareholder in the properties of the corporation is *inchoate* only. The interest of the shareholder on a particular property becomes actual, direct and existing only upon the liquidation of the assets of the corporation and the same property is assigned to the shareholder concerned.

4. *Acquisition of court of jurisdiction* – service of summons may be made on the president, general manager, corporate secretary, treasurer or in-house counsel. *(Sec. 11, Rule 14, Rules of Court).*

5. *Changes in individual membership* – corporation remains unchanged and unaffected in its identity by changes in its individual membership.

Q: Is a corporation liable for torts?

A: Yes whenever a tortuous act is committed by an officer or agent under the express direction or authority of the stockholders or members acting as a body, or, generally, from the directors as the governing body. *(PNB v. CA, G.R. No. L-27155, May 18, 1978)*

Q: Is a corporation liable for crimes?

A:

GR: No. Since a corporation is a mere legal fiction, it cannot be held liable for a crime committed by its officers, since it does not have the essential element of malice; in such case the responsible officers would be criminally liable. *(People v. Tan Boon Kong, G.R. No. L-32066. Mar. 15, 1930)*

Note: An officer of a corporation can be held criminally liable for acts or omissions done in behalf of the corporation *only* where the law directly makes the person who fails to perform the act in the prescribed manner expressly liable criminally .*(Sia v. People, L-30896, Apr. 28, 1983)*

XPN: If the penalty of the crime is only fine or forfeiture of license or franchise. *(Ching v Secretary of Justice, G. R. No. 164317, Feb. 6, 2006)*

Q: Is a corporation entitled to moral damages?

A:

GR: A corporation is not entitled to moral damages because it has no feelings, no emotions, no senses. (*ABS-CBN Broadcasting Corporation v. CA, G.R. No. 128690 Jan 21, 1999 and Phillip Brothers Oceanic, Inc, G.R. No. 126204, Nov. 20, 2001*)

XPN:

1. The corporation may recover moral damages under item 7 of Article 2219 of the New Civil Code because said provision expressly authorizes the recovery of moral damages in cases of libel, slander, or any other form of defamation. Article 2219(7) does not qualify whether the injured party is a natural or juridical person. Therefore, a corporation, as a juridical person, can validly complain for libel or any other form of defamation and claim for moral damages *(Filipinas Broadcasting Network, Inc. v. AMEC-BCCM, G.R. No. 141994, Jan 17, 2005.*

2. When the corporation has a reputation that is debased, resulting in its humiliation in the business realm *(Manila Electric Company v. T.E.A.M. Electronics Corporation, et. al., G.R. No. 131723, Dec. 13, 2007.*

Q: What is the doctrine of piercing the veil of corporate fiction?

A: It is the doctrine that allows the State to disregard the notion of separate personality of a corporation for justifiable reason/s.

Note: This is an exception to the Doctrine of Separate Corporate Entity.

Q: What are the effects of piercing the veil?

A: Courts will look at the corporation as an aggregation of persons undertaking the business as a group.

Note: When the veil of corporate fiction is pierced in proper cases, the corporate character is not necessarily abrogated. It continues for legitimate objectives. The decision applies only for that

particular case. *(Reynoso IV v. CA, G.R. Nos. 116124-25, Nov 22, 2000)*

Q: What circumstances the mere existence of which does not necessarily entitle piercing the veil?

A:

1. Controlling ownership of the corporation's share
2. 2 corporations have common directors
3. Substantial identity of the incorporators or 2 corporations and identity of its business

Q: What are the tests in piercing the corporate veil?

A:

1. Fraud test (When corporate fiction used to justify a wrong, protect fraud of defend crime)
2. Control test
3. Alter-ego or instrumentality test (or conduit cases)
4. Public convenience or objective test
5. Equity cases/test

Q: Plaintiffs filed a collection action against X Corporation. Upon execution of the court's decision, X Corporation was found to be without assets. Thereafter, plaintiffs filed an action against its present and past stockholder Y Corporation which owned substantially all of the stocks of X corporation. The two corporations have the same board of directors and Y Corporation financed the operations of X corporation. May Y Corporation be held liable for the debts of X Corporation? Why?

A: Yes, Y Corporation may be held liable for the debts of X Corporation. The doctrine of piercing the veil of corporation fiction applies to this case. The two corporations have the same board of directors and Y Corporation owned substantially all of the stocks of X Corporation, which facts justify the conclusion that the latter is merely an extension of the personality of the former, and that the former controls the policies of the latter. Added to this is the fact that Y Corporation controls the finances of X Corporation which is merely an adjunct, business conduit or alter ego of Y Corporation. (*CIR v. Norton & Harrison Company, G.R. No. L-17618, Aug. 31, 1964)* **(2001 Bar Question)**

E. CAPITAL STRUCTURE

Q. What are the components of a corporation?

A:

1. *Corporators* – Those who compose a corporation, whether as stockholders or members

2. *Incorporators* – They are those mentioned in the Articles of Incorporation as originally forming and composing the corporation and who are signatories thereof.

3. *Directors and trustees* – The Board of Directors is the governing body in a stock corporation while the Board of Trustees is the governing body in a non-stock corporation.

4. *Corporate officers* – they are the officers who are identified as such in the Corporation Code, the Articles of Incorporation, or the By-laws of the corporation.

5. *Stockholders* – Owners of shares of stock in a stock corporation.

6. *Members* – Corporators of a corporation which has no capital stock. They are not owners of shares of stocks, and their membership depends on terms provided in the articles of incorporation or by-laws *(Sec. 91*).

7. *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. *(Sec. 3.10, R.A. No. 8799, SRC)*

8. *Subscriber* – persons who have agreed to take and pay for original, unissued shares of a corporation formed or to be formed.

9. *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.

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(1) NUMBER AND QUALIFICATIONS OF INCORPORATORS

Q: What are the distinctions between corporator and incorporator?

A:

INCORPORATOR	CORPORATOR
Signatory of the Articles of Incorporation	May or not be signatory of the Articles of Incorporation
Does not cease to be an incorporator upon sale of his shares	Cease to be a corporator by sale of his shares in case of stock corporation. In case of non-stock corporation, when the corporator ceases to e a member.
GR: 5 to 15 natural persons **XPN:** In case of cooperative,incorporator of rural bank; corporation sole	No limit
Originally forms part of the corporation	Not necessarily
GR: Filipino citizenship is not a requirement. **XPN:** When engaged in a business which is partly or wholly nationalized where majority must be residents	Depending on the nature of business of the corporation. If it is nationalized, the citizenship becomes material.

Q: What are the required number and the qualifications of incorporators in a stock corporation?

A:

1. Natural person
2. **GR:** Not less than 5 but not more than 15

   XPN: Corporation sole

3. Of legal age
4. Majority must be residents of the Philippines
5. Each must own or subscribe to at least one share. *(Sec.10)*

Q: Who can be incorporators?

A:

GR: Only natural persons can be incorporators.

XPN: When otherwise allowed by law, Rural Banks Act of 1992, where incorporated cooperatives are allowed to be incorporators of rural banks.

Note: An incorporator can be corporator. Non-residents may be incorporators because the law only requires the majority to be residents of the Philippines.

An incorporator remains to be an incorporator even if he will later on cease to be a shareholder. However, an incorporator who ceases to hold a share cannot be considered a corporator.

(2) MINIMUM CAPITAL STOCK AND SUBSCRIPTION REQUIREMENTS

Q: What are the capital stock requirements?

A:

GR: There is no minimum authorized capital stock as long as the paid-up capital is not less than P5,000.00

XPN: As provided by special law (e.g. Banks).

Q: Is it required that each subscriber pay 25% of *each* subscribed share?

A: No. It is only required that at least 25% of the subscribed capital must be paid.

(3) CORPORATE TERM

Q: What is the term of corporate existence?

A:

GR: It depends on the period stated in the Articles of Incorporation.

XPN: Unless sooner dissolved or unless said period is extended.

Note: Extension may be made for periods not exceeding (50) years in any single instance by an amendment of the articles of incorporation. However, extension must be made within 5 years before the expiry date of the corporate term. Extention must aldo comply with procedural requirements for amendment of AOI.

Q: What is the doctrine of relation or relating back doctrine?

A: Generally, the filing and recording of a certificate of extension after the term cannot relate back to the date of the passage of the resolution of the stockholders to extend the life of the corporation. However, the doctrine of

relation applies if the failure to file the application for extension within the term of the corporation is due to the neglect of the officer with whom the certificate is required to be filed or to a wrongful refusal on his part to receive it *(Aquino, Philippine Corporate Law Compendium, 2006).*

(4) CLASSIFICATION OF SHARES

Q: What are the kinds or classifications of share?

A:

1. Par value shares
2. No par value shares
3. Common shares
4. Preferred shares
5. Redeemable shares
6. Treasury shares
7. Founder's share
8. Voting shares
9. Non-voting shares
10. Convertible shares
11. Watered stock
12. Fractional share
13. Shares in escrow
14. Over-issued stock
15. Street certificate
16. Promotion share

Q: What are par value shares?

A: Shares with a value fixed in the articles of incorporation and the certificates of stock. The par value fixes the minimum issue price of the shares.

Note: A corporation cannot sell less than the par value but a shareholder may sell the same less than the par value because it is his.

Shares sold below its par value is called watered stocks.

Q: What are no par value shares?

A: These are shares having no stated value in the article of incorporation.

Q: What are the limitations on no par value shares?

A:

1. Shares which are no par value, cannot have an issued price of less than P5.00;
2. The entire consideration for its issuance constitutes capital so that no part of it should be distributed as dividends;
3. They cannot be issued as preferred stocks;
4. They cannot be issued by banks, trust companies, insurance companies, public utilities and building and loan association;
5. The articles of incorporation must state the fact that it issued no par value shares as well as the number of said shares;
6. Once issued, they are deemed fully paid and non-assessable. *(Sec. 6)*

Q: What are common shares?

A: These are ordinarily and usually issued stocks without extraordinary rights and privileges, and entitle the shareholder to a *pro rata* division of profits. It represents the residual ownership interest in the corporation. The holders of this kind of share have complete voting rights and they cannot be deprived of the said rights except as provided by law.

Q: What are preferred shares?

A: These entitle the shareholder to some priority on distribution of dividends and assets over those holders of common shares.

Q: Are holders of preferred shares creditors?

A: No. Holders thereof cannot compel the corporation to give them dividends. The preference only applies once dividends are declared.

Q: What are the kinds of preferred shares?

A:

1. *Preferred shares as to assets* – Shares which gives the holder preference in the distribution of the assets of the corporation in case of liquidation.

    a. *Participating preferred shares* – Entitled to participate with the common shares in excess distribution

    b. *Non-participating preferred shares* – Not entitled to participate with the common shares in excess distribution.

2. *Preferred shares as to dividends*– Shares which are entitled to receive dividends on said share to the extent agreed upon before any dividends at all are paid to the holders of common stock.

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a. *Cumulative preferred shares* – If a dividend is omitted in any year, it must be made up in a later year before any dividend may be paid on the common shares in the later year.

b. *Non-cumulative preferred shares* – There is no need to make up for undeclared dividends

Q: What is preferred cumulative participating share of stock?

A: This is a kind of share which gives the holder preference in the payment of dividends ahead of common stockholders and to be paid the dividends due for prior years and to participate further with common stockholders in dividend declaration.

Q: What are redeemable shares?

A: These are shares of stocks issued by a corporation which said corporation can purchase or take up from their holders upon expiry of the period stated in certificates of stock representing said shares *(Sec. 8).*

Q: What are unrestricted retained earnings (URE)?

A: These are surplus profits not subject to encumbrance.

Q: What are the limitations on redeemable shares?

A:

1. Issuance of redeemable shares must be expressly provided in the articles of incorporation;
2. The terms and conditions affecting said shares must be stated both in the articles of incorporation and in the certificates of stock;
3. Redeemable shares may be deprived of voting rights in the articles of incorporation, unless otherwise provided in the Code. *(Sec. 6, par. 6)*
4. Redemption cannot be made if it will cause insolvency of the corporation.

Q: What are treasury shares?

A: Shares that have been earlier issued as fully paid and have thereafter been acquired by the corporation by purchase, donation, and redemption or through some lawful means. *(Sec. 9)*

To put simply, these are shares reacquired by the corporation. They are called treasury shares because they remain in the corporate treasury until reissued. More importantly, they have no:

1. Voting Rights
2. Right to dividends.

Note: Treasury shares are not retired shares. They do not revert to the unissued shares of the corporation but are regarded as property acquired by the corporation which may be reissued or resold at a price to be fixed by the Board of Directors *(SEC Rules Governing Redeemable and Treasury Shares, CCP No. 1-1982).*

Q: What are the other means in which a corporation may acquire its own shares?

A:

1. To collect or compromise unpaid indebtedness to the corporation;
2. To eliminate fractional shares;
3. To pay dissenting or withdrawing stockholders entitled to payment for their shares;
4. Redemption; and
5. Close corporation.

Q: What are the limitations on treasury shares?

A:

1. They may be re-issued or sold again as long as they are held by the corporation as treasury shares.
2. Cannot participate in dividends.
3. It cannot be represented during stockholder's meetings.
4. The amount of URE equivalent to the cost of treasury shares being held shall be restricted from being declared and issued as dividends.

Note: When treasury shares are sold below its par or issued value, there can be no watering of stock because such watering contemplates an original issuance of shares.

Q: What are founders' shares?

A: Shares classified as such in the articles of incorporation which may be given special preference in voting rights and dividend payments. But if an exclusive right to vote and be voted for as director is granted, this privilege is

subject to approval by the SEC, and cannot exceed 5 years from the date of approval. *(Sec. 7)*

Q: What are voting shares?

A: Shares with a right to vote. If the stock is originally issued as voting stock, it may not thereafter be deprived of the right to vote without the consent of the holder.

Q: What are non-voting shares?

A: Shares without right to vote.

The law only authorizes the denial of voting rights in the case of redeemable shares and preferred shares, provided that there shall always be a class or series of shares which have complete voting rights.

Q: What are the instances when holders of non-voting shares are allowed to vote?

A: These redeemable and preferred shares, when such voting rights are denied, shall nevertheless be entitled to vote on the following fundamental matters:

1. Amendment of articles of incorporation
2. Adoption and amendment of by-laws
3. Sale, lease, exchange, mortgage, pledge or other disposition of all or substantially all of the corporate property
4. Incurring, creating or increasing bonded indebtedness
5. Increase or decrease of capital stock
6. Merger or consolidation of the corporation with another corporation or other corporations
7. Investment of corporate funds in another corporation or business in accordance with this Code
8. Dissolution of the corporation. *(Sec. 6 par. 6)*

Q: What are convertible shares?

A: A share that is changeable by the stockholder from one class to another at a certain price and within a certain period.

<u>GR</u>: Stockholder may demand conversion at his pleasure.

<u>XPN</u>: Otherwise restricted by the articles of incorporation.

Q: What is a fractional share?

A: A share with a value of less than one full share.

Q: What are shares in escrow?

A: Subject to an agreement by virtue of which the share is deposited by the grantor or his agent with a third person to be kept by the depositary until the performance of certain condition or the happening of a certain event contained in the agreement.

Q: What is an over-issued stock?

A: It is a stock issued in excess of the authorized capital stock; it is null and void.

Q: What is a street certificate?

A: It is a stock certificate endorsed by the registered holder in blank and the transferee can command its transfer to his name from issuing corporation.

Q: What is promotional share?

A: This is a share issued by promoters or those in some way interested in the company, for incorporating the company, or for services rendered in launching or promoting the welfare of the company.

Q: Are classes of shares infinite?

A: Yes. There can be other classifications as long as they are indicated in the AOI, stock certificate and not contrary to law.

Q: Who may classify shares?

A:

1. *Incorporators* - the classes and number of shares which a corporation shall issue are first determined by the incorporators as stated in the articles of incorporation filed with the SEC.

2. *Board of directors and stockholders* - after the corporation comes into existence; they may be altered by the board of directors and the stockholders by amending the articles of incorporation pursuant to Sec. 16.

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F. INCORPORATION AND ORGANIZATION

Q: What is incorporation?

A: It is the performance of conditions, acts, deeds, and writings by incorporators, and the official acts, certification or records, which give the corporation its existence.

Q: What are the steps in the creation of a corporation?

A:
1. Promotion
2. Incorporation (Sec10)
3. Formal organization and commencement of business operations (Sec22)

(1) PROMOTER

Q: Who is a promoter?

A: Is a person who brings about or cause to bring about the formation and organization of a corporation by:
1. bringing together the incorporators or the persons interested in the enterprise,
2. procuring subscriptions or capital for the corporation and
3. setting in motion the machinery which leads to the incorporation of the corporation itself.

Q: What is the liability of a promoter?

A: All promoter(s) have joint personal liability for a corporation that was never formed. He remains liable on contracts even after incorporation even though corporation adopts the contract.

Q: Are promoters agents of a corporation?

A: No. Promoters are not agents of the corporation *before* it comes into existence.
Upon incorporation, the practice is for the BOD to pass a resolution ratifying the contracts entered into by the incorporators with the promoter. Then, they become agents of the corporation.

Q: What are the kinds of underwriting agreement?

A:
1. *English* – the underwriter sells what the corporation cannot sell
2. *Firm Commitment* – the underwriter purchases outright the securities and then resells the same
3. *Best Efforts* – the underwriter merely sells for commission.

(2) SUBSCRIPTION CONTRACT

Q: What is a subscription contract?

A: It is a contract for the acquisition of *unissued* stock in an existing corporation or a corporation still to be formed. It is considered as such notwithstanding the fact that the parties refer to it as purchase or some other contract. *(Sec. 60)*

Q: What are the kinds of subscription contracts?

A:
1. <u>**GR**</u>**:** *Pre-incorporation subscription* – entered into before the incorporation and irrevocable for a period of six (6) months from the date of subscription unless all other subscribers consent or if the corporation failed to materialize. It cannot also be revoked after filing the Articles of Incorporation with the SEC *(Sec. 61)*

   <u>**XPN**</u>**:** When creditors will be prejudiced thereby.

2. *Post-incorporation subscription* – entered into after incorporation.

(3) PRE-INCORPORATION SUBCRIPTION AGREEMENTS

Q: Who are required to pay their subscription in full?

A:
1. Non-resident foreign subscribers upon incorporation must pay in full their subscriptions unless their unpaid subscriptions are guaranteed by a surety bond or by an assumption by a resident stockholder through an affidavit of liability.
2. In case of no-par value shares, they are deemed fully paid and non-assessable.

Q: Is a stockholder entitled to the shares of stock subscribed although not fully paid?

A: Yes. As long as the shares are not considered delinquent, they are entitled to all rights granted

to it whether or not the subscribed capital stocks are fully paid.

Q: What are the distinctions between subscription and purchase?

A:

SUBSCRIPTION	PURCHASE
May be made before or after incorporation	May be made only after incorporation
Subscriber becomes a stockholder even if he has not fully paid the subscription	Buyer does not become a stockholder until the fulfillment of the terms of the sale and registration thereof in the books of the corporation
Cannot be released from his subscription unless all stockholders agree thereto and no creditor is thereby prejudiced	The corporation may rescind or cancel the contract for non-fulfillment of the contract by the buyer
Corporate creditors may proceed against the subscriber for his unpaid subscription in case the assets of the corporation are not sufficient to pay their claims	Creditors may not proceed against the buyer for the unpaid price as there is no privity of contract between them
May be in any form, written or oral, express or implied, and therefore, not covered by the Statute of Frauds	In purchase amounting to more than 500 pesos, the Statute of Frauds shall apply
Subscription price are considered assets of the corporation, hence, creditors may go after them	Purchase price does not become assets of the corporation unless fully paid

Q: What is the rule on right to issuance of certificate of stock?

A: A corporation may now, in the absence of provisions in their by-laws to the contrary, apply payments made by subscribers-stockholders, either as:

1. *Full payment* for the corresponding number of shares of stock, the par value of each of which is covered by such payment; or

2. *Payment pro-rata* to each and all the entire number of shares subscribed for. *(Baltazar v. Lingayen Gulf Electric Power Co., Inc, G.R. No. L-16236-38, June 30,* 1965)

(4) CONSIDERATION FOR STOCKS

Q: What are valid considerations in a subscription agreement?

A:

1. Actual cash paid to the corporation;

2. Property, tangible or intangible (*i.e.* patents or copyrights), the requisites are as follows:
   a. The property is actually received by the corporation
   b. The property is necessary or convenient for its use and lawful purposes
   c. It must be subject to a fair valuation equal to the par or issued value of the stock issued
   d. The valuation thereof shall initially be determined by the incorporators; and
   e. The valuation is subject to the approval by the SEC.

3. Labor or services actually rendered to the corporation

4. Prior corporate obligations or indebtedness

   Note: The indebtedness involved is one that is acknowledged by the board.

5. Amounts transferred from unrestricted retained earnings to stated capital (in case of declaration of stock dividends)

6. Outstanding shares in exchange for stocks in the event of reclassification or conversion.

Note: Promissory notes or future services are not valid considerations**.**

(5) ARTICLES OF INCORPORATION

Q: Define articles of incorporation.

A: Articles of Incorporation (AOI) is one that defines the charter of the corporation and the contractual relationships between the State and the corporation, the stockholders and the State, and between the corporation and its stockholders.

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Q: What are the contents of AOI?

A: NaP- PlaTINum-ASONO

1. **Na**me of corporation
2. **P**urpose/s, indicating the primary and secondary purposes
3. **Pla**ce of principal office

   Note: To determine proper venue in filing of an action

4. **T**erm of existence
5. Names, nationalities and residences of **I**ncorporators
6. **Num**ber of directors or trustees, which shall not be less than 5 nor more than 15, except for corporation sole
7. Names, nationalities, and residences of the persons who shall **A**ct as directors or trustees until the first regular ones are elected and qualified
8. If a **S**tock corporation, the amount of its authorized capital stock, number of shares and in case the shares are par value shares, the par value of each share;
9. Names, nationalities, number of shares, and the amounts subscribed and paid by each of the **O**riginal subscribers which shall not be less than 25% of authorized capital stock;
10. If **N**on-stock, the amount of capital, the names, residences, and amount paid by each contributor, which shall not be less than 25% of total subscription; name of treasurer elected by subscribers; and
11. **O**ther matters as are not inconsistent with law and which the incorporators may deem necessary and convenient. *(Sec. 14)*

Q: What are the limitations in the amendment of AOI?

A:

1. The amendment must be for legitimate purposes and must not be contrary to other provisions of the Corporation Code and Special laws;
2. Approved by *majority* of BOD/BOT;
3. Vote or written assent of stockholders representing 2/3 of the outstanding capital stock or 2/3 of members;
4. 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/s made;
5. Certification under oath by corporate secretary and a majority of the BOD/BOT stating the fact that said amendment/s have been duly approved by the required vote of the stockholders or members, shall be submitted to the SEC;
6. Must be approved by SEC. *(Sec. 16);*
7. Must be accompanied by a favorable recommendation of the appropriate government agency in cases of:
   a. Banks
   b. Banking and quasi-banking institutions
   c. Building and loan associations
   d. Trust companies and other financial intermediaries
   e. Insurance companies
   f. Public utilities
   g. Educational institutions
   h. Other corporations governed by special laws. *(Sec. 17 [2])*

Q: When does amendment of AOI take effect?

A: Upon approval by the SEC. That is upon issuance of amended certificate of incorporation.

Q: Is it necessary that the approval of SEC be express?

A: No, implied approval of SEC is also allowed. Thus amendment may also take effect from the date of filing with SEC if not acted upon within *6 months* from the date of filing for a cause not attributable to the corporation.

Q: What are the provisions of AOI that cannot be amended?

A: Those matters referring to accomplished facts, except to correct mistakes.

E.g.

1. Names of incorporators
2. Names of original subscribers to the capital stock of the corporation and their subscribed and paid up capital
3. Names of the original directors
4. Treasurer elected by the original subscribers
5. Members who contributed to the initial capital of the non-stock corporation
6. Witnesses to and acknowledgement with AOI

Q: What are the grounds for the rejection or disapproval of AOI or amendment thereto by the SEC?

A:
1. If such is not substantially in accordance with the *form* prescribed
2. The *purpose/s* of the corporation are patently unconstitutional, illegal, immoral, or contrary to government rules and regulations
3. The treasurer's affidavit concerning the amount of capital stock subscribed and/or paid is false
4. The required percentage of *ownership* of the capital stock to be owned by Filipino citizens has not been complied with. *(Sec. 17)*

Note: The above grounds are not exclusive. The grounds according to P.D. No. 902-A are:

1. Fraud in procuring its certificate of incorporation;
2. Serious misrepresentation as to what the corporation can do or its doing to the great prejudice of, or damage to, the general public;
3. Refusal to comply with, or defiance or a lawful order of the SEC restraining the commission of acts which would amount to a grave violation of its franchise;
4. Continuous inoperation for a period of at least five (5) years after commencing the transaction of its business *(Sec. 22);*
5. Failure to file the by-laws within the required period;
6. Failure to file required reports.

Q: Is there an automatic rejection of the AOI or any amendment thereto?

A: No, the SEC shall give the incorporators a reasonable time within which to correct or modify the objectionable portions of the AOI or amendment.*(Sec. 17[1])*

Q: What is the effect of non-use of corporate charter and continuous inoperation of a corporation?

A:
1. *Failure to organize and commence business within 2 years from incorporation* – its corporate powers ceases and the corporation shall be deemed dissolve.

2. *Continuous inoperation for at least 5 years* – ground for the suspension or revocation of corporate franchise or certificate of incorporation *(Sec. 22).*

Note: The above shall not be applicable if it is due to causes beyond the control of the corporation as determined by SEC.

Q: Is the dissolution or revocation due to failure to operate or inoperation automatic?

A: No, SEC is of the opinion that there should be proper proceedings for the revocation of AOI in compliance with due process.

(6) CORPORATE NAME

Q: What are the limitations in adopting corporate name?

A:
1. The proposed name is identical or deceptively or confusingly similar to that of any existing corporation
2. Any other name protected by law; or
3. Patently deceptive, confusing or contrary to existing laws. *(Sec. 18)*
4. The corporate name shall contain the word "Corporation" or its abbreviation "Corp." or "Incorporated", or "Inc."
5. The partnership name shall contain the word "Company" or "Co."
6. For limited partnership, the word "Limited" or "Ltd." Shall be included
7. If the name or surname of a person is used as part of a corporate or partnership name, the consent of said person or his heirs must be submitted except if that person is a stockholder, member, partner or a declared national hero.
8. The name of a dissolved firm shall not be allowed to be used by other firms within 3 years after the approval of the dissolution of the corporation by SEC, unless allowed by the last stockholders representing at least majority of the outstanding capital stock of the dissolved firm *(SEC Memorandum Circular 14).*

Q: If a corporation changes its corporate name, is it considered a new corporation?

A: No, it is the same corporation with a different name, and its character is in no respect changed. *(Republic Planter's Bank v. CA, G.R. No. 93073, Dec 21, 1992)*

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(7) REGISTRATION AND ISSUANCE OF CERTIFICATE OF INCORPORATION

Q: What are the basic requirements for a stock corporation?

A:
1. Name verification slip
2. AOI and by-laws
3. Treasurer's affidavit
4. Registration data sheet
5. Proof of payment of subscription like Bank Certificate of Deposit if the paid-up capital is in cash
6. Favorable endorsement from proper government agency in case of special corporations.

Q: What is the content of a treasurer's affidavit?

A: That at least 25% of the authorized capital stock of the corporation has been subscribed, and at least 25% of the total subscription has been fully paid in actual cash and/or property; such paid-up capital being not less than P5,000.

Q: What is the doctrine of corporate entity?

A:

GR: A corporation comes into existence upon the issuance of the certificate of incorporation. Then and only then will it acquire a juridical personality.

XPN: Sec. 112 clearly states that from and after the filing with the SEC of the articles of incorporation, the chief archbishop shall become corporation sole

(8) ELECTION OF DIRECTORS AND TRUSTEES

Q: Is permanent representation allowed in the BOD?

A: No, the board of directors of corporations must be elected from among the stockholders or members directors every year. *Estoppel* does not set in to legitimize what is wrongful. *(Grace Christian High School v. CA, G.R. No. 108905, Oct. 23, 1997)*

Q: What are the limitations on the election of directors/ trustees?

A:
1. At a meeting of stockholders or members called for the election of directors or trustees, there must be present either in person or by representative authorized to act by written proxy, the owners of the *majority* of the outstanding capital stock or majority of the members entitled to vote.
2. The election must be by ballot *if requested;*
3. A stockholder cannot be deprived in the articles of incorporation or in the by-laws of his statutory right to use any of the methods of voting in the election of directors;
4. No delinquent stock shall be voted;
5. The candidates receiving the highest number of votes shall be declared elected. *(Sec. 24)*

Q: Is a provision in the by-laws of the corporation declaring a person engaged in a competing business ineligible for nomination for elections to the board of directors valid?

A: Yes, provided that before such nominee is disqualified, he should be given due process to show that he is not covered by the disqualification *(Gokongwei v. SEC, G.R. No. L-45911, Apr. 11, 1979).*

Note: The disqualification of a competition from being elected to the board is a reasonable exercise of corporate authority.

Q: Who has jurisdiction over election contests in stock and non-stock corporation?

A: As amended by R.A. 8799 (The Securities Regulation Code), the jurisdiction of the SEC under Sec. 5 P.D. No. 902-A (SEC Reorganization Act) is now transferred to Courts of General Jurisdiction (Regional Trial Court). Thus, RTC now has jurisdiction over election contest.

Q: In case where there are 2 lists of BOD submitted to SEC, which one is controlling?

A: It is the *list of directors in the latest general information sheet* as filed with the SEC which is controlling. *(Premium Marble Resources, Inc. v. CA, G.R. No. 96551, Nov. 4, 1996)*

Q: What is the next step after the election of directors?

A: The directors must formally organize by the election of corporate officers. *(Sec. 25)*

Q: Who are the corporate officers?

A:
1. *President* – Must be a director at the time the assumes office, not at the time of appointment;
2. *Treasurer* – May or may not be a director; as a matter of sound corporate practice, must be a resident
3. *Secretary* – Need not be a director unless required by the by-laws; must be a resident and citizen of the Philippines; *(Sec. 25)*; and
4. Such *other officers* as may be provided in the by-laws.

Note: An officer is also considered a corporate officer if he has been appointed by the board of directors. *(Easycall Communications Phils., Inc. v. Edward King, G.R. No. 145901, Dec. 15, 2005)*
Any two or more positions may be held concurrently by the same person, except that no one shall act as president and secretary or as president and treasurer at the same time. *(Sec. 25)*

Q: What are the distinctions between a corporate officer and a corporate employee?

A:

CORPORATE OFFICER	CORPORATE EMPLOYEE
Position is provided for in the by-laws or under the Corporation Code.	Employed by the action of the managing officer of the corporation.
RTC acting as a special commercial court has jurisdiction over intra-corporate controversies.	LA has jurisdiction in case of labor disputes.

(9) ADOPTION OF BY-LAWS

Q: What are by-laws?

A: Rules and regulations or private laws enacted by the corporation to regulate, govern and control its own actions, affairs and concerns and of its stockholders or members and directors and officers in relation thereto and among themselves in their relation to it.

Q: What are the requisites for the validity of by-laws?

A:
1. Must be consistent with the Corporation Code, other pertinent laws and regulations
2. Must not be contrary to morals and public policy
3. Must not impair obligations and contracts or property rights of stockholders
4. Must be consistent with the charter or articles of incorporation
5. Must be reasonable
6. Must be of general application and not directed against a particular individual.

Q: In case of conflict between the by-laws and the articles of incorporation which prevails?

A: The AOI prevails because the by-laws are intended merely to supplement the former.

Q: What is the binding effect of by-laws?

A:
1. *As to members and corporation* – They have the force of contract between the members themselves.

2. *As to third persons* – They are not bound to know the by-laws which are merely provisions for the government of a corporation and notice to them will not be presumed.

Note: By-laws have no extra-corporate force and are not in the nature of legislative enactments so far as third persons are concerned.

Q: Give the procedures in adopting by-laws.

A: The by-laws may be adopted before or after incorporation. In all cases, the By-laws shall be effective only upon the issuance by the SEC of a certification that the by-laws are not inconsistent with the AOI.

1. *Pre - incorporation* – It shall be approved and signed by all the incorporators and submitted to the SEC, together with AOI.

2. *Post - incorporation*
   a. Vote of the majority of the stockholders representing the outstanding capital stock or members;
   b. By-laws shall be signed by the stockholders or members voting for them;
   c. It shall be kept in the principal office of the corporation and subject to the inspection of the stockholders ore members during office hours

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d. Copy thereof, duly certified by the BOD or BOT countersigned by the secretary of the corporation, shall be filed with the SEC and shall be attached with the original AOI. *(Sec. 46)*

Q: What is the effect of non-filing of the articles of incorporation within the required period?

A: Failure to submit the by-laws within 30 days from incorporation does not automatically dissolve the corporation. It is merely a ground for suspension or revocation of its charter after proper notice and hearing. The corporation is, at the very least, a *de facto* corporation whose existence may not be collaterally attacked. *(Sawadjaan v. CA, G.R. No. 142284, June 8, 2005)*

Q: What are the contents of by-laws?

A:

1. Time, place and manner of calling and conducting regular or special meetings of directors or trustees
2. Time and manner of calling and conducting regular or special meetings of the stockholder or members
3. The required quorum in meeting of stockholders or members and the manner of voting therein
4. The form for proxies of stockholders and members and the manner of voting them
5. The qualification, duties and compensation of directors or trustees, officers and employees
6. Time for holding the annual election of directors or trustees and the mode or manner of giving notice thereof
7. Manner of election or appointment and the term of office of all officers other than directors or trustees
8. Penalties for violation of the by-laws
9. In case of stock corporations, the manner of issuing certificates
10. Such other matters as may be necessary for the proper or convenient transaction of its corporate business and affairs. *(Sec. 47)*

Q: What are the ways of amending, repealing or adopting new by-laws?

A:

1. *Amendment may be made by stockholders together with the Board* – by majority vote of directors and owners of at least a majority of the outstanding capital stock/members; *or*

2. By the board only after due delegation by the stockholders owning 2/3 of the outstanding capital stock/members. Provided, that such power delegated to the board shall be considered as revoked whenever stockholders owning at least majority of the outstanding capital stock or members, shall vote at a regular or special meeting. *(Sec. 48)*

Q: What are the distinctions between AOI and by-laws?

A:

AOI	BY-LAWS
Condition precedent in the acquisition of corporate existence	Condition subsequent; its absence merely furnishes a ground for the revocation of the franchise
Essentially a contract between the corporation and the stockholders/ members; between the stockholders/ member inter se, and between the corporation and the State;	For the internal government of the corporation but has the force of a contract between the corporation and the stockholders/ members, and between the stockholders and members;
Executed before incorporation	May be executed after incorporation. Sec. 46 allows the filing of the by-laws simultaneously with the Articles of Incorporation
Amended by a majority of the directors/ trustees and stockholders representing 2/3 of the outstanding capital stock, or 2/3 of the members in case of non-stock corporations	May be amended by a majority vote of the BOD and majority vote of outstanding capital stock or a majority of the member in non-stock corporation
Power to amend/repeal articles cannot be delegated by the stockholders/ members to the board of directors/ trustees	Power to amend or repeal by-laws or adopt new by-laws may be delegated by the 2/3 of the outstanding capital stock or 2/3 of the members in the case of non-stock corporation

G. CORPORATE POWERS

Q: What are the kinds of powers of corporation?

A:

1. *Express powers* – Granted by law, Corporation Code, and its Articles of Incorporation or Charter, and administrative regulations

2. *Inherent/incidental powers* – Not expressly stated but are deemed to be within the capacity of corporate entities.

3. *Implied/necessary powers* – Exists as a necessary consequence of the exercise of the express powers of the corporation or the pursuit of its purposes as provided for in the Charter

(1) GENERAL POWERS

Q: What are the general powers of a corporation?

A: SuSuCo-ABSP-MEDPO

1. To **SU**e and be sued
2. Of **SU**ccession
3. To adopt and use of **Co**rporate seal
4. To amend its **A**rticles of Incorporation
5. To adopt its **B**y-laws
6. *For **S**tock corporations*: issue and sell stocks to subscribers and treasury stocks; *for non-stock corporations*: admit members
7. To **P**urchase, receive, take or grant, hold, convey, sell, lease, pledge, mortgage and deal with real and personal property, securities and bonds;
8. To **E**nter into merger or consolidation
9. To **M**ake reasonable **D**onations for public welfare, hospital, charitable, cultural, scientific, civic or similar purposes, *provided* that no donation is given to any
   a. Political party,
   b. Candidate and
   c. Partisan political activity.

10. To establish **P**ension, retirement, and other plans for the benefit of its directors, trustees, officers and employees – basis of which is the labor code
11. To exercise **O**ther powers essential or necessary to carry out its purposes.

Q: When does the power to sue and be sued commence?

A: Upon issuance by SEC of Certificate of Incorporation.

Q: What are the limitations of the corporation in dealing with property?

A:

1. In dealing with any kind of property, it must be in the furtherance of the purpose for which the corporation was organized.

2. *Constitutional limitations* – cannot acquire public lands except by lease.

   With regard to private land, 60% of the corporation must be owned by the Filipinos, same with the acquisition of a condo unit.

   Note: No law disqualifies a person from purchasing shares in a landholding corporation even if the latter will exceed the allowed foreign equity, what the law disqualifies is the corporation from owning land.

3. *Special law* – subject to the provisions of the Bulk Sales Law

Q: What are the requisites for a valid donation?

A:

1. Donation must be reasonable
2. Must be for valid purposes including public welfare, hospital, charitable, cultural, scientific, civic or similar purposes
3. Must not be an aid in any
   a. Political party,
   b. Candidate and
   c. Partisan political activity
4. Donation must bear a reasonable relation to the corporation's interest and not be so remote and fanciful.

Q: Can a corporation act as surety or guarantor?

A:

GR: No.

XPN: Such guaranty may be given in the accomplishment of any object for which the corporation was created, or when the particular transaction is reasonably necessary or proper in the conduct of its business.

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Q: What are the specific powers of a corporation?

A:

1. Power to extend or shorten corporate term. *(Sec. 37)*
2. Increase or decrease corporate stock. *(Sec. 38)*
3. Incur, create, or increase bonded indebtedness. *(Sec. 38)*
4. Deny pre-emptive right. *(Sec. 39)*
5. Sell, dispose, lease, encumber all or substantially all of corporate assets. *(Sec. 40)*
6. Purchase or acquire shares. *(Sec. 41)*
7. Invest corporate funds in another corporation or business for other purpose other than primary purpose .*(Sec. 42)*
8. Declare dividends out of unrestricted retained earnings. *(Sec. 43)*
9. Enter into management contract with another corporation (not with an individual or a partnership – within general powers) whereby one corporation undertakes to manage all or substantially all of the business of the other corporation for a period not longer than five (5) years for any one term. *(Sec. 44)*
10. Amend Articles of Incorporation. *(Sec. 16)*

(2) SPECIFIC POWERS

(a) POWER TO EXTEND OR SHORTEN CORPORATE TERM

Note: May be used as means to voluntarily dissolve a corporation

Q: What are the procedural requirements in extending/shortening corporate term?

A:

1. Majority vote of the BOD or BOT;
2. Ratification by 2/3 of the SH representing outstanding capital stock or by at least 2/3 of the members in case of non-stock corporation;
3. 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;
4. Copy of the amended AOI shall be submitted to the SEC for its approval; and
5. In case of special corporation, a favorable recommendation of appropriate government agency. *(Sec. 37)*

Note: The extension must be done during the lifetime of the corporation not earlier than 5 years prior to the expiry date unless exempted. The extension must not exceed 50 years.

After the term had expired without extension, the corporation is dissolved. The remedy of the stockholders is reincorporation.

Any dissenting stockholder may exercise his appraisal right in case of shortening or extending corporate term *(Sec. 37).*

(b) POWER TO INCREASE OR DECREASE CAPITAL STOCK

Q: What are the procedural requirements in increasing or decreasing capital stock?
A:

1. Majority vote of the BOD;
2. Ratification by stockholders representing 2/3 of the outstanding capital stock;
3. Written notice of the proposed increase or diminution of the capital stock and of the time and place of the stockholder's meeting at which the proposed increase or diminution of the capital stock must be addressed to each stockholder at his place of residence as shown on the books of the corporation and deposited to the addressee in the post office with postage prepaid, or served personally
4. A certificate in duplicate must be signed by a majority vote of the directors of the corporation and countersigned by the chairman and the secretary of the stockholder's meeting, setting forth:
   a. That the foregoing requirements have been complied with;
   b. The amount of increase or diminution of the capital stock;
   c. If an increase of the capital stock, the amount of capital stock or number of shares of no par stock 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 stockholder if such increase is for the purpose of making effective stock dividend authorized;

d. The amount of stock represented at the meeting; and
e. The vote authorizing the increase or diminution of the capital stock

Note: The increase or decrease in the capital stock or the incurring, creating or increasing bonded indebtedness shall require prior approval of the SEC.

Q: What is the additional requirement with respect to the increase of capital stock?

A: The application to be filed with the SEC shall be accompanied by the sworn statement of the treasurer of the corporation, showing that at least 25% of the amount subscribed has been paid either in cash or property or that there has been transferred to the corporation property the valuation of which is equal to 25% of the subscription.

Q: What shall be the basis of the required 25% subscription?

A: It shall be based on the additional amount by which the capital stock increased and not on the total capital stock as increased.

Note: There will be no treasurer's affidavit in case of decrease in capital stock. Corporation need not exhaust its original capital before increasing capital stock.

Q: What is the additional requirement with respect to the decrease of capital stock?

A: The same must not prejudice the right of the creditors.

Q: What are the ways of increasing or decreasing the capital stock?

A: By increasing or decreasing the:

1. Number of shares and retaining the par value;
2. Par value of existing shares without increasing or decreasing the number of shares;
3. Number of shares and increasing or decreasing the par value.

Q: The stockholders of People Power, Inc. (PPI) approved two resolutions in a special stockholders' meeting:

a) Resolution increasing the authorized capital stock of PPI; and
b) Resolution authorizing the Board of Directors to issue, for cash payment, the new shares from the proposed capital stock increase in favor of outside investors who are non-stockholders.

The foregoing resolutions were approved by stockholders representing 99% of the total outstanding capital stock. The sole dissenter was Jimmy Morato who owned 1% of the stock.

Are the resolutions binding on the corporation and its stockholders including Jimmy Morato, the dissenting stockholder?

A: No. The resolutions are not binding on the corporation and its stockholders including Jimmy Morato. While these resolutions were approved by the stockholders, the directors' approval, which is required by law in such case, does not exist. **(1998 Bar Question)**

Q: What remedies, if any, are available to Morato?

A: Jimmy Morato can petition the Securities and Exchange Commission to declare the two (2) resolutions, as well as any and all actions taken by the Board of Directors thereunder, null and void. **(1998 Bar Question)**

Q: What is bonded indebtedness?

A: It is a long term indebtedness secured by real or personal property (corporate assets).

Note: The requirements for the power to incur, create or increase bonded indebtedness is also the same with the power to increase or decrease capital stock.

Not all borrowings of the corporation need stockholders' approval. Only bonded indebtedness requires such approval.

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(c) POWER TO DENY PRE-EMPTIVE RIGHT

Q: What is pre-emptive right?

A: It is the preferential right of shareholders to subscribe to all issues or disposition of shares of any class in proportion to their present shareholdings. *(Sec. 39)*

Q: What is the purpose of pre-emptive right?

A: To enable the shareholder to retain his proportionate control in the corporation and to retain his equity in the surplus.

Q: Is there pre-emptive right on the re-issuance of treasury shares?

A: Yes. When a corporation reacquires its own shares which thereby become treasury shares, all shareholders are entitled to pre-emptive right when the corporation reissues or sells these treasury shares. The re-issuance of treasury shares is not among the exception provided by Sec. 39 when pre-emptive right does not exist.

Q: May pre-emptive right be waived by the stockholder?

A: Yes when the stockholder fails to exercise his pre-emptive right after being notified and given an opportunity to avail of such right.

Q: Is the pre-emptive right of a stockholder transferable?

A: Yes, unless there is an express restriction in the AOI.

Q: Suppose that X Corporation has already issued the 1000 originally authorized shares of the corporation so that its Board of Directors and stockholders wish to increase X's authorized capital stock. After complying with the requirements of the law on increase of capital stock, X issued an additional 1000 shares of the same value.

Assume that stockholder A presently holds 200 out of the 1000 original shares. Would A have a pre-emptive right to 200 of the new issue of 1000 shares? Why?

A: Yes, A would have a pre-emptive right to 200 of the new issue of 1000 shares. A is a stockholder of record holding 200 shares in X Corporation. According to the Corporation Code, each stockholder has the pre-emptive right to all issues of shares made by the corporation in proportion to the number of shares he holds on record in the corporation.

Q: When should stockholder A exercise the pre-emptive right?

A: Pre-emptive right must be exercised in accordance with the Articles of Incorporation or the By-Laws. When the Articles of Incorporation and the By-Laws are silent, the Board may fix a reasonable time within which the stockholders may exercise the right.

Q: Assuming a stockholder disagrees with the issuance of new shares and the pricing for the shares, may the stockholder invoke his appraisal rights and demand payment for his shareholdings?

A: No, the stockholder may not exercise appraisal right because the matter that he dissented from is not one of those where right of appraisal is available under the Corporation Code. **(1999 Bar Question)**

Q: When can the corporation deny pre-emptive right?

A: The corporation can deny pre-emptive right if the articles of incorporation or amendment thereto denies such right.

Q: Distinguish pre-emptive right from right of first refusal.

A:

PRE-EMPTIVE RIGHT	RIGHT OF FIRST REFUSAL
May be exercised even when there is no express provision of law	Arises only by virtue of contractual stipulations but is also granted under the provisions on close corporation
Pertains to unsubscribed portion of the authorized capital stock. A right that may be claimed against the corporation. It includes treasury shares.	Exercisable against another stockholder of the corporation of his shares of stock

Q: What are the instances when pre-emptive right is not available?

A:

1. Shares to be issued to comply with laws requiring stock offering or minimum stock ownership by the public;

2. Shares issued in good faith with the approval of the stockholders representing 2/3 of the outstanding capital stock in exchange for property needed for corporate purposes;
3. Shares issued in payment of previously contracted debts;
4. In case the right is denied in the Articles of Incorporation;
5. Waiver of the right by the stockholder.

(d) SELL, LEASE, EXCHANGE, MORTGAGE, PLEDGE OR OTHER DISPOSITION (SLEMPO) OF ALL OR SUBSTANTIALLY ALL OF CORPORATE ASSETS

Q: What are the procedural requirements?

A:

1. Majority vote of the BOD or BOT
2. Ratification by stockholders representing at least 2/3 of the outstanding capital stock or by at least 2/3 of the members in case of non-stock corporation
3. Written notice of the proposed action and of the time and place of the meeting 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. *(Sec. 40)*

Note: The sale of the assets shall be subject to the provisions of existing laws on illegal combinations and monopolies.

After such authorization or approval by the stockholders the board may, nevertheless, in its discretion, abandon such SLEMPO. *(Sec. 40)*

Any dissenting stockholder shall have the option to exercise his appraisal right.

Q: What is meant by substantially all of corporate assets?

A: If the corporation would be:

1. rendered incapable of continuing the business, or
2. accomplishing the purpose for which it was incorporated.

Q: When may the corporation forgo the ratification by SH / members?

A:

1. If sale is necessary in the usual and regular course of business;
2. If the proceeds of the sale or other disposition of such property and assets are to be appropriated for the conduct of the remaining business;
3. If the transaction does not cover all or substantially all of the assets.

Q: What is the effect of sale of all or substantially all of assets of one corporation to another corporation?

A:

GR: The selling corporation of all or substantially all of the assets of the purchasing corporation shall not be liable for the debts of the transferor corporation.

XPN:

1. Express or implied assumption of liabilities;
2. Merger or consolidation;
3. If the purchase was in fraud of creditors;
4. If the purchaser becomes a continuation of the seller;
5. If there is violation of the Bulk Sales Law.

(e) POWER TO ACQUIRE OWN SHARES

Q: Can a corporation acquire its own shares?

A:

GR: In the absence of statutory authority, the corporation cannot acquire its own shares
XPN: SEC Opinion, Oct. 12, 1992, imposed the following conditions on its exercise:

1. The capital of the corporation must not be impaired;
2. Legitimate and proper corporate objective is advanced;
3. Condition of the corporate affairs warrants it;
4. Transaction is designed and carried out in good faith
5. Interest of creditors not impaired, that is, not violative of the trust fund doctrine.

Note: Sec. 41 of the Code requires that:

1. the acquisition should be for a legitimate corporate purpose; and
2. there should be unrestricted retained earnings [URE].

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Q: What are the instances where corporation may acquire its own shares?

A:
1. To eliminate fractional shares out of stock dividends;
2. 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;
3. To pay dissenting or withdrawing stockholders (in the exercise of the stockholder's appraisal right);
4. To acquire treasury shares;
5. Redeemable shares *regardless* of existence of retained earnings;
6. To effect a decrease of capital stock;
7. In close corporations, when there is a deadlock in the management of the business.

(g) INVEST CORPORATE FUNDS IN ANOTHER CORPORATION OR BUSINESS FOR OTHER PURPOSE OTHER THAN PRIMARY PURPOSE

Q: What are the requirements?

A:
1. Approval by the majority vote of the BOD or BOT
2. Ratification by stockholders representing at least 2/3 of the outstanding capital stock or by at least 2/3 of the members in case of non-stock corporation
3. Ratification must be made at a meeting duly called for the purposes, and
4. Prior written notice of the proposed investment and the time and place of the meeting shall be made addressed to each stockholder or member by mail or by personal service.

Note: Investment of a corporation in a business which is in line with its primary purpose requires only the approval of the board.

Any dissenting stockholder shall have appraisal right.

(f) POWER TO DECLARE DIVIDENDS OUT OF UNRESTRICTED RETAINED EARNINGS (URE)

Q: What are the requirements?

A:
1. Existence of unrestricted retained earnings
2. Resolution of the board
3. In case of stock dividend, resolution of the board with the concurrence of votes representing 2/3 of outstanding capital.

Q: What are unrestricted retained earnings?

A: These are retained earnings which have not been reserved or set aside by the board of directors for some corporate purpose.

Q: Who are entitled to receive dividends?

A: The stockholders of record date in so far as the corporation is concerned; if there is no record date, the stockholders at the time of declaration of dividends (not at the time of payment).

Note: In case of transfer, dividends declared *before* the transfer of shares belong to the transferor and those declared *after* the transfer belongs to the transferee.

Q: Who are entitled to receive dividends in case of mortgaged or pledged shares?

A:

GR: The mortgagor or the pledgor has the right to receive the dividends.

XPN: When the mortage or pledge is recorded in the books of the corporation, in such a case then the mortgagee or pledgee is entitled to receive the dividends.

Q: What are the forms of dividends?

A:
1. Cash

   Note: Cash dividends due on delinquent stock shall first be applied to the unpaid balance on the subscription plus cost and expenses.

2. Stock

   Note: Stock dividends are withheld from the delinquent stockholder until his unpaid subscription is fully paid.

3. Property

   Note: Stockholders are entitled to dividends PRO-RATA based on the total number of shares and not on the amount paid on shares.

Q: When may corporation declare dividends?

A:

<u>**GR**</u>**:** Even if there are existing profits, BOD has discretion to determine whether dividends are to be declared.

<u>**XPN**</u>**:** Stock corporations are prohibited from retaining surplus profits in excess of 100% of their paid-in capital stock.

<u>**XPN to XPN**</u>**:**

1. Definite corporate expansion projects approved by the board of directors;
2. Corporation is prohibited under any loan agreement with any financial institution or creditor from declaring dividends without its/his consent and such consent has not yet been secured;
3. The retention is necessary under special circumstances obtaining in the corporation, such as when there is a need for special reserve for probable contingencies.

Q: What if there is a wrongful or illegal declaration of dividends?

A: The Board of Directors is liable. The stockholders should return the dividends to the corporation *(solutio indebiti)*.

Q: What are the sources of dividends?

A:

<u>**GR**</u>**:** Dividends can only be declared out of actual and *bona fide* unrestricted retained earnings.

<u>**XPN**</u>**:** Dividends can be declared out of capital in the following instances:

1. Dividends from investments wasting assets corporation;
2. Liquidating dividends

Q: What are the sources of retained earnings? Is it available for dividends?

A:

SOURCES OF RETAINED EARNINGS	AVAILABILITY FOR DIVIDENDS
Paid-in surplus – It is the difference between the par value and the issued value or selling price of the shares	It cannot be declared as cash dividend but can be declared only as stock dividends
Revaluation surplus – Increase in the value of a fixed asset as a result of its appreciation. They are by nature subject to fluctuations.	Cannot be declared as dividends because there is no actual gain (gain in paper only).
Reduction surplus – the surplus arises from the reduction of the par value of the issued shares of stocks.	It cannot be declared as cash dividend but can be declared only as stock dividends
Gain from Sale of Real Property	Available as dividends
Treasury Shares	Cannot be declared as stock or cash dividends but it may be declared as property dividend
Operational Income Income	Available as dividends

Q: Distinguish cash and stock dividends.

A:

CASH DIVIDENDS	STOCK DIVIDENDS
Part of general fund	Part of capital
Results in cash outlay	No cash outlay
Not subject to levy by corporate creditors	Once issued, can be levied by corporate creditors because they're part of corporate capital
Declared only by the board of directors at its discretion (majority of the quorum only, not majority of all the board)	Declared by the board with the concurrence of the stockholders representing at least 2/3 of the outstanding capital stock at a regular/special meeting
Does not increase the corporate capital	Corporate capital is increased
Its declaration creates a debt from the corporation to each of its stockholders	No debt is created by its declaration
If received by *individual*: subject to tax; If received by *corporation*: not subject to tax	Not subject to tax either received by individual or a corporation
Cannot be revoked after announcement	Can be revoked despite announcement but before issuance
Applied to the unpaid balance of delinquent shares	Can be withheld until payment of unpaid balance of delinquent shares

Note: For the purposes of this distinction, property dividends are considered as cash dividends.

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Q: May stock dividends be issued to a person who is not a stockholder in payment of services rendered?

A: No. Only stockholders are entitled to payment of stock dividends. *(Nielson & Co., Inc. v. Lepanto Consolidated Mining Co., G.R. No. 21763, Dec. 17, 1966).*

(h) POWER TO ENTER INTO MANAGEMENT CONTRACT

Q: What is a management contract?

A: It is 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. *(Sec. 44)*

Note: Sec. 44 refers only to a management contract with another corporation. Hence, it does not apply to management contracts entered into by a corporation with natural persons.

Q: What are the requirements?

A:

1. Contract must be approved by the majority of the BOD or BOT of both managing and managed corporation;
2. Ratified by the stockholders owning at least the majority of the outstanding capital stock, or members in case of a non-stock corporation, of both the managing and the managed corporation, at a meeting duly called for the purpose
3. Contract must be approved by the stockholders of the managed corporation owning at least 2/3 of the outstanding capital stock entitled to vote, 2/3 members when:
    a. Stockholders representing the same interest in both of the managing and the managed corporation own or control more than 1/3 of the total outstanding capital stock entitled to vote of the managing corporation;
    b. Majority of the members of the BOD of the managing corporation also constitute a majority of the BOD of the managed corporation.

Q: What is the allowed period for every management contract entered into by the corporation?

A:

<u>**GR**</u>**:** Management contract shall be entered into for a period not longer than 5 years for any one term.

<u>**XPN**</u>**:** In cases of service contracts or operating agreements which relate to the exploitation, development, exploration or utilization of natural resources, it may be entered for such periods as may be provided by the pertinent laws or regulations.

(i) ULTRAVIRES ACTS

Q: What are *ultra vires* acts?

A: Those powers that are not conferred to the corporation by law, by its AOI and those that are not implied or necessary or incidental to the exercise of the powers so conferred. *(Sec 45)*

Q: What are the types of *ultra vires* acts (UVA)?

A:

1. Acts done beyond the powers of the corporation (through BOD)
2. Ultra vires acts by corporate officers
3. Acts or contracts which are per se illegal as being contrary to law.

Q: When does the act of the officers bind the corporation?

A:

1. If it is provided in the by-laws
2. If authorized by the board
3. Under the doctrine of apparent authority
4. When the act was ratified

Q: What is the doctrine of apparent authority?

A: If a corporation knowingly permits one of its officers, or any other agent, to act within the scope of an apparent authority, it holds him out to the public possessing the power to do those acts; and thus, the corporation will, as against anyone who has in good faith dealt with it through such agent, be estopped from denying the agent's authority.

Q: When is the corporation estopped to deny ratification of contracts or acts entered by its officers or agents?

A: Generally, when the corporation has knowledge that its officers or agents exceed their power, it must promptly disaffirm the contract or act, and allow the other party or third person to act in the belief that it was authorized or has been ratified. Otherwise, if it acquiesces, with knowledge of the facts, or if it fails to disaffirm, ratification will be implied. *(Premiere Development Bank vs. CA, G.R. No. 159352, Apr. 14, 2004)*

Q: What are the effects of an ultra vires act?

A: *Ultra vires acts* entered into by the board of directors binds the corporation and the courts will not interfere unless terms are oppressive and unconscionable. *(Gamboa vs. Victoriano, G.R. No. L-43324. May 5, 1979)*

These are the effects for the specific acts:

1. *Executed contract* – courts will not set aside or interfere with such contracts
2. *Executory contracts* – no enforcement even at the suit of either party (void and unenforceable)
3. *Partly executed and partly executory* – principle of "no unjust enrichment at expense of another" shall apply
4. *Executory contracts apparently authorized but ultra vires* – the principle of estoppel shall apply.

Q: What are the distinctions between *ultra vires* acts and illegal acts?

A:

ULTRA VIRES ACT	ILLEGAL ACTS
Not necessarily unlawful, but outside the powers of the corporation	Unlawful; against law, morals, public policy, and public order
Can be ratified	Cannot be ratified
Can bind the parties if wholly or partly executed	Cannot bind the parties

Q: What are the remedies in case of *ultra vires* act?

A:

1. *State*
   a. Obtain a judgment of forfeiture; or
   b. The SEC may suspend or revoke the certificate of registration

2. *Stockholders*
   a. Injunction; or
   b. Derivative suit

3. *Creditors* - Nullification of contract in fraud of creditors.

(j) DOCTRINE OF INDIVIDUALITY OF SUBCRIPTION

Q: What is the Doctrine of Individuality of Subscription?

A: A subscription is one entire and indivisible whole contract. It cannot be divided into portions. *(Sec. 64)*

(k) DOCTRINE OF EQUALITY OF SHARES

Q: What is the doctrine of equality of shares?

A: Where the articles of incorporation do not provide for any distinction of the shares of stock, all shares issued by the corporation are presumed to be equal and enjoy the same rights and privileges and are also subject to the same liabilities. *(Sec. 6)*

(l) TRUST FUND DOCTRINE

Q: What is the trust fund doctrine?

A: The subscribed capital stock of the corporation is a trust fund for the payment of debts of the corporation which the creditors have the right to look up to satisfy their credits, and which the corporation may not dissipate. The creditors may sue the stockholders directly for the latter's unpaid subscription.

Q: What are the exceptions to the trust fund doctrine?

A: The Code allows distribution of corporate capital only in these instances:
1. Amendment of the AOI to reduce authorized capital stock;
2. Purchase of redeemable shares by the corporation regardless of existence of unrestricted retained earnings;
3. Dissolution and eventual liquidation of the corporation.

(3) HOW EXERCISED

Q: How are corporate powers exercised?

A:
1. *By the shareholders* – The shareholders participate in controlling the affairs of the corporation by exercising their right to vote. They can elect the directors who will actually govern the

corporation and they can also vote on important matters that are still reserved to them by the Corporation Code. *(Aquino, 2006)*

2. *By the Board of Directors* – The Board of Directors is primarily responsible for the governance of the corporation. Their primary duty is to set the policies for the accomplishment of the corporate objectives. *(Art. 3, Revised Code of Corporate Governance).* They elect the officers who carry out the policies that they have established.

3. By the Officers – They are elected by the Board of Directors tasked to carry out the policies laid down by the Board, the articles of incorporation and the by-laws.

H. STOCKHOLDERS AND MEMBERS

Q: How does one become a shareholder in a corporation?

A: A person becomes a shareholder the moment he:

1. Enters into a subscription contract with an existing corporation (he is a stockholder upon acceptance of the corporation of his offer to subscribe whether the consideration is fully paid or not),
2. Purchase treasury shares from the corporation, or
3. Acquires shares from existing shareholders by sale or any other contract.

(1) FUNDAMENTAL RIGHTS

Q: What are the rights of stockholders?

A:

1. *Management Right*
   a. To attend and vote in person or by proxy at a stockholders' meetings. *(Secs. 50, 58)*
   b. To elect and remove directors. *(Secs. 24, 18)*
   c. To approve certain corporate acts. *(Sec. 58)*
   d. To compel the calling of the meetings. *(Sec. 50)*
   e. To have the corporation voluntarily dissolved. *(Sec. 118, 119)*
   f. To enter into a voting trust agreement. *(Sec. 59)*
   g. To adopt/amend/repeal the by-laws or adopt new by-laws. *(Secs. 46, 48)*

2. *Proprietary rights*
   a. To transfer stock in the corporate book. *(Sec. 63)*
   b. To receive dividends when declared .*(Sec. 43)*
   c. To the issuance of certificate of stock or other evidence of stock ownership. *(Sec. 63)*
   d. To participate in the distribution of corporate assets upon dissolution. *(Sec. 118, 119)*
   e. To pre-emption in the issue of shares. *(Sec. 39)*

3. *Remedial rights*
   a. To inspect corporate books. *(Sec. 74)*
   b. To recover stock unlawfully sold for delinquency. *(Sec. 69)*
   c. To demand payment in the exercise of appraisal right. *(Secs. 41, 81)*
   d. To be furnished recent financial statements or reports of the corporation's operation *(Sec. 75);*
   e. To bring suits (derivative suit, individual suit, and representative suit).

(2) PARTICIPATION IN MANAGEMENT

(a) PROXY

Q: What is a proxy?

A: Proxy is a written authorization, empowering another person (proxy) to represent a shareholder and vote in his stead in the stockholder's meeting.

Q: What are the requirements for a valid proxy?

A:

1. Proxies shall be in writing and shall be signed by the stockholder or member concerned
2. The proxy shall be filed before the scheduled meeting with the corporate secretary;

   Note: For public companies, the SEC requires that proxy forms be submitted at least 5 days before the meeting.

3. Unless otherwise provided (continuing in nature) in the proxy, it shall be valid only for the meeting for which it is intended; and

4. No proxy shall be valid and effective for a period longer than 5 years at any one time. *(Sec.58 B.P. 68 as amended by Sec. 20, SRC)*

Note: Stockholders or members may attend and vote in their meetings by proxy *(Sec. 58); directors cannot do so.* Directors must always act in person. *(Sec. 25).*

Q: Is the power to appoint a proxy a personal right?

A: Yes. The right to vote is inseparable from the right of ownership of stock. Therefore, to be valid, a proxy must have been given by the person who is the legal owner of the stock and is entitled to vote. *(SEC Opinion, Sept. 9, 1991)*

Note: In non-stock corporations the right to vote by proxy, or even the right to vote itself may be denied to members in the articles of incorporation or the by-laws as long as the denial is not discriminatory.

Q: What is the duration of proxy?

A:

1. *Specific proxy* – authority granted to the proxy holder to vote only for a particular meeting on a specific date.

2. *Continuing proxy* – grants authority to a proxy to appear and vote for and in behalf of a shareholder for a continuing period which should not be more than 5 years at any one time.

   Note: By-laws may provide for a shorter duration of a continuing proxy.

Q: What is the extent of authority of a proxy?

A:

1. *General proxy* – A general discretionary power to attend and vote at annual meeting.

2. *Limited proxy* – Restrict the authority to vote to specified matters only and may direct the manner in which the vote shall be cast

Q: When may the right to vote by proxy be exercised?

A:

1. Election of the BOD/BOT
2. Voting in case of joint ownership of stock
3. Voting by trustee under VTA
4. Pledge or mortgage of shares
5. As provided for in the by-laws

Q: How and when is a proxy revoked?

A: A proxy may be revoked in writing, orally or by conduct.

<u>**GR**</u>**:** One who has given a proxy the right to vote may revoke the same at anytime.

<u>**XPN:**</u> Said proxy is coupled with interest even it may appear by its terms to be irrevocable.

(b) VOTING TRUST AGREEMENT

Q: What is a voting trust agreement (VTA)?

A: It is an agreement whereby one or more stockholders transfer their shares of stocks to a trustee, who thereby acquires for a period of time the *voting rights (and/or any other specific rights)* over such shares; and in return, trust certificates are given to the stockholder/s, which are transferable like stock certificates, subject, to the trust agreement.

Q: What are the specific limitations on VTA?

A:

1. VTA can be entered into for a period not exceeding 5 years at any one time except when it is a condition in a loan agreement but shall automatically expire upon full payment of the loan;
2. It must be in writing and notarized, and shall specify the terms and conditions thereof; *(Sec. 59)*

Q: What are the procedural requirements for VTA to be valid?

A:

1. Execution and notarization of the VTA stating the terms and conditions thereof

2. A certified copy of such agreement shall be filed with the corporation and with

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the SEC, otherwise, it is ineffective and unenforceable

3. The certificate/s of stock covered by the VTA shall be cancelled

4. A new certificate shall be issued in the name of the trustee/s stating that they are issued pursuant to the VTA

5. The transfer shall be noted in the books of the corporation, that it is made pursuant to said VTA

6. The trustee/s shall execute and deliver to the transferors voting trust certificates, which shall be transferable in the same manner and with the same effect as certificates of stock

7. 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. *(Sec. 59)*

Q: What is the effect of a voting trust agreement with respect to the rights of the trustor and the trustee?

A: A voting trust agreement results in the separation of the voting rights of a stockholder from his other rights such as the right to receive dividends and other rights to which a stockholder may be entitled until the liquidation of the corporation. It is the trustee of the shares who acquires legal title to the shares under the voting trust agreement and thus entitled to the right to vote and the right to be elected as board of directors while the trustor-stockholder has the beneficial title which includes the right to receive dividends *(Lee vs. CA 205 SCRA 752)*

Note: Unless expressly renewed, all rights granted in a voting trust agreement shall automatically expire at the end of the agreed period, and 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 transferors. *(Sec. 59)*

Q: What are the distinctions between a voting trust agreement and proxy?

A:

VOTING TRUST	PROXY
The agreement is irrevocable	Revocable anytime except one with interest
Trustee acquires legal title to the shares of the transferring stockholder	Proxy has no legal title to the shares of the principal
Not only right to vote is given, other rights as well except the right to receive dividends	Only right to vote is given
The trust may vote in person or by proxy unless the agreement provides otherwise	The proxy must vote in person
The agreement must be notarized	Proxy need not be notarized
Trustee is not limited to act at any particular meeting	Proxy can only act at a specified stockholder's meeting (if not continuing)
The share certificate shall be cancelled and transferred to the trustee	No cancellation of the certificate shall be made
A trustee can vote and exercise all the rights of the stockholder even when the latter is present	A proxy can only vote in the absence of the owners of the stock
The voting right is divorced from the ownership of stocks	The right to vote is inherent in or inseparable from the right to ownership of stock
An agreement must not exceed 5 years at any one time except when the same is made a condition of a loan.	A proxy is usually of shorter duration although under Sec. 58 it cannot exceed 5 years at any one time
Governed by the law on trust	Governed by the law on agency

Q: What is a pooling agreement?

A: This is an agreement, also known as *voting agreement*, entered into by and between 2 or more stockholders to make their shares as one unit (ex: Shareholders, A,B,C,D,E, holds 50% of the outstanding capital stock, entered into a pooling agreement to vote for F as a member of the board of director). This usually relates to election of directors where parties often provide for arbitration in case of disagreement. This does not involve a transfer of stocks but is merely a private agreement (*Sec. 100).*

Q: When are pooling agreements valid?

A: 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.

Q: What is the difference between Pooling Agreement and Voting Trust Agreement?

A: In Pooling Agreement, the stockholders themselves exercise their right to vote. On the other hand, the trustees are the ones who exercise the right to vote under the Voting Trust Agreement.

(c) CASES WHEN STOCKHOLDERS ACTION IS REQUIRED

Q: Give the summary of vote requirements for stockholder and directors

A: See Appendix E

Q: Is a provision stating that the consent of the board must be obtained before transfer of shares valid?

A: No. A shareholder has the right to transfer, sell, assign or dispose his shares as an incident of ownership. A provision that requires any to first obtain the consent of the board of directors or other stockholders of the corporation before he can transfer his shares is *void* as it unduly restrains the exercise of the stockholder of his right to transfer.

(3) PROPRIETARY RIGHTS

Q: What are the proprietary rights of a stockholder?

A:

1. Right to Dividend
2. Right of First Refusal
3. Appraisal Right
4. Right to Inspect
5. Preemptive Right
6. Right to Vote

Q: What is the right to dividend of a stockholder?

A: It is the right of the stockholder to demand payment of dividends after board declaration. Stockholders are entitled to dividends pro rata based on the total number of shares that they own and not on the amount paid for the shares.

Q: Who is entitled to receive dividends?

A:

GR: Those stockholders at the time of declaration. Dividends belong to the person who owns the stock when the dividend is declared.

XPN:

1. In case a record date is provided for. A record date is the future date specified in the resolution declaring dividend that the dividend shall be payable to those who are stockholders of record on such specified future date or as of the date of the meeting declaring such dividends.
2. Unpaid Subscribers. Section 72 provides that holders of shares not fully paid which are not delinquent shall have all the rights of a stock holder.

Q: What are the instances where a stockholder may exercise his appraisal right?

A: Any stockholder of a corporation shall have the right to dissent and demand payment of the fair value of his shares in the following instances:

1. In case any amendment to the articles of incorporation has the effect of changing or restricting the rights of any stockholder or class of shares, or of authorizing preferences in any respect superior to those of outstanding shares of any class, or of extending or shortening the term of corporate existence.
2. 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.
3. In case of merger or consolidation.

Q: What is the right of first refusal?

A: A right that grants to the corporation or another stockholder the right to buy the shares of stock of another stockholder at a fixed price and only valid if made on reasonable terms and consideration.

Except in the case of a close corporation where the right of first refusal is required to be a feature to be found in the articles of incorporation, the right of first refusal can only arise by means of a

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contractual stipulation, or when it is provided for in the articles of incorporation.

Note: When the by-laws provide a right of first refusal, it is null and void. There is no authority to create property restrictions in by-laws provisions. *(Hodges v. Lezama, 62 O.G. 6823)*

Q: May a provision in the articles of incorporation validly grant a right of first refusal in favor of other stockholders?

A: Yes, the SEC, as a matter of policy, allows restrictions on transfer of shares in the articles of incorporation if the same is *necessary* and *convenient* to the attainment of the objective for which the company was incorporated, unless palpably unreasonable under the circumstances. (*SEC Opinion, Feb. 20, 1995*)

Q: What is the Right to Inspect?

A: It is the right of a stockholder to inspect the books of the corporation provided the following requisites are present:

1. It must be exercised at reasonable hours on business days;
2. The stockholder has not improperly used any information he has secured through any previous examination and
3. Demand is made in good faith or for a legitimate purpose.

Q: What is Preemptive right?

A: It is the preferential right of shareholders to subscribe to all issues or disposition of shares of any class in proportion to their present shareholdings. *(Sec. 39)*

Q: How can the stockholders exercise their right to vote?

A: The stockholders can exercise their right to vote through the election, replacement and removal of Board of Directors or Trustees and on other corporate acts which require stockholders' approval.

Q: What are the conditions for the issuance of non-voting shares?

A: The issuance of non- voting shares is subject to the following conditions under Section 6 of the Corporation Code:

1. Only preferred or redeemable shares may be made non-voting shares;
2. There must remain other shares with full voting rights

Q: When are non-voting shares entitled to vote?

A: The non-voting shares may still vote in the following matters:

1. Amendment of the articles of incorporation
2. Adoption and amendment of by-laws
3. Sale, lease, exchange, mortgage, pledge or other disposition of all or substantially all of the corporate property.
4. Incurring, creating or increasing bonded indebtedness
5. Increase or decrease of capital stock
6. Merger or consolidation of the corporation with another corporation or other corporations
7. Investment of corporate funds in another corporation or business in accordance with the corporation code
8. Dissolution of the corporation

Q: What is the rule in case of pledged or mortgaged shares?

A: As a rule, 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

XPN: The pledgee or mortgagee is expressly given by the pledgor or mortgagor such right in writing which is recorded on the appropriate corporate books.

Q: What is the rule in case of joint ownership of stock?

A: Generally, in case of shares of stock owned jointly by two or more persons, in order to vote the same, the consent of all the co-owners shall be necessary.

XPN: If 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.

Note: treasury shares shall have no voting right as long as such shares remain in treasury.

(4) REMEDIAL RIGHTS

Q: What actions can the stockholders or members bring?

A:
1. *Derivative suit* – one brought by one or more stockholders or members in the name and on behalf of the corporation to redress wrongs committed against it or to protect or vindicate corporate rights, whenever the officials of the corporation refuse to sue or are the ones to be sued or hold control of the corporation. The requisites are as follows:

   a. There should be an existing cause of action in favor of the corporation;
   b. Refusal of the corporation to file an action despite demand from the stockholder.
   c. The party filing the suit must be a stockholder at the time of the objectionable acts or transactions occurred unless such transactions are continuing in nature; and
   d. The action must be brought in the name of the corporation which must be alleged

   Note: The stockholder is only nominal party in a derivative suit. The real party in interest is the corporation.

2. *Individual suit* – and action brought by a stockholder against the corporation for direct violation of his contractual rights.

3. *Representative suit* – one brought by a person in his own behalf and on behalf of all similarly situated.

Q: Which court has jurisdiction over a derivative suit?

A: A derivative suit is an intra-corporate controversy hence under the jurisdiction of the RTC acting special commercial court.

Q: AA, a minority stockholder, filed a suit against BB, CC, DD, and EE, the holders of majority shares of MOP Corporation, for alleged misappropriation of corporate funds. The complaint averred, inter alia, that MOP Corporation is the corporation in whose behalf and for whose benefit the derivative suit is brought. In their capacity as members of the Board of Directors, the majority stockholders adopted a resolution authorizing MOP Corporation to withdraw the suit. Pursuant to said resolution, the corporate counsel filed a Motion to Dismiss in the name of the MOP Corporation. Should the motion be granted or denied? Reason briefly.

A: It should not be denied. The requisites for a valid derivative suit exist in this case. First, AA was exempt from exhausting his remedies within the corporation and did not have a demand on the Board of Directors for the latter to sue. Here, such a demand would be futile, since the directors who comprise the majority (namely BB, CC, DD and EE are the ones guilty of the wrong complained of. Second, AA appears to be a stockholder at the time of the alleged misappropriation of corporate funds. Third, the suit is brought on behalf and for the benefit of MOP Corporation. In this connection, it was held in *Commart* (*Phils*.) *Inc*. *v*. *SEC*, *G.R. No. 85318, June 3, 1991,* that to grant to the corporation concerned the right of withdrawing or dismissing the suit, at the instance of the majority stockholders and directors who themselves are the persons alleged to have committed the breach of trust against the interests of the corporation would be to emasculate the right of the minority stockholders to seek redress for the corporation. Filing such action as a derivative suit even by a lone stockholder is one of the protections extended by law to minority stockholders against abuses of the majority.

(5) OBLIGATIONS OF A STOCKHOLDER

Q: What are the obligations of stockholders?

A: The stockholders have the following obligations:

1. Obligation to pay the corporation for the unpaid subscription including interest therein;

2. Obligation to pay the creditors of the corporation to the extent of their subscription if the corporate assets are not sufficient.

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ASST. SUBJECT HEADS: KIMVERLY A. ONG & JOANNA MAY D.G. PEÑADA; MEMBERS: MA. ELISA JONALYN A. BARQUEZ, ANGELI R. CARPIO, ANTONETTE T. COMIA, ALBAN ROBERT LORENZO F. DE ALBAN, JOEBEN T. DE JESUS, CHRIS JARK ACE M. MAÑO, ANNA MARIE P. OBIETA, RUBY ANNE B. PASCUA, FLOR ANGELA T. SABAUPAN, GIAN FRANCES NICOLE C. VILCHES

(6) MEETINGS

Q: When will stockholders/members meeting be held?

A:

DATE OF MEETING	REQUIRED *WRITTEN* NOTICE
Regular meeting	
1. Annually on date fixed in the by-laws; *or* 2. If there is no date in the by-laws – any date in April as determined by the board. *Venue:* In the city or municipality where the principal office is located	1. Within the period provided in the by-laws 2. In the absence of provision in the by-laws – 2 weeks prior to the meeting.
Special meeting	
1. Any time deemed necessary; *or* 2. As provided in the by-laws *Venue:* Principal office	1. Within the period provided in the by-laws 2. If no provision in the by-laws – 1 week prior to the meeting

Q: What is the required quorum in a stock corporation?

A:
GR: Shall consist of the stockholders representing *majority of the outstanding capital stock or a majority* of the actual and living members with voting rights, in the case of non-stock corporation. *(Tan v. Sycip, G.R. No. 153468, Aug. 17, 2006)*

XPN:
1. A different quorum may be provided for in the by-laws
2. The corporation code provides for certain resolutions that must be approved by at least 2/3 of the outstanding capital stock, in which case, majority of the outstanding capital stock is insufficient to constitute a quorum, presence of the stockholders representing 2/3 of the outstanding capital stock is necessary for such purpose.

Q: What are the requirements for a valid meeting whether stockholders/members or the board?

A:
1. It must be held in the proper place;
2. It must be held at the stated date and at the appointed time or at a reasonable time thereafter;
3. It must be called by the proper person:
   a. The person or persons designated in the by-laws have authority to call stockholders' or members' meeting
   b. In the absence of such provision in the by-laws it may be called by a director or trustee or by an officer entrusted with the management of the corporation
   c. A stockholder or member may make the call on order of the SEC whenever for any cause there is no person authorized to call a meeting
   d. The special meeting for the removal of directors or trustees may be called by the secretary or by stockholder or member.
4. There must be a previous notice
5. There must be a quorum

Q: What are the rules on meeting or voting which are applicable to certain kinds of shares?

A:
1. *Delinquent shares* shall not be entitled to vote
2. *Treasury shares* have no voting rights while they remain in the treasury *(Sec. 57)*
3. *Fractional shares* shall not be entitled to vote
4. *Escrow shares* shall not be entitled to vote before the fulfillment of the condition imposed thereon
5. *Unpaid shares*, if not delinquent, are entitled to all the rights of a stockholder including the right to vote
6. *Sequestered shares*
   As a rule, the right to vote remains on the shareholder and the entity making the sequestration may not exercise the right to vote

   XPN: **The Two-Tiered Test**
   a. Whether there is a *prima facie* evidence showing that the said shares are ill-gotten and thus belong to the State
   b. Whether there is an immediate danger of dissipation thus necessitating their continued

sequestration and voting by the PCGG while the main issue is pending with the Sandiganbayan. *(Republic vs. Sandiganbayan, G.R. No. 107789, Apr. 30, 2003)*

<u>**XPN to the XPN:**</u> The two-tiered test does not apply in cases involving funds of public character (public character exception). In such cases, the government is granted the authority to vote said shares, namely:

a. Where the government shares are taken over by private persons or entities who or which registered them in their own names; and
b. Where the capitalization of shares that were acquired with public funds somehow landed in private hands *(ibid).*

7. *Pledgor, mortgagor, or administrator shares (Sec. 55);* pledgor or mortagor has the right to attend and vote at meetings unless pledge or morgagee is expressly given such right in writing, as recorded on the books.

   Executor, administrators, receivers, and other legal representatives may attend and vote in behalf of the stockholder or members without need of any written proxy. In *Gochan v. Young, G.R. No. 131889, Mar. 12, 2001*, it was held that heirs are not prohibited from representing the deceased with regard to shares of stock registered in the name of the latter, especially when no administrator has been appointed.

8. *Shares jointly owned (Sec. 56)* – consent of all the co-owners is necessary, unless there is a written proxy signed by all the co-owners. If shares are owned in an "and/or" capacity by the holders thereof, any one of the joint owners can vote or appoint a proxy thereof.

Q: Is teleconferencing or video-conferencing valid?

A: Yes. (*R.A. 8792, as implemented by SEC Memo. Circular No. 15, Nov 30, 2001)* provided:

1. Directors must express their intent on teleconferencing;
2. Proper identification of those attending;
3. The corporate secretary must safeguard the integrity of the meeting by recording it. There is no violation of the Anti-Wire Tapping Act (R.A. 4200) because all the parties to the board meeting are aware that all the communications are recorded.

Note: The basic types of teleconferencing are:
1. Video conferencing;
2. Computer conferencing;
3. Audio conferencing.

I. BOARD OF DIRECTOR AND TRUSTEES

(1) REPOSITORY OF CORPORATE POWERS

Q: Who shall exercise corporate powers?

A:

<u>**GR**</u>**:** The Board of Directors or the Board of Trustees *(Sec. 23).*

<u>**XPN**</u>**:**
1. In case of delegation to the Executive Committee duly authorized in the by-laws;

2. Authorization pursuant to a contracted manager which may be an individual, a partnership, or another corporation.

   Note: In case the contracted manager is another corporation, the special rule in Sec. 44 applies.

3. In case of close corporations, the stockholders may manage the business of the corporation instead by a board of directors, if the articles of incorporation so provide.

Q: Who is an independent director?

A: 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 *(Sec 38, SRC).*

Q: How many independent directors are required for the corporations covered by the Revised Code of Corporate Governance (RCCG)?

A: At least 2 or such number of independent directors that constitute 20% of the members of the board whichever is lesser, but in no case less than 2 *(Art. 3 [A], RCCG).*

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Note: All other companies not covered are encouraged to have independent directors on their board.

(2) TENURE, QUALIFICATIONS AND DISQUALIFICATIONS OF DIRECTORS

Q: What is the term of office of BOD/BOT?

A:

GR: The regular director shall hold office for 1 year.

XPN: If no election is held, the directors and officers shall hold position under a hold-over capacity until their successors are elected and qualified. This is applicable to a going concern where there is no break in the exercise of the duties of the officers and directors. *(SEC Opinion, Dec. 15, 1989).*

Q: What are the qualifications of a director?

A:

1. Must own at least 1 share of the capital stock;

   Note: Ownership of stock shall stand in his name on the books of the corporation.
   A person who does not own a stock at the time of his election or appointment does not disqualify him as director if he becomes a shareholder before assuming the duties of his office. *(SEC Opinions, Nov. 9, 1987 & Apr. 5, 1990)*

2. Must be a natural person;

   Note: What is material is the legal title, not beneficial ownership of the stock as appearing on the books of the corporation.

Q: What are the additional qualifications provided by the Revised Code of Corporate Governance?

A: A director should have the following:

1. College education or equivalent academic degree
2. Practical understanding of the business of the corporation
3. Membership in good standing in relevant industry, business or professional organizations
4. Previous business experience *(Art 3. [D], RCCG)*

Q: What are the common qualifications of a director and trustee?

A:

1. Majority of the directors/trustees must be residents of the Philippines *(Sec. 23)*
2. He must not have been convicted by final judgment of an offense punishable by imprisonment for period exceeding 6 years or a violation of the Corporation Code, committed within 5 years prior to the date of his election *(Sec. 27)*
3. He must be of legal age
4. Other qualifications as may be prescribed in special laws or regulations or in the by-laws of the corporation

Q: What are the grounds for disqualification of a director?

A:

1. Conviction by final judgment of an offense punishable by imprisonment exceeding 6 years
2. Violation of the Corporation Code committed within 5 years prior to his election or appointment *(Sec 27)*

Note: Please read Art 3. [E] of the Revised Code of Corporate Governance.

(3) ELECTIONS

Q: What are the different method of voting?

A:

1. *Straight voting* – every stockholder may vote such number of shares *for as many* persons as there are directors to be elected.

2. *Cumulative voting for one candidate* – a stockholder is allowed *to concentrate* his votes and give one candidate, as many votes as the number of directors to be elected multiplied by the number of his shares shall equal.

3. *Cumulative voting by distribution* – a stockholder may *cumulate* his shares by multiplying the number of his shares by the number of directors to be elected and distribute the same among as many candidates as he shall see fit.

Note: Cumulative voting in case of non-stock corporations only if it is provided in the AOI. The members of non-stock corporations may cast as many votes as there are trustees to be

elected but may cast not more than one vote for one candidate.

Q: What is the quorum required in a stock or non-stock corporation?

A: Majority of the outstanding capital stock as stated in the articles of incorporation.

(4) REMOVAL

Q: Who may remove directors or trustees?

A: The power to remove belongs to the stockholders exclusively. *(Sec. 28)*

Q: What are the requisites for removal of directors or trustees?

A:

1. It must take place either at a regular meeting or special meeting of the stockholders or members called for the purpose
2. Previous notice to the stockholders or members of the intention to remove a director
3. A vote of the stockholders representing 2/3 of outstanding capital stock or 2/3 of members
4. Generally, removal may be with or without cause

   However, if the director was elected by the minority, there must be cause for removal because the minority may not be deprived of the right to representation to which they may be entitled under Sec. 24 of the Code.*(Sec. 28)*

Q: In 1999, Corporation A passed a board resolution removing X from his position as manager of said corporation. The by-laws of A corporation provide that the officers are the president, vice-president, treasurer and secretary. Upon complaint filed with the SEC, it held that a manager could be removed by mere resolution of the board of directors. On motion for reconsideration, X alleged that he could only be removed by the affirmative vote of the stockholders representing 2/3 of the outstanding capital stock. Is X's contention legally tenable. Why?

A: No. Stockholders' approval is necessary only for the removal of the members of the Board. For the removal of a corporate officer or employee, the vote of the Board of Directors is sufficient for the purpose. **(2001 Bar Question)**

(5) FILLING OF VACANCIES

Q: What are the ways of filling up the vacancies in the board?

A:

1. Vacancies filled up by stockholders or members, if it is due to
   a. Removal
   b. Expiration of term
   c. Grounds other than removal or expiration of term, *e.g.* death, resignation, abandonment, or disqualification where the remaining directors do not constitute a quorum for the purpose of filling the vacancy
   d. If the vacancy may be filled by the remaining directors or trustees but the board refers the matter to stockholders or members; or
   e. increase in the number of directors

2. Vacancies filled up by the remaining directors constituting a quorum or by the members of the board if still constituting a quorum, at least a majority of them are empowered to fill any vacancy occurring in the board other than by removal by the stockholders or members, expiration of term or increase in the number of board seats. (*Sec. 29)*

Note: A director elected to fill vacancy shall serve the unexpired term. *(Sec. 29)*

(6) COMPENSATION

Q: How are directors compensated?

A:

GR: Directors, in their capacity as such, are not entitled to receive any compensation except for reasonable per diems.

XPN:

1. When their compensation is fixed in the by-laws
2. When granted by the vote of stockholders representing at least a majority of the outstanding capital stock at a regular or special meeting
3. When they are also officers of the corporation

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4. When a BOD/BOT becomes entitled to compensation other than reasonable per diems

Q: What is the limitation on the compensation of directors?

A: 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. *(Sec. 30)*

(7) DISLOYALTY

Q: What is doctrine of corporate opportunity?

A: 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:

A director shall refund to the corporation all the profits he realizes on a business opportunity *(Sec. 34)* which:

1. The corporation is financially able to undertake;
2. From its nature, is in line with corporations business and is of practical advantage to it; and
3. The corporation has an interest or a reasonable expectancy.

Note: The rule shall be applied notwithstanding the fact that the director risked his own funds in the venture.

If such act is ratified by a vote of the stockholders representing at least 2/3 of the outstanding capital stock, the director is excused from remitting the profit realized.

Q: Malyn, Schiera and Jaz are the directors of Patio Investments, a close corporation formed to run the Patio Cafe, an al fresco coffee shop in Makati City. In 2000, Patio Cafe began experiencing financial reverses, consequently, some of the checks it issued to its beverage distributors and employees bounced.

In October 2003, Schiera informed Malyn that she found a location for a second cafe in Taguig City. Malyn objected because of the dire financial condition of the corporation.

Sometime in April 2004, Malyn learned about Fort Patio Cafe located in Taguig City and that its development was undertaken by a new corporation known as Fort Patio, Inc., where both Schiera and Jaz are directors. Malyn also found that Schiera and Jaz, on behalf of Patio Investments, had obtained a loan of P500, 000.00, from PBCom Bank, for the purpose of opening Fort Patio Cafe. This loan was secured by the assets of Patio Investments and personally guaranteed by Schiera and Jaz.

Malyn then filed a corporate derivative action before the Regional Trial Court of Makati City against Schiera and Jaz, alleging that the two directors had breached their fiduciary duties by misappropriating money and assets of Patio Investments in the operation of Fort Patio Cafe.

Did Schiera and Jaz violate the principle of corporate opportunity? Explain.

A: Shciera and Jaz violated the principle of corporate opportunity, because they used Patio Investments to obtain a loan, mortgaged its assets and used the proceeds of the loan to acquire a coffee shop through a corporation they formed. *(Sec. 34)* **(2005 Bar Question)**

(8) BUSINESS JUDGMENT RULE

Q: What is business judgment rule?

A: **<u>GR:</u>** Courts will not interfere in the decisions made by the BOD as regards the internal affairs of the corporation

XPN: Unless such contracts are so unconscionable and oppressive as to amount to a wanton destruction of rights of the minority. *(Ingersoll v. Malabon Sugar Co., G.R. No. L-16977, Apr. 21, 1922)*

Q: What are the consequences of business judgment rule?

A:

1. Resolutions and transactions entered into by the Board within the powers of the corporation cannot be reversed by the courts not even on the behest of the stockholders.

2. Directors and officers acting within such business judgment cannot be held personally liable for such acts.

(9) SOLIDARY LIABILITY FOR DAMAGES

Q: What are the instances when directors or trustees are solidary liable with the corporation?

A:

GR: The directors or trustees are not liable solidarily with the corporation by reason of their separate and distinct personalities.

XPN:
1. Willfully and knowingly voting for and **A**ssenting to patently unlawful acts of the corporation; (*Sec. 31)*
2. **G**ross negligence or bad faith in directing the affairs of the corporation; (*Sec. 31)*
3. Acquiring any personal or pecuniary **I**nterest in conflict of duty; *(Sec. 31)*
4. **A**greeing or stipulating in a contract to hold himself liable with the corporation; or
5. By virtue of a specific provision of **L**aw *(Uichico vs. NRLC, G.R. No. 121434, June 2, 1997).*

Note: When the officers of the corporation exceeded their authority, their actions are not binding upon the corporation unless ratified by the corporation or is estopped from disclaiming them *(Reyes v. RCPI Credit Employees Union, G.R. No. 146535, Aug. 18, 2006).*

Q: When could a director be solidary liable with the corporation for termination of employees?

A: Only when the termination is done with malice or in bad faith on the part of the director. Without any evidence of bad faith or malice, directors may not be held personally liable *(Equitable Banking Corporation vs. NLRC, GR No. 02467, June 13,* 1997*).*

(10) LIABILITIES FOR WATERED STOCKS

Q: What is the liability of directors for the issuance of watered stocks?

A: Any director or officer of a corporation consenting to the issuance of stocks for a consideration less than its par or issued value or for a consideration in any form other than cash, valued in excess of its fair value, or who, having knowledge thereof, does not forthwith express his objection in writing and file the same with the corporate secretary, 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 *(Sec. 65).*

(11) PERSONAL LIABILITY

Q: What are the instances where a director may be held personally liable?

A:
1. Willfully and knowingly voting for and Assenting to patently unlawful acts of the corporation. (*Sec. 31)*
2. Gross negligence or bad faith in directing the affairs of the corporation. (*Sec. 31)*
3. Acquiring any personal or pecuniary Interest in conflict of duty. *(Sec. 31)*
4. Acting without authority or in excess of authority or are motivated by ill-will, malice or bad faith, which gives rise to consequent damages. *(Lim vs. NLRC, G.R. No. 80685. March 16,* 1989)
5. Consenting to the issuance of Watered stocks, or, having knowledge thereof, failing to file objections with the secretary. *(Sec. 65)*

(12) RESPONSIBILITIES FOR CRIMES

Q: When is a director or officer liable for a criminal offense?

A: Where a law requires a corporation to do a particular act, failure of which on the part of the responsible officer to do so constitutes an offense, the responsible officer is criminally liable therefore. The reason is that a corporation can act through its officers and agents and where the business itself involves a violation of law all who participate in it are liable. While the corporation may be fined for such criminal offense if the law so provides, only the responsible corporate officer can be imprisoned. *(People vs. Tan Boon Kon, 1930)* However, a director or officer can be held liable for a criminal offense only when there is a specific provision of law making a particular officer liable because being a corporate officer by itself is not enough to hold him criminally liable.

(13) SPECIAL FACT DOCTRINE

Q: What is Special Fact Doctrine?

A: It is a doctrine holding that a corporate officer with superior knowledge gained by virtue of being an insider owes a limited fiduciary duty to a shareholder in transactions involving transfer of stock *(Miriam Webster Dictionary, 2006).*

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(14) INSIDE INFORMATION

Q: What is inside Information?

A: Information not known to the public that one has obtained by virtue of being an insider like a director *(Miriam Webster Dictionary, 2006)*.

(15) CONTRACTS

Q: Give the rules on contracts entered into by directors/trustees of or officers.

A:

1. *Contracts which are entered by one or more of the corporate directors/trustees, or officers (Sec. 32)* – Voidable at the option of the corporation, unless:

   a. The presence of such director/trustee in the board meeting approving the contract was not necessary to constitute a quorum;
   b. The vote of such director/trustee in the board meeting approving the contract was not necessary for the approval of the contract;
   c. The contract is fair and reasonable under the circumstances;
   d. In the case of an officer, there was previous authorization by the board of directors.

   Note: Even if stockholders representing 2/3 of the outstanding capital stock authorizes the contract, the 3rd element (contract is fair and reasonable) cannot be dispensed with if the transaction is to be valid and enforceable.

2. *Contracts entered into between corporations with interlocking directors (Sec. 33)* – Valid, provided that:
   a. The contract is not fraudulent; and
   b. The contract is fair and reasonable under the circumstances.

Q: What is the effect if the interlocking director's interest in nominal in one corporation and substantial in another?

A: If the interlocking director's interest in one corporation or corporations is "nominal" (not exceeding 20% of the outstanding capital stock) and in the other substantial, then all the first 3 conditions prescribed in Sec. 32 must be present with respect to the corporation in which he has nominal interest.

Where any of the first two conditions is absent, said contract must be ratified by the vote of the stockholders representing at least 2/3 of the outstanding capital stock or 2/3 of the members in a meeting called for the purpose, provided:

1. That full disclosure of the adverse interest of the director/ trustee involved is made at such meeting
2. The contract is fair and reasonable under the circumstances.

Q: Suppose that the by-laws of X Corporation, a mining firm, provides that "The directors shall be relieved from all liability for any contract entered into by the corporation with any firm in which the directors may be interested." Thus, director A acquired claims which overlapped with X's claims and were necessary for the development and operation of X's mining properties. Is the by-law provision valid? Why?

A: No. It is in violation of Sec. 32 of the Corporation Code.

Q: What happens if director "A" is able to consummate his mining claims over and above that of the corporation's claims?

A: "A" should account to the corporation for the profits which he realized from the transaction. He grabbed the business opportunity from the corporation. *(Sec. 34)* **(2001 Bar Question)**

(16) EXECUTIVE COMMITTEE

Q: What is an executive committee?

A: A body created by the by-laws and composed of not more than three members of the board which, subject to the statutory limitations, has all the authority of the board to the extent provided in the board resolution or by-laws. The committee may act by a majority vote of all of its members *(Sec. 35)*.

Note: An executive committee can only be created by virtue of a provision in the by-laws and that in the absence of such by-law provision, the board of directors cannot simply create or appoint an executive committee to perform some of its functions. *(SEC Opinion, Sept. 27, 1993)*

A person not a director can be a member of the executive committee but only in a recommendatory or advisory capacity.

Q: Are the decisions of the executive committee subject to appeal to the board?

A: No. However, if the resolution of the Executive Committee is invalid, *i.e. not one of the powers conferred to it,* it may be ratified by the board *(SEC Opinion, July 29, 1995).*

Q: What are the limitations on the powers of the executive committee?

A: It cannot act on the following:
1. Matters needing stockholder approval
2. Filling up of board vacancies
3. Amendment, repeal or adoption of by-laws
4. Amendment or repeal of any resolution of the Board which by its express terms is not amendable or repealable
5. Cash dividend declaration. *(Sec. 3)*

Q: What are the executive committees provided in the Revised Code of Corporate Governance?

A:
1. Audit Committee
2. Nomination Committee
3. Compensation and Remuneration Committee

(17) MEETINGS

Q: When will BOD/BOT meetings be held?

A:

DATE OF MEETING	REQUIRED *WRITTEN /VERBAL* NOTICE
Regular Meeting	
1. The date fixed in the by-laws; *or* 2. If there is no date in the by-laws – shall be held monthly *Venue:* Anywhere	1. Within the period provided in the by-laws 2. In the absence of provision in the by-laws – 1 day prior to the scheduled meeting
Special Meeting	
1. Any time upon the call of the president; *or* 2. As provided in the by-laws *Venue:* Anywhere	1. Within the period provided in the by-laws 2. If no provision in the by-laws – 1 day prior to the scheduled meeting

Q: Who shall preside at all meetings?

A: The president shall preside at all meetings of the directors or trustees as well as of stockholders or members unless the by-laws provide otherwise. *(Sec. 54)*

Note: 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.

Q: What is the required number of BOD/BOT to constitute quorum?

A:

GR: Majority of the number of directors or trustees.

XPN: If AOI or the by-laws provide for a greater number.

Note:

GR: Every decision of at least a majority of the directors or trustees present at a meeting at which there is quorum shall be valid as a corporate act.

XPN:

1. The election of officers which shall require the vote of a majority of *all* the members of the board. *(Sec. 25 [2])*
2. No board approval is necessary where there is custom, usage and practice in the corporation not requiring prior board approval or where subsequent approval is sufficient. *(Board of Liquidators v. Kalaw, G.R. No. L-18805, Aug. 14, 1967)*

Note: The quorum is the same even if there is vacancy in the board.

A meeting with a quorum remains to be such throughout the proceedings even if at any time during the proceedings, the required number of participants to constitute a quorum is lessened (e.g. walk-out during the meeting).

Q: What is the effect of Abstention?

A: An abstention may have the practical effect of a "no" vote since the motion may fail for lack of sufficient "yes" votes. Unless a greater number is called for in the articles or bylaws, a matter is deemed "approved" by the board if at any meeting at which a quorum is present at least a majority of the required quorum of directors

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votes in favor of the action *(Sec 7211, United States Corporation Code).*

Note: The Corporation Code is based from the United States Corporation Code; annotations of the US Corporation Code might apply.

Q: When to Abstain?

A: Whenever a director believes he/she has a conflict of interest, the director should abstain from voting on the issue and make sure his/her abstention is noted in the minutes. *(Robert's Rules, 10th ed., p 394.)* The other reason a director might abstain is that he/she believes there was insufficient information for making a decision. Otherwise, directors should cast votes on all issues put before them. Failure to do so could be deemed a breach of their fiduciary duties.

Q: Give an example where a director needs to abstain

A: To avoid "Insider Trading", Insiders are obligated to abstain from trading the shares of his corporation. This duty to abstain is based on two factors:

1. The existence of a relationship giving access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone;
2. The inherent unfairness involved when a party takes advantage of such information knowing it is unavailable to those with whom he is dealing *(SEC vs. Interport Resources Corporation, G.R. No. 135808, October 6, 2008)*.

J. CAPITAL AFFAIRS

(1) CERTIFICATE OF STOCK

Q: What is a certificate of stock?

A: It is a paper representation or tangible evidence of the stock itself and of various interests therein *(Tan v. SEC, G.R. No. 95696, Mar. 3, 1992)*

Q: What are the requisites for the issuance of the Certificate of Stock?

A:

1. The certificate must be signed by the president or vice-president, countersigned by the secretary or assistant secretary
2. The certificate must be sealed with the seal of the corporation
3. The certificate must be delivered
4. The par value as to par value shares, or full subscription as to no par value shares must be fully paid, the basis of which is the doctrine of indivisibility of subscription
5. The original certificate must be surrendered where the person requesting the issuance of a certificate is a transferee from the stockholder *(Bitong v. CA., G.R. No. 123553, July 13, 1998).*

Q: What are the distinctions between shares of stock from certificates of stock?

A:

SHARE OF STOCK	CERTIFICATE OF STOCK
Unit of interest in a corporation	Evidence of the holder's ownership of the stock and of his right as a shareholder and of his extent specified therein.
It is an incorporeal or intangible property	It is concrete and tangible
It may be issued by the corporation even if the subscription is not fully paid.	It may be issued only if the subscription is fully paid.

(A) NATURE OF THE CERTICIATE

Q: What is the nature of a certificate of stock?

A: A certificate of stock is a *prima facie* proof that the stock described therein is valid and genuine in the absence of an evidence to the contrary.

(B) UNCERTIFICATED SHARES

Q: What is an uncertificated share?

A: An uncertificated share is a subscription duly recorded in the corporate books but has no corresponding certificate of stock yet issued.

Q: May a stockholder alienate his shares even if there is no certificate of stock issued by the corporation?

A: Yes. The absence of a certificate of stock does not preclude the stock holder from alienating or transferring his shares of stock.

Q: In case of a fully paid subscription but the corporations has not yet issued a certificate of stock, how can the transfer be effected?

A: In case of a fully paid subscription, without the corporation having issued a certificate of stock, the transfer may be effected by the subscriber or stockholder executing a contract of sale of deed of assignment covering the number of shares sold and submitting said contract or deed to the corporate secretary for recordal.

Q: How are transfers of subscription not fully paid done?

A: In case of subscription not fully paid, the corporation may record such transfer, provided that the transfer is approved by the board of directors and the transferee executes a verified assumption of obligation to pay the unpaid balance of the subscription.

(C) NEGOTIABLITY

Q: Is a stock certificate negotiable?

A: No. It is regarded as *quasi*-negotiable in the sense that it may be transferred by endorsement coupled with delivery.

Q: Why is a stock certificate not negotiable?

A: Because the holder thereof takes it without prejudice to such rights or defenses as the registered owners or transferor's creditor may have under the law, except insofar as such rights or defenses are subject to the limitations imposed by the principles governing estoppel. *(De los Santos v. Republic, G.R. No. L-4818, Feb. 28, 1955)*

Q: A is the registered owner of Stock Certificate No. 000011. He entrusted the possession of said certificate to his best friend B who borrowed the said endorsed certificate to support B's application for passport (or for a purpose other than transfer). But Bsold the certificate to X, a bona fide purchaser who relied on the endorsed certificates and believed him to be the owner thereof.

Can A claim the shares of stocks from X? Explain.

A: No. Since the shares were already transferred to "B", "A" cannot claim the shares of stock from "X". The certificate of stock covering said shares have been duly endorsed by "A" and entrusted by him to "B". By his said acts, "A" is now estopped from claiming said shares from "X", a *bona fide* purchaser who relied on the endorsement by "A" of the certificate of stock. **(2001 Bar Question)**

i. REQUIREMENTS FOR VALID TRANSFER OF STOCK

Q: What are the requirements for a valid transfer of stock?

A:
1. The certificate of stock must be duly endorsed by the transferor or his legal representative.
2. There must be delivery of the stock certificate.
3. To be valid against third parties, the transfer must be recorded in the books of the corporation. *(G.R. No. 124535, September 28, 2001)*

Q: How are shares of stock transferred?

A:
1. If represented by a certificate, the following must be strictly complied with:
   a. Indorsement by the owner and his agent
   b. Delivery of the certificate
   c. To be valid to third parties, the transfer must be recorded in the books of the corporation. *(Rural Bank of Lipa v. CA, G.R. No. 124535, Sept 28, 2001).*

2. If not represented by a certificate (such as when the certificate has not yet been issued or where for some reason is not in the possession of the stockholder).
   a. By means of deed of assignment: and
   b. Such is duly recorded in the books of the corporation.

Q: A is the registered owner of Stock Certificate No. 000011. He entrusted the possession of said certificate to his best friend B who borrowed the said endorsed certificate to support B's application for passport (or for a purpose other than transfer). But Bsold the certificate to X, a bona fide purchaser who relied on the endorsed certificates and believed him to be the owner thereof.

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A: No. Since the shares were already transferred to "B", "A" cannot claim the shares of stock from "X". The certificate of stock covering said shares have been duly endorsed by "A" and entrusted by him to "B". By his said acts, "A" is now estopped from claiming said shares from "X", a bona fide purchaser who relied on the endorsement by "A" of the certificate of stock. **(2001 Bar Question)**

Q: What if the transfer is not recorded, is it valid?

A: Yes, but, only insofar as the parties to the transfer are concerned.

Note: To bind the corporation the deed effecting the transfer must be duly recorded in the corporate books. *(Sec. 63)*

Q: May a stockholder bring suit to compel the corporate secretary to register valid transfer of stocks?

A: Yes, it is the corporate secretary's duty and obligation to register transfers of stocks.

Q: What are the remedies where corporation refuses to transfer certificate of stocks?

A:

1. Petition for mandamus
2. Suit for specific performance of an express or implied contract
3. May sue for damages where specific performance cannot be granted

Note: There must be a special power of attorney executed by the registered owner of the share authorizing transferor to demand transfer in the stock and transfer book *(Ponce vs. Arsons Cement, G.R. No. 139802, Dec. 10, 2002)*.

The law does not prescribe a period within which the registration of the transfer of shares should be effected. Hence, the action to enforce the right does not accrue until there has been a demand and a refusal concerning the transfer.

Q: When may the corporation validly refuse to register the transfer of shares?

A: The corporation may refuse to register the transfer of shares if it has an existing unpaid claim over the shares to be transferred. The "unpaid claim" refers to the unpaid subscription on the shares transferred and not to any other indebtedness that the transferor may have to the corporation. (*Sec. 63)*

(D) ISSUANCE

Q: When may a corporation issue a stock certificate?

A: Under Sec. 64 of the Corporation Code, a certificate of stock may only be issued to a subscriber if the full amount of subscription together with interest and expenses (in case of delinquent shares) if any due, has been paid.

Q: What is the rule on right to issuance?

A: A corporation may now, in the absence of provisions in their by-laws to the contrary, apply payments made by subscribers-stockholders, either as:

1. *Full payment* for the corresponding number of shares of stock, the par value of each of which is covered by such payment; or
2. *Payment pro-rata* to each and all the entire number of shares subscribed for. *(Baltazar v. Lingayen Gulf Electric Power Co., Inc, G.R. No. L-16236-38, June 30, 1965)*

Q: What is the Doctrine of Individuality of Subscription?

A: A subscription is one entire and indivisible whole contract. It cannot be divided into portions. *(Sec. 64)*

(E) STOCK AND TRANSFER BOOK

Q: What books are required to be kept by a corporation?

A:

1. Book for the minutes of SH and BOD meetings
2. Record of transactions
3. Stock and transfer book
4. Other books required to be kept

i. CONTENTS

Q: What are the contents of a stock and transfer book?

A:

1. All stocks in the name of the stockholders alphabetically arranged
2. Amount paid and unpaid on all stocks and the date of payment of any installment

3. Alienation, sale or transfer of stocks
4. Other entries as the by-laws may prescribe

ii. WHO MAY MAKE VALID ENTRIES

Q: Who may make proper entries in stock and transfer books?

A: The obligation and duty falls on the corporate secretary. If the corporate secretary refuses to comply, the stockholder may rightfully bring suit to compel performance. The stockholder cannot take the law on to his hands; otherwise such entry shall be void. *(Torres, Jr. v. CA, G.R. No. 120138, Sept. 5, 1997)*

Q: What is the probative value of the stock and transfer book?

A: The entries are considered *prima facie* evidence of the matters stated therein and may be subject to proof to the contrary *(Bitong v. CA, G.R. No. 123553, July 13, 1999).*

Q: Who are the persons given the right to inspect corporate books?

A:

1. Any director, trustee, stockholder or member
2. Voting trust certificate holder
3. Stockholder of sequestered company
4. Beneficial owners of shares

Q: What is the basis of SH's right of inspection?

A: As owners of the assets and property of the corporation stockholders should be entitled to the right of inspection which is predicated upon the necessity of self-protection.

Q: What are the limitations on the right to inspection?

A:

1. The right must be exercised during reasonable hours on business days
2. The person demanding the right has not improperly used any information obtained through any previous examination of the books and records of the corporation
3. The demand is made in good faith or for legitimate purpose germane to his interest as a styockholder. *(Sec. 74)*
4. It should follow the formalities that may be required in the by-laws
5. The right does not extend to trade secrets
6. It is subject to limitations under special laws, *e.g.* Secrecy of Bank Deposits and FCDA or the Foreign Currency Deposits Act.

Note: The right extends, in compliance with equity, good faith, and fair dealing, to a foreign subsidiary wholly-owned by the corporation

(F) LOST OR DESTROYED CERTIFICATES

Q: What is the procedure for the issuance of a new stock certificate in lieu of those which have been lost, stolen or destroyed?

A:

1. The registered owner of a certificate of stock in a corporation or his legal representative shall file with the corporation an affidavit in triplicate setting forth, if possible, the circumstances as to how the certificate was lost, stolen or destroyed, the number of shares represented by such certificate, the serial number of the certificate and the name of the corporation which issued the same.

2. After verifying the affidavit and other information and evidence with the books of the corporation, said corporation shall publish a notice in a newspaper of general circulation published in the place where the corporation has its principal office, once a week for three (3) consecutive weeks at the expense of the registered 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, if no contest has been presented to said corporation regarding said certificate of stock, the right to make such contest shall be barred and said corporation shall cancel in its books the certificate of stock which has been lost, stolen or destroyed and issue in lieu thereof new certificate of stock.

4. If the registered owner files a bond or other security effective for a period of one (1) year, a new certificate may be issued even before the expiration of the one (1) year period.

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Q: May the corporation be sued for the issuance of new certificates of stock in case of lost or destroyed certificate?

A: No, the corporation cannot be sued unless there is bad faith, fraud or negligence present.

Q: A stockholder claimed that his stock certificate was lost. After going through with the procedure for the issuance of lost certificate, and no contest was presented within 1 year from the last publication, the corporation issued a new certificate of stock in lieu of the supposed lost certificate. The stockholder immediately sold his shares and endorsed the replacement certificate to a buyer. It turned out that the original certificate was not lost, but sold and endorsed to another person. (1) May the corporation be made liable by the aggrieved party? (2) Who will have a better right over the shares, the endorsee of the original certificate or the endorsee of the replacement certificate?

A:

1. No, the corporation cannot be made liable. Except in cases of fraud, bad faith, or negligence on the part of the corporation and its officers, no action may be brought against any corporation which have issued certificates of stock in lieu of those lost, stolen, or destroyed pursuant to the procedure prescribed by law.

2. The endorsee of the replacement certificate has a better right to the shares. After expiration of 1 year from the date of the last publication, and no contest has been presented to said corporation regarding said certificate, the right to make such contest has been barred and said corporation already cancelled in its books the certificate which have been lost, stolen, or destroyed and issued in lieu thereof new certificate.

Q: What if there are oppositions on the issuance of new certificates, what may the corporation do?

A: The corporation may file an interpleader proceeding to compel the parties to litigate among themselves.

Q: When may a corporation issue a replacement certificate of subscription without waiting for the expiration of one year?

A: The registered owner shall file a bond or other security effective for a period of one (1) year in which case a new certificate may be issued even before the expiration of the one (1) year period. Provided, That if a contest has been presented to said corporation or if an action is pending in court regarding the ownership of said certificate of stock which has been lost, stolen or destroyed, the issuance of the new certificate of stock in lieu thereof shall be suspended until the final decision by the court regarding the ownership of said certificate of stock which has been lost, stolen or destroyed. *(Sec. 73)*

(G) SITUS OF SHARES OF STOCK

Q: Where is the situs of shares of stock?

A: The situs of shares of stock is the country where the corporation is domiciled.

Note: For purposes of execution, attachment, garnishment or auction sale, it is not the domicile or the residence of the owner of the shares but the domicile or residence of the corporation, which is the place of its principal business, which determines the situs of the shares of stock.

(2) WATERED STOCK

(A) DEFINITION

Q: What is a watered stock?

A: A stock issued in exchange for cash, property, share, stock dividends, or services lesser than its par value.

Watered Stocks include stocks:

1. Issued without consideration *(bonus share)*
2. Issued for a consideration other than cash, the fair valuation of which is less than its par or issued value *(discount share)*
3. Issued as stock dividend when there are no sufficient retained earnings to justify it
4. Issued as fully paid when the corporation has received a lesser sum of money than its par or issued value

Note: "Water" in the stock represents the difference between the fair market value at the time of the issuance of the stock and the par or issued value f

said stock. Both par and no par stocks can thus be watered stocks.

Watered stocks refer only to original issue of stocks but not to a subsequent transfer of such stocks by the corporation.

(B) LIABILITY OF DIRECTORS FOR WATERED STOCKS

Q: What is the extent of the liability of directors who consented to the issuance of a watered stock?

A: Directors who consent to the issuance of a watered stock are personally liable. Although the general rule is that directors, trustees or officers are not solidarily liable with the corporation, consenting to the issuance of a watered stock is one of the exceptions.

Note: Pursuant to Sec. 65 of the Corporation Code, a director or officer who consents to the issuance of a watered stock or having knowledge thereof does not forthwith express his written objection with the corporate secretary is liable jointly and severally with the stockholder concerned for the water in the stock in favor of the corporation and its creditors.

(C) TRUST FUND DOCTRINE FOR LIABILITY FOR WATERED STOCK

Q: What is the trust fund doctrine?

A: The subscribed capital stock of the corporation is a trust fund for the payment of debts of the corporation which the creditors have the right to look up to satisfy their credits, and which the corporation may not dissipate.

Q: Where does the solidary liability of directors consenting to the issuance of watered stock emanates?

A: The solidary liability of the directors emanates from the fiduciary character of the position of director or corporate officer.

(3) PAYMENT OF BALANCE OF SUBSCRIPTION

Q: Who are required to pay their subscription in full?

A:

1. Non-resident foreign subscribers upon incorporation must pay in full their subscriptions unless their unpaid subscriptions are guaranteed by a surety bond or by an assumption by a resident stockholder through an affidavit of liability.
2. In case of no-par value shares, they are deemed fully paid and non-assessable.

Q: When should the balance of the subscription be paid?

A: It should be paid:

1. On the date specified in the subscription contract, without need of demand or call, or
2. If no date of payment has been specified, on the date specified on the call made by the BOD; or within 30 days from the date of call (grace period is granted
3. When insolvency supervenes upon a corporation and the court assumes jurisdiction to wind it up, all unpaid subscriptions become payable on demand, and are at once recoverable, without necessity of any prior call.

Q: Will the unpaid balance accrue interest?

A: Yes, if so required by the by-laws 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. *(Sec. 66)*

The above interest is different from the interest contemplated by Sec. 67. The said unpaid balance will only accrue interest, *by way of penalty, on the date specified in the contract of subscription or on the date stated in the call made by the board*.

Note: Interest contemplated in Sec. 66 is pertains to moratory interest which is the interest on account of delay, while Sec. 67 speaks of compensatory interest which is the ineterst on account of subscription in an installment basis.

Q: What is the effect of failure to pay the subscription on the date it is due?

A: It shall render the entire balance due and payable and shall make the shareholder liable for interest at the legal rate on such balance, unless a different rate of interest is provided in the by-laws.

(A) CALL BY BOARD OF DIRECTORS

Q: How does the board of directors call for the payment of unpaid subscription?

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A: A call is made in a form of board resolution that unpaid subscription to the capital stock are due and payable and the same or such percentage thereof shall be collected, together with all accrued interest, on a specified date and that if no payment is made within 30 days from said date, all stocks covered by said subscription shall thereupon become delinquent and shall be subject to public auction sale.

Q: Is the call of the board of directors always necessary to collect payment for unpaid subscription?

A: No. A call is not necessary where the subscription contract specifies the date of payment.

(B) NOTICE REQUIREMENT

Q: What is the notice requirement in case there is a call of the board of directors for payment of subscription?

A: The notice of the call has to be served on the stockholders concerned in the manner prescribed in the call, which may either be by registered mail and/or personal delivery and publication.

(4) SALE OF DELINQUENT SHARES

Q: When will the share become delinquent?

A: If within 30 days from expiry of the date of payment or from the date stated in the call made by the board, no payment is made, all stocks covered by said subscription shall thereupon become delinquent and shall be subject to delinquency sale unless the BOD orders otherwise.

Note: "Call" means the resolution or formal declaration of the board that the unpaid subscriptions are due and payable.

Q: What are the remedies of corporations to enforce payment of stocks?

A:

1. Extra-judicial sale at public auction *(Sec. 67)*
2. Judicial action *(Sec. 70)*

Q: What is the procedure for the sale of delinquent stocks?

A:

1. *Resolution* – the board shall issue resolution ordering the sale of delinquent stock
2. *Notice* – notice of said sale, with a copy of the resolution, shall be sent to every delinquent stockholder either personally or by registered mail
3. *Publication* – the notice shall furthermore be published once a week for two consecutive weeks in a newspaper of general circulation in the province or city where the principal office of the corporation is located
4. *Sale* – the delinquent stock shall be sold at the public auction to be held not less than 30 days nor more than 60 days from the date stocks become delinquent;
5. *Transfer* – the stock so purchased shall be transferred to such purchaser in the books of the corporation and a certificate for such stock shall be issued in his favor; and
6. *Credit remainder* – the remaining shares, if any, shall be credited in favor of the delinquent stockholder who shall likewise be entitled to the issuance of a certificate of stock covering the same *(Aquino, Philippine Corporate Law Compendium, 2006).*

Q: Who is the winning bidder in a delinquency sale?

A:

1. The person participating in the delinquency sale who offers to pay the full amount of the balance of the subscription together with the accrued interest, costs of advertisement and expenses of sale, for the smallest number of shares;
2. If there is no bidder as mentioned above, the corporation may bid for the same, and he total amount due shall be credited as paid in full in the books of the corporation. Such shares shall be considered as treasury shares.

Note: The board is not bound to accept the highest bid unless the contrary appears. This is for the reason that in public sale, the bidder is the one making the offer to purchase which the corporation is free to accept or reject.

Q: When may delinquency sale be discontinued or cancelled?

A: If the delinquent SH pays the unpaid balance plus interest, costs and expenses on or before the date specified for the sale or when the BOD orders otherwise.

Q: Can a stockholder assail the delinquency sale?

A: The stockholder may file an action to nullify the sale on the ground of irregularity or defect in the notice of sale or in the sale itself. But the stockholder must first pay the amount for which the shares are sold with interest from the date of sale at the legal rate. The action shall be commenced within 6 months from the date of sale. *(Sec. 69)*

(A) EFFECT OF DELINQUENCY

Q: What are the effects of stock delinquency?

A:

1. *Upon the stockholder*
   a. Accelerates the entire amount of the unpaid subscription;
   b. Subjects the shares to interest expenses and costs;
   c. Disenfranchises the shares from any right that inheres to the to a stockholder, except the right to dividends (but which shall be applied to any amount due on said shares, or, in the case of stock dividends, to be withheld by the corporation until full payment of the delinquent shares. *(Sec. 43)*

2. *Upon the director owning delinquent shares*
   a. If the delinquent stockholder is a director, the director shall continue to be a director but he cannot run for re-election (*Sundiang and Aquino, Reviewer in Commercial Law, 2006)*
   b. A delinquent stockholder seeking to be elected as director may not be a candidate for, not be duly elected to, the board.

(B) CALL BY RESOLUTION OF BOARD OF DIRECTORS

Q: Does a call of the board of directors required to declare a stock delinquent?

A: No. Stocks become delinquent when the unpaid subscription and accrued interests thereon are not paid within 30 days from their due date as specified in the subscription contract or in the call by the board of directors.

The delinquency is automatic after said 30 day period and does not need a declaration by the board making the stock delinquent.

(C) NOTICE OF SALE

Q: What is the notice requirement in case of sale of delinquent stock?

A: The notice of sale and copy of the board resolution ordering the sale shall be:

1. Sent to every delinquent stockholder either personally or by registered mail or;
2. Published once a week for 2 consecutive weeks in a newspaper of general circulation in the province or city where the principal office of the corporation, as specified in its articles of incorporation, is located.

(D) AUCTION SALE

Q: What is the procedure for the auction sale of a delinquent share?

A: The procedure is as follows:

1. The board of directors shall pass a board resolution ordering the sale of delinquent stock.
2. A notice of sale and copy of the board resolution ordering the sale shall be sent to every delinquent stockholder either personally or by registered mail or; published once a week for 2 consecutive weeks in a newspaper of general circulation in the province or city where the principal office of the corporation, as specified in its articles of incorporation, is located.
3. The minimum bid shall be the full amount of the balance on the subscription plus the accrued interest, cost of advertisement and expenses of sale for the smallest number of shares.
4. The sale will be awarded to the highest bidder who will be given a certificate of sale and the same will be registered in the books of the corporation.
5. Should there be no bidder, the corporation may bid for the same if it

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has unrestricted earnings to cover the amount.

Q: How do you determine the highest bidder in an auction sale?

A: Given the total amount due, the highest bidder is determined by the smallest number of shares or a fraction of a share that the bidder is willing to buy for said total amount.

Q: May the sale of delinquent share in public auction be questioned?

A: The sale at public auction of delinquent share is absolute and not subject to redemption. However, an action may be filed to question the sale, the requisites for which are:

1. There should be allegation and proof of irregularity or defect in the notice of sale or in the sale itself.

2. The party filing the action must first pay the party holding the stock the sum for which the stock was sold with legal interest from the date of sale.

3. The action is filed within 6 months from the date of sale.

Q: Does the action to question a delinquency sale prescribe?

A: Yes. The action prescribes 6 months from such sale.

(5) ALIENATION OF SHARES

Q: Is the registration of the corporation of the transfer of shares required for the alienation to be valid?

A: As between the parties to the contract of sale, registration of the transfer of shares is not required for the sale to be valid but until it has been recorded in the books of the corporation, the transferee will not be considered as a stockholder of the corporation.

Q: What are the reasons for the recordal of the alienation of shares?

A: The reasons for the recordal are:

1. To enable the corporation to know at all times their actual stock holders.

2. To afford the corporation the opportunity to object or refuse its consent to the transfer in case it has any claim against the stock and

3. To avoid fictitious and fraudulent transfer

(A) ALLOWABLE RESTRICTIONS ON THE SALE OF SHARES

Q: Can a stockholder dispose of his shares without any restriction?

A: Shares of stock are regarded as personal property of the stockholder and as a general rule, he may dispose of them as he sees fit unless the corporation has been dissolved, or unless the right to do so has been restricted in the articles of incorporation and in the stock certificate or the owner's right of disposing his shares has been hampered by his own actions.

Q: Can the corporation provide regulations to the sale/transfer of the shares of stockholders?

A: Yes, but the authority granted to a corporation to regulate the transfer of its stock does not empower it to restrict the right of a stockholder to transfer his shares, but merely authorizes the adoption of regulations as to the formalities and procedure to be followed in effecting transfer *(Thomson vs. CA, G.R. No. 116631, October 28,* 1998*).*

Q: What are the requisites for a restriction to be valid?

A: To be valid, restrictions on the sale/transfer of shares must be:

1. Provided in the articles of incorporation and
2. it must be printed at the back of the certificate of stock.

Note: The latter requirement is needed to bind third persons who may buy or deal with the shares of stock.

(B) SALE OF PARTIALLY PAID SHARES

Q: May a shareholder sell his shares if the payment of his subscription is incomplete?

A: Yes. The incomplete payment of the subscription does not preclude the subscriber from alienating his shares of stock. Since in this case, there is still no stock certificates that can be

issued *(See Sec. 64),* the transfer may be thru a "Share Purchase Agreement Contract."

(C) SALE OF A PORTION OF SHARES NOT FULLY PAID

Q: Is the sale of a portion of shares not fully paid allowed?

A: Yes, in case of delinquent shares.

(D) SALE OF ALL SHARES NOT FULLY PAID

Q: Is the sale of shares of not fully paid subscription allowed?

A: Yes but to bind the corporation, consent of the corporation shall be obtained unless not allowed by AOI.

(E) SALE OF FULLY PAID SHARES

Q: Is the sale of fully paid shares allowed?

A: Yes, even without the consent of the corporation as long as the requisites for the valid transfer of shares are complied.

(F) REQUISITES OF A VALID TRANSFER

Q: What are the requirements for a valid transfer of stock already fully paid and covered by stock ccertificates?

A:

1. There must be a delivery of the stock certificate.
2. The certificate of stock must be duly endorsed by the transferor or his legal representative.
3. To be valid against third parties, the transfer must be recorded in the books of the corporation *(Rural Bank of Lipa vs. CA, G.R. No. 124535, September 28, 2001).*

(G) INVOLUNTARY DEALINGS

Q: What is involuntary dealing?

A: It refers to such writ, order or process issued by a court of record affecting shares of stocks which by law should be registered to be effective, and also to such instruments which are not the willful acts of the registered owner and which may have been executed even without his knowledge or against his consent.

Q: Give examples of involuntary dealings of a share.

A:

1. Attachment
2. Sale on execution of judgment or sales for taxes
3. Adverse claims
4. Foreclosure of mortgage of stocks

Q: Must involuntary dealings be registered?

A: Yes. It is the act of registration which creates a constructive notice to the whole world of such instrument or court writ or process and is the operative act that conveys ownership or affects the land insofar as third persons are concerned. *(Aquino, p. 185, 2007 ed)*

K. DISSOLUTION AND LIQUIDATION

Q: What is meant by dissolution?

A: It is the extinguishment of the franchise of a corporation and the termination of its corporate existence.

(1) MODES OF DISSOLUTION

Q: What are the modes of dissolution of corporation?

A: Voluntary and Involuntary dissolution.

(A) VOLUNTARY

Q: What are the *voluntary* modes of dissolution of a corporation?

A:

1. Where no creditors are affected
   Procedure:
   a. Majority vote of the board of directors or trustees; and
   b. Resolution duly adopted by the affirmative vote of the stockholders owning at least 2/3 of the outstanding capital stock or at least 2/3 of the members at a meeting duly called for that purpose.
   c. 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.
   d. Such copy shall be filed with SEC. *(Sec. 118)*

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2. Where creditors are affected
   Procedure:
   a. Filing a petition for dissolution with the SEC
   b. Such petition must be signed by majority of the board of directors or trustees
   c. Must also be verified by the president or secretary or one of its directors
   d. The dissolution was resolved upon by the affirmative vote of the stockholders representing at least 2/3 of the outstanding capital stock or at least 2/3 of the members at a meeting duly called for that purpose.
   e. If there is no sufficient objection, and the material allegations of the petition are true, a judgment shall be rendered 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. *(Sec. 119)*

3. By shortening the corporate term – A voluntary dissolution may be effected by amending the AOI to shorten its corporate term pursuant to the provisions of the Code. A copy of the amended AOI shall be submitted to the SEC. Upon approval of the amended AOI of the expiration of the shortened term, the corporation shall be deemed dissolved without any further proceedings, subject to the provisions of the Code on liquidation.

   As an additional requirement, the SEC requires to submit the final audited financial statement not older than 60 days before the application for shortening the corporate term.

4. In case of a corporation sole, by submitting to the SEC for approval, a verified declaration of dissolution *(Sec.115)*. This merely needs the affidavit of the presiding elder. No need for a board resolution.

5. By merger or consolidation, whereby the constituent corporations automatically cease upon issuance by the SEC of the certificate of merger or consolidation, except the surviving or consolidated corporation which shall continue to exist. *(Secs. 79 and 80)*

6. Expiration of the corporate term *(Sec. 11).*

(B) INVOLUNTARY

Q: What are the *involuntary* modes of dissolution of a corporation?

A:
1. By expiration of corporate term

2. Failure to organize and commence transaction of its business within 2 years from date of incorporation *(Sec. 22).*

3. Continuous inoperation for a period of at least 5 years.

4. Legislative dissolution. In this case, a corporation created by special law is dissolved also by a special law.

5. Dissolution of SEC on grounds under existing laws.

Q: What are examples of dissolution by the SEC under existing laws?

A: Examples of dissolution by the SEC under special laws are:

1. Failure to file by-laws within the required period but, according to a SEC Opinion, SEC will give it the opportunity to explain such failure and not automatically dissolve the corporation.

2. By order of the SEC upon a verified petition and after proper notice and hearing on the ground of serious misrepresentation as to what the corporation can do or is doing to the great prejudice of or damage to the general public.

3. Revocation or forfeiture of the franchise or certificate of incorporation due to its misuse or non-use pursuant to *quo warranto* proceedings filed by the Solicitor General.

4. Failure to file required reports.

Q: XYZ Corporation entered into a contract of lease with ABC, Inc., over a piece of real estate for a term of 20 years, renewable for another 20 years, provided that XYZ's corporate term is extended in accordance with law. Four years after the term of XYZ Corporation expired, but still within the period allowed by the lease contract for the extension of the lease period, XYZ Corp. notified ABC, Inc., that it is exercising the option to extend the lease. ABC, Inc., objected to the proposed extension, arguing that since the corporate life of XYZ Corp. had expired, it could no longer opt to renew the lease. XYZ Corp. countered that withstanding the lapse of its corporate term it still has the right to renew the lease because no quo warranto proceedings for involuntary dissolution of XYZ Corp. has been instituted by the Office of the Solicitor General. Is the contention of XYZ Corp. meritorious? Explain briefly.

A: XYZ Corporation's contention is not meritorious based on the ruling of the Supreme Court *in PNB v. CFI of Rizal, May 27, 1992.* XYZ Corp. was dissolved *ipso facto* upon the expiration of its original term. It ceased to be a body corporate for the purpose of continuing the business for which it was organized, except only for purposes connected with its winding up or liquidation. Extending the lease is not an act to wind up or litigate XYZ's affairs. It is contrary to the idea of winding up the affairs of the corporation. **(2004 Bar Question)**

(2) METHODS OF LIQUIDATION

Q: What are the modes of liquidation?

A:

1. By the corporation itself or its board of directors or trustees; *(Sec. 122, par. 1)*
2. By a trustee to whom the assets of the corporation had been conveyed. *(Sec. 122, par. 2); (Board of Liquidators v. Kalaw, G.R. No. L-18805, Aug. 14, 1967)*
3. By a management committee or rehabilitation receiver appointed by SEC; *(Sec. 119, last par.)*

Q: Does a corporation in the process of liquidation have legal authority to engage in any new business?

A: No, a corporation in the process of liquidation has no legal authority to engage in any new business, even if the same is in accordance with the primary purpose stated in its article of incorporation.

Q: The Securities and Exchange Commission approved the amendment of the articles of incorporation of GHQ Corporation shortening its corporate life to only 25 years in accordance with Sec. 120 of the Corporation Code. As shortened, the corporation continued its business operations until May 30, 1997, the last day of its corporate existence. Prior to said date, there were a number of pending civil actions, of varying nature but mostly money claims filed by creditors, none of which was expected to be completed or resolved within five years from May 30, 1997. If the creditors had sought your professional help at that time about whether or not their cases could be pursued beyond May 30, 1997, what would have been your advice?

A: The cases can be pursued even beyond May 30, 1997, the last day of the corporate existence of GHQ Corporation. The corporation is not actually dissolved upon the expiration of its corporate term. There is still the period for liquidation or winding up. **(2000 Bar Question)**

Q: X Corporation shortened its corporate life by amending its articles of incorporation. It has no debts but owns a prime property located in Quezon City. How would the said property be liquidated among the five stockholders of said corporation? Discuss two methods of liquidation.

A: The prime property of X Corporation can be liquidated among the five stockholders after the property has been conveyed by the corporation to the five stockholders, by dividing or partitioning it among themselves in any two of the following ways:

1. By physical division or partition based on the proportion of the values of their stockholdings; or
2. By selling the property to a third person and dividing the proceeds among the five stockholders in proportion to their stockholdings; or
3. After the determination of the value of the property, by assigning or transferring the property to one stockholder with the obligation on the part of said stockholder to pay the other four stockholders the amount/s in proportion to the value of the stockholding of each. **(2001 Bar Question)**

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Q: What are the consequences if the liquidation is not terminated within the 3-year period?

A:

1. Pending suits for or against the corporation which were initiated prior to the expiration of the 3-year period shall continue. *(Gelano v. CA, G.R. No. L-39050, Feb. 24, 1981)*
2. New actions may still be filed against the trustee of the corporation even after the expiration of the 3-year period but before the affairs of said corporation have been finally liquidated or settled by the trustee. *(Republic v. Marsman, G.R. No. L-18956 Apr. 27, 1972)*
3. A corporation which has a pending action which cannot be finished within the 3-year period is authorized to convey all its property, including pending choses of action, of a trustee to enable it to prosecute and defend suits by or against the corporation beyond the 3-year period. Where no trustee is appointed, its counsel who prosecuted and represented the interest of the corporation may be considered as trustee of said corporation, at least with respect to the matter in litigation (*Gelano v. CA, G.R. No. L-39050, Feb. 24, 1981).* The directors may also be permitted to continue as trustees to complete the liquidation. *(Clemente v. CA, G.R. No. 82407, Mar. 27, 1995)*
4. The creditors of the corporation who were not paid may follow the property of the corporation that may have passed to its stockholders unless barred by prescription or laches or disposition of said property in favor of a purchaser in good faith.

Q: What is the rationale behind the 3-year period?

A: The continuance of a corporation's legal existence for three years for the purpose of enabling it to close up its business is necessary to enable the corporation to collect the demands due it as well as to allow its creditors to assert the demands against it.

Q: May the corporation, through its president condone penalties and charges after it had been placed under receivership?

A: No. The appointment of a receiver operates to suspend the authority of a corporation and of its directors and officers over its property and effects, such authority being reposed in the receiver *(Yam v. CA, G.R. No. 104726 Feb 11, 1999).*

Q: When may the Commission appoint a receiver to undertake the winding up and liquidation of a corporation?

A: Where the application for dissolution of a corporation is upon application, affecting rights of creditors, or involuntarily initiated by verified complaint, the Commission may appoint a receiver to undertake the winding up rather than entrust the responsibility to directors and corporate officers.

Q: What is the effect if the corporation appoints a trustee and convey all its property to him for the benefit of stockholders, members, creditors and other persons in interest?

A: After such conveyance to the trustee, all interest which the corporation had in the property terminates and the legal interests vests in the trustee, subject to the beneficial interest of stockholders, members, creditors or other persons in interest.

L. OTHER CORPORATIONS

(1) CLOSED CORPORATION

Q: What is a close corporation?

A:

1. Whose articles of incorporation provide that:
   a. All the corporation's issued stock of all classes, exclusive of treasury shares, shall be held of record by not more than a specified number or persons not exceeding twenty (20);
   b. All the issued stock of all classes shall be subject to one or more specified restrictions on transfer;
   c. The corporation shall not list in any stock exchange or make any public offering of any of its stock of any class.
2. Whose stocks, at least 2/3 of the voting stocks or voting rights of which are owned or controlled by another corporation which is a close corporation.

Note: The Corporation is not a close corporation even if the shares belong to less than twenty if not all the requisites are present. *(San Juan Structural and Steel Fabricators, Inc. v. CA, G.R. No. 129459, Sept. 29, 1998)*

(A) CHARACTERISTICS OF A CLOSE CORPORATION

Q: What are the characteristics of a close corporation?

A:

1. Stockholders may act as directors without need of election and therefore are liable as directors
2. Stockholders who are involved in the management of the corporation are liable in the same manner as directors are
3. Quorum may be greater than mere majority
4. Transfer of stocks to others, which would increase the number of stockholders to more than the maximum are invalid
5. Corporate actuations may be binding even without a formal board meeting, if the stockholder had knowledge or ratified the informal action of the others
6. Pre-emptive right extends to all stock issues
7. Deadlock in board are settled by the SEC, on the written petition by any stockholder
8. Stockholder may withdraw and avail of his right of appraisal

Q: What cannot be a close corporation?

A: MOSBI PEP

1. **M**ining companies
2. **O**il companies
3. **S**tock exchanges
4. **B**anks
5. **I**nsurance companies
6. **P**ublic utility
7. **E**ducational institutions
8. Other corporation declared to be vested with **P**ublic interest. *(Sec. 96)*

Note: A "close corporation" is different from a "closed corporation" and a "closely held corporation".

(B) VALIDITY ON RESTRICTIONS ON TRANSFER OF SHARES

Q: What are the conditions for validity of restrictions on transfer of shares?

A:

1. Such restrictions must appear in the AOI and in the by-laws as well as in the certificate of stock, otherwise they shall not be binding on any purchaser thereof in good faith
2. They shall not be more onerous than granting the existing stockholders or the corporations the option to purchase the shares of the transferring stockholders with such reasonable terms, conditions, or period stated therein

Note: Any transfer made should not result in exceeding the number of stockholders as allowed by the Code.

Q: What is the nature of restrictions on transfer?

A: It is in the nature of a right of first refusal in favor of stockholders which can be waived by the stockholder, if the latter fails to exercise the option to purchase within the period stated in the articles and by-laws.

(C) ISSUANCE OR TRANSFER OF STOCK IN BREACH OF QUALIFYING CONDITION

Q: Can good faith be a defense in the issuance or transfer in breach of qualifying conditions?

A: No, according to Sec. 99, there is a conclusive presumption of knowledge of the restrictions.

(D) WHEN BOARD MEETING IS UNNECESSARY OR IMPROPERLY HELD

Q: What is the effect of unnecessary or improperly held board meeting?

A: Any action by the directors of a close corporation without a meeting shall be valid if:

1. Before or after such action is taken, written consent is signed by all the directors
2. All the stockholders have actual or implied knowledge of the action and make no prompt objection
3. The directors are accustomed to take informal action with the express or implied acquiescence of all the stockholders

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4. All the directors have express or implied knowledge of the action in question and make no prompt objection thereto.

(E) PRE-EMPTIVE RIGHT

Q: What is the difference between pre-emptive right in an ordinary corporation and in a close corporation?

A: In an ordinary corporation, the pre-emptive right extends only to new issues out of the increased capital stock. In a close corporation, pre-emptive right extends to all stock, including treasury stock.

(F) AMENDMENT TO THE ARTICLES OF INCORPORATION

Q: Corporation A, a close corporation, amended its articles of incorporation and removed the provision that all shares of stock, exclusive of treasury stock, shall be held by a specified number of shareholders not exceeding 20.

What is the effect of such amendment to Corporation A?

A: It is a special feature of a close corporation that its shares of stock exclusive of treasury shares shall be held by not more that 20 stock holders. The deletion of such special feature would render Corporation A, no longer a close corporation.

Q: What is the required number of vote for the deletion of such special feature?

A: The amendment by deletion of said special feature and of the provision reducing a quorum or voting requirements requires the vote of 2/3 of all outstanding shares, regardless of their classifications, restrictions or voting rights. All other matters may be amended by an ordinary vote by stockholders constituting a quorum.

(G) DEADLOCKS

Q: What is deadlock in a close corporation?

A: It is when the directors or stockholders are so divided respecting the management of the business and affairs of the corporation that the votes required for any corporate action cannot be obtained and as a result, business and affairs can no longer be conducted to the advantage of the stockholders generally.

Q: What is the remedy in case of deadlocks in a close corporation?

A: The SEC may be asked to intervene and the SEC may perform such actions that may be necessary under the circumstances including the appointment of a provisional director who, as an impartial person will have all the powers of a duly elected director.

(2) NON-STOCK CORPORATION

(A) DEFINITION

Q: What is the concept of a non-stock corporation?

A: It is one where no part of its income is distributable as dividends to its members.

Even if there is a statement of capital stock, for as long as there is no distribution of unrestricted retained earnings to its members, the corporation is non-stock.

Any profit which it may obtain as an incident to its operations shall whenever necessary or proper, be used in furtherance of the purpose or purposes for which it was organized.

Note: They are governed by the same rules established for stock corporations, subject however, to special provisions governing non-stock corporations.

Q: What are the characteristics of a non-stock corporation?

A:

1. It does not have capital stock divided into shares

2. No part of its income during its existence is distributable as dividends to its members, trustees, or officers

(B) PURPOSES

Q: For what purposes may a non-stock corporation be organized?

A: Non-stock corporation may be formed or organized for charitable, religious, educational, professional, cultural, fraternal, literary, scientific, social, civic service, or similar purposes, like trade, industry, agriculture and like chambers, or any combination thereof.

(C) TREATMENT OF PROFITS

Q: May a non-stock corporation earn profit?

A: Yes. Mere intangible or pecuniary benefit to the members does not change the nature of the corporation.

Q: If a non-stock corporation earns profit, does it render such corporation a stock corporation?

A: No. The fact that a non-stock corporation earns a profit does not make it a profit-making corporation where such profit or income is used for purposes set forth in its articles of incorporation and is not distributed to its incorporators, members or officers.

(D) DISTRIBUTION OF ASSETS UPON DISSOLUTION

Q: What is the order of distribution of assets on dissolution of non-stock corporations?

A:

1. All its creditors shall be paid
2. Assets held subject to return on dissolution, shall be delivered back to their givers
3. Assets held for charitable, religious purposes, etc., without condition for their return on dissolution, shall be conveyed to one or more organizations engaged in similar activities as dissolved corporation;
4. All other assets shall be distributed to members, as provided for in the Articles or by-laws
5. In case of there is no provision in the AOI or by-laws, distribution may be made in accordance to a plan of distribution adopted by the board of trustees by majority vote and by at least 2/3 of the members. *(Sec. 94)*

Q: Can a non-stock corporation offset unused contributions of members against the balance of receivables from the same members?

A: No. The unused contributions of members cannot be offset against the balance of receivables because this would amount to distribution of the capital of the corporation. Members of Non-stock Corporation are not entitled to distribution of capital. They are only entitled to distribution of capital upon dissolution when it is provided for in the articles of incorporation or by-laws. *(SEC Opinion, Nov. 27, 1985)*

(3) RELIGIOUS CORPORATION

Q: What is a religious corporation?

A: A corporation composed entirely of spiritual persons and which is organized for the furtherance of a religion or for perpetuating the rights of the church or for the administration of church or religious work or property. It is different from an ordinary non-stock corporation organized for religious purposes. *(Secs. 109- 116)*

Q: Are religious groups required to be registered with the SEC?

A: No, the Corporation Code does not require any religious groups to be registered as a corporation but if it wants to acquire legal personality, its members should incorporate under the Code.

Q: What are the kinds of Religious Corporation?

A:

1. *Corporation sole* – a special form of corporation, usually associated with the clergy, consisting of one person only and his successors, who is incorporated by law to give some legal capacities and advantages *(Sec. 110);*
2. *Religious societies or corporate aggregate* – a non-stock corporation governed by a board but with religious purposes. It is incorporated by an *aggregate of persons*, religious order, diocese, synod, sect, etc. *(Sec. 116)*

(A) CORPORATION SOLE

Q: How is a corporation sole organized?

A: By the mere filing of a verified articles of incorporation with the SEC without the need of an issuance of a certificate of incorporation. *(Sec. 111)*

(i) NATIONALITY

Q: What is the nationality of a corporation sole?

A: A corporation sole does not have any nationality but for purposes of applying

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nationalization laws, nationality is determined not by the nationality of its presiding elder but by the nationality of its members, constituting the sect in the Philippines. Thus, the Roman Catholic Church can acquire lands in the Philippines even if it is headed by the Pope. *(Roman Catholic Apostolic Church v. Land Registration Commission, G.R. No. L-8451, Dec. 20, 1957)*

Q: May a corporation sole acquire property?

A: Yes, a corporation sole may acquire property even without court intervention by purchase, donation and other lawful means.

Q: How may a corporation sole alienate property?

A:

1. By obtaining an order from the RTC of the province where the property is situated after notice of the application for leave to sell or mortgage has been given by publication or otherwise

2. 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, and the intervention of the courts shall not be necessary. *(Sec. 113)*

Q: How is the vacancy filled in a corporation sole?

A: By accession to the office by the successors of any chief archbishop, bishop, priest, minister, rabbi or presiding elder. *(Sec. 114)*

Note: They shall be permitted to transact business on the filing with the SEC a copy of their commission, certificate of election, or letters of appointment, duly certified by any notary public.

Q: How is a corporation sole dissolved?

A: By filing a verified declaration of dissolution stating:

1. The name of the corporation
2. Reason for dissolution
3. Authorization for the dissolution by the particular religious denomination, sect or church
4. Names and addresses of the persons who will supervise the dissolution and winding up

Q: If a corporation sole wants to become a corporation aggregate, does it need to be dissolved first?

A: No. There is no point to dissolving the corporation sole of one member to enable the corporation aggregate to emerge from it. The Corporation Code provides no specific mechanism for amending the articles of incorporation of a corporation sole but Section 109 of the Corporation Code allows the application to religious corporations of the general provisions governing non-stock corporations.

In non-stock corporations, the amendment needs the concurrence of at least two-thirds of its membership. If such approval mechanism is made to operate in a corporation sole, its one member in whom all the powers of the corporation technically belongs, needs to get the concurrence of two-thirds of its membership *(Iglesia Evangelica Metodista v. Bishop Lazaro. GR. 184088 July 6, 2010).*

Q: What are the requirements for amendment of the articles of incorporation of a corporation sole?

A: The requirements for amendment of the articles of incorporation of a coporation sole are:

1. The amendment is not contrary to any provision or requirement under the Corporation Code, and that
2. That it is for a legitimate purpose. *(Iglesia Evangelica Metodista v. Bishop Lazaro. GR. 184088 July 6, 2010)*

(ii) RELIGIOUS SOCIETIES

Q: What are religious societies?

A: Religious societies are groups within a religious denomination such as religious order, diocese, synod or district organization.

Q: Can religious societies incorporate themselves for the administration and management of its affairs, properties and estate?

A: Yes, provided that such incorporation is not forbidden by the constitution, rules, regulations or discipline of the religious denomination which it is part. (Sec. 116)

Q: What are the requirements for a religious society to be incorporated?

A: See Sec. 116

Q: Where two factions of a religious denomination are in dispute as to who would be entitled to the possession of the properties of the corporation, to whose favor should the issue be resolved?

A: The issue should be resolved in favor of the faction having the numerical majority of the members. The minority, in choosing to separate themselves into a distinct body, and refusing the authority of the governing body, can claim no rights to the property from the fact that they once have been members.

(4) FOREIGN CORPORATIONS

Q: What is a foreign corporation?

A: It is a corporation formed, organized or existing under any law other than those of the Philippines, and whose laws allow Filipino citizens and corporation to do business in its own country or state. *(Sec. 123)*

Note: The definition espouses the incorporation test and the reciprocity rule and is significant for licensing purposes.

(A) BASES OF AUTHORITY OVER FOREIGN CORPORATION

Q: What are the bases of authority over foreign corporation?

A:

1. Consent
2. Doing business in the Philippines

(i) CONSENT

Q: What is an example of consent of foreign corporation?

A: Filing of an action by a foreign corporation before Philippine courts would mean that by voluntary appearance the local courts have actually obtained jurisdiction over the "person" of the foreign corporation. *(Communication Materials and Design, Inc. v. CA, 260 SCRA 673, 73 SCAD 374 (1996)*

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(ii) DOCTRINE OF DOING BUSINESS

Q: What are the jurisdictional tests of "doing or transacting business" in the Philippines for foreign corporations?

A:

1. Twin Characterization Test
   a. *Continuity Test* – doing business implies a continuity of commercial dealings and arrangements, and contemplates to some extent the performance of acts or works or the exercise of some functions normally incident to and in progressive prosecution of, the purpose and object of its organization.
   b. *Subsequent Test* – a foreign corporation is doing business in the country if it is continuing the body or substance of the enterprise of business for which it was organized. *(Philippine Corporate Law, Villanueva, 2001 ed.)*

2. Contract Test
   Whether the contracts entered into by the foreign corporation, or by an agent acting under the control and direction of the foreign corporation, are consummated in the Philippines.

   To be "doing or transacting business in the Philippines" for the purposes of Sec. 133 of the Corporation Code, the foreign corporation must actually transact business in the Philippines, that is, perform specific business transactions within the Philippines territory on a continuing basis, in its own name or for its own account.

   Note: Actual transaction of business within the Philippine territory is an essential requisite for the Philippines to acquire jurisdiction over a foreign corporation and thus require the foreign corporation to secure a Philippine business license *(B. Van Zuiden Bros., Ltd. v. GTVL Manufacturing Industries, Inc., G.R. No. 147905, May 28, 2007).*

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Q: What are the considered as "doing or transacting business" in the Philippines for foreign corporations?

A:

1. Soliciting orders, service contracts, and opening offices
2. Appointing representatives, distributors domiciled in the Philippines or who stay for a period or periods totaling 180 days or more
3. Participating in the management, supervision or control of any domestic business, firm, entity, or corporation in the Philippines
4. Any act or acts that imply a continuity of commercial dealings or arrangements, and contemplate to some extent the performance of acts or works or the exercise of some functions normally incident to and in progressive prosecution of, the purpose and object of its organization.

Q: What are the requisites for obtaining license to do business?

A:

1. The foreign corporation should file a verified application containing and together with the following:
   a. Designated resident agent (who will receive summons and notices for the corporation;
   b. a special power of attorney should also be submitted for such purpose;
2. An agreement that if it ceases to transact business or if there is no more resident agent, summons shall then be served through SEC;
3. Oath of Reciprocity. Certificate under Oath of the authorized official of the foreign corporation's country that allows Filipino citizens and corporations to do business in said country.
4. Within 60 days from issuance of license, the corporation should deposit at least P100, 000.00 (cash, property or bond) for the benefit of creditors subject to further deposit every six months.

Q: Why do foreign corporations need license to transact business in the Philippines?

A: Foreign corporations need license to:

1. Place them under the jurisdiction of the court;
2. Place them in the same footing as domestic corporation;
3. Protect the public in dealing with the said corporation.

Q: What are the jurisprudential rules related to the consequences of not obtaining license by a foreign corporation?

A:

1. *Doctrine of isolated transactions* – foreign corporations, even unlicensed ones can sue or be sued on a transaction or series of transactions set apart from their common business in the sense that there is no intention to engage in a progressive pursuit of the purpose and object of business transaction *(Eriks Pte. Ltd. v. CA, G.R. No. 118843, Feb. 6, 1997)*

2. *In pari delicto rule* – in the case of *Top-Weld manufacturing vs. ECED S.A. (G.R. No. L-44944, Aug. 9, 1985),* the court denied the relief prayed for by petitioner when it ruled that the very purpose of the law was circumvented and evaded when the petitioner entered into the said agreements despite the prohibition contained in the questioned law. The parties were considered as being *in pari delicto* because they equally violated R.A. No. 5455.

3. *Doctrine of Estoppel* – the party is estopped from questioning the capacity of a foreign corporation to institute an action in our courts where it had obtained benefits from its dealings with such foreign corporations and thereafter omitted a breach or sought to renege its obligations *(Merrill Lynch v. CA, G.R. No. 978160, July 24, 1992)*

Q: What are considered doing business under the Foreign Investment Act?

A: Under the Foreign Investment Act, the following are considered doing business:

1. Soliciting orders
2. Service contracts
3. 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
4. Opening offices, whether called liason offices or branches
5. Establishing a factory, workshop or processing plant
6. Undertaking building construction or erection projects
7. Opening a store, whether wholesale or retail without prejudice to the provisions of the Retail Trade Act
8. Maintaining or operating a warehouse for business purposes including the storage, display or delivery of its own products
9. Participating in the management, supervision or control of any domestic business, firm, entity or corporation in the Philippines
10. Any other act or acts that imply a continuity of commercial dealings or arrangements, and contemplate to that extent, performance normally incident to , and in progressive prosecution of, commercial gain or of the purpose and object of the business organization
11. It shall not include:
    a. 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
    b. Having a nominee director or officer to represent its interests in such corporations
    c. Appointing a representative or distributor domiciled in the Philippines which transacts business in its own name and for its own account
12. The following acts by themselves shall not be deemed doing business in the Phil:
    a. The publication of a general advertisement through newspapers, brochures or other publication media or through radio or television
    b. Maintaining the stock of goods in the Phil solely for the purpose of having the same processed by another entity in the Phil.
    c. Collecting information in the Phil.
    d. Performing services auxiliary to an existing contract or sale, which are not on a continuing basis.

Q: What are not considered doing business under the Foreign Investment Act?

A: Under the Foreign Investment Act, the following are not considered doing business:
1. Mere investment as a shareholder by a foreign entity in a foreign corporation duly registered to do business.
2. The exercise of rights as a stock investor and
3. Having a nominee director or officer to represent its interest in such corporation
4. Appointing a representative or distributor domiciled in the Philippines which transacts business in its own name and for its own account.
5. Publication of general advertisement through any print or broadcast media
6. Maintaining a stock of goods in the Philippines solely for the purpose of having the same processed by another entity in the Philippines.
7. Consignment by a foreign entity of equipment with a local company to be used in the processing of products for export and
8. Performing services auxiliary to an existing isolated contract of sale which are not on a continuing basis, such as installing in the Philippines machinery it has manufactured or exported to the Philippines, servicing the same, training domestic workers to operate it and similar incidental services.

(B) NECESSITY OF A LICENSE TO DO BUSINESS

Q: Why is there a necessity to require a foreign corporation to acquire a license before engaging in business in the Philippines?

A: The purpose of the law in requiring that a foreign corporation doing business in the Philippines be licensed to do so is to subject such corporation to the jurisdiction of the courts. The object is not to prevent foreign corporation from performing single acts but to prevent it from acquiring a domicile for the purpose of business without taking steps necessary to render it amenable to suits in local courts.

(i) REQUISITES FOR ISSUANCE OF LICENSE

Q: What are the requisites for the issuance of license to a foreign corporation?

A: A foreign corporation applying for a license shall submit to the SEC:

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1. Copy of its articles of incorporation and by-laws, certified in accordance with law
2. Their translation to an official language of the Philippines, if necessary.
3. The application, which shall be under oath.
4. 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:
    a. The laws of the country or state of the applicant allow Filipino citizens and corporations to do business therein
    b. The applicant is an existing corporation in good standing.
    c. 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:

1. Applicant is solvent and in sound financial condition, and
2. 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.

Note: Foreign banking, financial and insurance corporations shall, in addition to the above requirements, comply with the provisions of existing laws applicable to them.

(ii) RESIDENT AGENT

Q: Who can be a resident agent?

A:
1. An individual, who must be of good moral character and of sound financial standing, residing in the Philippines; or
2. A domestic corporation lawfully transacting business in the Philippines, designated in a written power of attorney by a foreign corporation authorized to do business in the Philippines.

Q: What is the purpose of appointing a resident agent?

A: The appointment of a resident agent is required for the purpose of accepting and receiving, on behalf of the foreign corporation: a) notice affecting the corporation pending the establishment of its local office and b) summons and other legal processes in all proceedings for or against the corporation.

Q: Can a resident agent sign the certificate of non-forum shopping?

A: No, while a resident agent may be aware of the actions filed against the principal, he may not be aware of the actions initiated by the principal, therefore he cannot sign the certificate of non-forum shopping that is a requirement for filing of an initiatory pleading in court *(Expert Travel & Tours Inc. v. CA, G.R. No. 152392, May 26, 2005).*

(C) PERSONALITY TO SUE

Q: Do all foreign corporations have the personality to sue?

A: No.
GR: Only foreign corporations that have been issued a license to operate a business in the Philippines have the personality to sue. (*Sec.133)*

XPN: Under the rule on estoppel, a party is estopped to challenge the personality of a foreign corporation to sue, even if it has no license, after having acknowledged the same by entering to a contract with it.

One who has dealt with a corporation of foreign origin as a corporate entity is estopped to deny its corporate existence.

(D) SUABILITY OF FOREIGN CORPORATIONS

Q: Can a foreign corporation without any license, engaged in doing business in the Philippines, be sued in the country?

A: Yes. While an unlicensed foreign corporation doing business in the country cannot maintain any action, said corporation can be sued in the country.

(E) INSTANCES WHERE AN UNLICENSED FOREIGN CORPORATION BE ALLOWED TO SUE

Q: Give instances when unlicensed foreign corporations can sue.

A:
1. Isolated transactions;
1. The action aims to protect its good name, goodwill, and reputation;
2. The subject contracts provide that Philippine courts will be the only venue to future disputes or controversies;
3. A license subsequently granted enables the foreign corporation to sue on contracts executed before the grant of the license;
4. Recovery of erroneously delivered property;
5. Where the unlicensed foreign corporation has a domestic corporation.

Q: May a foreign corporation not engaged in business in the Philippines and a national of a country which is a party to any convention, treaty, or agreement relating to intellectual property rights or the repression of unfair competition, to which the Philippines is also a party or extend reciprocal rights sue in trademark or service mark enforcement action?

A: Yes, the foreign corporation mentioned above may sue in trademark or service mark enforcement action. This is in accordance with Section 160, in relation to Section 3 of R.A. No. 8393, The Intellectual Property Code. *(Sehwani Inc. v. In-n-Out Burger, G.R. No. 171053, Oct. 15, 2007)*

(F) GROUNDS FOR REVOCATION OF LICENSE

Q: What are the grounds for revocation of license of a foreign corporation?

A:
1. Failure to file annual reports required by the Code;
2. Failure to appoint and maintain a resident agent in the Philippines as required by the Code;
3. Failure to inform the SEC of the change of address of the resident agent;
4. Failure to submit copy of amended articles or by-laws or articles of merger or consolidation;
5. A misrepresentation in material matters in reports;
6. Failure to pay taxes, imposts, and assessments;
7. Engage in business unauthorized by SEC; and
8. Acting as dummy of a foreign corporation; *(Sec. 134).*

(M) MERGER AND CONSOLIDATION

1. DEFINITION AND CONCEPT

Q: What is merger?

A: One where a corporation absorbs the other and remains in existence while others are dissolved. *(Sec. 76)*

Q: What is consolidation?

A: One where a new corporation is created and consolidating corporations are extinguished. *(Sec. 76)*

Q: What are the distinctions between merger and consolidation?

A:

MERGER	CONSOLIDATION
All of the constituent corporations involved are dissolved except one	All consolidated corporations are dissolved without exception
No new corporation is created	A single new corporation emerges
The surviving corporation acquires all the assets, liabilities, and capital stock of all constituent corporations	All assets, liabilities, and capital stock of all consolidated corporations are transferred to the new corporation

(2) CONSTITUENT VS. CONSOLIDATED CORPORATION

Q: What is the difference between a constituent and consolidated corporation?

A: A constituent corporation is created when two or more corporations merge into a single corporation which is one of those merging corporations. A consolidated corporation, on the other hand, is created when two or more

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corporations merge into an entirely new corporation.

(3) PLAN OF MERGER OR CONSOLIDATION

Q: What is a plan of merger or consolidation?

A: The plan of merger or consolidation is a plan created by the representatives of the constituent corporations, providing for the details of such merger.

Q: What should the plan of merger or consolidation contain?

A: The plan of merger or consolidation shall set forth the following:

1. Names of corporations involved *(constituent corporations)*
2. Terms and mode of carrying it out
3. 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.

(4) ARTICLES OF MERGER OR CONSOLIDATION

Q: What is an article of merger or consolidation?

A: An article of merger or consolidation is a document to be signed by the president or vice-president of the each corporation and signed by their secretary or assistant secretary setting 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
3. As to each corporation, the number of shares or members voting for and against such plan, respectively

(5) PROCEDURE

Q: What is the procedure for merger or consolidation?

A:

1. Board of each corporation shall draw up a plan of merger or consolidation, setting forth:
    a. Names of corporations involved *(constituent corporations)*
    b. Terms and mode of carrying it out
    c. 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 by 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. The plan may still be amended before the same is filled with the SEC; however, 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 such 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:
    a. Plan of merger or consolidation
    b. In stock corporation, the number of shares outstanding; in non-stock, the number of members
    c. 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. *(Secs. 76-79)*

(6) EFFECTIVITY

Q: When shall the merger or consolidation become effective?

A: Upon issuance by the SEC of the certificate of merger and consolidation.

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.

(7) LIMITATIONS

Q: What are the limitations with regard to merger or consolidation of corporations?

A: Subject to the limitations provided by the Constitution, the merger or consolidation should not create illegal combinations nor create monopolies and it should not eliminate free and healthy competition.

(8) EFFECTS

Q: What are the effects of a merger or consolidation?

A: The effects of merger or consolidation are:

1. The constituent corporations shall become a single corporation which:
   a. In case of merger, shall be the surviving corporation designated in the plan of merger
   b. In case of consolidation, shall be the consolidated corporation designated in the plan of consolidation
2. The separate 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:
   a. All the rights, privileges, immunities and franchises of each of the constituent corporations
   b. 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
   c. These shall be deemed transferred to and vested in such surviving or consolidated corporation without further act or deed
5. The surviving or consolidated corporation shall:
   a. 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
   b. 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
   c. The rights of creditors or liens upon the property of any of such constituent corporations shall not be impaired by such merger or consolidation

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SECURITIES REGULATION CODE

I. STATE POLICY (PURPOSE)

Q: What is the nature of the Securities Regulation Code (SRC)?

A: The SRC is enacted to protect the public from unscrupulous promoters, who stake business or venture claims which have really no basis, and sell shares or interests therein to investors.

Q: What is the state policy with regard to the SRC?

A:

1. Establish a socially-conscious market that regulates itself
2. Encourage widest participation of ownership in enterprises and enhance democratization of wealth
3. Promote development of capital market
4. Protect investors and ensure full and fair disclosure about securities
5. Minimize, if not totally eliminate, insider trading and other fraudulent or manipulative devices; and practices which distorts the free market

II. POWERS AND FUNCTIONS OF THE SECURITIES AND EXCHANGE COMMISSION (SEC)

Q: What are the powers and functions of the Commission?

A:

1. Regulatory

   a. *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;

   b. *Formulate policies and recommendations* on issues concerning the securities market;

   c. *Advise Congress and other government agencies* on all aspects of the securities market and propose legislation and amendments thereto;

   d. *Approve, reject, suspend, revoke or require amendments* to registration statements, and registration and licensing applications

   e. *Regulate, investigate or supervise* the activities of persons to ensure compliance

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

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

   h. *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

   i. *Deputize any and all enforcement agencies of the Government* as well as any *private institutions*

   j. *Compel the officers* of any registered corporation or association to *call meetings* of stockholders or members

   k. *Suspend, or revoke,* after proper notice and hearing *the franchise or certificate of registration* of corporations, partnerships or associations

   l. *Exercise such other powers* as which are incidental to the primary powers of the Commission

2. Adjudicative

   a. *Issue cease and desist order*

   b. *Punish for contempt of the Commission,* both direct and indirect

   c. *Issue subpoena duces tecum and summon witnesses* to appear in any proceedings of the Commission

d. *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.

Note: The SEC's jurisdiction under Section 5 of PD No. 902-A (intra-corporate disputes) has been transferred to the appropriate RTC, pursuant to Sec. 5.2 of SRC.

III. SECURITES TO BE REGISTERED

Q: What are securities?

A: 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:

1. *Equity instruments* – Shares of stock, certificates of interest or participation in a profit sharing agreement, certificates of deposit for a future subscription, proprietary or non-proprietary membership certificates in corporations
2. *Investments instruments* – Investment contracts, , fractional undivided interests in oil, gas, or other mineral rights
3. *Debt instruments* – bonds, debentures, notes, evidence of indebtedness, asset-backed securities
4. *Derivatives* – options and warrants
5. *Trust instruments* – Certificates of assignments, certificates of participation, trust certificates, voting trust certificates or similar instruments;
6. *Future* – Other instruments as may in the future be determined by the SEC. **(1996 Bar Question)**

Q: What is registration with regard to securities?

A: It is the disclosing to the SEC of all material and relevant information about the issuer of the security.

Q: Why is registration of securities mandated?

A: Its purpose is to inform the public for them to be able to make good business judgment. It is the filing of registration statement.

Q: What is the rule with regard to registration of securities?

A:

GR: No security can be sold or offered for sale or distribution within the Philippines *unless* accompanied by a registration statement filed with and approved by the SEC.

XPN:
1. Exempt securities
2. Securities sold in *exempt transactions.*

Q: What are the effects of non-registration?

A: The issuer would be penalized. Issuers of securities not registered shall be subject criminal, civil and administrative charges.

Q: What are the exempt securities?

A:

1. Any security issued or guaranteed by the Government of the Philippines, or by any political subdivision or agency thereof, or by any person controlled or supervised by, and acting as instrumentality of said government.

2. 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: Provided, that the SEC may require compliance with the form and content of disclosures the SEC may prescribe

3. Certificates issued by a receiver or by a trustee in bankruptcy duly approved by the proper adjudicatory body.

4. Any security or its derivatives the sale or transfer of which, by law, is under the supervision and regulation of the Office of Insurance Commission, Housing and Land Use Regulatory Board, or the Bureau of Internal Revenue.

5. Any security issued by a bank except its own shares of stock.

6. Other securities as determined by the SEC

Note: Being an issuer of an exempt security does not exempt such issuer from the requirement of submission of reports – full and fair disclosure.

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Q: What are exempt transactions?

A:

1. Any judicial sale, or sale by an executor, administrator, guardian, receiver or trustee in insolvency or bankruptcy
2. Those sold by a pledge, mortgagee, or any other similar lien holder, to liquidate a bona fide debt (a security pledged in good faith as security for such debt
3. Those sold or offered for sale in an isolated transaction, the owner not being an underwriter
4. Distribution by the corporation of securities to its stockholders as dividends;
5. Sale of capital stock of a corporation to its own stockholders exclusively
6. Bonds or notes secured by a mortgage are sold to a single purchaser at a single sale
7. Delivery of security in exchange for any other security pursuant to the right of conversion
8. Broker's transactions executed upon the customer's orders
9. Share subscriptions prior to incorporation or in pursuance of an increase in its authorized capital stock
10. Exchange of securities by the issuer with its existing security holders exclusively
11. Sale by issuer to fewer than 20 persons in the Philippines during any 12 month period
12. Sale to banks, investment houses, insurance companies and any entities ruled qualified by the SEC

IV. PROCEDURE FOR REGISTRATION OF SECURITIES

Q: What is the procedure for registration of securities?

A:

1. *Application* – All securities required to be registered shall be registered through the filing by issuer with SEC, of a sworn registration statement.
2. *Prospectus* – The registration statement shall include any prospectus required or permitted to be delivered;
3. *Other information* – The information required for the registration of any kind and all securities shall include, among others, the effect of the securities' issue on ownership, on the mix of ownership, especially foreign and local ownership;
4. *Signatories to registration statement* – The registration statement shall be signed by the issuer's:
    a. Executive officer
    b. Principal operating officer
    c. Comptroller
    d. Principal accounting officer
    e. Corporate secretary or persons performing similar functions

    Note: it shall be accompanied by a duly verified resolution of the BoD of the issuer
5. *Written consent of expert* – 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
6. *Certification by selling stockholders* – Where the registration statement includes:
    a. Shares to be sold by the selling shareholders
    b. A written certification by such selling shareholders as to the accuracy of any part of the registration statement contributed by such selling shareholders shall also be filed
7. *Fees* – The issuer shall pay to the SEC; the SEC shall prescribe by rule,

diminishing the fees in inverse proportion, the value of the aggregate price of the offering

8. *Notice and publication* – Notice of the filing of the registration statement shall be immediately published by the issuer in two newspapers of general circulation in the Philippines; once a week for two consecutive weeks, reciting that:
   a. A registration statement has been filed, and
   b. The aforesaid registration statement and papers attached thereto are open to inspection at the SEC during business hours.

   Note: copies shall be furnished to interested parties at a reasonable charge.

9. *SEC Power for production of books* – The SEC may:
   a. Compel the production of all the books and papers of such issuer
   b. Administer oaths
   c. Examine the officers of such issuer, or any other person connected therewith as to its business and affairs

10. *Ruling* – Within 45 days after the date of the filing of the registration statement, or by such later date to which the issuer has consented, the SEC shall declare the registration statement effective or rejected, unless the applicant is allowed to amend the registration statement.

Q: What are the grounds for rejection and revocation of registration?

A: The following acts constitute a ground for revocation of registration:

1. The issuer:
   a. Has been judicially declared insolvent
   b. Has violated any of the provisions of the Code, the rules promulgated pursuant thereto, or any order of the SEC of which the issuer has notice in connection with the offering for which a registration statement has been filed
   c. Has been or is engaged or is about to engage in fraudulent transactions
      Has made any false or misleading representations of material facts in any prospectus concerning the issuer or its securities; or
   d. Has failed to comply with any requirement that the SEC may impose as a condition for registration of the security for which registration statement has been filed.

2. The registration statement is on its face incomplete or inaccurate or includes any untrue statement of a material fact or omits to state a material fact required to be stated therein.

3. The issuer or any underwriter has been convicted by a competent judicial or administrative body of an offense involving moral turpitude and/or fraud or is enjoined by the SEC or other competent judicial or administrative body for violations of securities, commodities and other related laws

4. Any issuer who refuses to permit the examination to be made by the Commissioner.

Q: What are the grounds for suspension or cancellation of certificate of registration?

A:
1. Fraud in procuring registration
2. Serious misrepresentation as to objectives of corporation
3. Refusal to comply with lawful order of SEC
4. Continuous inoperation for at least 5 years
5. Failure to file by-laws within required period
6. Failure to file reports
7. Other similar grounds. (*Sec. 6 [L]*)

Q: What are the grounds for suspension of registration?

A:
1. If any time, the information contained in the registration statement filed is or has become misleading, incorrect, inadequate or incomplete in any material respect; or

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2. The sale or offering for sale of the security registration there under may work or tend to work a fraud;
3. Pending investigation of the security registered to ascertain whether the registration of such security should be revoked on any ground specified the SRC; *and*
4. Refusal to furnish information required by the Commission. (*Sec. 15*)

Q: Who are the securities market professionals as classified by the SRC?

A: They are the broker, dealer, associated person of a broker or dealer, and a salesman.

Q: Who is a broker?

A: A person engaged in the business of buying and selling securities for the account of others.

Q: Who is a dealer?

A: Any person who buys and sells securities for his/her own account in the ordinary course of business.

Q: Who is an associated person of a broker or dealer?

A: He is an employee of a broker or dealer 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.

Q: Who is a salesman?

A: He is a natural person, employed as such, or as an agent, by a dealer, issuer or broker to buy and sell securities; but for the purpose of registration, shall not include any employee of an issuer whose compensation is not determined directly or indirectly on sales of securities of the issuer.

Q: What is the obligation of the broker to his client?

A: The primary obligation of the broker is to ensure his account's compliance with the law. (*Abacus Securities Corp. v. Ampil, G.R. No. 160922, Feb. 27, 2006*)

Note: Since a brokerage relationship is essentially a contract for the employments of an agent, the law on contracts govern the broker-principal relationship

Q: Are security market professionals required to be registered?

A: Yes. No broker shall sell any securities unless he is registered with the SEC *(Sec. 19, Revised Securities Act) (Nicolas* vs. *CA*, *et al., G.R. No. 12285, Mar. 27, 1998)*

Q: Can a stockbroker without license from the SEC, recover management fees allegedly earned from handling the securities transactions of a client?

A: No. An unlicensed person may not recover compensation for services as a broker where a statute or ordinance is applicable and such is of a regulatory nature.

Q: What is margin trading?

A: A kind of trading that allows a broker to advance for the customer/investor part of the purchase price of the security and to keep it as collateral for such advance.

Q: What is the margin allowance standard?

A: The credit extended must be for an amount not greater than, whichever is higher of:

1. 65% of the current market price of the security; or
2. 100% of the lowest market price during the preceding 36 months, but not more than 75% of the current market price.

Q: What are the purposes of the margin requirements?

A: They are primarily intended to achieve a macroeconomic purpose – the protection of the overall economy from excessive speculation in securities. Their recognized secondary purpose is to protect small investors.

Q: Who has the burden of compliance with margin requirements?

A: The brokers and dealers.

Note: In securities trading, the brokers are essentially the counterparties to the stock transactions at the Exchange. Since the principals of the broker are generally undisclosed, the broker is personally liable for the contracts thus made. Brokers have a right to be reimbursed for sums advanced by them with the express or implied authorization of the principal. *(Abacus Securities Corporation v. Ampil, G.R. No. 160016, Feb. 27, 2006)*

V. PROHIBITIONS ON FRAUD, MANIPULATIONS AND INSIDER TRADING

A. MANIPULATION OF SECURITY PRICES

Q: What acts are considered manipulation of security prices?

A:

1. Transactions intended to create active trading:
   a. *Wash Sale* – engaging in transaction in which there is no genuine change in the actual ownership of a security
   b. *Matched Sale* – There is a change of ownership in the securities by entering an order for the purchase/sale of security with the knowledge that a simultaneous order 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.
   c. Similar transactions where there is no change of beneficial ownership.

2. Engaging in transactions which induce price to increase or decrease:
   a. *Marking the close* – buying and selling securities at the close of the market to alter the closing price of the security.
   b. *Painting the tape* – engaging in a series of transactions in securities that are reported publicly to give the impression of activity or price movement in a security.
   c. *Squeezing the float* – refers to taking advantage of a shortage of securities in the market by controlling the demand side and exploiting market congestion during such shortages in a way to create artificial prices.
   d. *Hype and dump* – engaging in buying activity at increasingly higher prices and then selling securities in the market at the higher prices.
   e. *Boiler room operations* – the use of high pressure sale tactics to promote purchase and sale of securities
   f. *Daisy chain* – it refers to a series of purchase and sales of the same issue at successively higher prices by the same group of people with the purpose of manipulating prices are drawing unsuspecting investors into the market leaving them defrauded of their money and securities.

Q: Suppose A is the owner of several inactive securities. To create an appearance of active trading for such securities, A connives with B by which A will offer for sale some of his securities and B will buy them at a certain fixed price, with the understanding that although there would be an apparent sale, A will retain the beneficial ownership thereof.

1. **Is the arrangement lawful?**
2. **If the sale materializes, what is it called?**

A:

1. No. The arrangement is not lawful. It is an artificial manipulation of the price of securities. This is prohibited by the Securities Regulation Code.
2. If the sale materializes, it is called a wash sale or simulated sale. **(2001 Bar Question)**

B. SHORT SALES

Q: What is Short Selling?

A: It is the selling of shares which the seller does not actually own or possess and therefore he cannot, himself, supply the delivery.

C. FRAUDULENT TRANSACTIONS

Q: What are considered fraudulent transactions?

A:

1. Obtaining money or property by means of any untrue statement of a material fact

2. Engaging in any act, transaction, practice or course of business, which operates as a fraud or deceit upon any person.

D. INSIDER TRADING

Q: What is insider trading?

A: A purchase or sale made by an insider or his relative within the second degree shall be presumed to be effected while in possession of material non-public information if transacted *after* such information came into existence but

prior to the public dissemination of such information, and lapse of reasonable time for the market to absorb such information.

Q: Who is an insider?

A: A person in possession of corporate information not generally available to the public.

Q: Who may be an insider?

A:
1. The issuer
2. A director or officers of or a person controlling the issuer
3. A person whose relationship or former relationship to the issuer gives him access to material information about the issuer or the security that is not generally available to the public
4. 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
5. Constructive Insider – A person who learns such information by a communication from any of the foregoing insiders. (*Sec. 3.8*) **(1995 Bar Question)**

Q: What are the other prohibited acts in an insider trading?

A: It shall be unlawful:
1. For an insider to communicate material non-public information about the issuer or the security to any person who thereby becomes an insider, where original insider communicating knows or has reason to believe that such person will likely buy or sell on the basis of such information
2. For any person, other than the tender offeror, who is in possession of material non-public information relating to such tender offer to transact securities covered by the tender offer
3. For the tender offeror, or those acting in his behalf, the issuer of securities covered by the tender offer, and any insider, to communicate material non-public information relating to the tender offer which would likely result in violation of prohibition of the insider from trading.

Q: When is information "material non-public"?

A: If:
1. Information about the issuer or the security which 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
2. 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 *(Sec. 27.2).* **(1995 Bar Question)**

Q: What are the possible defenses against insider trading?

A:
1. That the information was acquired not on account of his relationship with the issuer; or
2. That the other party knew or can be presumed to know the material information.

VI. PROTECTION OF INVESTORS

Q: What are the provisions in the SRC intended to protect the investors?

A:
1. Tender Offer Rule
2. Rules on proxy solicitation
3. Disclosure rule

A. TENDER OFFER RULE

Q: What is a tender offer?

A: Publicly declared intention to buy securities of public companies given to all stockholders by:
1. Filing with the SEC a declaration to that effect, and paying the filing fee.
2. Furnishing the issuer a statement containing the information required of the issuers as SEC may prescribe, including subsequent or additional materials.
3. Publishing all requests or invitations for tender, or materials making a tender offer or requesting or inviting letters of such security.

Note: It is also defined as an offer by the acquiring person to stockholders of a public company for them

to tender their shares on the terms specified in the offer.

Q: What is the purpose of tender offer?

A: Tender offer is in place to protect the interest of minority stockholders of a target company against any scheme that dilutes the share value of the investments. It affords such minority shareholders the opportunity to withdraw or exit from the company under reasonable terms, a chance to sell their shares at the same price as those of the majority stockholders.

Q: In what instances is a tender offer required to be made?

A:

The SRC provides:

1. The person intends to acquire 15% or more of the equity share of a public company pursuant to an agreement made between or among the person and one or more sellers.
2. The person intends to acquire 30% or more of the equity shares of a public company within a period of 12 months.
3. The person intends to acquire equity shares of a public company that would result in ownership of more than 50% of the said shares.

However, the IRR of the SRC provides:

1. The person intends to acquire 35% or more of the equity share of a public company pursuant to an agreement made between or among the person and one or more sellers.
2. The person intends to acquire 35% or more of the equity shares of a public company within a period of 12 months.
3. The person intends to acquire equity shares of a public company that would result in ownership of more than 51% of the said shares.

Note: Tender offer applies to both direct and indirect acquisition.

Q: What may be considered as a public company?

A:

1. Those listed on an exchange; or
2. Those with assets of at least 50M pesos and having 200 shareholders owning at least 100 shares each.

Q: What are the unlawful and prohibited acts relating to tender offers?

A: It shall be unlawful for any person to:

1. Make any untrue statement of a material fact or omit to state any material fact necessary in order to make statements made not misleading, and

2. Engage in any fraudulent, deceptive, or manipulative acts or practices in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation.

B. RULES ON PROXY SOLICITATION

Q: What are the requisite for valid proxy solicitation?

A:

1. It must be in writing
2. It must be signed by the stockholder or his duly authorized representative
3. It must be filed before the scheduled meeting with the corporate secretary *(Sec. 20)*

Note: The proxy 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.

Q: What are the rules on proxy solicitation with regard to broker or dealer?

1. No broker or dealer shall give any proxy, consent or authorization, in respect of any security carried for the account of a customer, to a person other than the customer, without the express written authorization of such customer.

2. A broker or dealer who holds or acquires the proxy for at 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. *(Sec. 20)*

C. DISCLOSURE RULE

Q: When does disclosure begin?

A: It begins at registration and continues periodically thru periodic report.

Q: May it be suspended?

A: Yes. It may be suspended when on the first day of the fiscal year if it has less than 100 shareholders *(Rule 17.1, SRC IRR).*

Q: When does the disclosure requirement end?

A:

GR: Disclosure does not end because once a reporting company, it remains as such even when registration of securities has been revoked *(Rule 13 SCR IRR).*

XPN: If the primary license is revoked.

XPN to the XPN: In case of hospitals and educational institutions if the primary license is revoked, disclosure requirement still continues because of public interest.

Q: Give the reportorial requirements.

A:

1. *Issuers*:
   a. Within 135 days, after the end of the issuer's fiscal year, an annual report which shall include, a balance sheet, profit and loss statement and statement of cash flows, for such last fiscal year, certified by an independent certified public accountant, and a management discussion and analysis of results of operations;
   b. Other periodical reports for interim fiscal periods and current reports on significant developments of the issuer *(Sec. 17)*

2. *Persons Acquiring Securities*:
   If the issuer is one that has to make a report, any person who acquires directly or indirectly the beneficial ownership of more than 5% of such class, or in excess of such lesser per centum as the Commission may prescribe, shall, within 10 days after such acquisition or such reasonable time as fixed by the Commission, submit to the issuer of the security, to the Exchange where the security is traded, and to the Commission a sworn statement containing:

   a. His personal circumstances
   b. The nature of such beneficial ownership
   c. If the purpose was to acquire control of the business, any plans the recipient may have affecting a major change in
   d. the business
   e. The number of shares beneficially owned, and the number of shares for which there is a right to acquire
   f. granted to such person or his associates
   g. Information as to any agreement with a third person regarding the securities *(Sec. 18)*

3. Persons that has beneficial ownership of 10% or more:

   Every person who is directly or indirectly the beneficial owner of more than 10% of any class of any equity security, or who is director or an officer of the issuer of such security, shall file:

   a. Statement with the SEC 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,
   b. Within 10 days after the close of each calendar month, if there is a change in ownership during such month, a statement indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month. *(Sec. 23)*

VII. CIVIL LIABILITIES

Q: What are the grounds for civil liability to arise?

A:

1. False Registration Statement. *(Sec. 56)*
2. Fraud with connection to prospectus, communications and reports. *(Sec. 57)*
3. Fraud in connection with security transactions. *(Sec. 58)*
4. Manipulation of security prices. *(Sec. 60)*
5. Insider trading. *(Sec. 61)*

Q: Who are the persons that may be liable in case of false registration statement?

1. The issuer and every person who signed the registration statement
2. Every person who was a director of, or any other person performing similar functions, or a partner in, the issuer at the time of the filing of the registration statement or any part, supplement or amendment thereof with respect to which his liability is asserted
3. Every person who is named in the registration statement as being or about to become a director of, or a person performing similar functions, or a partner in, the issuer and whose written consent thereto is filed with the registration statement
4. Every auditor or auditing firm named as having certified any financial statements used in connection with the registration statement or prospectus
5. Every person who, with his written consent, which shall be filed with the registration statement, 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, with respect to the statement, report, or valuation, which purports to have been prepared or certified by him
6. Every selling shareholder who contributed to and certified as to the accuracy of a portion of the registration statement, with respect to that portion of the registration statement which purports to have been contributed by him
7. Every underwriter with respect to such security

Note: 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 twelve months beginning from the effective date of the registration statement, then the right of recovery under this subsection shall be conditioned on proof that such person acquired the security relying upon such untrue statement in the registration statement or relying upon the registration statement and not knowing of such income statement, but such reliance may be established without proof of the reading of the registration statement by such person *(Sec. 56).*

Q: Who are the persons liable with regard to fraud with connection to prospectus, communications and reports?
A:

1. Any person who offers to sells or sells
   a. in violation any provisions on registration of securities; and
   b. by the use of any means or instruments of transportation or communication, by means of a prospectus or other written or oral communication.

Q: Who are the persons liable with regard to fraud in connection with security transactions?

A: Any person who engages in any act or transaction in violation of Sections 19.2, 20 or 26 of SRC.

Q: Who are the persons liable for the manipulation of security prices?

A: Any person who willfully participates in any act or transaction in violation of Section 24 shall be liable to any person who shall purchase or sell any security at a price which was affected by such act or transaction.

Q: Who are the persons liable with regard to insider trading?

A: Any person in case of legal tender who:

1. Purchases or sells a security while in possession of material information not generally available to the public.
2. Communicates material non-public information

Q: How are the persons enumerated liable?

A: Jointly and severally

Q: What is the prescriptive period for filing of action?

A: 2 years after the discovery of the facts constituting the cause of action and within 5 years after such cause of action accrued

Q: What court has the jurisdiction over civil liabilities?

A: Regional Trial Court

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Q: What is the limitation for awarding damages?

A:

1. The court can award not exceeding triple the amount of the transaction plus actual damage

2. The court is also authorized to award attorney's fees not exceeding 30%of the award

Q: When may the court award exemplary damages?

A: In cases of:
1. Bad Faith
2. Fraud
3. Malevolence or
4. Wantonness in the violation of SRC or the rules and regulations promulgated

BANKING LAWS

I. THE NEW CENTRAL BANK ACT (RA 7653)

Q: What is Bangko Sentral ng Pilipinas (BSP)?

A: The state's central monetary authority; it is the government agency charged with the responsibility of administering the monetary, banking and credit system of the country and is granted the power of supervision and examination over bank and non-bank financial institutions performing quasi-banking functions, including savings and loan associations. *(Busuego vs. CA, G.R. No. L-48955, June 30, 1987)*

A. STATE POLICIES

Q: What are the policies of the state with respect to the creation of the BSP?

A:

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.

2. In line with this policy, and considering its unique functions and responsibilities, the central monetary authority established under this Act, while being a government-owned corporation, shall enjoy fiscal and administrative autonomy *(Sec. 1.)*

B. CREATION OF THE BANGKO SENTRAL NG PILIPINAS

Q: What are the salient considerations on the creation of BSP?

A:

1. It is established as an independent central monetary authority.

2. Its capital shall be P50,000,000,000, to be fully subscribed by the Philippine Government.

3. The P10,000,000,000 of the capital shall be fully paid for by the Government upon the effectivity of this Act and the balance to be paid for within a period of 2 years from the effectivity of this Act in such manner and form as the Government, through the Secretary of Finance and the Secretary of Budget and Management, may thereafter determine. *(Sec. 2)*

C. RESPONSIBILITY AND PRIMARY OBJECTIVE

Q: What are the responsibilities of BSP

A:

1. To provide policy directions in the areas of money, banking, and credit
2. To supervise bank operations
3. To regulate the operations of finance companies and non-bank financial institutions performing quasi-banking functions, and similar institutions. *(Sec. 3)*

Q: What are the primary objectives of BSP

A:

1. To maintain price stability conducive to a balanced and sustainable growth of the economy.
2. To promote and maintain monetary stability and the convertibility of the peso. *(Sec. 3)*

Q: What are the function of BSP

1. Issuer of currency. *(Sec. 49-60)*
2. Custodian of reserves. *(Secs. 64-66, 94, 103)*
3. Clearing channel or house; especially where the PCHC does not operate .*(Sec. 102)*
4. Banker of the government – the BSP shall be the official depository of the Government and shall represent it in all monetary fund dealings *(Secs. 110- 116)*
5. Financial advisor of the government *(Secs. 123-124)* – Under Article VII, Sec. 20 of the 1987 Constitution, the President may contract or guarantee foreign loans but with the prior concurrence of the Monetary Board.
6. Source of credit *(Secs. 61-63, 81-89, 109)*
7. Supervisor of the banking system *(Sec. 25*
   – shall include the power to:
   a. Examine, extending to enterprises wholly or majority-owned or controlled by the bank *(Sec. 7, RA 8791)*; this power may not be restrained by a writ of injunction unless there is convincing proof

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that the action of the BSP is aplainly arbitrary *(Sec. 25)*
b. Place a bank under receivership or liquidation *(Sec. 30)*
c. Initiate criminal prosecution of erring officers of banks
8. Government agent *(Secs. 117-122)*

D. MONETARY BOARD

Q: What is the Monetary Board?

A: The body through which the powers and functions of the Bangko Sentral are exercised. *(Sec 6)*

Q: What are the powers and functions of the Monetary Board?

A:

1. Issue rules and regulations it considers necessary for the effective discharge of the responsibilities and exercise of its powers

2. Direct the management, operations, and administration of the Bangko Sentral, reorganize its personnel, and issue such rules and regulations as it may deem necessary or convenient for this purpose

3. Establish a human resource management system

4. Adopt an annual budget for and authorize such expenditures by the Bangko Sentral as are in the interest of the effective administration and operations of the Bangko Sentral in accordance with applicable laws and regulations

5. Indemnify its members and other officials of the Bangko Sentral, 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. *(Sec 15)*

Note: In the event of a settlement or compromise, indemnification shall be provided only in connection with such matters covered by the settlement as to which the Bangko Sentral is advised by external counsel that the person to be indemnified did not commit any negligence or misconduct. The costs and expenses incurred in defending the aforementioned action, suit or proceeding may be paid by the Bangko Sentral in advance of the final disposition of such action, suit or proceeding upon receipt of an undertaking by or on behalf of the member, officer, or employee to repay the amount advanced should it ultimately be determined by the Monetary Board that he is not entitled to be indemnified as provided in this subsection. *(Sec 15)*

E. HOW BSP HANDLES BANKS IN DISTRESS

Q: What is the function of the BSP on a distressed bank?

A: Appointment of a conservator or receiver or closure of the bank.

Q: Distinguish between the grounds for conservatorship, receivership and liquidation and their effects.

A: See Appendix F

(1) CONSERVATORSHIP

Q: Who is a conservator?

A: One appointed if the bank is in the state of illiquidity or the bank fails or refuses to maintain a state of liquidity adequate to protect its depositors and creditors. The bank still has more assets than its liabilities but its assets are not liquid or not in cash thus it cannot pay its obligation when it falls due. The bank, not the Central Bank, pays for fees.

Q: What are the powers of a conservator?

A:

1. To take charge of the assets, liabilities, and the management thereof
2. Recognize the management
3. collect all monies and debts due said bank
4. Exercise all powers necessary to restore its viability with the power to overrule or revoke the actions of the previous management and board of directors of the bank or quasi-bank *(First Philippine International Bank vs. CA, G.R. No. 115849, Jan. 24, 1996).*

Note: Such powers cannot extend to post facto repudiation of perfected transactions. Thus, the law merely gives

the conservator power to revoke contracts that are deemed to be defective- void, voidable, unenforceable or rescissible. Hence, the conservator merely takes the place of the bank's board.

5. To bring court actions to assail or repudiate contracts entered into by the bank.

Q: When is conservatorship terminated?

A: When Monetary Board is satisfied that the institution can continue to operate on its own and the conservatorship is no longer necessary.

Note: When the Monetary Board, 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 losses to its depositors or creditors, the bank will go under receivership.

(2) CLOSURE

Q: When may the Monetary Board close a bank or quasi bank?

A:

1. *Cash Flow test* - Inability to pay liabilities as they become due in the ordinary course of business *(Sec. 30 [a] NCBA).*
2. *Balance sheet test* – Insufficiency of realalizable assets to meet its liabilities *(Sec 30 [b] NCBA).*
3. Inability to continue business without involving probable losses to its depositors and creditors *(Sec 30 [c] NCBA).*
4. willful violation of a cease and desist order under Section 37 that has become final, involving acts or transactions which amount to fraud or a dissipation of the assets *(Sec 30 [d] NCBA).*
5. Notification to the BSP or public announcement of a bank holiday *(Sec 53, GBL).*
6. Suspension of payment of its deposit liabilities continuosly for more than 30 days *(Sec 53, GBL).*
7. Persisting in conducting its business in an unsafe or unsound manner *(Sec 56, GBL).*

Q: What is the close now-hear later doctrine?

A: The law does not contemplate prior notice and hearing before the bank may be directed to stop operations and placed under receivership. The purpose is to prevent unwarranted dissipation of the bank's assets and as a valid exercise of police power to protect the depositors, creditors, stockholders and the general public. *(Central Bank of the Philippines v. CA, G.R. No. 76118 Mar. 30, 1993)*

Q: Can the closure and liquidation of a bank, which is considered an exercise of police power, be the subject of judicial inquiry?

A: Yes. While the closure and liquidation of a bank may be considered an exercise of police power, the validity of such exercise of police power is subject to judicial inquiry and could be set aside if it is either capricious, discriminatory, whimsical, arbitrary, unjust or a denial or due process and equal protection clauses of the Constitution *(Central Bank v. CA, G.R. No. L-50031-32, July 27, 1981).*

Q: Upon maturity of the time deposit, the bank failed to remit. By reason of punitive action taken by Central Bank, the bank has been prevented from performing banking operations. Is the bank still obligated to pay the time deposits despite the fact that its operations were suspended by the Central Bank?

A: The suspension of operations of a bank *cannot* excuse non-compliance with the obligation to remit the time deposits of depositors which matured before the bank's closure. *(Overseas Bank of Manila v. CA, G.R. No. 45886, Apr. 19, 1989)*

(3) RECEIVERSHIP

Q: Who is a receiver?

A: One appointed if bank is already insolvent which means that its liabilities are greater than its assets.

Q: What are the duties of a receiver?

A:

1. The receiver shall immediately gather and take charge of all the assets and liabilities of the institution.
2. Administer the same for the benefit of the creditors, and exercise the general powers of a receiver under the Revised Rules of Court

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3. 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 *(Sec 30, NCBA).*

Q: Is the receiver authorized to transact business in connection with the bank's assets and property?

A: No, the receiver only has authority to administer the same for the benefit of its creditors. *(Abacus Real Estate Development Center, Inc. v. Manila Banking Corp, G.R. No. 162270, Apr. 6, 2005)*

Q: Should the issue of whether or not the Monetary Board's resolution is arbitrary be only raised in a separate action?

A: No. While resolutions of the Monetary Board forbidding a bank to do business on account of a condition of insolvency and appointing a receiver to take charge of the bank's assets or determining whether the bank may be rehabilitated or should be liquidated are by law "final and executory." However, they can be set aside by the court on one specific ground - if the action is plainly arbitrary and made in bad faith. Such contention can be asserted as an affirmative defense of a counterclaim in the proceeding for assistance in liquidation. *(Salud v. Central Bank, G.R. No. L-17630, Aug. 19, 1986)*

(4) LIQUIDATION

Q: What is liquidation?

A: It is an act of settling a debt by payment or other satisfaction. It is also the act or process of converting assts into cash especially to settle debts *(Black's Law Dictionary).*

Q: Can the liquidator of a distressed bank prosecute and defend suits against the bank and foreclose mortgages for and in behalf of the bank while the issue on receivership and liquidation is still pending?

A: Yes. The Central Bank is vested with the authority to take charge and administer the monetary and banking systems of the country and this authority includes the power to examine and determine the financial conditions of banks for the purpose of closure on the ground of insolvency. Even if the bank is questioning the validity of its closure, during the pendency of the case the liquidator can continue prosecution suits for collection and foreclosure of mortgages, as they are acts done in the usual course of administration of the bank. *(Banco Filipino v. Central Bank, G.R. No. 70054, Dec. 11, 1991)*

Q: An intra-corporate case was filed before RTC. On the other hand, another complaint was filed before BSP to compel a bank to disclose its stockholdings invoking the supervisory power of the latter. Is there a forum shopping?

A: None. The two proceedings are of different nature praying for different relief. The complaint filed with the BSP was an invocation of its supervisory powers over banking operations which does not amount to a judicial proceeding. *(Suan v. Monetary Board, A.C. No. 6377, Mar. 12, 2007)*

Q: Where will the claims against the insolvent bank be filed?

A: Where liquidation is undertaken with judicial intervention, all claims against the insolvent bank should be filed in the liquidation proceeding. It is not necessary that a claim be initially disputed in a court or agency before it is filed with the liquidation court. *(Ong v. CA, G.R. No. 112830, Feb. 1, 1996)*

Note: The judicial liquidation is intended to prevent multiplicity of actions against the insolvent bank.

Where it is the bank that files a claim against another person or legal entity, the claim should be filed in the regular courts.

Q: What is the rule of promissory estoppel?

A: The doctrine was applied in one case where the SC held that the CB may not thereafter renege on its representation and liquidate the bank after majority stockholders of the bank complied with the conditions and parted with value to the profit of CB, which thus acquired additional security for its own advances, to the detriment of the bank's stockholders, depositors and other creditors. *(Ramos v. Central Bank of the Philippines, G.R. No. L-29352, Oct. 4, 1971)*

Q: Can a final and executory judgment against an insolvent bank be stayed?

A: Yes, after the Monetary Bank has declared that a bank is insolvent and has ordered it to cease operations, the assets of the insolvent bank are held in trust for the equal benefit of all creditors.

One cannot obtain an advantage or preference over another by attachment, execution or otherwise. The final judgment against the bank should be stayed as to execute the judgment would unduly deplete the assets of the banks to the obvious prejudice of other depositors and creditors. *(Lipana v. Development Bank of Rizal, G.R. No. L-73884, Sept. 24, 1987)*

F. HOW BSP HANDLES EXCHANGE CRISIS

Q: What is Legal Tender?

A: All notes and coins issued by the Bangko Sentral are fully guaranteed by the Republic and shall be legal tender in the Philippines for all debts, both public and private *(Sec. 52)*

Q: What is the legal tender power of coins?

A:

1. *1-Peso, 5-Peso and 10-Peso coins:* In amounts not exceeding P1,000.00
2. *25 centavo coin or less:* In amounts not exceeding P100.00 *(Circular No. 537, 2006)*

Q: What are the rules on BSP's Authority to replace legal tender?

A:

1. Notes and coins called in for replacement shall remain legal tender for a period of one year from the date of call.
2. After that period, they shall cease to be legal tender during the following year or for such longer period as MB may determine.
3. After the expiration of this latter period, the notes and coins which have not been exchanged shall cease to be a liability of BSP and shall be demonetized. *(Sec. 57)*

Note: 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. However, 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).

Q: What is the period of replacement?

A:

1. Notes for any series or denomination – More than 5 years old
2. Coins – More than 10 years old

Q: How is the Power to determine Rates of Exchange exercised?

A:

1. The Monetary Board shall determine the rates at which the Bangko Sentral shall buy and sell spot exchange, and shall establish deviation limits from the effective exchange rate or rates as it may deem proper.
2. The Monetary Board shall similarly determine the rates for other types of foreign exchange transactions by the Bangko Sentral, 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.

Q: What actions does the Bangko Sentral take when international stability of Peso is threatened?

A: Whenever the international reserve of the Bangko Sentral falls to a level which the Monetary Board considers inadequate to meet the prospective demands on the Bangko Sentral 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 Monetary Board, are contrary to the national welfare, the Monetary Board shall:

1. Take such remedial measures as are appropriate and within the powers granted to the Monetary Board, and the Bangko Sentral

2. Submit to the President of the Philippines and the Congress, and make public a detailed report which shall includes, 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 Monetary Board

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c. The monetary, fiscal or administrative measures further proposed
d. The character and extent of the cooperation required from other government agencies for the successful execution of the policies of the Monetary Board (Sec. 67).

Q: What are the emergency restrictions on the foreign exchange operations?

A:

1. Temporarily suspending and restricting sales of foreign exchange by the Bangko Sentral;

2. Subjecting all transactions in gold and foreign exchange to license by the Bangko Sentral;

3. Requiring that any foreign exchange thereafter obtained by any person residing or entity operating in the Philippines be delivered to the Bangko Sentral or to any bank or agent designated by the Bangko Sentral for the purpose, at the effective exchange rate or rates *(Sec. 72)*

   Note: In order that the Bangko Sentral may at all times have foreign exchange resources sufficient to enable it to maintain the stability and convertibility of the peso, or in order to promote the domestic investment of bank resources, the Monetary Board may require the banks to sell to the Bangko Sentral or to other banks all or part of their surplus holdings of foreign exchange. *(Sec. 76)*

II. SECRECY IN BANK DEPOSITS (R.A. 1405)

A. PURPOSE

Q: What is the purpose?

A:

1. To encourage deposit in banking institutions; and
2. To discourage private hoarding so that banks may lend such funds and assist in the economic development of the country.

B. PROHIBITED ACTS

Q: What are the prohibited acts under the law?

A:

1. Examination/inquiry/looking into all deposits of whatever nature with banks or banking institutions in the Philippines (including investment in bonds issued by the government) by any person, government official or office *(Sec. 2)*
2. Disclosure by any official or employee of any banking institution to any authorized person of any information concerning said deposit *(Sec. 3)*

C. DEPOSITS COVERED

Q: What are the kinds of deposits covered?

A:

1. All deposits of whatever nature with banks or banking institutions found in the Philippines; or
2. Investments in bonds issued by the Philippine government, its branches, and institutions. *(Sec. 2, R.A. 1405)*

Q: Are trust funds covered by the term "deposit?"

A: Yes, the money deposited under the trust agreement is intended not merely to remain with the bank but to be invested by it elsewhere. To hold that this type of account is not protected by R.A. 1405 would encourage private hoarding of funds that could otherwise be invested by banks in other ventures, contrary to the policy behind the law. *(Ejercito v. Sandiganbayan, G.R. No. 157294-95, Nov. 30, 2006)*

Note: Despite such pronouncement that trust funds are considered deposits, trust funds remain *not covered* by PDIC.

Q: Are foreign currency deposits covered by the Secrecy in Bank Deposits (R.A. 1405)?

A: No. Foreign currency deposits are covered by R.A. 6426 otherwise known as the Foreign Currency Act. Under the same law, all authorized foreign currency deposits are considered of an absolutely confidential nature and, *except upon the written permission of the depositors*, in no instance shall be examined, inquired or looked into by any person, government official, bureau or office whether judicial or administrative private.

D. EXCEPTIONS

Q: What are the instances where examination or disclosure of information about deposits can be allowed?

A:

1. Upon written consent of the depositor. *(Sec. 2)*

2. In cases of impeachment. *(Sec. 2)*

3. Upon order of competent court in cases of bribery or dereliction of duty of public officials. *(Sec. 2)*

4. In cases where the money deposited or invested is the subject matter of the litigation. *(Sec. 2)*

5. Upon order of the Commissioner of Internal Revenue in respect of the bank deposits of a decedent for the purpose of determining such decedent's gross estate. *(Sec. 6[F][1], NIRC)*

6. Upon the order of the Commissioner of Internal Revenue in respect of bank deposits of a taxpayer who has filed an application for compromise of his tax liability by reason of financial incapacity to pay his tax liability. *(Sec. 6[f][1],NIRC)*

7. In case of dormant accounts/deposits for at least 10 years under the Unclaimed Balances Act. (*Sec. 2, Act No. 3936*).

8. When the examination is made by the BSP to insure compliance with the AML Law in the course of a periodic or special examination

9. With court order:
   a. In cases of unexplained wealth under Sec. 8 of the Anti-Graft and Corrupt Practices Act *(PNB v. Gancayco, L-18343, Sept. 30, 1965)*
   b. In cases filed by the Ombudsman and upon the latter's authority to examine and have access to bank accounts and records *(Marquez v. Desierto, GR 138569, Sept. 11, 2003)*

10. Without court order: If the AMLC determines that a particular deposit or investment with any banking institution is related to the following: **HK-MAD**

    a. **H**ijacking,
    b. **K**idnapping,
    c. **M**urder,
    d. Destructive **A**rson, and
    e. Violation of the Dangerous **D**rugs Act. (2004, 2006 Bar Question)

Q: What are the requisites before the Ombudsman may examine deposits?

A:
1. There is a pending case before court of competent jurisdiction
2. The account must be clearly identified
3. There is notice upon the account holder and bank personnel of their presence during inspection.

Note: The inspection must cover only the account identified in the pending case. *(Marquez v. Desierto, G.R. No. 138569, Sept. 11, 2003)*

Q: Can a bank be compelled to disclose the records of the accounts of a depositor under the investigation for unexplained wealth?

A: Since cases of unexplained wealth are similar to cases of bribery, dereliction of duty, no reason is seen why it cannot be excepted from the rule making bank deposits confidential. In this connection, inquiry into illegally acquired property in anti-graft cases extends to cases where such property is concealed by being held or recorded in the name of other persons. This is also because the Anti-Graft and Corrupt Practices Act, bank deposits shall be taken into consideration in determining whether or not a public officer has acquired property manifestly out of proportion with his lawful income*. (PNB v. Gancayco, G.R. No. L-18343, Sept. 30, 1965)*

Q: In an action filed by the bank to recover the money transmitted by mistake, can the bank be allowed to present the accounts which it believed were responsible for the acquisition of the money?

A: Yes, R.A. 1405 allows the disclosure of bank deposits in cases where the money deposited is the subject matter of litigation. In an action filed by the bank to recover the money transmitted by mistake, necessarily, an inquiry into the whereabouts of the amount extends to whatever is concealed by being held or recorded in the name of the persons other than the one

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responsible for the illegal acquisition. *(Mellon Bank, N.A. v. Magsino, G.R. No. 71479, Oct. 18, 1990)*

Q: The Law on Secrecy of Bank Deposits provides that all deposits of whatever nature with banks or banking institutions are absolutely confidential in nature and may not be examined, inquired or looked into by any person, governmental official, bureau or office. However, the law provides exceptions in certain instances. Which of the following may not be among the exceptions?

1. **in cases of impeachment**
2. **in cases involving bribery**
3. **in cases involving BIR inquiry**
4. **in cases of anti-graft and corrupt practices**
5. **in cases where the money involved is the subject of litigation**

A: Under Section 6(F) of the National Internal Revenue Code, the Commissioner of Internal Revenue can inquire into the deposits of a decedent for the purpose of determining the gross estate of such decedent. Apart from this case, a BIR inquiry into bank deposits cannot be made.

Thus, exception 3 may not always be applicable. Turning to exception 4, an inquiry into bank deposits is possible only in prosecutions for unexplained wealth under the Anti-graft and Corrupt Practices Act. However, all other cases of anti-graft and corrupt practices will not warrant an inquiry into bank deposits. Thus, exception 4 may not always be applicable. Like any other exception, it must be interpreted strictly.

Exceptions 1, 2, and 5 on the other hand, are provided expressly in the Law on Secrecy of Bank Deposits. They are available to depositors at all times. **(2004 Bar Question)**

E. GARNISHMENT OF DEPOSITS, INCLUDING FOREIGN DEPOSITS

Q: Does garnishment of a bank deposit violate the law?

A: No, the prohibition against examination does not preclude its being garnished for satisfaction of judgment. The disclosure is purely incidental to the execution process and it was not the intention of the legislature to place bank deposits beyond the reach of judgment creditor. *(PCIB v. CA, G.R. No. 84526, Jan. 28, 1991)*

Q: How about foreign currency deposits, can they be subject to garnishment?

A:

GR: 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. (*Sec 8. R.A. 6426)*

XPN: The application of Section 8 of R.A. 6426 depends on the extent of its justice. The garnishment of a foreign currency deposit should be allowed to prevent injustice and for equitable grounds, otherwise, it would negate Article 10 of the New Civil Code which provides that "in case of doubt in the interpretation or application of laws, it is presumed that the lawmaking body intended right and justice to prevail. *(Salvacion vs. Central Bank of the Philippines, G.R. 94723, August 21, 1997)*

Q: Can the foreign currency deposit of a transient foreigner who illegally detained and raped a minor Filipina, be garnished to satisfy the award for damages to the victim?

A: The exemption from garnishment of foreign currency deposits under R.A. 6426 cannot be invoked to escape liability for the damages to the victim. The garnishment of the transient foreigner's foreign currency deposit should be allowed to prevent injustice and for equitable grounds. The law was enacted to encourage foreign currency deposit and not to benefit a wrongdoer. *(Salvacion vs. Central Bank of the Philippines, G.R. 94723, August 21, 1997)*

F. PENALTIES FOR VIOLATION

Q: What are the penalties for violation of R.A. 1405?

A: The penalty of imprisonment of not more than 5 years or a fine of not more than 20,000pesos or both, in the discretion of the court shall be imposed upon any official or employee of a banking institution who, upon conviction, was found to have violated R.A. 1405.

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III. GENERAL BANKING ACT (R.A. 8791)

A. DEFINITION AND CLASSIFICATION OF BANKS

Q: What are banks?

A: Entities engaged in the lending of funds obtained through deposits from public.

Q: What are the elements determinative of a bank?

A:

1. Must be authorized by law;
2. Accepts fund, in the form of a deposit, from the public; *and*
3. Lends money to the public.

Q: Give the classifications of banks and their definition.

1. *Universal banks* - Primarily governed by the General Banking Law (GBL), can exercise the powers of an investment house and invest in non-allied enterprises and have the highest capitalization requirement.

2. *Commercial banks* - Ordinary banks governed by the GBL which have a lower capitalization requirement than universal banks and can neither exercise the powers of an investment house nor invest in non-allied enterprises.

3. *Thrift banks* – These are a) Savings and mortgage banks; b) Stock savings and loan associations; c) Private development banks, which are primarily governed by the Thrift Banks Act *(R.A. 7906).*

4. *Rural banks* – Mandated to make needed credit available and readily accessible in the rural areas on reasonable terms and which are primarily governed by the Rural Banks Act of 1992 *(RA 7353).*

5. *Cooperative banks* – Those banks organized whose majority shares are owned and controlled by cooperatives primarily to provide financial and credit services to cooperatives. It shall include cooperative rural banks. They are governed primarily by the Cooperative Code *(RA 6938).*

6. *Islamic banks* – Banks whose business dealings and activities are subject to the basic principles and rulings of Islamic Shari'a, such as the Al Amanah Islamic Investment Bank of the Philippines which was created by *RA 6848.*

7. *Other classification of banks* as determined by the Monetary Board of the Bangko Sentral ng Pilipinas.

Q: Differentiate universal banks, commercial banks and thrift banks.

A: See Appendix G

B. DISTINCTION OF BANKS FROM QUASI-BANKS AND TRUST ENTITIES

Q: What is a quasi-bank?

A: These are entities engaged in the borrowing of funds through the issuance, endorsement or assignment with recourse or acceptance of deposit substitutes for purposes of re-lending or purchasing of receivables and other obligations (Sec 4). Unlike banks, quasi-banks do not accept deposits.

Q: What are trust entities?

A: These are entities engaged in trust business that act as a trustee or administer any trust or hold property in trust or on deposit for the use, benefit, or behoof of others *(Sec. 79).* A bank does not act as a trustee.

Q: What are financial intermediaries?

A: Persons or entities whose principal functions include the lending, investing, or placement of funds on pieces of evidence of indebtedness or equity deposited with them, acquired by them or otherwise coursed through them, either for their own account or for the account of others.

Q: What are deposit substitutes?

A: It is an alternative form of obtaining funds from the public, other than deposits, through the issuance, endorsement, or acceptance of debt instruments, for the borrower's own account, for the purpose of relending or purchasing of receivables and other obligations. These instruments may include, but need not be limited to, banker's acceptances, promissory notes, participations, certificates of assignment and similar instruments with recourse, and repurchase agreements.

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C. BANK POWERS AND LIABILITIES

Q: What are the corporate powers of a bank?

A: All powers provided by the corporation code like issuance of stocks and entering into merger or consolidation with other corporation or banks.

Q: What are the rules regarding the issuance of stocks by a bank?

A:

1. The Monetary Board may prescribe rules and regulations on the types of stock a bank may issue.

2. Banks shall issue par value stocks only .*(Sec. 9)*

3. **GR:** No bank shall purchase or acquire shares of its own capital stock or accept its own shares as a security for a loan

   XPN: when authorized by the Monetary Board

   Note: That in every case the stock so purchased or acquired shall, within six months from the time of its purchase or acquisition, be sold or disposed of at a public or private sale. *(Sec 10)*

4. 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.

   Note: 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)*

5. 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 corporations or related groups of persons with the bank. *(Sec 12)*

6. Two or more corporations owned or controlled by the same family group or same group of persons (*Corporate Stockholdings)* shall be considered related interests and must be fully disclosed in all transactions by such corporations or related group of persons with the bank. *(Sec 13)*

Q: What is the effect of merger or consolidation of banks to the number of directors allowed?

A: The number of directors may be more than 15 but should not exceed 21 *(Sec. 17).*

Q: How many independent directors are required?

A: 2 *(Sec. 16)*

Q: When may the Monetary Board limit the grant of compensation to the directors?

A: Only in exceptional cases and when the circumstances warrant, such as but not limited to the following:

1. When a bank is under comptrollership or conservatorship
2. When a bank is found by the Monetary Board to be conducting business in an unsafe or unsound manner
3. When a bank is found by the Monetary Board to be in an unsatisfactory financial condition

Q: What is required for a bank may register or amend their articles of incorporation with SEC?

A: Certificate of Authority to Register issued by the Monetary Board. *(sec. 14)*

Q: What should be proven by banks to satisfy the Monetary Board and grant that certificate?

A:

1. That 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. That the public interest and economic conditions, both general and local, justify the authorization

3. That 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.

Q: When are the banks prohibited on declaring of dividends?
A:

1. Its clearing account with the Bangko Sentral is overdrawn; or
2. It is deficient in the required liquidity floor for government deposits for five or more consecutive days, or
3. It does not comply with the liquidity standards/ratios prescribed by the Bangko Sentral for purposes of determining funds available for dividend declaration; or
4. It has committed a major violation as may be determined by the Bangko Sentral

Q: What are the powers which may be necessary in carrying on the business of commercial banking?

A:

1. Accepting drafts and issuing letters of credit
2. Discounting and negotiating promissory notes, drafts, bills of exchange and other instrument evidencing debt
3. Accepting or creating demand deposits, receiving other types of deposit and deposit substitutes
4. Buying and selling FOREX and gold or silver bullion
5. Acquiring marketable bonds and other debt securities
6. Extending credit
7. Determination of bonds and other debt securities eligible for investment including maturities and aggregate amount of such investment, subject to such rules as the Monetary Board may promulgate. *(Sec. 29)*

Q: What are the additional powers given to a universal bank aside from those mentioned in section 29?

A:

1. Act as investment house
2. Ability invest in non-allied enterprises. *(Sec 24)*

D. DILIGENCE REQUIRED BY BANKS

Q: What is the degree of diligence required of banks in handling deposits?

A: Extraordinary diligence. The appropriate standard of diligence must be very high, if not the highest, degree of diligence; *highest degree of care (PCI Bank vs. CA, 350 SCRA 446, PBCom vs. CA, G.R. No. 121413, 29 Jan. 2001)* This applies only to cases where banks are acting in their fiduciary capacity, that is, as depository of the deposits of their depositors*. (Reyes v. CA, G.R. No. 118492, Aug. 15, 2001)*

Q: Does the bank need to exercise extra-ordinary diligence in all commercial transactions?

A: No, the degree of diligence required of banks, is more than that of a good father of the family where the fiduciary nature of their relationship with their depositors is concerned, that is, depositary of deposits. But the same higher degree of diligence is not expected to be exerted by banks in commercial transactions that do not involve their fiduciary relationship with their depositors, such as sale and issuance of foreign exchange demand draft. *(Reyes v. CA, G.R. No. 118492, Aug. 15, 2001)*

Q: What is the effect when the teller gave the passbook to a wrong person?

A: If the teller gives the passbook to the wrong person, they would be clothing that person presumptive ownership of the passbook, facilitating unauthorized withdrawals by that person. For failing to return the passbook to authorized representative of the depositor, the bank presumptively failed to observe such high degree of diligence in safeguarding the passbook and insuring its return to the party authorized to receive the same. The bank's liability, however, is mitigated by the depositor's contributory negligence in allowing a withdrawal slip signed by authorized signatories to fall into the hands of an impostor. *(Consolidated Bank and Trust Corporation vs. CA, GR No, 138569, September 11, 2003).*

Q: Did a bank exercise the diligence required when the pretermination of the account is allowed despite discrepancies in the signature and photograph of the person claiming to be the depositor and failure to surrender the original certificate of time deposit?

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A: No. The bank is negligent because the depositor did not present the certificate of deposit *(Citybank, N.A., vs. Sps. Cabamongan, G.R. No. 146918, May 2, 2006).*

Q: Is the bank liable when an employee encashed a check without the requisite of endorsement?

A: *Yes.* The fiduciary nature of the relationship between the bank and the depositors must always be of paramount concern. *(Philippine Savings Bank vs. Chowking, G.R. No. 177526, July 04, 2008).*

E. NATURE OF BANK FUNDS AND BANK DEPOSITS

Q: What is the deposit function of banks?

A: The function of the bank to receive a thing, primarily money, from depositors with the obligation of safely keeping it and returning the same.

Q: What are the kinds of deposits between a bank and its depositors?

A:

1. *As debtor-creditor:*
   a. *Demand deposits* – all those liabilities of banks which are denominated in the Philippine currency and are subject to payment in legal tender upon demand by representation of checks.

   b. *Savings deposits* – the most common type of deposit and is usually evidenced by a passbook.

      Note: The requirement of presentation of passbooks is usually included in the terms and conditions printed in the passbooks. A bank is negligent if it allows the withdrawal without requiring the presentation of passbook *(BPI v. CA, GR No. 112392, Feb. 29, 2000).*

   c. *Negotiable order of withdrawal account (NOWA)* – Interest-bearing deposit accounts that combine he payable on demand feature of checks and investment feature of saving accounts.

   d. *Time deposit* – an account with fixed term; payment of which cannot be legally required within such a specified number of days.

2. *As trustee-trustor: Trust account* – a savings account, established under a trust agreement containing funds administered by the bank for the benefit of the trustor or another person or persons.

3. *As agent-principal:*
   a. Deposit of checks for collection
   b. Deposit for specific purpose
   c. Deposit for safekeeping

Q: What are the types of deposit accounts?

A:

1. Individual; or
2. Joint:
   a. *"And" account* – the signature of both co-depositors are required for withdrawals.
   b. *"And/or" account* – either one of the co-depositors may deposit and withdraw from the account without the knowledge consent and signature of the other.

Q: Is an anonymous account prohibited?

A:

GR: Anonymous accounts or those under fictitious names are prohibited. *(R.A. 9160 as amended by by R.A. 9194; BSP Circular No. 251, July 21, 2000)*

XPN: In case where numbered accounts is allowed such as in foreign currency deposits. However, banks/non-bank financial institutions should ensure that the client is identified in an official or other identifying documents. *(Sec. 8, R.A. 6426 as amended, FCDA)*

Q: What is the nature of a bank deposit?

A: All kinds of bank deposits are loan. The bank can make use as its own the money deposited. Said amount is not being held in trust for the depositor nor is it being kept for safekeeping. *(Tang Tiong Tick v. American Apothecaries, G.R. No. 43682, Mar. 31, 1938)*

Q: In the enforcement of obligations concerning deposit, will the remedy of mandamus lie?

A: No, because all kinds of deposit are loans. Thus, the relationship being contractual in nature, mandamus cannot be availed of because mandamus will not lie to enforce the performance of contractual obligations. *(Lucman v. Alimatar Malawi, G.R. No. 159794, Dec. 19, 2006)*

Q: Does the fiduciary nature of the bank-depositor relationship convert the contract between banks and depositors to a trust agreement?

A: No, thus, failure by the bank to pay the depositor is failure to pay simple loan, and not a breach of trust. *(Consolidated Bank and Trust Corp. v. CA, G.R. No. 138569, Sept. 11, 2003)*

Q: After procuring a checking account, the depositor issued several checks. He was surprised to learn later that they had been dishonored for insufficient funds. Investigation disclosed that deposits made by the depositor were not credited to its account. Is the bank liable for damages?

A: Yes, the depositor expects the bank to treat his account with utmost fidelity, whether such account consist only of a few hundred pesos or of millions. The bank must record every single transaction accurately, down to the last centavo, and as promptly as possible. This has to be done if the account is to reflect at any given time the amount of money the depositor can dispose of as he sees fit, confident that the bank will deliver it as and to whomever he directs. A blunder on the part of the bank, such as the dishonor of the check without good reason, can cause the depositor not a little embarrassment if not also financial loss and perhaps even civil and criminal litigation. *(Simex Intl. v. CA, G.R. No. 88013, Mar. 19, 1990)*

Q: Is a safety deposit box a form of deposit or lease?

A: The contract for the use of a safe deposit box should be governed by the *law on lease.*

Under the old banking law, a safety deposit box is a *special deposit*. However, the new General Banking Law, while retaining the renting of safe deposit box as one of the services that the bank may render, deleted reference to depository function. *(Divina, Handbook on Philippine Commercial Law)*

F. STIPULATION ON INTERESTS

Q: What are the rules on stipulation of interests?
A:

1. *Central Bank Circular 416* – 12% per annum in cases of:
    a. Loans
    b. Forbearance of money, goods and credits
    c. Judgement involving such loan or forbearance, in the absence of express agreement as to such rate of interest

    Note: During the interim period from the date of judgment until actual payment.

    Pursuant to P.D. No. 116 amending Act No. 2655 (Usury Law), the Central Bank of the Philippines issued Circular No. 416 raising the legal rate of interest from 6% to 12% per annum.

    In the absence of a stipulation as to interest, the loan due will now earn interest at the legal rate of 12% per annum. *(Sulit v. CA, G.R. No. 119247, Feb. 17, 1997).*

2. *Interest accruing from unpaid interest* – interest due shall earn interest from the time it is judicially demanded although the obligation may be silent upon this point.

Q: If the bank was forbidden by Central Bank to do business, does it still have the obligation to pay interest on deposit?

A: No, because a bank lends money, engages in international transactions, acquires foreclosed mortgaged properties or their proceeds and generally engages in other banking and financing activities in order that it can derive income therefrom. Therefore, unless a bank can engage in those activities from which it can derive income, it is inconceivable how it can carry on as a depository obligated to pay interest on money deposited with it. *(Fidelity & Savings and Mortgage Bank v. Cenzon, G.R. No. L-46208, Apr. 5, 1990)*

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G. GRANT OF LOANS AND SECURITY REQUIREMENTS

Q: What is net worth?

A: The total of the unimpaired paid-in surplus, retained earnings and undivided profit, net of valuation reserves and other adjustments as may be required by the BSP. *(Sec. 24.2)*

Q: What is risked based capital?

A: The minimum ratio prescribed by the Monetary Board which the net worth of a bank must bear to its total risk assets which may include contingent accounts.

Note: However, the Monetary Board may require or suspend compliance with such ratio whenever necessary for a maximum period of one year and that such ratio shall be applied uniformly to banks of the same category *(Sec. 34).*

Q: What is the effect of non-compliance with the ratio?

A:

1. Distribution of net profits may be limited or prohibited and MB 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; or

2. **<u>GR:</u>** Acquisition of major assets and making of new investments may be restricted.

   <u>XPN:</u> purchases of evidence of indebtedness guaranteed by the Government *(Sec. 34).*

   Note: In case of a bank merger or consolidation, or when a bank is under rehabilitation under a program approved by BSP, the MB may temporarily relieve the surviving bank, consolidated bank, or constituent bank or corporations under rehabilitation from full compliance with the required capital ratio. *(Sec. 5)*

Q: What are the limitations imposed upon banks with respect to its loan function?

A:

1. **<u>GR</u>:** *Single borrower's limit* – The total amount of loans, credit accommodations and guarantees that the bank could grant should at no time exceed 25% of the bank's net worth. *(Sec 35.1, GBL)*

   <u>XPN</u>:
   a. As the Monetary Board may otherwise prescribe for reasons of national interest
   b. Deposits of rural banks with government-owned or controlled financial institutions like LBP, DBP, and PNB.

2. The total amount of loans, credit accommodations and guarantees prescribed in (a) may be increased by an additional 10% of the net worth of such bank provided that additional liabilities are adequately secured by trust receipt, shipping documents, warehouse receipts and other similar documents which must be fully covered by an insurance. *(Sec. 35.2, GBL)*

3. Loans and other credit accommodations *secured* by REM shall not exceed 75% of the appraised value of the real estate security plus 60% of the appraised value of the insured improvements *(Sec. 37, GBL)*

   CM/intangible property such as patents, trademarks, etc. *shall not exceed 75%* of the appraised value of the security *(Sec. 38, GBL)*

4. Loans being contractual, the period of payment may be subject to stipulation by the parties. In the case of amortization, the amortization schedule has no fixed period as it depends on the project to be financed such that if it was capable of raising revenues, it should be at least once a year with a grace period of 3 years if the project to be financed is not that profitable which could be deferred up to 5 years if the project was not capable of raising revenues. *(Sec. 44, GBL)*

5. Loans granted to **DOSRI**:
   a. **<u>D</u>**irector
   b. **<u>O</u>**fficer
   c. **<u>S</u>**tockholder, which should at least 1% (if below 1% - not anymore covered)
   d. **<u>R</u>**elated **<u>I</u>**nterests, such as DOS's spouses, their relatives within the

first degree whether by consanguinity or affinity, partnership whereby DOS is a partner or a corporation where DOS owns at least 20%.

Q: What are excluded from such loan limitations?

A: Non-risk loans, such as:
1. Loans secured by obligations of the Bangko Sentral ng Pilipinas or the Philippine Government
2. Loans fully guaranteed by the Government
3. Loans covered by assignment of deposits maintained in the lending bank and held in the Philippines
4. Loans, credit accommodations and acceptances under letters of credit to the extent covered by margin deposits
5. Other loans or credit accommodations which the MB may specify as non-risk items.

Q: What is joint and solidary signature (JSS) practice?

A: A common banking practice requiring as an additional security for a loan granted to a corporation the joint and solidary signature of a major stockholder or corporate officer of the borrowing corporation. *(Security Bank v. Cuenca, G.R. No. 138544, Oct. 3, 2000)*

Q: In case of DOSRI accounts, what are the requirements that must be complied with?

A:
1. *Procedural requirement* - Loan must be approved by the majority of all the directors not including the director concerned. CB approval is not necessary; however, there is a need to inform them prior to the transaction. Loan must be entered in the books of the corporation. *(Sec. 36)*

2. *Substantive requirement* - Loan must not exceed the paid in contribution and unencumbered deposits. (Not to exceed 15% of the portfolio or 100% of the net worth, whichever is lower.) *(Sec. 36 [4])*

Q: What is the effect of non-compliance with the foregoing requirements?

A: Violation of DOSRI is a crime and carries with it penal sanction.

Q: What are the transactions covered by the DOSRI regulation?

A: The transaction covered are loan and credit accommodation. Not being a loan, the ceiling will *not* apply to lease and sale. However, it should still comply with the *procedural requirement.*

Q: What is the arms-length rule?

A: It provides that any dealings of a bank with any of its DOSRI shall be upon terms not less favorable to the bank than those offered to others. *[Sec. 36 (2)]*

Q: Can the bank terminate the loan and demand immediate payment if the borrower used the funds for purposes other than that agreed upon?

A: If the bank finds that the borrower has not employed the funds borrowed for the purpose agreed upon between the bank and the borrower, the bank may terminate the loan and demand immediate payment. *(Banco de Oro v. Bayuga, G.R. No. L-49568, Oct. 17, 1979)*

H. PENALTIES FOR VIOLATION

Q: What are the acts that may be penalized of fine and imprisonment as provided in the New Central Bank Act (NCBA)?

A:
1. Refusal to Make Reports or Permit Examination *(Sec. 34 NCBA)*
2. False Statement *(Sec. 35. NCBA)*
3. Other acts that violates any banking laws *(Sec. 36, NCBA)*

Q: What are the administrative sanctions that the Monetary Board may impose notwithstanding with Sections 34-36 of NCBA?

A:
1. Fines in amounts as may be determined by the Monetary Board 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

2. Suspension of rediscounting privileges or access to Bangko Sentral credit facilities

3. Suspension of lending or foreign exchange operations or authority to

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accept new deposits or make new investments

4. Suspension of interbank clearing privileges; and/or

5. Revocation of quasi-banking license. *(Sec 37, NCBA)*

   Note: Resignation or termination from office shall not exempt such director or officer from administrative or criminal sanctions.

Q: Who may file a criminal case for violations of banking laws?

A: It does not appear from the law that only the Central Bank or its respondent officials can cause the prosecution of alleged violations of banking laws. Said violations constitute a public offense, the prosecution of which is a matter of public interest and hence, anyone – even private individuals – can denounce such violations before the prosecuting authorities. *(Perez v. Monetary Board, G.R. No. L-23307, June 30, 1967)*

Q: May the Monetary Board issue sanctions on unfit directors?

A: Yes. After due notice to the board of directors of the bank, the Monetary Board 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, GBL)*

Q: How could a bank be dissolved?

A:
1. Voluntary Liquidation *(Sec. 68 GBL)*
2. Receivership and Involuntary Liquidation *(Sec. 69 GBL)*

Q: What is the penalty for transactions after the bank becomes insolvent?

A: Any director or officer of any bank declared insolvent or placed under receivership by the Monetary Board who refuses to turn over the bank's records and assets to the designated receivers, or who tampers with banks records, or who appropriates for himself for another party or destroys or causes the misappropriation and destruction of the bank's assets, or who receives or permits or causes to be received in said bank any deposit, collection of loans and/or receivables, or who 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 GBL)*.

IV. PHILIPPINE DEPOSIT INSURANCE CORPORATION (R.A. 3591 AS AMENDED BY R.A. 9302)

A. BASIC POLICY

Q. What is the basic policy for the creation of the PDIC?

A: PDIC shall promote and safeguard the interests of the depositing public by way of providing permanent and continuing insurance coverage in all insured deposits. *(As Amended by Sec. 1, R.A. 9302)*

Q: What is the coverage of the insurance?

A: The deposit liabilities of any bank or banking institution, which is engaged in the business of receiving deposits, shall be insured with PDIC. The coverage is compulsory.

B. CONCEPT OF INSURED DEPOSITS

Q: What is an insured deposit?

A: Insured deposit means the amount due to any bona fide depositor for legitimate deposits in an insured bank net of any obligation of the depositor to the insured bank as of the date of closure, but not to exceed P500,000.00. Such net amount shall be determined according to such regulations as the Board of Directors may prescribe. *(As amended by Sec. 3, R.A. 9576)*

C. LIABILITY TO DEPOSITORS

(1) DEPOSIT LIABILITIES REQUIRED TO BE INSURED WITH PDIC

Q: What are deposits covered by insurance?

A:
1. The unpaid balance of money or its equivalent received by a bank in the usual course of business and for which it has given of is obliged to give credit to a commercial, checking, savings, time or thrift account, or issued in accordance with Banko Sentral rules and regulations and other applicable laws, together with such other obligations of a bank, which,

consistent with banking usage and practices, the Board of Directors shall determine and prescribe by regulations to be deposit liabilities of the bank; and

2. Subject to the approval of the Board of Directors, any insured bank which is incorporated under the laws of the Philippines which maintains a branch outside the Philippines may elect to include for insurance its deposit obligations payable only at such branch. *(As Amended by Sec. 2 R.A. 9576)*

Note: The approval of the Board shall be final and executor, and may not be restrained or set aside by the court, except on appropriate petition for certiorari on the ground that the action was taken in excess of jurisdiction or with such grave abuse of discretion as to amount to a lack or excess of jurisdiction. The petition for certiorari may only be filed within 30 days from notice of denial of claim for deposit insurance. *(As Amended by Sec. 2 R.A. 9576)*

Q: Are deposits in foreign currency covered?

A: Deposit obligations in foreign currency of any insured bank are likewise insured.

Note: Foreign currency deposits are covered under the provisions of RA 3591, as amended, and insurance payment shall be in the same currency in which the insured deposits are denominated (*Sec.9, RA 6426; Circular No. 1389, 1993*).

(2) COMMENCEMENT OF LIABILITY

Q: When will the liability by the Corporation to pay insured deposits commence?

A: Whenever an insured bank shall have been closed by the Monetary Board pursuant to Section 30 (Proceedings in Receivership and Liquidation) of R.A. 7653, otherwise known as the New Central Bank Act, payment of the insured deposits on such closed bank shall be made by the Corporation as soon as possible. *(Sec 14 R.A.3591, as amended)*

(3) DEPOSIT ACCOUNTS NOT ENTITLED TO PAYMENT

Q: What are the deposits which are excluded from PDIC coverage?

A:

1. Investment products such as bonds and securities, trust accounts, and other similar instruments
2. Deposit accounts or transactions which are unfunded, or that are fictitious or fraudulent
3. Deposit accounts or transactions constituting, and/or emanating from, unsafe and unsound banking practice/s, as determined by the Corporation, in consultation with the BSP, after due notice and hearing, and publication of a cease and desist order issued by the Corporation against such deposit accounts or transactions
4. Deposits that are determined to be the proceeds of an unlawful activity as defined under R.A. 9160, as amended. *(As Amended by Sec. 2 R.A. 9576)*

(4) EXTENT OF LIABILITY

Q: What is the extent of the PDIC's liability to a bank depositor?

A: 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 P500,00.00 per depositor.

(5) DETERMINATION OF INSURED DEPOSITS

Q: When and how shall PDIC commence the determination of insured deposits?

A: PDIC shall commence the determination of insured deposits due the depositors of a closed bank upon its actual takeover of the closed bank. PDIC shall give notice to the depositors of the closed bank of the insured deposits due them by whatever means deemed appropriated by the Board of Directors. PDIC 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. *(Sec 16 R.A. 3591, as amended)*

(6) CALCULATION OF LIABILITY

(a) PER DEPOSITOR, PER CAPACITY RULE

Q: What are the types of deposits covered?

A: Demand, savings and time deposits. If the depositor has all three types of accounts with the

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same bank, he can only recover up to P500,000.00. He is considered as one depositor.

Q: Is the liability of PDIC on a per bank or per branch basis?

A: Per bank basis. *(Catindig 2003, Verde Publications)*

Q: How do you determine the amount due to a depositor?

A: 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 and the name of the others.

(b) JOINT ACCOUNTS

Q: How is the amount due determined in case of joint account?

A: 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:

1. 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

2. If the account is held by a juridical person or entity with one or more natural persons, the maximum insured shall be presumed to belong entirely to such juridical person or entity.

Note: 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 P500,000.00.

The provisions of any law to the contrary notwithstanding, 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 [*Sec. 4 (g)*].

Illustration:

1. A has P400,000 deposit – can recover P400,000
2. A has P200,000 deposit in 3 branches – only P500,000
3. A has P200,000 deposit in 3 branches of XYZ and another P200,000 deposit in 3 branches of ABC – P500,000 on each bank
4. A and/or B P600,000 deposit – half (P300,000) each

Note: Individually-owned accounts are insured separately from joint accounts. If depositor made more than 1 joint account, the maximum amount he can recover is only up to 250,000.

(c) MODE OF PAYMENT

Q: What are the modes of payment of an insured deposit?

A:

1. By cash; or
2. By making available to each depositor a transferred deposit in another insured bank in an amount equal to insured deposit of such depositor. *(Sec. 14 R.A. 3591, as amended)*

Note: Provided: PDIC , in its discretion, may require proof of claims to be filed before paying the insured deposits, and that in any case where PDIC 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. *(Sec. 14 R.A. 3591, as amended)*

(d) EFFECT OF PAYMENT OF INSURED DEPOSIT

Q: What are the effects of payment to the depositor of his insured deposit?

A:

1. PDIC is discharged from any further liability to the depositor; and
2. PDIC is subrogated to all the rights of the depositor against the closed bank to the extent of such payment.

(e) PAYMENTS OF INSURED DEPOSITS AS PREFERRED CREDIT UNDER ARTICLE 2244, CIVIL CODE

Q: Are insured deposits paid by PDIC to the depositor/s preferred credits under Article 2244 against the close bank?

A: Yes. All payments by PDIC of insured deposits in closed banks partake of the nature of public funds, and as such, must be considered a preferred credit similar to taxes due to the

National Government in the order of preference under Article 2244 of the New Civil Code. *(Sec. 15 R.A. 3591, as amended)*

(f) FAILURE TO SETTLE CLAIM OF INSURED DEPOSITOR

Q: What is the period by which PDIC shall settle a claim of insured depositor?

A: PDIC has 6 months from the date of filing of claim for insured deposit.

Q: What is the effect of failure to settle a claim of insured depositor within the 6-month period?

A:

GR: 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, upon conviction, subject the directors, officers or employees of PDIC responsible for the delay, to imprisonment from 6 months to one year.

XPN: The period shall not apply if the validity of the claim requires the resolution of issues of facts and or law by another office, body or agency. *(Sec 14 R.A. 3591, as amended)*

(g) FAILURE OF DEPOSITOR TO CLAIM INSURED DEPOSITS

Q: What is the period by which a depositor of insured deposits may file his claim?

A: 2 years from the closure of the bank by the Central Bank.

Q: What is the effect of the failure by a depositor to claim insured deposit/s within the period prescribed by law?

A: It constitutes a waiver of his (depositor) right to claim if he fails to claim his insured deposits with the PDIC within 2 years from actual takeover of the closed bank by the receiver, unless otherwise waived by PDIC. *(Sec. 16(e) R.A. 3591, as amended)*

Q: When may PDIC exercise its power to examine banks?

A:

1. PDIC may conduct examination of banks with prior approval of the Monetary Board. However, no examination can be conducted within 12 months from the last examination date; and
2. PDIC, may, in coordination with the Bangko Sentral, conduct a special examination as the Board of Directors, by an affirmative vote of a majority of all its members, if there is a threatened or impending closure of a bank. *(Sec 8 R.A. 3591, as amended)*

Note: Prior approval of the Monetary Board is not necessary when PDIC conducts an *investigation* of banks. "Investigation" and "examination" are distinct procedures under the charter of the PDIC and the BSP. The power of investigation covers all fact-finding investigations on fraud, irregularities and/or anomalies committed in banks that are conducted by PDIC based on complaints from depositors or other government agencies and/or final reports of examinations of banks conducted by the Bangko Sentral ng Pilipinas and/or PDIC. *(PDIC vs. Philippine Countryside Rural Bank, Inc., G.R. No. 176438, January 24, 2011)*

Q: When may PDIC exercise its power to inquire or examine deposit accounts?

A: PDIC may inquired into or examine deposit accounts and all information related thereto in case there is a finding of unsafe or unsound banking practice. *(Sec 8 R.A. 3591, as amended)*

Q: What are unsafe or unsound banking practices?

A: They refer to actions or lack of actions which are contrary to generally accepted standards of prudent operation.

Q: Does PDIC's inquiry or examination of deposit accounts violate the laws regarding secrecy of bank deposits?

A: No. Notwithstanding the provisions of Secrecy of Bank Deposits, Foreign Currency Act, General Banking Law, and other laws, PDIC and/or the Bangko Sentral, may inquire into or examine deposit accounts in case there is a finding of unsafe or unsound banking practice. *(Section 8 R.A. 3591, as amended)*

Q: When does splitting of deposits occur?

A: Whenever a depositor's deposit account exceeds P500,000.00 is broken down and transferred into 2 or more accounts in the name/s of natural or juridical persons who have no beneficial ownership on transferred deposits

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within 120 days immediately preceding or during a bank-declared bank holiday, or immediately preceding a closure order by the Monetary Board of the BSP for the purpose of availing of the maximum deposit insurance coverage. *(Sec 21(f)(5) R.A. 3591, as amended)*

Q: What is the penalty for splitting of deposits?

A: The penalty of prision mayor or a fine of not less than 50,000.00 but not more than 2,000,000.00, or both, at the discretion of the court. *(Sec. 21(f) R.A. 3591, as amended)*

Q: What is rule regarding issuances of TROs, etc. against PDIC for acts under R.A. 3591, as amended?

A:

GR: No court, except the Court of Appeals, shall issue any temporary restraining order, preliminary injunction or preliminary mandatory injunction against PDIC for any action under R.A. 3591, as amended. Such prohibition applies in all cases, disputes or controversies instituted by a private party, the insured bank, or any shareholder of the insured bank.

XPN: The Supreme Court may issue a restraining order or injunction when the matter is of extreme urgency involving constitutional issue, such that unless a temporary restraining order is issued, grave injustice and irreparable injury will arise.

INTELLECTUAL PROPERTY LAWS

I. INTELLECTUAL PROPERTY RIGHTS IN GENERAL

A. INTELLECTUAL PROPERTY RIGHTS

Q: What are covered by intellectual property rights?

A:

1. Copyright and Related Rights
2. Mark (trade, service and collective)
3. Geographic indications
4. Industrial designs
5. Patents
6. Layout designs (Topographies) of Integrated Circuits
7. Protection of Undisclosed Information. *(Sec. 4.1, Intellectual Property Code [IPC])*

B. DIFFERENCES BETWEEN COPYRIGHTS TRADEMARKS AND PATENT

Q: What are the distinctions among trademark, patent and copyright?

A:

INTELLECTUAL PROPERTIES	DEFINITION
Trademark	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.
Tradename	The name or designation identifying or distinguishing an enterprise.
Copyright	Literary and artistic works which are original intellectual creations in the literary and artistic domain protected from the moment of their creation.
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. *(Kho v. CA, G.R. No. 115758, Mar. 11, 2002).*

Q: What is a geographic indication?

A: It's an indication which identifies a good as originating in the territory, where a given quality, reputation or other characteristic of the good is essentially attributable to its geographical origin. *(Art. 22, Trade-Related Aspects of Intellectual Property Rights)*

C. TECHNOLOGY TRANSFER ARRANGEMENTS

Q: What is a technology transfer arrangement?

A: Contracts or arrangements involving the transfer of systematic knowledge for the manufacture of a product, the application of the process, or rendering a service including management contracts, and transfer, assignment or licensing of all forms of intellectual property rights, including licensing of computer software except computer software developed for mass market. *(Sec. 4.2, IPC)*

Q: What is undisclosed information?

A: It is an information which:

1. Is a secret in the sense that it is not, as a body or in precise configuration and assembly of components, generally known among, or readily accessible to persons within the circles that normally deal with the kind of information in question.

2. Has commercial value because it is a secret

3. Has been subjected to reasonable steps under the circumstances, by the person lawfully in control of the information, to keep it a secret. *(Article 39, TRIPS Agreement)*

Q: What is the nature of undisclosed information/trade secret?

A: Those trade secrets are of a privileged nature. The protection of industrial property encourages investments in new ideas and inventions and stimulates creative efforts for the satisfaction of human needs. It speeds up transfer of technology and industrialization, and thereby bring about social and economic progress. Verily, the protection of industrial secrets is inextricably linked to the advancement of our economy and fosters healthy competition in trade. *(Air Philippines Corporation v. Pennswell, Inc., G.R. No. 172835, Dec. 13, 2007)*

II. PATENTS

Q: What is a patent?

A: A statutory grant which confers to an inventor or his legal successor, in return for the disclosure of the invention to the public, the right for a

limited period of time to exclude others from making, using, selling or importing the invention within the territory of the country that grants the patent.

A. PATENTABLE INVENTIONS

Q: What are the patentable inventions?

A: Any technical solution of a problem in any field of human activity which is *new, involves an inventive step and is industrially applicable*. It may be, or may relate to, a *product*, or *process*, or an *improvement* of any of the foregoing. *(Sec. 21)*

Q: What are the conditions for patentability?

A: NIA

1. ***N****ovelty* – An invention shall not be considered new if it forms part of a prior art. *(Sec. 23, IPC)*

2. ***I****nvolves 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.

3. *Industrially* ***A****pplicable* – An invention that can be produced and used in any industry, shall be industrially applicable *(Sec. 27, IPC).*

Q: What is prior art?

A:

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

2. *The whole contents of a published application, 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 the IPC, there shall be a 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. 24, IPC)*

Q: What is meant by "made available to the public" and what are its effects?

A: To be "made available to the public" means at least one member of the public has been able to access knowledge of the invention without any restriction on passing that knowledge on to others.

GR: When a work has already been made available to the public, it shall be non-patentable for absence of novelty.

XPN: Non-prejudicial disclosure – the disclosure of information contained in the application *during the 12-month period before the filing date or the priority date of the application* if such disclosure was made by:

1. The inventor;

2. A patent office and the information was contained:
   a. In another application filed by the inventor and should have not have been disclosed by the office, or
   b. In an application filed without the knowledge or consent of the inventor by a third party which obtained the information directly or indirectly from the inventor;

3. A third party which obtained the information directly or indirectly from the inventor. *(Sec. 25, IPC)*

Q: Who has the burden of proving want of novelty of an invention?

A: The burden of proving want of novelty is on him who avers it and the burden is a heavy one which is met only by clear and satisfactory proof which overcomes every reasonable doubt. *(Manzano v. CA, G.R. No. 113388. Sept. 5, 1997*)

Q: What is inventive step?

A:

GR: 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. 26, IPC)*

XPN: In the case of *drugs and medicines*, there is no inventive step if the invention results from the *mere discovery of a new form or new property of a known substance* which does *not*

result in the enhancement of the known efficacy of that substance. *(Sec. 26.2, as amended by R.A. 9502)*

Q: What is the test of non-obviousness?

A: If any person possessing ordinary skill in the art was able to *draw* the inferences and he constructs that the supposed inventor drew from prior art, then the latter did not really invent.

Q: Who is considered a person of ordinary skill?

A: A person who is presumed to:

1. Be an ordinary practitioner aware of what was common general knowledge in the art at the relevant date.
2. Have knowledge of all references that are sufficiently related to one another and to the pertinent art and to have knowledge of all arts reasonably pertinent to the particular problems with which the inventor was involved.
3. Have had at his disposal the normal means and capacity for routine work and experimentation. *(Rules and Regulations on Inventions, Rule 207)*

Q: What are other forms of patentable inventions?

A:

1. *Industrial design* – 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. *(Sec. 112, IPC)*

Note: Generally speaking, an industrial design is the ornamental or aesthetic aspect of a useful article. *(Vicente Amador, Intellectual Property Fundamentals, 2007)*

2. *Integrated circuit* – A product, in its final form, or an intermediate form, in which the elements, at least one of which is an active elements and some of all of the interconnections are integrally formed in and or on a piece of material, and in which is intended to perform an electronic function.

3. *Layout design/topography* – 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. *Registration* is valid for 10 years without renewal counted from date of commencement of protection.

4. *Utility model* – A name given to inventions in the mechanical field

Q: When does an invention qualify as a utility model?

A: If it is *new and industrially applicable*. A model of implement or tools of any industrial product even if not possessed of the quality of invention but which is of practical utility. *(Sec. 109.1, IPC)*

Q: What is the term of a utility model?

A: *7 years* from date of filing of the application *(Sec. 109.3, IPC).*

B. NON-PATENTABLE INVENTIONS

Q: What are *not* patentable inventions?

A: PAD-SCAD

1. **D**iscoveries, scientific theories and mathematical methods

2. In the case of **D**rugs and medicines, mere discovery of a new form or new property of a known substance which does not result in the enhancement of the efficacy of that substance

3. **S**chemes, rules and methods of performing mental acts, playing games or doing business, and programs for computers

4. Methods for treatment of the human or **A**nimal body

5. **P**lant 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

6. **A**esthetic creations

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7. Anything which is **C**ontrary to public order or morality. *(Sec. 22, IPC as amended by R.A. 9502)*

Q: Are computer programs patentable?

A:

GR: Computer programs are not patentable but are copyrightable.

XPN: They can be patentable if they are part of a process (*e.g.* business process with a step involving the use of a computer program).

C. OWNERSHIP OF A PATENT

Q: Who is entitled to a patent?

A:

1. *Inventor*, his *heirs*, or *assigns*.

2. Joint invention – *Jointly* by the inventors. *(Sec. 28, IPC)*

3. 2 or more persons invented separately and independently of each other – To the person *who filed* an application;

4. 2 or more applications are filed – the applicant who has the earliest filing date or, the *earliest* priority date. *First to file rule. (Sec. 29, IPC)*

5. Inventions created pursuant to a commission – *Person who commissions* the work, unless otherwise provided in the contract. *(Sec. 30.1, IPC)*

6. Employee made the invention in the course of his *employment contract*:
   a. The *employee*, if the inventive activity is *not* a part of his regular duties even if the employee uses the time, facilities and materials of the employer.
   b. The *employer*, if the invention is the result of the performance of his *regularly-assigned duties*, unless there is an agreement, express or implied, to the contrary. *(Sec. 30.2, IPC)*

Q: What is the "first to file" rule?

A:

1. 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
2. Where two or more applications are filed for the same invention, to the applicant whi has the earliest filing date. *(Sec. 29, IPC)*

Q: Cheche invented a device that can convert rainwater into automobile fuel. She asked Macon, a lawyer, to assist in getting her invention patented. Macon suggested that they form a corporation with other friends and have the corporation apply for the patent, 80% of the shares of stock thereof to be subscribed by Cheche and 5% by Macon. The corporation was formed and the patent application was filed. However, Cheche died 3 months later of a heart attack. Franco, the estranged husband of Cheche, contested the application of the corporation and filed his own patent application as the sole surviving heir of Cheche. Decide the issue with reasons.

A: The estranged husband of Cheche cannot successfully contest the application. The right over inventions accrue from the moment of creation and as a right it can lawfully be assigned. Once the title thereto is vested in the transferee, the latter has the right to apply for its registration. The estranged husband of Cheche, if not disqualified to inherit, merely would succeed to the interest of Cheche. **(1990 Bar Question)**

Q: Who may apply for a patent?

A: Any person who is a national or who is domiciled or has a real and effective industrial establishment in a country which is a party to any convention, treaty or agreement relating to intellectual property rights or the repression of unfair competition, to which the Philippines is also a party, or extends reciprocal rights to nationals of the Philippines by law. *(Sec. 3, IPC)*

Q: What are the steps in the registration of a patent?

A: The procedure for the grant of patent may be summarized as follows:
1. Filing of the application
2. Accordance of the filing date
3. Formality examination
4. Classification and Search
5. Publication of application
6. Substantive examination
7. Grant of Patent
8. Publication upon grant

9. Issuance of certificate (*Salao, Essentials of Intellectual Property Law: a Guidebook on Republic Act No. 8293 and Related Laws., 2008*)

Q: How is disclosure made?

A: 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.

Q: What is a claim?

A: Defines the matter for which protection is sought. Each claim shall be clear and concise, and shall be supported by the description.

Q: What is an abstract?

A: A concise summary of the disclosure of the invention as contained in the description, claims and merely serves as technical information.

Q: What is unity of invention?

A: The application shall relate to *one invention only or to a group of inventions forming a single general inventive concept. (Sec. 38.1)* If several independent inventions which do not form a single general inventive concept are claimed in one application, *the application must be restricted to a single invention*. *(Sec. 38.2, IPC)*

Q: What is the concept of divisional applications?

A: Divisional applications come into play when two or more inventions are claimed in a single application but are of such a nature that a single patent may not be issued for them. The applicant, is thus required to "divide", that is, to limit the claims to whichever invention he may elect, whereas those inventions not elected may be made the subject of separate applications which are called "divisional applications". *(Smith-Kline Beckman Corp. v. CA, GR No. 126627, Aug. 14,2003)*

Q: What is priority date?

A: 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. *(Sec. 31, IPC)*

Q: What are the conditions in availing of priority date?

A:

1. The local application expressly claims priority;
2. It is filed *within 12 months* from the date the earliest foreign application was filed; and
3. A certified copy of the foreign application together with an English translation is filed within 6 months from the date of filing in the Philippines. *(Sec. 31, IPC)*

Q: Leonard and Marvin applied for Letters Patent claiming the right of priority granted to foreign applicants. Receipt of petitioners' application was acknowledged by respondent Director on *March 6, 1954*. Their Application for Letters Patent in the US for the same invention indicated that the application in the US was filed on *March 16, 1953*. They were advised that the "Specification" they had submitted was "incomplete" and that responsive action should be filed with them four months from date of mailing, which was August 5, 1959. On July *3, 1962*, petitioners submitted two complete copies of the Specification. Director of patents held that petitioners' application may not be treated as filed. Is the director correct?

A: Yes, it is imperative that the application be complete in order that it may be accepted. It is essential to the validity of Letters Patent that the specifications be full, definite, and specific. The purpose of requiring a definite and accurate description of the process is to apprise the public of what the patentee claims as his invention, to inform the Courts as to what they are called upon to construe, and to convey to competing manufacturers and dealers information of exactly what they are bound to avoid. To be entitled to the filing date of the patent application, an invention disclosed in a previously filed application must be described within the instant application in such a manner as to enable one skilled in the art to use the same for a legally adequate utility. *(Boothe v. Director of Patents, G.R. No. L-24919, Jan. 28, 1980)*

Q: What are the rights conferred by a patent application after the first publication?

A: The applicant shall have all the rights of a patentee *against any person* who, without his

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authorization, exercised any of the rights conferred under Section 71 in relation to the invention claimed in the published patent application, as if a patent had been granted for that invention, *provided* that the said person had:

1. Actual knowledge that the invention that he was using was the subject matter of a published application; *or*
2. Received written notice that the invention was the subject matter of a published application being identified in the said notice by its serial number

Note: That the action may *not* be filed until after the grant of a patent on the published application and within four (4) years from the commission of the acts complained of *(Sec. 46, IPC).*

Q: When shall the patent take effect?

A: A patent shall take effect on the date of the *publication of the grant of the patent* in the IPO Gazette*. (Sec. 50.3, IPC)*

Q: What is the duration of a patent, utility model and industrial design?

A:

1. *Patent* – 20 years from date of *filing* of application without renewal. *(Sec. 54, IPC)*

2. *Utility Model* – 7 years from the filing date of the application without renewal. (*Sec. 109.3, IPC)*

3. *Industrial Design* – 5 years from the filing date of the application, renewable for not more than two (2) consecutive periods of five (5) years each. *(Sec. 118.2, IPC)*

D. GROUNDS FOR CANCELATION OF A PATENT

Q: What are the grounds for the cancellation of *patents*?

A: NDCI

1. The invention is **N**ot new or patentable;
2. The patent does not **D**isclose the invention in a manner sufficiently clear and complete for it to be carried out by any person skilled in the art; or
3. **C**ontrary to public order or morality.*(Sec. 61.1, IPC)*
4. Patent is found **I**nvalid in an action for infringement *(Sec. 82, IPC)*

Q: What if the ground/s for cancellation relate to some of the claims or parts of the claim only?

A: Cancellation may be effected to such extent only. *(Sec. 61.2, IPC)*

Q: What are the grounds for cancellation of a *utility model*?

A:

1. The invention does *not* qualify for registration as a utility model
2. That the description and the claims *do not* comply with the prescribed requirements
3. Any drawing which is necessary for the understanding of the invention has *not* been furnished
4. That the owner of the utility model registration is *not* the inventor or his successor in title. *(Sec. 109.4, IPC)*

Q: What are the grounds for cancellation of an *industrial design*?

A:

1. The subject matter of the industrial design is *not registrable*;
2. The subject matter is *not new*; or
3. The subject matter of the industrial design *extends* beyond the content of the application as originally filed *(Sec. 120IPC).*

E. REMEDY OF THE TRUE AND ACTUAL OWNER

Q: What are the remedies of persons not having the right to a patent?

A: If a person other than the applicant is declared by final court order or decision as having the right to a patent, he may within 3 months after such decision has become final:

1. Prosecute the application as his own
2. File a new patent application
3. Request the application to be refused; or
4. Seek cancellation of the patent.

Q: What is the remedy of a true inventor?

A: He may only ask the court to substitute him as a patentee or to cancel the patent and ask for damages when the application of the false inventor is granted. He may not the IPO of processing the false application.

F. RIGHTS CONFERED BY A PATENT

Q: What are the rights conferred by a patent?

A:

1. Subject matter is a *product* – Right to restrain, prohibit and prevent any unauthorized person or entity from making, using, offering for sale, selling or importing the product.

2. Subject matter is a *process* – Right to *restrain prohibit* and *prevent* any unauthorized person or entity from manufacturing, dealing in, using, offering for sale, selling or importing any product obtained directly or indirectly from such process *(Sec. 71, IPC).*

3. Right to *assign* the patent, to *transfer* by succession, and to *conclude* licensing contracts. *(Sec. 71.2, IPC)*

G. LIMITATION OF PATENT RIGHTS

Q: What are the exceptions to the rights conferred by a patent?

A:

1. *In general*

   a. **<u>GR:</u>** If put on the market in the Philippines by the owner of the product, or with his express consent.

      <u>XPN:</u> Drugs and medicines - introduced in the Philippines *or anywhere else in the world by the patent owner,* or by any party authorized to use the invention *(Sec. 72.1, as amended by R.A. 9502)*

   b. Where the act is done privately and on a non-commercial scale or for a non-commercial purpose. *(Sec. 72.2, IPC)*

   c. Exclusively for *experimental use* of the invention for scientific purposes or educational purposes (experimental use provision). *(Sec. 72.3, IPC)*

   d. *Bolar Provision* - In the case of *drugs* and *medicines*, where the act includes testing, using, making or selling the invention including any data related thereto, solely for purposes reasonably related to the development and submission of information and issuance of approvals by government regulatory agencies required under any law of the Philippines or of another country that regulates the manufacture, construction, use or sale of any product.*(Sec. 72.4, IPC)*

   e. 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. *(Sec. 72.5, IPC)*

   f. 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. *(Sec. 72.5, IPC)*

2. *Prior user* – Person other than the applicant, who in good faith, started using the invention in the Philippines, or undertaken serious preparations to use the same, before the filing date or priority date of the application shall have the right to continue the use thereof, but this right shall only be transferred or assigned further with his enterprise or business. *(Sec. 73, IPC)*

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3. *Use by Government* – A government agency or third person authorized by the government may exploit invention even without agreement of a patent owner where:

   a. Public interest, 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 owner of patent is anti-competitive. *(Sec. 74, IPC)*

4. *Reverse reciprocity of foreign law* – 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

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property rights in that country, shall reciprocally be enforceable upon nationals of said country, within Philippine jurisdiction. *(Sec. 231, IPC)*

Q: Who is a parallel importer?

A: One which imports, distributes, and sells genuine products in the market, *independently of an exclusive distributorship or agency agreement* with the manufacturer.

Note: Such acts of "underground sales and marketing" of genuine goods, undermines the property rights and goodwill of the rightful exclusive distributor. Such goodwill is protected by the law on unfair competition. *(Solid Triangle v. Sheriff, G.R. No. 144309, Nov. 23, 2001)*

Q: What is the doctrine of exhaustion?

A: Also known as the *doctrine of first sale*, it provides that the patent holder has control of the first sale of his invention. He has the opportunity to receive the full consideration for his invention from his sale. Hence, he exhausts his rights in the future control of his invention.

It espouses that the patentee who has already sold his invention and has received all the royalty and consideration for the same will be deemed to have released the invention from his monopoly. The invention thus becomes open to the use of the purchaser without further restriction. *(Adams v. Burke, 84 U.S. 17, 1873)*

Q: How does the Doctrine Exhaustion of apply in Philippine jurisdiction?

A:

GR: Patent rights are Exhausted by first sale in the Philippines *(Domestic exhaustion)*.

XPN: Except however on drugs and medicines: first sale in any jurisdiction exhausts *(International exhaustion) (R.A. 9502).*

Q: What are the different kinds of exhaustion?

A:

1. *International exhaustion* – allows any party to import into the national territory a patented product from any other country in which the product was placed on the market by the patent holder or any authorized party.
2. *Regional exhaustion* – allows the possibility of importing into the national territory a patented product originating from any other member state of a regional trade agreement.
3. *National exhaustion* – limits the circulation of products covered by patent in one country to only those put on the market by the patent owner or its authorized agents in that same country. In this case, there can be no parallel importation.
4. *Modified exhaustion* – all respect identical to the International exhaustion except for the allowance of the restriction of the extent of exhaustion through explicit contractual terms. *(Carlos Correa,. "Internationalization of the Patent System and New Technologies". International Law Journal, Vol. 20. No.3 , 2002)*

H. PATENT INFRINGEMENT

Q: What constitutes infringement of patent?

A:

1. Making, using, offering for sale, selling or importing a patented product or a product obtained directly or indirectly from a patented process; or
2. Use of a patented process without authorization of the owner of the patent *(Sec. 76, IPC)*

Q: What are the *tests* in patent infringement?

A:

1. *Literal infringement Test* – Resort must be had, in the first instance, to words of the claim. If the accused matter clearly falls within the claim, infringement is committed.

   Minor modifications are sufficient to put the item beyond literal infringement. *(Godines v. CA, G.R. No. L-97343, Sept. 13, 1993)*

2. *Doctrine of Equivalents* – There is infringement where 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. *(Ibid.)*

3. *Economic interest test* – when the process-discoverer's economic interest are compromised, *i.e.,* when others can import the products that result from the process, such an act is said to be prohibited.

Q: Does the use of a patented process by a third person constitute an infringement when the alleged infringer has substituted, in lieu of some unessential part of the patented process, a well-known mechanical equivalent."

A: Yes, under the doctrine of mechanical equivalents, the patentee is protected from colorable invasions of his patent under the guise of substitution of some part of his invention by some well known mechanical equivalent. It is an infringement of the patent, if the substitute performs the same function and was well known *at the date of the patent* as a proper substitute for the omitted ingredient. *(Gsell v. Yap-Jue, G.R. No. L-4720, Jan. 19, 1909)*

Q: What is meant by "equivalent device"?

A: It is such as a mechanic of ordinary skill in construction of similar machinery, having the forms, specifications and machine before him, could substitute in the place of the mechanism described *without the exercise of the inventive faculty.*

Q: What is the "doctrine of file wrapper estoppel"?

A: This doctrine balances the doctrine of equivalents. Patentee is precluded from claiming as part of patented product that which he had to excise or modify in order to avoid patent office rejection, and he may omit any additions that he was compelled to add by patent office regulations.

Q: What is the "doctrine of contributory infringement"?

A: Aside from the infringer, 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 adapted for infringing the patented invention and not suitable for substantial non-infringing use is liable jointly and severally with the infringer as a *contributory infringer*. It must be proven that the product can only be used for infringement purposes. If it can be used for legitimate purposes, the action shall not prosper.

Q: What are the remedies of the owner of the patent against infringers?

A:

1. *Civil action for infringement* – The owner may bring a civil action with the appropriate Regional Trial Court to recover from infringer the damages sustained by the former, plus attorney's fees and other litigation expenses, and to secure an injunction for the protection of his rights.

2. *Criminal action for infringement* – If the infringement is *repeated*, the infringer shall be criminally liable and upon conviction, shall suffer imprisonment of not less than six (6) months but not more than three (3) years and/or a fine not less than P100,000.00 but not more than P300,000.00

3. *Administrative remedy* – Where the amount of damages claimed is not less than P200,000.00, the patentee may choose to file an administrative action against the infringer with the Bureau of Legal Affairs (BLA). The BLA can issue injunctions, direct infringer to pay patentee damages, but unlike regular courts, the BLA may not issue search and seizure warrants or warrants of arrest.

Q: What are the limitations to the civil/criminal action?

A:

1. No damages can be recovered for acts of infringement committed more than four (4) years before the filing of the action for infringement. *(Sec. 79, IPC)*

2. The criminal action prescribes in three (3) years from the commission of the crime. *(Sec. 84, IPC)*

Q: Who can file an action for infringement?

A:

1. The *patentee* or his *successors-in-interest* may file an action for infringement. *(Creser Precision Systems,*

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Inc. v. CA, G.R. No. 118708, Feb. 2, 1998)

2. Any *foreign national or juridical entity* who meets the requirements of Sec. 3 and not engaged in business in the Philippines, to which a patent has been granted or assigned, whether or not it is licensed to do business in the Philippines. *(Sec. 77, IPC)*

Q: What are the defenses in an action for infringement?

A:
1. Invalidity of the patent; *(Sec. 81, IPC);*
2. Any of the grounds for cancellation of patents:
   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. *(Sec. 61, IPC)*

I. LICENSING

Q: What are the modes of obtaining license to exploit patent rights?

A:
1. Voluntary licensing *(Sec. 85, IPC)* and
2. Compulsory licensing *(Sec. 93, IPC)*

Q: What is voluntary licensing?

A: The grant by the patent owner to a third person of the right to exploit a patented invention.

Q: What are the rights of a licensor in voluntary licensing?

A: In the absence of any provision to the contrary in the technology transfer arrangement, the grant of a license shall not prevent the licensor from granting further licenses to third person nor from exploiting the subject matter of the technology transfer arrangement himself *(Sec. 89, IPC).*

Q: Who can grant a compulsory license?

A:

1. 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 (*Sec. 93, IPC).*

2. R.A. 9502 *(Universally Accessible Cheaper and Quality Medicines Act of 2008)* however amended Sec. 93 so that it is the Director General of the IPO who may grant a license to exploit patented invention under the grounds enumerated therein.

   Note: Clarification either by legislation of judicial interpretation as to who has jurisdiction should be made to avoid confusion. *(Salao, Essential of Intellectual Property Law: a Guidebook on Republic Act No. 8293 and Related Laws, 2008)*

Q: What are the grounds for compulsory licensing and the period for filing a petition?

A:

1. National emergency

2. Where the public interest, at any time after the grant of the patent

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 at any time after the grant of the patent

4. In case of public non-commercial use of the patent by the patentee, without satisfactory reason at any time after the grant of the patent

5. If the patented invention is not being worked in the Philippines on a commercial scale, although capable of being worked, without satisfactory reason after the expiration of 4 years from the date of filing of the application or 3 years from the date of the patent whichever is later. *(Sec. 93 in relation to Sec. 94)*

6. Where the demand for patented drugs and medicines is not being met to an adequate extent and on reasonable terms, as determined by the Secretary of the Department of Health *(Sec. 10, R.A. 9502)*

Q: Grounds for cancellation of the compulsory license?

A:

1. Ground for the grant of the compulsory license no longer exists and is unlikely to recur;
2. Licensee has neither begun to supply the domestic market nor made serious preparation therefore;
3. Licensee has not complied with the prescribed terms of the license.

Q: Cezar works in a car manufacturing company owned by Joab. Cezar is quite innovative and loves to tinker with things. With the materials and parts of the car, he was able to invent a gas-saving device that will enable cars to consume less gas. Francis, a co-worker, saw how Cezar created the device and likewise, came up with a similar gadget, also using scrap materials and spare parts of the company. Thereafter, Francis filed an application for registration of his device with the Bureau of Patents. Eighteen months later, Cezar filed his application for the registration of his device with the Bureau of Patents.

Q: Is the gas-saving device patentable? Explain.

A: Yes because it is new, it involves an inventive step and it is industrially applicable.

Q: Assuming that it is patentable, who is entitled to the patent? What, if any, is the remedy of the losing party?

A: Francis is entitled to the patent, because he had the earlier filing date. The remedy of Cezar is to file a petition in court for the cancellation of the patent of Francis on the ground that he is the true and actual inventor, and ask for his substitution as patentee. **(2005 Bar Question)**

Q: Supposing Albert Einstein were alive today and he filed with the Intellectual Property Office (IPO) an application for patent for his theory of relativity expressed in the formula E=mc2. The IPO disapproved Einstein's application on the ground that his theory of relativity is not patentable. Is the IPO's action correct?

A: Yes, the IPO's action is correct. Section 22 of the Intellectual Property Law expressly states that discoveries, scientific theories and mathematical methods are among those matters which are not patentable. **(2006 Bar Question)**

J. ASSIGNMENT AND TRANSMISSION OF RIGHTS

Q: What are the forms of assignment?

A:

1. *Total* – assignment of entire right, title or interest in and to the patent and the invention covered thereby.
2. *Partial*
   a. *Separate rights* – assignment of a specific right (ex: right to sell)b.
   b. *Pro Indiviso* – assignment of an aliquot part which results in co-ownership

Q: How is the transfer of rights effected?

A:

1. By inheritance or bequest
2. License contract

Q: What is the effect of an assignment of a patent?

A: The assignment works as an estoppels by deed, preventing the assignor from denying the novelty and utility of the patented invention when sued y the assignee for infringement.

Q What should be the form of an assignment?

A:

1. In writing
2. Acknowledged and certified before a notary public or other officer authorized to perform notarial acts
3. Recorded in the IPO

Q: What is the effect if the assignment was not recorded in the IPO?

A: A deed of assignment affecting title 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. Even without recordal, the instruments are binding upon the parties.

Q: May a licensee maintain a suit for infringement?

A:

<u>**GR:**</u> Only the patentees, his heirs, assignee, grantee or personal representatives may bring an action for infringement.

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XPN: If the licensing agreement provides that the licensee may bring an action for infringement or if he was authorized to do so by the patentee through a special power of attorney.

III. TRADEMARKS

A. DEFINITION OF MARKS, COLLECTIVE MARKS, TRADENAMES

Q: What is a trademark and how does it differ from a trade name?

A: Any visible sign capable of distinguishing the goods *(trademark)* or services *(service mark)* of an enterprise. A *trade name* is a name or designation identifying or distinguishing an enterprise.

TRADEMARK	TRADE NAME
Goods or services offered by a proprietor or enterprise are designated by trademark (goods) or service marks (services).	A natural or artificial *person* who does business and produces or performs the goods or services designated by trademark or service mark.
Refers to the *goods*.	Refers to *business* and its *goodwill*.
Acquired *only* by *registration.*	Need *not* be registered.

Q: What is a collective mark?

A: A "collective mark" or collective trade-name" is a mark or trade-name used by the members of a cooperative, an association or other collective group or organization. (*Sec. 40, R.A. 166*)

Q: What are the functions of trademark?

A:

1. To point out distinctly the origin or ownership of the articles to which it is affixed.
2. To secure to him who has been instrumental in bringing into market a superior article or merchandise the fruit of his industry and skill
3. To prevent fraud and imposition. (*Etepha v. Director of Patents, G.R. No. L-20635, Mar. 31, 1966*)

Q: S Development Corporation sued Shangrila Corporation for using the "S" logo and the tradename "Shangrila". The former claims that it was the first to register the logo and the tradename in the Philippines and that it had been using the same in its restaurant business. Shangrila Corporation counters that it is an affiliate of an international organization which has been using such logo and tradename "Shangrila" for over 20 years. However, Shangrila Corporation registered the tradename and logo in the Philippines only after the suit was filed.

Which of the two corporations has a better right to use the logo and the tradename? Explain.

A: S Development Corporation has a better right to use the logo and tradename, since it was the first to register the logo and tradename.

Alternative Answer:
S Development Corporation has a better right to use the logo and tradename, because its certificate of registration upon which the infringement case is based remains valid and subsisting for as long as it has not been cancelled. *(Shangrila International Hotel Management v. CA, G.R. No. 111580, June 21, 2001)* **(2005 Bar Question)**

Q: How does the international affiliation of Shangrila Corporation affect the outcome of the dispute? Explain.

A: Since Shangrila Corporation is *not* the owner of the logo and tradename but is merely an affiliate of the international organization which has been using them it is not the owner and does not have the rights of an owner. *(Sec. 147, IPC)*

Alternative Answer:
The international affiliation of Shangrila Corporation shall have no effect on the outcome of the dispute. Section 8 of the Paris Convention provides that "there is no automatic protection afforded an entity whose tradename is alleged to be infringed through the use of that name as a trademark by a local entity." *(Kabushi Kaisha Isetan v. IAC, G.R. No. 75420, Nov. 15, **1991**)* **(2005 Bar Question)**

Q: What are the salient features of the Paris convention of trademarks?

A:

1. *National Treatment Principle* – foreign nationals are to be given the same treatment in each of the member countries as that country makes available in its own citizens.

2. *Right of Priority* – any person who has duly filed registration for trademark shall enjoy a right of priority of 6 months *(Rule 203, Trademark Rules)*

3. *Protection against Unfair Competition*

4. *Protection of Tradenames* – protected in all countries without obligation of filing or registration.

5. *Protection of Well-Known Marks*

B. ACQUISITION OF OWNERSHIP OF MARK

Q: How are marks acquired?

A: *Marks* are acquired *solely* through *registration*. *(Sec. 122, IPC)*

Q: What marks may be registered?

A: Any word, name, symbol, emblem, device, figure, sign, phrase, or any combination thereof *except* those enumerated under Section 123, IPC.

Q: What are the requirements for a mark to be registered?

A:

1. A visible sign (not sounds or scents); *and*
2. Capable of distinguishing one's goods and services from another.

Q: What is the doctrine of secondary meaning?

A: This doctrine is to the effect that a word or phrase originally incapable of exclusive appropriation with reference to an article on the market, because it is geographical or otherwise descriptive, may nevertheless be used exclusively by one producer with reference to his article so long as in that trade and to that branch of the purchasing public, the word or phrase has come to mean that the article was his product. (*G. and C. Merriam Co. v. Saalfield, 198 F. 369, 373, cited in Ang v. Teodoro, G.R. No. L-48226, Dec. 14, 1942)*

Q: Is there an infringement of trademark when two similar goods use the same words, "PALE PILSEN"?

A: No, because "pale pilsen" are *generic words* descriptive of the color (pale) and of a type of beer (pilsen), which is a light bohemian beer with strong hops flavor that originated in the City of Pilsen in Czechoslovakia. Pilsen is a primarily *geographically descriptive word*, hence, *non-registrable* and *not appropriable* by any beer manufacturer *(Asia Brewery, Inc. v. CA, G.R. No. 103543, July 5, 1993).*

Q: Who may file an opposition to trademark registration and on what ground?

A: 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. *(Sec. 134, IPC)*

Q: Laberge, Inc., manufactures and markets after-shave lotion, shaving cream, deodorant, talcum powder and toilet soap, using the trademark "PRUT", which is registered with the Phil. Patent Office. Laberge does not manufacture briefs and underwear and these items are not specified in the certificate of registration. JG who manufactures briefs and underwear, wants to know whether, under our laws, he can use and register the trademark "PRUTE" for his merchandise. What is your advice?

A: Yes, he can use and register the trademark "PRUTE" for his merchandise. The trademark registered in the name of Laberge Inc. covers only after-shave lotion, shaving cream, deodorant, talcum powder and toilet soap. It does not cover briefs and underwear. The *limit* of the trademark is stated in the *certificate* issued to Laberge Inc. It does *not* include briefs and underwear which are *different* products protected by Laberge's trademark. JG can register the trademark "PRUTE" to cover its briefs and underwear *(Faberge Inc. v. IAC, G.R. No. 71189, Nov. 4, 1992)* **(1994 Bar Question)**

C. ACQUISITION AND OWNERSHIP OF TRADE NAME

Q: How are trade names acquired?

A: Trade names or business names are acquired through adoption and use. Registration is not required. (Sec. 165, IPC)

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D. NON-REGISTRABLE MARKS

Q: What marks may not be registered?

A:

1. Consists of *immoral*, *deceptive* or *scandalous* matter or *falsely suggest* a connection with persons, institutions, beliefs, or national symbols

2. 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*

3. 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 *except* by written consent of the widow

4. Identical with a *registered mark* belonging to a *different* proprietor or a mark with an *earlier* filing or *priority* date, in respect of:
   1. The *same* goods or services, or
   2. *Closely related* goods or services, or
   3. If it *nearly resembles* such a mark as to be likely to deceive or cause *confusion*;

5. Is identical with an *internationally well-known mark, whether or not it is registered* here, used *for identical or similar goods* or *services*

6. Is identical with an *internationally well-known mark* which is *registered* in the Philippines with respect to *non-similar* goods or services. *Provided*, that the interests of the owner of the registered mark are likely to be *damaged* by such use

7. Is likely to *mislead* the public as to the nature, quality, characteristics or geographical origin of the goods or services

8. Consists exclusively of signs that are *generic* for the goods or services that they seek to identify

9. Consists exclusively of signs that have become *customary* or *usual* to designate the goods or services in everyday language and established trade practice

10. Consists exclusively 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

11. 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

12. Consists of *color alone, unless* defined by a given form; or

13. Is *contrary* to public order or morality. *(Sec. 123)*

E. PRIOR USE OF MARK AS A REQUIREMENT

Q: Is the prior use of the mark still a requirement for registration?

A: No. Actual prior use in commerce in the Philippines has been abolished as a condition for the registration of a trademark. *(RA 8293)*

Q: When is non-use excused?

A:

1. If caused by circumstances arising independently of the will of the owner. Lack of funds is not an excuse.
2. A use which does not alter its distinctive character though the use is different from the form in which it is registered.
3. Use of mark in connection with one or more of the goods/services belonging to the class in which the mark is registered.
4. The use of a mark by a company related to the applicant/registrant.
5. The use of a mark by a person controlled by the registrant. (*Section 152, IPC*)

F. TEST TO DETERMINE CONFUSING SIMILARITY BETWEEN MARKS

Q: What are the tests in determining whether there is a trademark infringement?

A:

1. *Dominancy test* – Focuses on the similarity of the *prevalent features* of the competing marks. If the competing trademark contains the main or essential or dominant features of another, and confusion is likely to result, infringement takes place. (*Asia Brewery v. CA, G.R. No. 103543, 5 July 1993)*

2. *Totality or holistic test* – 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.

Note: The *dominancy test* only relies on *visual comparisons* between two trademarks whereas the *totality or holistic test* relies *not only on the visual but also on the aural and connotative comparisons and overall impressions* between the two trademarks. *(Societe Des Produits Nestl, S.A. v. CA, G.R. No. 112012, Apr. 4, 2001)*

Q: N Corporation manufactures rubber shoes under the trademark "Jordann" which hit the Philippine market in 1985, and registered its trademark with the Bureau of Patents, Trademarks and Technology in 1990. PK Company also manufactures rubber shoes with the trademark "Javorski" which it registered with BPTTT in 1978. In 1992, PK Co adopted and copied the design of N Corporation's "Jordann" rubber shoes, both as to shape and color, but retained the trademark "Javorski" on its products. May PK Company be held liable to N Co? Explain.

A: PK Co may be liable for unfairly competing against N Co. By copying the design, shape and color of N Corporation's "Jordann" rubber shoes and using the same in its rubber shoes trademarked "Javorski," PK is obviously trying to pass off its shoes for those of N. It is of no moment that the trademark "Javorski" was registered ahead of the trademark "Jordann." Priority in registration is not material in an action for unfair competition as distinguished from an action for infringement of trademark. The basis of an action for unfair competition is confusing and misleading similarity in general appearance, not similarity of trademarks. *(Converse Rubber Co. v. Jacinto Rubber & Plastics Co., G.R. Nos. 27425, 30505, Apr. 28, 1980)* **(1996 Bar Question)**

Q: What is the so-called "related goods principle"?

A: Goods are related when they; 1) belong to the *same class* or have the same *descriptive properties;* 2) when they possess the *same physical attributes* or *essential characteristics* with reference to their form, composition, texture or quality.

Q: What is the rule of idem sonans?

A: Two names are said to be "*idem sonantes*" if the *attentive ear finds difficulty in distinguishing them when pronounced*. *(Martin v. State, 541 S.W. 2d 605)*

Note: Similarity of sound is sufficient to rule that the two marks are confusingly similar when applied to merchandise of the same descriptive properties. *(Marvex Commercial v. Director of Patent, G.R. No. L-19297, Dec. 22, 1966)*

Q: What are the types of confusion that arise from the use of similar or colorable imitation marks?

A:

1. Confusion of *goods* (product confusion); and
2. Confusion of *business* (source or origin confusion). (*McDonald's Corporation v. L.C. Big Mak Burger, Inc., et al., G.R. No. 143993, Aug. 18, 2004)*

Note: 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*.

Q: What is colorable imitation?

A: 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. *(Societe des Produits Nestlé, S.A. v. CA, G.R. No. 112012, Apr. 4, 2001)*

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G. WELL-KNOWN MARKS

Q: What constitutes an internationally well-known mark?

A:

1. Considered by the *competent authority of the Philippines* to be "well-known" international *and* in the Philippines as the mark of a person other than the applicant or registrant

2. Need *not* be used or registered in the Philippines

3. Need *not* be known by the public at large but only by *relevant sector* of the public.

Q: What does the law provide as regards internationally-well known marks?

A:

GR: Prohibition on subsequent registration does *not* include services and goods of *different* nature or kind.

XPN:

1. If the *internationally well-known mark* is *not registered in the Philippines*, the application for registration of a subsequent or similar mark can be rejected only if the goods or services specified in the application are *similar* to those of the internationally well-known mark

2. If the internationally well-known mark *is registered in the Philippines,* the application for registration of a subsequent or similar mark can be refused *even if* the goods or services specified in the application are *not identical or similar* to those of the internationally well-known mark

H. RIGHTS CONFERRED BY REGISTRATION

Q: What is the duration of a certificate of trademark registration?

A: *10 years, renewable for a period of another 10 years.* Each request for renewal must be made *within 6 months* before or after the expiration of the registration.

Q: What are the rights of a *registered* mark owner?

A:

1. Protection against reproduction, or imitation or unauthorized use of the mark (infringement of mark)
2. To stop entry of imported merchandise into the country containing a mark identical or similar to the registered mark

3. To transfer or license out the mark.

I. USE BY THIRD PARTIES OF NAMES, ETC. SIMILAR TO REGISTERED MARK

Q: What is the effect of use of Indications by third parties for purposes other than those for which the mark is used?

A: Registration of the mark shall not confer on the registered owner the right to preclude third parties from using bona fide their names, addresses, pseudonyms, a geographical name, or exact indications concerning the kind, quality, quantity, destination, value, place of origin, or time of production or of supply, of their goods or services.

J. INFRINGEMENT AND REMEDIES

Q: What is trademark infringement?

A: The use *without consent* of the trademark owner of any a) *reproduction, b) counterfeit, c) copy* or d) *colorable imitation* of any *registered* mark or tradename in connection with the *sale, offering for sale, or advertising* of any goods, business or services on *or* in connection with which such use is likely to *cause confusion or mistake or to deceive* purchasers or others as to the *source or origin* of such goods or services, or *identity* of such business; or *reproduce, counterfeit, copy or colorably imitate* any such mark or tradename *and apply* such reproduction, counterfeit, copy or colorable limitation to labels, signs, prints, packages, wrappers, receptacles or advertisements intended to be used upon or in connection with such goods, business or services *(Esso Standard Eastern v. CA, G.R. No. L-29971, Aug. 31, 1982)*

Q: What are the elements to be established in trademark infringement?

A:

1. The *validity* of the mark
2. The *plaintiff's ownership* of the mark
3. The use of the mark or its colorable imitation by the alleged infringer results in "*likelihood of confusion*." *(McDonald's Corporation v. L.C. Big Mak Burger, Inc., G.R. No. 143993, Aug 18, 2004)*

Q: What is meant by non-competing goods?

A: Those which, though they are not in actual competition, are so related to each other that it might reasonably be assumed that they originate from one manufacturer.
Non-competing goods may also be those which, being entirely unrelated, could not reasonably be assumed to have a common source. In the case of related goods, confusion of business could arise out of the use of similar marks; in the latter case of non-related goods, it could not. The vast majority of courts today follow the modern theory or concept of "related goods" which the court has likewise adopted and uniformly recognized and applied. *(Esso Standard Eastern, Inc. v. CA, G.R. No. L-29971, Aug. 31, 1982)*

Q: Is there infringement even if the goods are non-competing?

A:

GR: No.

XPN: If it *prevents* the natural expansion of his business and, *second*, by having his business reputation *confused* with and put at the mercy of the second user. *(Ang v. Teodoro, G.R. No. L-48226, Dec. 14, 1942)*

Q: What are the remedies of the owner of the trademark against infringers?

A:

1. *Civil* — both civil and criminal actions may be filed with the Regional Trial Courts. The owner of the registered mark may ask the court to issue a *preliminary injunction* to quickly prevent infringer from causing damage to his business. Furthermore, the court will require infringer to pay *damages* to the owner of the mark provided defendant is shown to have had notice of the registration of the mark (which is presumed if a letter R within a circle is appended) and stop him permanently from using the mark.

2. *Criminal* — the owner of the trademark may ask the court to issue a search warrant and in appropriate cases, remedies available shall also include the seizure, forfeiture and destruction of the infringing goods and of any materials and implements the predominant use of which has been in the commission of the offense.

3. *Administrative* — This remedy is the same as in patent infringement cases. If the amount of damages claimed is not less than P200,000.00, the registrant may choose to seek redress against the infringer by filing an administrative action against the infringer with the Bureau of Legal Affairs.

Q: How is the amount of damages in a civil action for infringement ascertained?

A: The owner of a trademark which has been infringed is entitled to actual damages:

1. The reasonable profit which the complaining party would have made, had the defendant not infringed his said rights; or
2. The profit which the defendant actually made out of infringement; or
3. The court may award as damages a reasonable percentage based upon the amount of gross sales of the defendant of the value of the services in connection with which the mark or trade name was issued.

Q: What court has jurisdiction over violations of intellectual property rights?

A: It 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.

Note: R.A. 8293 and R.A. 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 law. *(Samson v. Daway, G.R. No. 160054-55, July 21, 2004)*

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Q: What are the limitations on the actions for infringement?

A:

1. *Right of prior user* – registered mark shall be without affect against any person who, in good faith, before filing or priority date, was using the mark for purposes of his business. *(Sec 159.1, IPC)*

2. *Relief against publisher* – injunction against future printing against an innocent infringer who is engaged solely in the business of printing the mark. *(Sec. 159.2, IPC)*

3. *Relief against newspaper* – injunction against the presentation of advertising matter in future issues of the newspaper, magazine or in electronic communications in case the infringement complained of is contained in or is part of paid advertisement in such materials. *(Sec. 159.3, IPC)*

K. UNFAIR COMPETITION

Q: What distinguishes infringement of trademark from unfair competition?

A:

INFRINGEMENT OF TRADEMARK	UNFAIR COMPETITION
Unauthorized use of a trademark.	The passing off of one's goods as those of another.
Fraudulent intent is unnecessary.	Fraudulent intent is essential.
Prior registration of the trademark is a prerequisite to the action.	Registration is not necessary. (*Del Monte Corp. v. CA, G.R. No. 78325, Jan. 23, 1990*)

Q: What is the right protected under unfair competition?

A: 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. *(Sec. 168.1, IPC)*

Q: Who are guilty of unfair competition?

A:

1. Any person, who is *selling* his goods and gives them the *general appearance* of goods of another manufacturer or dealer, *either* as to the *goods themselves* or in the *wrapping of the packages* in which they are contained, or the *devices* or *words* thereon, or in *any other feature of their appearance,* which would be likely to influence purchasers to believe that the goods offered are those of a manufacturer or dealer, other than the actual manufacturer or dealer, or who otherwise *clothes the goods with such appearance as shall deceive the public and defraud* another of his legitimate trade, or any subsequent vendor of such goods or any agent of any vendor engaged in selling such goods with a like purpose;

2. 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

3. 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. *(Sec. 168.3)*

Q: Is the law on unfair competition broader than the law on trademark?

A: Yes. For the latter (trademark infringement) 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. *(Mighty Corporation v. E. & J. Gallo Winery, G.R. No. 154342, July 14, 2004)*

Q: What are the elements of an action for unfair competition?

A:

1. *Confusing similarity* in the *general appearance* of the goods; and

   Note: 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.

2. *Intent to deceive* the public and *defraud* a competitor.

   Note: 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. (*McDonald's Corporation v. L.C. Big Mak Burger, Inc., et al., G.R. No. 143993, Aug. 18, 2004)*

Q: The NBI found that SG Inc. is engaged in the reproduction and distribution of counterfeit "playstation games" and thus applied with the Manila RTC warrants to search respondent's premises in Cavite. RTC granted such warrants and thus, the NBI served the search warrants on the subject premises. SG Inc. questioned the validity of the warrants due to wrong venue since the RTC of Manila had no jurisdiction to issue a search warrant enforceable in Cavite. Is the contention of SG Inc. correct?

A: No, unfair competition is a transitory or continuing offense under Section 168 of Republic Act No. 8293. As such, petitioner may apply for a search warrant in any court where any element of the alleged offense was committed, including any of the courts within Metro Manila and may be validly enforced in Cavite. *(Sony Computer Entertainment Inc. v. Supergreen Inc. G.R. No. 161823, Mar. 22, 2007)*

L. TRADE NAMES OR BUSSINESS NAMES

Q: What is a trade name or business name?

A: Any individual name or surname, firm name, device nor word used by manufacturers, industrialists, merchants, and others to identify their businesses, vocations or occupants *(Converse rubber Corp. vs. Universal Rubber Products, GR No. L-27425, L-30505, April 28, 1980).*

Q: What are the limitations on use of trade name or business name?

A: A person may not:

1. Use any name or designation contrary to public order or morals

2. Use a name if it is liable to deceive trade circles or the public as to the nature of the enterprise identified by that name. *(Sec. 165.1, IPC)*

3. Subsequently use a trade name likely to mislead the public as a third party. *(Sec. 165.2, b, IPC)*

4. Copy or simulate the name of any domestic product (for imported products).

5. Copy or simulate a mark registered in accordance with the provisions of IPC (for imported products).

6. Use mark or trade name calculated to induce the public to believe that the article is manufactured in the Philippines, or that it is manufactured in any foreign country or locality other than the country or locality where it is in fact manufactured.

   Note: Items 4, 5 and 6 only applies to imported products and those imported articles shall not be admitted to entry at any customhouse of the Philippines *(Sec. 166, IPC).*

Q: How is the change in the ownership of a trade name made?

A: It shall be made with the transfer of the enterprise or part thereof identified by that name. *(Sec. 165.4, IPC)*

M. COLLECTIVE MARKS

Q: What is a collective mark?

A: A "collective mark" or "collective trade-name" is a mark or trade-name used by the members of a cooperative, an association or other collective group or organization. *(Sec. 40, R.A. 166)*

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Q: What should an application for registration of a collective mark contain?

A:

1. The application shall designate the mark as a collective mark
2. Accompanied by a copy of the agreement, if any, governing the use of the collective mark *(Sec. 167.2, IPC)*

Q: What are the grounds for the cancellation of collective marks?

A:

1. The Court shall cancel the registration of a collective mark if the person requesting the cancellation proves that only the registered owner uses the mark,

2. Or that he uses or permits its use in contravention of the agreements referred to in Subsection 166.2,

3. Or that he uses or permits its use in a manner liable to deceive trade circles or the public as to the origin or any other common characteristics of the goods or services concerned *(Sec 167.3).*

Note: The registration of a collective mark, or an application therefor shall not be the subject of a license contract.

N. CRIMINAL PENALTIES

Q: What are the criminal penalties for unfair competition, infringement, false designation of origin and false representations?

A: A penalty of imprisonment from 2 years to 5and a fine ranging from P50,000 to P200,000 *(Sec. 170, IPC.)*

Q: Can trademark registration be cancelled?

A: Yes, by any person who believes that he will be damaged by the registration of the mark:

1. Within 5 years, from the date of the registration of the mark; or

2. At any time;
   a. If the registered mark becomes the generic name for the goods or services, or a portion thereof, for which it is registered;
   b. If the mark has been abandoned;
   c. If its registration was obtained fraudulently or contrary to the provisions of the IPC;
   d. If the registered mark is being used by, or with the permission of, the registrant so as to misrepresent the source of the goods or services on or in connection with which the mark is used;
   e. Non-use of the mark within the Philippines, without legitimate reason, for an uninterrupted period of 3 years.

IV. COPYRIGHTS

Q: What is copyright?

A: A right over literary and artistic works which are original intellectual creations in the literary and artistic domain protected from the moment of creation. *(Sec. 171.1, IPC)*

A. BASIC PRINCIPLES

Q: What are the elements of copyrightability?

A:

1. *Originality* – Must have been created by the author's *own* skill, labor, and judgment without directly copying or evasively imitating the work of another. *(Ching Kian Chuan v. CA, G.R. No. 130360, Aug. 15, 2001)*

2. *Expression* – Must be embodied in a medium sufficiently permanent or stable to permit it to be perceived, reproduced or communicated for a period more than a transitory duration.

Q: What are the elements of originality?

A:

1. It is independently created by the author, and
2. It possesses some minimal degree of creativity

Q: When does copyright vest?

A: Works are protected from the time of their creation, irrespective of their mode or form of expression, as well as of their content, quality and purpose.

B. COPYRIGHTABLE WORKS

Q: What are copyrightable works?

A:

1. Literary and Artistic Works
BOLD-MAN-GAS-PAP-CO

    a. **B**ooks, pamphlets, articles and other writings
    b. Lectures, sermons, addresses, dissertations prepared for **O**ral delivery, whether or not reduced in writing or other material form
    c. **L**etters
    d. **D**ramatic, choreographic works
    e. **M**usical compositions
    f. Works of **A**rt
    g. Periodicals and **N**ewspapers
    h. Works relative to **G**eography, topography, architecture or science
    i. Works of **A**pplied art
    j. Works of a **S**cientific or technical character
    k. **P**hotographic works
    l. **A**udiovisual works and cinematographic works
    m. **P**ictorial illustrations and advertisements
    n. **C**omputer programs; and
    o. **O**ther literary, scholarly, scientific and artistic works. *(Sec. 172.1, IPC)*

2. Derivative Works

    a. Dramatizations, translations, adaptations, abridgements, arrangements, and other *alterations* of literary or artistic works;

    b. Collections of literary, scholarly, or artistic works and compilations of data and other materials which are original by reason of the selection or coordination or arrangement of their contents. *(Sec. 173)*

Note: Derivative Works shall be protected as new works, provided that such new work shall not affect the force of any subsisting copyright upon the original works employed or any part thereof, or be construed to imply any right to such use of the original works, or to secure or extend copyright in such original works. *(Sec. 173.2, IPC)*

Q: P&D was granted a copyright on the technical drawings of light boxes as "advertising display units". SMI, however, manufactured similar or identical to the light box illustrated in the technical drawings copyrighted by P&D for leasing out to different advertisers. Was this an infringement of P&D's copyright over the technical drawings?

A: No, P&D's copyright protection extended only to the technical drawings and not to the light box itself. The light box was not a literary or artistic piece which could be copyrighted under the copyright law. If SMI reprinted P&D's technical drawings for sale to the public without license from P&D, then no doubt they would have been guilty of copyright infringement. Only the expression of an idea is protected by copyright, not the idea itself. If what P&D sought was exclusivity over the light boxes, it should have instead procured a patent over the light boxes itself. *(Pearl and Dean Inc. v. Shoe Mart Inc., GR No. 148222, Aug. 15, 2003)*

Q: What is the difference between collection of work and collective work?

A:

COLLECTION OF WORK	COLLECTIVE WORK
It is not necessary that there is an agreement. Individual contribution is capable of copyright protection.	There is an agreement whereby the authors bound themselves not to be identified with the work.

Q: Juan Xavier wrote and published a story similar to an unpublished copyrighted story of Manoling Santiago. It was, however, conclusively proven that Juan Xavier was not aware that the story of Manoling Santiago was protected by copyright. Manoling Santiago sued Juan Xavier for infringement of copyright. Is Juan Xavier liable?

A: Yes. Juan Xavier is liable for infringement of copyright. It is not necessary that Juan Xavier is aware that the story of Manoling Santiago was protected by copyright. The work of Manoling Santiago is protected from the time of its creation. **(1998 Bar Question)**

Note: There will still be originality sufficient to warrant copyright protection if "the author, through his skill and effort, has contributed a distinguishable variation from the older works." In such a case, of course, only those parts which are new are protected by the new copyright. Hence, in such a case, there is no case of infringement. Juan Xavier is

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no less an "author" because others have preceded him.

C. NON-COPYRIGHTABLE WORKS

Q: What are the subjects not protected?

A:

1. Idea, procedure, system, method or operation, concept, principle, discovery or mere data as such
2. News of the day and other items of press information
3. Any official text of a legislative, administrative or legal nature, as well as any official translation thereof
4. Pleadings
5. Decisions of courts and tribunals – this refers to original decisions and not to annotated decisions such as the SCRA or SCAD as these already fall under the classification of derivative works, hence copyrightable
6. Any work of the Government of the Philippines

   GR: Conditions imposed prior the 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 condition the payment of royalties.

   XPN: 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 administration agencies, in deliberative assemblies and in meetings of public character. *(Section 176, IPC)*

7. TV programs, format of TV programs *(Joaquin v. Drilon, G.R. No. 108946, Jan. 28, 1999)*
8. Systems of bookkeeping; and
9. Statutes.

Q: BJ Productions, Inc. (BJPI) is the holder/grantee of a copyright of "Rhoda and Me", a dating game show aired from 1970 to 1977. Subsequently, however, RPN aired the game show "It's a Date", which was produced by IXL Productions, Inc. (IXL). As such, an information for copyright infringement was filed against RPN. The DOJ Secretary directed the prosecutor to dismiss the case for lack of probable cause. Was the decision of the DOJ Secretary correct?

A: Yes, the format of a show is not copyrightable. The copyright law enumerates the classes of work entitled to copyright protection.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. It is a new or independent right granted by the statute, and not simply a pre-existing right regulated by the statute. 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. The copyright does not extend to the general concept or format of its dating game show. *(Joaquin v. Drilon, G.R. No. 108946, Jan. 28, 1999)*

Q: Rural is a certified public utility providing telephone service to several communities in Manila. It obtains data for the directory from subscribers, who must provide their names and addresses to obtain telephone service. Feist Publications, Inc., is a publishing company that specializes in area-wide telephone directories covering a much larger geographic range than directories such as Rural's. Feist extracted the listings it needed from Rurals's directory without its consent. Are directories copyrightable?

A: No, directories are not copyrightable and therefore the use of them does not constitute infringement. The Intellectual Property Code mandates originality as a prerequisite for copyright protection. This requirement necessitates independent creation plus a modicum of creativity. Since facts do not owe their origin to an act of authorship, they are not original, and thus are not copyrightable. A compilation is not copyrightable per se, but is copyrightable only if its facts have been "selected, coordinated, or arranged in such a way that the resulting work as a whole constitutes an original work of authorship." Thus, the statute envisions that some ways of selecting, coordinating, and arranging data are not sufficiently original to trigger copyright protection. Even a compilation that is copyrightable receives only limited protection, for the copyright does not extend to facts contained in the compilation. *(Feist Publications, Inc. v. Rural Telephone Service Co., 499 U.S. 340)*

D. RIGHTS OF A COPYRIGHT OWNER

Q: What is the presumption of authorship?

A: 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, presumed to be the author of the work. This is applicable even if the name is a pseudonym, where the pseudonym leaves no doubt as to identity of the author. *(Sec. 219.1, IPC)*

The person or body corporate, whose name appears on the 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. *(Sec. 219.2, IPC)*

Q: What are the rights of an author?

A:

1. *Economic rights* – The right to carry out, authorize or prevent the following acts:

   a. Reproduction of the work or substantial portion thereof
   b. Carry-out derivative work (dramatization, translation, adaptation, abridgement, arrangement or other transformation of the work)
   c. First distribution of the original and each copy of the work by sale or other forms of transfer of ownership
   d. Rental right
   e. Public display
   f. Public performance
   g. Other communications to the public.

2. *Moral rights* – For reasons of professionalism and propriety, the author has the right:
   a. To require that the authorship of the works be attributed to him (attribution right)
   b. To make any alterations of his work prior to, or to withhold it from publication
   c. Right to preserve integrity of work**,** object to any distortion, mutilation or other modification which would be prejudicial to his honor or reputation; and
   d. To restrain the use of his name with respect to any work not of his own creation or in a distorted version of his work. *(Sec.193, IPC)*

3. *Droit de suite* (Right to proceeds in subsequent transfers or follow up rights) – This is an inalienable right of the author or his heirs to receive to the extent of 5% of the gross proceeds of the sale or lease of a work of painting or sculpture or of the original manuscript of a writer or composer, subsequent to its first disposition by the author.

   The following works are not covered:
   a. Prints
   b. Etchings
   c. Engravings
   d. Works of applied art
   e. Similar works wherein the author primarily derives gain from the proceeds of reproductions. *(Sec. 201, IPC)*

Q: ABC is the owner of certain musical compositions among which are the songs entitled: "Dahil Sa Iyo", "Sapagkat Ikaw Ay Akin," "Sapagkat Kami Ay Tao Lamang" and "The Nearness Of You." Soda Fountain Restaurant hired a combo with professional singers to play and sing musical compositions to entertain and amuse customers. They performed the above-mentioned compositions without any license or permission from ABC to play or sing the same. Accordingly, ABC demanded from Soda Fountain payment of the necessary license fee for the playing and singing of aforesaid compositions but the demand was ignored. ABC filed an infringement case against Soda Fountain. Does the playing and singing of musical compositions inside an establishment constitute public performance for profit?

A: Yes. The patrons of the Soda Fountain pay only for the food and drinks and apparently not for listening to the music, but the music provided is for the purpose of entertaining and amusing the customers in order to make the establishment more attractive and desirable. For the playing and singing the musical compositions involved, the combo was paid as independent contractors by Soda Fountain. It is therefore obvious that the expenses entailed thereby are added to the overhead of the restaurant which are either eventually charged in the price of the food and drinks or to the overall total of additional income produced by the bigger volume of business which the entertainment was programmed to attract. Consequently, it is beyond question that the

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playing and singing of the combo in defendant-appellee's restaurant constituted performance for profit. *(FILSCAP v. Tan, G.R., No. L-36402, Mar. 16, 1987)*

Q: Malang Santos designed for Ambassador Neri for his personal christmas greetings for the year 1959 a christmas card depicting a Philippine rural Christmas time scene. The following year McCullough Printing Company, without the knowledge and authority of Santos, displayed the very design in its album of Christmas cards and offered it for sale. Santos filed for copyright infringement contending that the publication of his design was limited as it was intended only for Ambassador Neri's use, hence, it could not be used for public consumption. Is there copyright infringement?

A: No. If there were a condition that the cards are to be limitedly published, then Ambassador Neri would be the aggrieved party, and not Santos. And even if there was such a limited publication or prohibition, the same was not shown on the face of the design. When the purpose is a limited publication, but the effect is general publication, irrevocable rights thereupon become vested in the public, in consequence of which enforcement of the rights under a copyright becomes impossible. *(Malang v. McCullough Printing Company, G.R. No. L-19439, Oct. 31, 1964)*

Q: May an author be compelled to perform his contract?

A: An author cannot be compelled to perform his contract to create a work or for the publication of his work already in existence. However, he may be held liable for damages for breach of such contract. *(Sec. 195, IPC)*

Q: What is the nature of moral rights?

A: These are personal rights independent from the economic rights. Being a personal right, it can only be given to a natural person. Hence, even if he has licensed or assigned his economic rights, he continues to enjoy the above-mentioned moral rights. *(Amador, Intellectual Property Fundamentals, 2007)*

Q: What is the term of moral rights?

A: It shall last during the lifetime of the author and for fifty (50) years after his death and shall not be assignable or subject to license. *(Sec. 198, IPC)*

Note: The person/s to be charged with the posthumous enforcement of moral rights shall be named in writing to be filed with the National Library. In default of such person or persons, such enforcement shall devolve upon either the author's heirs, and in default of the heirs, the Director of the National Library. *(ibid.)*

Q: What are the exceptions to moral rights?

A:

a. Absent any special contract at the time creator licenses/permits another to use his work, the following are deemed not to contravene creator's moral rights, provided they are done in accordance with reasonable customary standards or requisites of the medium:
    a. Editing
    b. Arranging
    c. Adaptation
    d. Dramatization
    e. Mechanical and electric reproduction

b. Complete destruction of work unconditionally transferred by creators. *(Sec. 197, IPC)*

Q: Can moral rights be waived?

A:

GR: Moral rights can be waived in writing, expressly so stating such waiver.

XPN: Even in writing, waiver is not valid if:

1. Use the name of the author, title of his work, or his reputation with respect to any version/adaptation of his work, which because of alterations, substantially tend to injure literary/artistic reputation of another author

2. Use name of author in a work that he did not create

Q: What are the neighboring rights?

A: These are the rights of performers, producers of sound recording and broadcasting organizations.

Q: What is the scope of a performer's rights?

A: Performers shall enjoy the following exclusive rights:

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.

2. The right of authorizing the direct or indirect reproduction of their performances fixed in sound recordings, in any manner or form;

3. 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;

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

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. 203, IPC)*

Q: What are the moral rights of performers?

A: The performer, shall, as regards his live aural performances or performances fixed in sound recordings, have the right to claim to be identified as the performer of his performances, except where the omission is dictated by the manner of the use of the performance, and to object to any distortion, mutilation or other modification of his performances that would be prejudicial to his reputation.

Q: When are performer's rights lost?

A: Once a performer has authorized broadcasting or fixation of his performance. *(Sec 205, IPC)*

Note: Fair use and limitations to copyrights shall apply *mutatis mutandis* to performers. *(Ibid.)*

Q: When are performers entitled to additional remuneration on their performance?

A: The performer shall be entitled to an additional remuneration equivalent to at least 5% of the original compensation he received for the first communication or broadcast in every communication to the public or broadcast of a performance subsequent to the first communication or broadcast, unless otherwise provided in the contract. *(Sec. 206, IPC)*

Q: What is the scope of the rights of producers on sound recordings?

A: Producers of sound recordings shall enjoy the following exclusive rights:

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

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

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. 208, IPC)*

Note: Fair use and limitations to copyrights shall apply *mutatis mutandis* to performers. *(Sec. 210, IPC)*

Q: What is the scope of the rights of broadcasting organizations?

A: Broadcasting organizations shall enjoy the exclusive right to carry out, authorize or prevent any of the following acts:

1. The rebroadcasting of their broadcasts
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
3. The use of such records for fresh transmissions or for fresh recording. *(Sec. 211, IPC)*

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Q: When are neighboring rights not applicable?

A:

1. Exclusive use of a natural person for own personal purposes
2. Short excerpts for reporting current events
3. Sole use for the purpose of teaching or for scientific research
4. Fair use of the broadcast

Q: What are the term of protection given to performers, producers and broadcasting organizations?

A:

1. For performances not incorporated in recordings, 50 years from the end of the year in which the performance took place; and

2. For sound or image and sound recordings and for performances incorporated therein, 50 years from the end of the year in which the recording took place.

3. In case of broadcasts, the term shall be 20 years from the date the broadcast took place. The extended term shall be applied only to old works with subsisting protection under the prior law. *(Sec. 215, IPC)*

Q: To whom are the rights granted to copyrightable works applicable (points of attachment)?

A:

1. *For literary and artistic works and derivative works*
   a. Works of authors who are nationals of, or have their habitual residence in, the Philippines;
   b. Audio-visual works the producer of which has his headquarters or habitual residence in the Philippines;
   c. Works of architecture erected in the Philippines or other artistic works incorporated in a building or other structure located in the Philippines;
   d. Works first published in the Philippines; and
   e. Works first published in another country but also published in the Philippines within thirty days, irrespective of the nationality or residence of the authors. *(Sec. 221, IPC)*

2. *For perfomers*
   a. Performers who are nationals of the Philippines;
   b. Performers who are not nationals of the Philippines but whose performances:
      i. Take place in the Philippines; or
      ii. Are incorporated in sound recordings that are protected under IPC; or
      iii. Which has not been fixed in sound recording but are carried by broadcast qualifying for protection under IPC. *(Sec. 222, IPC)*

3. *Of sound recordings*
   a. Sound recordings the producers of which are nationals of the Philippines; and
   b. Sound recordings that were first published in the Philippines. *(Sec. 223, IPC)*

4. *For broadcast*
   a. Broadcasts of broadcasting organizations the headquarters of which are situated in the Philippines; and
   b. Broadcasts transmitted from transmitters situated in the Philippines. *(Sec. 224, IPC)*

Note: The provisions of IPC shall also apply to works, performers, producers of sound recordings and broadcasting organizatins that are to be protected by virtue of and in accordance with any international convention or other international agreement to which the Philippines is a party. *(Sec. 221.2 and 224.2, IPC)*

E. RULES ON OWNERSHIP OF COPYRIGHT

Q: Who owns copyright?

A:

1. *Author* – Original literary and artistic works. *(Sec. 178.1, IPC)*

2. *Co-authors* – Works of joint authorship; in the *absence* of agreement, their rights shall be governed by the rules on co-ownership.

Note: If work of joint authorship consists of parts that can be used separately, then the author of each part shall be the original owner of the copyright in the part that he has created. *(Sec. 178.2, IPC)*

3. In the course of employment, the copyright shall belong to:

    a. The employee, if not a part of his regular duties even if the employee uses the time, facilities and materials of the employer. *(Sec. 178.3, IPC)*
    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. *(ibid.)*

4. The person who commissioned the work shall own the work but the copyright thereto shall remain with the creator – In cases of work pursuant to commission, unless there is a written stipulation to the contrary. *(Sec. 178.4, IPC)*

5. **GR:** Producer, the author of the scenario, the composer of the music, the film director, and the author of the work so adapted – audiovisual work.

    XPN: The producers shall exercise the copyright to an extent required for the exhibition of the work in any manner. (*Sec. 178.5, IPC)*

6. *Writer* – in respect of letters subject to the provisions of Article 723, Civil Code. *(Sec. 178.6, IPC)*

7. **GR:** *Publishers* – deemed representatives of the author in case of anonymous and pseudonymous works.

    XPN: When the contrary appears or where the pseudonym or adopted name leaves no doubt as to the author's identity; or author discloses his identity.

8. In case of collective works – contributor is deemed to have waived his right unless he expressly reserves it. *(Sec. 196, IPC)*

Q: Distinguish collective work from joint work.

A:

COLLECTIVE WORK	JOINT WORK
Elements remain unintegrated and disparate.	Separate elements merge into a unified whole.
Work created by 2 or more persons at the initiative and under the direction of another with the understanding that it will be disclosed by the latter under his own name and that of the contributions of natural persons will NOT be identified	Work prepared by 2 or more authors with the intention that their contributions be merged into inseparable or independent parts of the unitary whole.
Each author shall enjoy copyright to his own contribution	Joint authors shall be co-owners. Co-ownership shall apply.
The work will be attributed to the person under whose initiative and direction it was created unless the contributor expressly reserves his right.	Joint authors shall be both entitled to the acknowledgment as authors of the work.

Q: BR and CT are noted artists whose paintings are highly prized by collectors. Dr. DL commissioned them to paint a mural at the main lobby of his new hospital for children. Both agreed to collaborate on the project for a total fee of two million pesos to be equally divided between them. It was also agreed that Dr. DL had to provide all the materials for the painting and pay for the wages of technicians and laborers needed for the work on the project. Assume that the project is completed and both BR and CT are fully paid the amount of P2M as artists' fee by DL. Under the law on intellectual property, who will own the mural? Who will own the copyright in the mural? Why? Explain.

A: Under Sec. 178.4 of the Intellectual Property Code, in case of commissioned work, the creator (in the absence of a written stipulation to the contrary) owns the copyright, but the work itself belongs to the person who commissioned the creation. Accordingly, the mural belongs to DL. However, BR and CT own the copyright, since there is *no* stipulation to the contrary**. (1995 Bar Question)**

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Q: What is the principle of "automatic protection"?

A: Works are protected by the sole fact of their creation irrespective of their content, quality or purpose. Such rights are conferred from the moment of creation.

Q: What is the term of protection of copyright?

A:

TYPE of WORK	DURATION
Single creation	Lifetime of the creator and for 50 years after his death
Joint creation	Lifetime of the last surviving co-creator and for 50 years after his death.
Anonymous or pseudonymous work	50 years after the date of their first publication; except where before the expiration of said period, the author's identity is revealed or is no longer in doubt, the 1st two mentioned rules shall apply; or if unpublished, 50 years from their making.
Work of an applied art of an artistic creation with utilitarian functions or incorporated in a useful article whether made by hand or produced on an industrial scale	25 years from the time of the making.
Audio-visual works including those produced by process analogous to photography or any process for making audio-visual recordings	50 years from date of publication and, if unpublished, from the date of making.
Newspaper Article	Lifetime of the author and 50 years after. *(Sec. 213, IPC)*

F. LIMITATIONS ON COPYRIGHT

Q: What are the general limitations on copyright?

A: The following acts shall not constitute infringement of copyright:

1. Performance of a work, once it has been lawfully made accessible to the public, if done privately and free of charge or for a charitable or religious institution or society.

2. The making of quotations from a published work if they are compatible with fair use and only to the extent justified for the purpose.

3. 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

4. As part of reports of current events (*e.g.* music played or tunes on the occasion of a sporting event and such tunes were picked up during a new coverage of the event).

5. For teaching purposes, provided that the source and of the name of the author, if appearing in the work, are mentioned.

6. Recording made in educational institutions of a work included in a broadcast for the use of such educational institutions, provided that such recording must be deleted within a reasonable period after they were first broadcast.

7. The making of ephemeral recordings by a broadcasting organization by means of its own facilities and for use in its own broadcast.

8. 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.

9. The public performance of a work, in a place where no admission fee is charged.

10. 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 (*e.g.* Public display

using posters mounted on walls and display boards).

11. Any use made of a work for the purpose of any judicial proceedings or for the giving of professional advice by a legal practitioner.

Q: What are the other limitations on copyright?

A:

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. *(Sec. 185, IPC)*

   Note: Decompilation, which is 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 (*e.g.* the software program for Windows 7 will be disassembled by a skilled programmer in order to understand much of the structure and operation of the program).

2. Copyright in a work of architecture shall include the right to control the erection of any building which reproduces the whole or a substantial part of the work either in its original form or in any form recognizably derived from the original, provided, that the copyright in any such work shall not include the right to control the reconstruction or rehabilitation in the same style as the original of a building to which that copyright relates. *(Sec. 186, IPC)*

3. The private reproduction of a published work in a single copy, where the reproduction is made by a natural person exclusively for research and private study, shall be permitted, without the authorization of the owner of copyright in the work but shall not extend to the reproduction of:
   a. A work of architecture in the form of building or other construction;
   b. An entire book, or a substantial part thereof, or of a musical work in graphic 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 author. *(Sec. 187, IPC)*

4. Any library or archive whose activities are not for profit may, without the authorization of the author of copyright owner, 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 user 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 persons 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.

   But 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 or similar works, unless the volume, tome or part is out of stock. *(Sec. 188, IPC)*

5. The reproduction in one back-up copy or adaptation of a computer program shall be permitted, without the authorization of the author of, or other owner of copyright in, a computer program, by the lawful owner of that computer program, provided, the copy or adaptation is necessary for:

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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. *(Sec. 187, IPC)*

6. The importation of a copy of a work by an individual for his personal purposes shall be permitted without the authorization of the author of, or other owner of copyright in, the work under the following circumstances:
   a. When copies of the work are not available in the Philippines and:
      i. Not more than one copy at one time is imported for strictly individual use only; or
      ii. The importation is by authority of and for the use of the Philippine Government; or
      iii. The importation, consisting of not more than three 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. *(Sec. 190, IPC)*

Q: What is the doctrine of "fair use"?

A: "Fair use" permits a secondary use that "serves the copyright objective of stimulating productive thought and public instruction without excessively diminishing the incentives for creativity".

Q: What are the factors that should be considered in order to determine "fair use"?

A:
1. The purpose and character of the use, including whether such use is of a commercial nature or is for non-profit educational purpose;
2. The nature of the copyrighted work;
3. The amount and substantiality of the portion used in relation to the copyrighted work as a whole; and
4. The effect of the use upon the potential market for or value of the copyrighted work.

Note: 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. *(Sec. 182.2, IPC)*

Q: What is the "must carry rule"?

A: Must-carry rule is another limitation on copyright. It obligates operators to carry the signals of local channels within their respective systems. This is to give the people wider access to more sources of news, information, education, sports event and entertainment programs other than those provided for by mass media and afforded television programs to attain a well informed, well-versed and culturally refined citizenry and enhance their socio-economic growth. *(ABS-CBN Broadcasting Corporation v. Philippine Multimedia System, G.R. No. 175769-70, Jan. 19, 2009)*

Q: Ford contracted with H&R Publishing to publish his unwritten memoirs. The agreement gave H&R the exclusive first serial right to license prepublication excerpts. As the memoirs were nearing completion, H&R, as the copyright holders, negotiated a prepublication licensing agreement with Time Magazine. Shortly before the Time article's scheduled release, an unauthorized source provided The Nation Magazine with the unpublished Ford manuscript. An editor of The Nation produced an article which consisted of verbatim quotes of copyrighted expression taken from the manuscript which were the gist of the memoirs. As a result, Time refused to pay H&R as agreed upon in the prepublication agreement. H&R brought an action for infringement against Nation Magazine. Nation magazine contended that the article it published constitutes fair use and thus it cannot be held liable for infringement. Is the contention correct?

A: No, the article does not constitute fair use. Taking into account the factors as especially relevant in determining fair use, leads to the conclusion that the use in question here was not fair. First of all, the purpose or character of the use was commercial (to scoop a competitor), meaning that The Nation's use was not a good faith use of fair use in simply reporting news. Also, although the verbatim quotes in question were an insubstantial portion of the Ford manuscript, they qualitatively embodied Mr. Ford's distinctive expression, and played a key role in the infringing article. And lastly, the effect of the use on the potential market for the value of the copyrighted work was also great, because the Nation's liberal use of verbatim excerpts posed substantial potential for damage to the marketability of first serialization rights in the copyrighted work. (*Harper & Row v. Nation Enterprises*, *471 U.S. 539, 1985)*

Q: What are published works?

A: Those works which, with the consent of the authors, are made available to the public by wire or wireless means in such a way that members of the public may access these works from a place and time individually chosen by them: provided, that availability of such copies has been such, as to satisfy the reasonable requirement of the public, having regard to the nature of the work. *(Sec. 171.7, IPC)*

Q: What is the difference between public performance and communication to the public of a performance?

A:

PUBLIC PERFORMANCE	COMMUNICATIONS TO THE PUBLIC OF A PERFORMANCE
Performance at a place or at places where persons outside the normal circle of a family and that family's closest social acquaintances are or can be present.	The transmission to the public, by any medium, otherwise than by broadcasting, of sounds of a performance or the representations of sounds fixed in a sound recording.
It is performed at a specific time and place. *(e.g. The Pacquiao-Clottey Match in Dallas* Texas Stadium)	The communication can be accessed through wired or wireless means at a time and place convenient to the viewer *(e.g. The Pacquiao-Clottey Match watched via YouTube)*

Q: May a copyright be transferred/assigned?

A: It 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. *(Sec. 180.1, IPC)*

Q: Is copyright similar with the material object?

A: No, 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 or of one or several copies of the work imply transfer or assignment of the copyright. *(Sec. 181, IPC)*

Q: What are the requisites for a transfer of copyright to take effect?

A:

1. If inter vivos, must be in writing; and
2. Filed in National Library upon payment of prescribed fees. (*Sec. 182, IPC*)

Q: Is filing of the assignment or license of copyright a mandatory requirement?

A: No, Section 182 uses the permissive word "may" in reference to the filing of the deed of assignment or transfer of copyright, this filing should not be understood as mandatory for validity and enforceability. The filing is entirely optional for the parties and may be useful only for evidentiary and notification purposes. *(Amador, Intellectual Property Fundamentals, 2007)*

Q: What is the limitation regarding submission of a literary, photographic or artistic work to a newspaper, magazine or periodical for publication?

A: Unless a greater right is expressly granted, such submission shall constitute only a license to make a single publication. *(Sec. 180.3, IPC)*

Note: If two 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. *(Ibid.)*

Q: What is copyright infringement?

A: It is 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. *(Habana v. Robles, G.R. No. 131522, July 19, 1999)*

Q: What does substantial reproduction mean?

A: It is not necessarily required 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". *(Habana v. Robles, G.R. No. 131522, July 19, 1999)*

Q: What is plagiarism?

A: It is the practice of claiming or implying original authorship of (or incorporating material from) someone else's written or creative work, in whole or in part, into one's own *without adequate acknowledgment.*

Q: What is the difference between copyright infringement and plagiarism?
A:

COPYRIGHT INFRINGEMENT	PLAGIARISM
The unauthorized use of copyrighted material in a manner that violates one of the copyright owner's exclusive rights, such as the right to reproduce or perform the copyrighted work, or to make derivative works that build upon it.	The use of another's information, language, or writing, when done without proper acknowledgment of the original source.
Copyright infringement is a very broad term that describes a variety of acts. It may be duplication of a work, rewriting a piece, performing a written work or doing anything that is normally considered to be the exclusive right of the copyright holder.	Plagiarism is specific as it refers only to using someone else's work without proper acknowledgement.
There is no copyright infringement on public documents.	Public documents can be plagiarized so long as it is not acknowledged.

Q: What are the available remedies in case of copyright infringement?

A:
1. Injunction
2. 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
3. Impounding during the pendency of the action sales invoices and other documents evidencing sales
4. Destruction without any compensation all infringing copies
5. Moral and exemplary damages *(Sec. 216.1)*; or
6. Seizure and impounding of any article, which may serve as evidence in the court proceedings. *(Sec. 216.2)*

Q: What are the criminal penalties in case of copyright infringement?

A:
1. 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.
2. Imprisonment of three (3) years and one (1) day to six (6) years plus a fine ranging from One hundred fifty thousand pesos to Five hundred thousand (P500,000) for the second offense.
3. Imprisonment of six (6) years and one day to nine (9) years plus a fine ranging from Five hundred thousand pesos (P500,000) to P1,500,000 for the third offense.
4. In all cases, subsidiary imprisonment in cases of insolvency.

Q: What is affidavit evidence?

A: An affidavit made before the notary public in actions for infringement, reciting the facts required to be stated under the IPC. *(Sec. 216.1)*

Note: As a prima facie proof, the affidavit shifts the burden of proof to the defendant, to prove the ownership of the copyrighted work.

SPECIAL LAWS

I. THE CHATTEL MORTGAGE LAW (ACT 1508 IN REL. TO ARTS. 1484, 1485, 2140 AND 2141 OF THE CIVIL CODE)

A. ESSENTIAL REQUISITES

Q: What are the essential requisites for a valid chattel mortgage?

A:

1. Constituted to secure fulfillment of the principal obligation
2. Mortgagor is the absolute owner of the property
3. Mortgagor has free disposal of the property, in the absence thereof, that he be legally authorized for such purpose
4. That it involves a personal property. *(Sec. 2085,NCC)*

B. FORMAL REQUISITES

Q : What are the formal requisites for a valid chattel mortgage?

A:

1. Affidavit of good faith
2. Registration with the Chattel Mortgage Registry
3. If necessary, additional registration with the proper government agency

Q: What is an affidavit of good faith?

A: A certificate included in the chattel mortgage contract executed by both mortgagor and mortgagee stating that:

1. The obligation is valid, just and subsisting; and
2. It is not one entered into for purposes of fraud.

Q: What is the effect of absence of affidavit of good faith?

A: It does not affect the validity of the chattel mortgage but the same will be unenforceable against third persons.

Q: What is the status of an unrecorded CM?

A: The mortgage is valid and binding between the parties. Registration is necessary only for the purpose of binding third person. *(Filipinas Marble Corp. v. IAC, G.R. No. L- 68010, May 30, 1986)* Knowledge, however is equivalent to registration.

C. REGISTRATION, WHEN AND WHERE

Q: What is the period within which to make registration and where?

A: There is no specific time within which a chattel mortgage should be recorded but the law is substantially complied with if registration is made:

1. Before the mortgagor has complied with his principal obligation; and
2. No right of innocent third parties is prejudiced.

Q: What is the dual registration rule?

A:

GR: The property must be registered twice; first, in the place where mortgagor resides and second, in the place where property is situated. *(Sec. 4, Act 1508)*

XPN: First, if the mortgagor resides in the same place where the property is located; second, if the amount of the loan is above P 500,000.00, registration which should be made in the city or municipality where the property is situated. (*Sec. 116, P.D. 1159)*

D. AFTER-ACQUIRED PROPERTY

Q: Can the CM cover after-acquired properties?

A:

GR: No, because Section 7 of Act 1508 provides:
A chattel mortgage shall be deemed to cover only the property described therein and not like or substituted property thereafter acquired by the mortgagor and placed in the same depository as the property originally mortgage.

XPN: Where the after-acquired property is in renewal of, or in substitution for, goods on hand when the mortgage was executed, or is purchased with the proceeds of the sale of such goods. *(Torres v. Limjap, G.R. No. 34385, Sept. 21, 1931)*

E. AFTER-INCURRED OBLIGATION

Q: Can the CM cover after-incurred obligations?

A: No, the affidavit of good faith in a CM makes it obvious that the debt referred to in the law is

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current, not an obligation that is yet merely contemplated. *(Acme Shoe v. CA, G.R. No. 103576, Aug. 22, 1996)*

Q: What then is the consequence of a CM covering after-incurred obligations?

A: A promise expressed in a CM to include debts that are yet to be contracted can be a binding commitment that can be compelled upon. The security itself, however, does not come into existence or arise until after a CM agreement covering newly contracted debt is executed either by concluding a fresh CM or by amending the old contract conformably with the form prescribed by the CM law. The remedy of foreclosure can only cover the debts extant at the time of constitution and during the life of the CM sought to be foreclosed.

F. RIGHT OF JUNIOR MORTGAGEE

Q: What is the right of a subsequent attaching creditor?

A: A subsequent attaching creditor acquired the properties in question subject to the creditor's mortgage lien as it existed thereon at the time of the attachment. What may be attached in this case is only the equity or right of redemption of the mortgagor. *(Allied Banking Corporation v. Salas, G.R. No. L-49091, Dec. 13, 1988)*

G. FORECLOSURE PROCEDURE

Q: When and how is foreclosure of CM conducted?

A: After 30 days from the time the condition is broken:

1. At a public auction by a public officer
2. Provided at least 10 days notice of the time, place, and purpose of such sale has been posted at two or more public places in such municipality
3. At a public place in the municipality where the mortgagor resides, or where the property is situated

H. REDEMPTION

Q: Is there a right of redemption in CM?

A: There is no right of redemption in Chattel Mortgage. There is only an equity of redemption.

Q: When is equity of redemption may be exercised?

A: Equity of redemption may be exercised by the mortgagor after his default in the performance of his obligation but before the sale of the mortgaged property or confirmation of sale.

Q: Who may redeem?

A: The following may redeem if the condition of the mortgage is broken:

1. Mortgagor
2. A person holding subsequent mortgage
3. A subsequent attaching creditor *(Sec. 13, Act 1508)*

I. CLAIM FOR DEFICIENCY

Q: Is the mortgagee entitled to recover the deficiency?

A:
<u>**GR**</u>: Yes, mortgagee is entitled to recover deficiency.

<u>**XPN:**</u>

1. Recto Law
2. In accommodation mortgages, the accommodation mortgagor is liable only to the extent of the value of the mortgaged property;
3. Due to death of mortgagor. *(Vda. De Jacob v. CA, G.R. No. 88602, Apr. 6, 1990)*

Q: When does the Recto Law apply (Articles 1484 & 1485 of the civil code Civil Code)?

A:

1. Sale of personal property, the price of which is payable in two or more installments

2. Contracts purporting to be leases of personal property with option to buy (*Art. 1485, NCC)*

Q: What are the requisites for the sale to be covered under the Recto Law?

A:

1. Sale of personal property
2. Payable in installments
3. CM constituted over the same property

Note: It does not contemplate a sale on straight term in which the balance, after payment of initial sum, should be paid in its totality at the time specified in the promissory note. *(Levy Hermanos*

Inc. v. Lazaro Blas Gervaci, G.R. No. 46306, Oct. 27, 1939)

Q: Under the Recto Law, what are the remedies of the unpaid seller?

A:

1. Exact fulfillment of the obligation, should the vendee fail to pay (action for specific performance)
2. Cancel the sale, should the vendee's failure to pay cover two or more installments (rescission); or
3. Foreclose the chattel mortgage on the thing sold, should the vendee's failure to pay cover 2 or more installments.

Q: Can the unpaid seller avail of all remedies?

A: No, the remedies are alternative.

Note: However, recovery of property through a replevin case preparatory to foreclosure will not bar the other remedies if there was no actual foreclosure. If seller-mortgagee opts to file an action for specific performance, he shall be deemed to have waived his right as a mortgagee but may still levy on the mortgaged property (on execution).

Q: Is the mortgagee's letter informing the mortgagor of his intent to foreclose is already considered a foreclosure of the chattel?

A: No. A mere offer by the mortgagor to surrender the chattel, not accepted by the mortgagee, does not preclude the mortgagee from bringing suit to recover the balance of the purchase price. *(Industrial Finance Corp v. Castor Tobias, G.R. No. L-41555, July 27 1977)*

II. REAL ESTATE MORTGAGE LAW (ACT 3135, AS AMENDED BY RA 4118)

A. COVERAGE

Q: What is real estate mortgage (REM)?

A: It is a contract whereby the debtor secures to the creditor the fulfillment of a principal obligation, specially subjecting to such security immovable property or real rights over immovable property which obligation shall be satisfied with the proceeds of the sale of said property or rights in case the said obligation is not complied with at the time stipulated.

Q: What is the nature of REM?

A: It creates real right over the property, such that in subsequent transfers by the mortgagor, the transferee must respect the mortgage.

B. REMEDIES AVAILABLE TO MORTGAGEE UPON DEFAULT OF THE MORTGAGOR

Q: What are the alternative remedies of the mortgagee?

A:

1. Mortgagor is living
   a. Foreclosure
      a. Judicial (Rule 68, ROC)
      b. Extrajudicial (Act 3135)
   b. Ordinary action for collection of money – effect is waiver of REM

2. Mortgagor is dead
   a. Waive the mortgage and claim the entire debt from the estate of the mortgagor as an ordinary claim
   b. Judicial foreclosure; and
   c. Rely on the mortgage. *(Sec. 7, Rule 86. ROC)*
   d. Extrajudicial foreclosure *(Act 3135)* before it is barred by prescription without right to file a claim for any deficiency. *(Vda. De Jacob v. CA, G.R. No. 88602, Apr. 6, 1990)*

C. NEED FOR SPECIAL POWER OF ATTORNEY

Q: Why is special of power of attorney needed?

A: Because an extrajudicial foreclosure may only be effected if the mortgage contract covering a real estate, clause is incorporated therein giving the mortgagee the power, upon default of the debtor to foreclose the mortgage by an extrajudicial sale of the mortgaged property *(Pineda, Credit Transactions and Quasi-contracts, 2006).*

D. AUTHORITY TO FORECLOSE EXTRAJUDICIALLY

Q: May the authority to sell may be done in a separate document but annexed to the contract of mortgage?

A: Yes *(Pineda, Credit Transactions and Quasi-contracts, 2006).*

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Q: Is the authority extinguished by the death of the mortgagor or mortgagee?

A: No, because it is an essential and inseparable part of a bilateral agreement *(G.R. No. L-21813, July 30, 1966).*

E. FORECLOSURE PROCEDURE

Q: What are the stages in extra-judicial foreclosure?

A:

1. Execution of contract of loan and REM agreement with the corresponding SPA.

2. Default of the mortgagor-debtor either by:
   a. Non-payment; or
   b. Violation of the terms of the loan or REM agreement.

3. Filing of petition for sale with clerk of court who acts as ex-officio sheriff (A.M. No. 99-10-05-00). Afterwards, the clerk of court will raffle it among the sheriffs, who shall conduct the foreclosure sale once given the authority to do so.

   Note: Petition is filed where the property is located. In case the mortgaged properties are located in different provinces, the venue of the extrajudicial foreclosure proceedings is the place where each of the mortgaged property is located.

   A mortgage action prescribes in 10 years from the time the right of action accrues, that is, from the time the mortgagor defaults in the payment of his obligation to the mortgagee and not from the date of the execution of the mortgage contract. *(Cando v. Spouses Olazo, G.R. No. 160741, Mar. 22, 2007)*

4. Compliance with certain jurisdictional requirements:
   a. *Publication* – in a newspaper of general circulation once a week for 3 consecutive weeks; and
   b. *Posting* – of the notice of sale for not less than 20 days in at least 3 public/conspicuous places in the province or municipality where property is located.

   Note: A certificate of posting is not indispensable for the validity of an extra judicial foreclosure sale of real property. What the law requires is the posting of the notice of sale and not the certificate of posting. *(DBP v. CA G.R. No. 125838 June 10, 2003)*

5. *Foreclosure* – the remedy available to the mortgagee by which he subjects the mortgaged property to the satisfaction of the obligation to secure which the mortgage was given. *(59 C.J.S. 482)*

6. *Registration of sale with the RD* – This pertains to the annotation of the sale to the TCT on file with the RD.

7. *Redemption* – The mortgagor reacquires or buys back the property, which may have passed under the mortgage.

8. *Consolidation of title* – By filing affidavit with RD. The Affidavit of Consolidation of Title must indicate the relevant dates to show mortgagor's failure to redeem within the allowable time. This enables the mortgagee to acquire full ownership over the property. His inchoate right ripens to full ownership.

9. *Cancellation of the title of the mortgagor and Issuance of a new title in favor of mortgagee* – The basis of which is the order of court confirming the sale.

10. *Petition for a writ of possession* – There is no need to file an ejectment suit. Here, the mortgagee employs force to oust the mortgagor from the property. This writ may be even issued during redemption period provided the mortgagee issued a bond, but the grant of which is discretionary on the part of the court. But if the petition for the writ is filed after the expiration of the redemption period, the issuance of which is ministerial on the part of the court. This writ can be issued without the issuance of a bond; in fact it can even be issued ex parte. The writ cannot be suspended even by the filing of the mortgagor of an action to annul the foreclosure sale.

Q: What is meant by *"once a week for three consecutive weeks"*?

A: A period of 7 days, inclusive of the first day of publication. The publication must be made 7 days apart. *(PNB v. CA, G.R. No. 108870, July 14, 1995)*

Q: Is there a need for personal notice?

A: No, because foreclosure of CM is an action *in rem* whereby mere publication is enough to confer jurisdiction over the subject matter. Personal notice to the parties is not necessary. *(GSIS v. CA, G.R. No. 40824, Feb. 23, 1989)*

Q: What happens when the foreclosure sale is postponed?

A: The notice of sale must be republished once a week for three consecutive weeks, otherwise, foreclosure is invalid. *(Tambunting v. CA, G.R. No. L-48278, Nov. 8, 1988)*

Q: Is the rule on republication absolute?

A:

GR: Yes.

XPN:

1. The sale was not finished and is continued the following day until completed; or
2. When there is waiver.

F. POSSESSION BY PURCHASER OF FORECLOSED PROPERTY

Q: Who retains possession of the foreclosed property?

A: Upon foreclosure, the mortgagor shall remain in possession of the property until the period to redeem expires and no redemption was made. If the winning bidder wants to take possession during the redemption period, he may execute a bond in the amount equivalent to the use of the property for 12 months, to indemnify the debtor in case it be shown that the sale was made without violating the mortgage or without complying with the requirements of the Act. Upon approval, a writ of possession will be issued in his favor.

G. REMEDY OF DEBTOR IF FORECLOSURE IS NOT PROPER

Q: What is the remedy of debtor if foreclosure is not proper?

A: If the winning bidder is able to secure possession, the mortgagor may petition that the sale is set aside and the writ of possession be cancelled on the ground that he wasn't in default or that the sale wasn't made in accordance with Act 3135. This must be filed within 30 days from issuance of the writ of possession

H. REDEMPTION

Q: Who may redeem?

A: The debtor, his successors-in-interest, or any judicial creditor or judgment creditor of said debtor, or any person having a lien on the property subsequent to the mortgage or deed of trust under which the property is sold, may redeem the same at any time within the term of 1 year from and after the date of the sale and such will be governed by the rules of Court.

Q: What is the amount of redemption price?

A: The redemption price would be the mortgaged obligation plus the interest as stipulated in the original obligation.

Q: What is the rule as to the redemption price in case the mortgagee is a banking institution?

A: Where the mortgagee is a banking institution, the redemption price is the amount fixed by the court in the order of execution or the amount due under the mortgaged deed. *(Tolentino v. CA, G.R. No. 171354, Mar. 7, 2007)*

Q: What is the redemption price in case of accomodation mortgagors?

A: Accommodation mortgagors are not liable for the payment of the loan of the debtor. The liability of the accommodation mortgagors extends only up to the loan value of their mortgaged property and not to the entire loan itself. Hence, it is only just that they be allowed to redeem their mortgaged property by paying only the winning bid price thereof (plus interest thereon) at the public auction sale. (*Belo v. PNB, G.R. No. 134330, Mar. 1, 2001)*

Q: When must the buyer exercise the right of redemption?

A: One year from the date of registration of certificate of sale.

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Note: The exercise of the right of redemption is an implied admission of the regularity of the foreclosure sale and estops the mortgagor from later impugning its validity on that ground. Redemption is inconsistent with the claim of the invalidity of the sale.

Q: When does the one year period for redemption not apply?

A: It does not apply to real estate mortgages constituted by juridical persons in favor of a bank, quasi-bank or trust entity. Right to redeem can only be exercised until but not after the registration of the certificate of sale or 3 months from foreclosure, whichever is earlier, under the following conditions:

1. Mortgagor must be a juridical person that is either a partnership or a corporation
2. Mortgagee is a bank, quasi-bank or trust entity; and
3. Foreclosure is done extra judicially.

Q: What is the effect of filing an action to annul the foreclosure sale during the one-year redemption period?

A: It will not toll the running of the one-year redemption period. *(MBTC v. Spouses Tan, G.R. No. 159934, June 26, 2008)*

Note: A judicial action instituted for the sole purpose of determining the amount of the redemption price, if filed before the expiration of the original period to redeem, has the effect of a valid exercise of the right to redeem and will suspend the running of the period of redemption even if unaccompanied by a simultaneous tender of the redemption price. However, before this rule can be made to apply, it is essential that the judicial action was instituted by the mortgagor in good faith and not merely designed to delay the redemptive period indefinitely. *(Heirs of Norberto Quisumbing v. PNB, G.R. No. 178242, Jan. 20, 2009)*

I. WRIT OF POSSESSION

Q: When is the issuance of the Writ of Possession a ministerial duty of the court?

A: The writ may be issued during redemption period provided the mortgagee gives a bond, the grant of which is discretionary on the part of the court. But if the petition for the writ is filed after the expiration of the redemption period, the issuance is ministerial on the part of the court

Q: What are the remedies availing in favor of third parties adversely affected by the order for the issuance of the writ of possession in favor of the winning bidder?

A:

1. Terceria to determine whether the sheriffs has rightly or wrongfully taken hold of the property not belonging to the judgment debtor or obligor; and
2. An independent separate action to vindicate their claim of ownership and/or possession over the foreclosed property. (*China Banking Corporation v. Ordinario, G.R. No. 121943, Mar. 24, 2003)*

   Note: A third party in possession of the property who is claiming a right adverse to that of the debtor/mortgagor may not be dispossessed on the strength of a mere ex parte possessory writ, since to do so would be tantamount to his summary ejectment. *(Penson v. Spouses Maranan, G.R. No. 148630, June 20, 2006).* The available remedies are cumulative.

Q: What is the effect of a pending action for annulment of sale?

A: the mortgagee is still entitled to writ of possession, without prejudice to the eventual outcome of the said case. *(Baldueza vs. CA, G.R. No. 155813, October 15, 2008)*

J. ANNULMENT OF SALE

Q: Is the filing of an action to nullify the extrajudicial sale a prejudicial question to the petition filed by the mortgagee for the issuance of the writ of possession?

A: No, a complaint for annulment of extrajudicial sale is a civil action and a petition for the issuance of writ of possession is but an incident to the land registration proceeding hence no prejudicial question can arise from the two actions. *(Pahang vs. Vestil GR. No. 148595, July 12, 2004).*

Q: Is the filing of the annulment of sale toll the 1 year redemption period?

A: No, Settled is the rule that the period within which to redeem the property sold at a sheriff's sale is not suspended by the institution to annul the foreclosure sale *(Metrobank vs. Sps. Tan, G.R. No. 178449, October 17, 2008).*

III. TRUTH IN LENDING ACT (RA 3765) (TILA)

A. PURPOSE

Q: What is the purpose of Truth in Lending Act (TILA)?

A: To protect persons from a lack of awareness of the true cost of credit and to prevent the uninformed use of credit.

B. OBLIGATION OF CREDITORS TO PERSON TO WHOM CREDIT IS EXTENDED

Q: When does TILA apply?

A: It applies to creditors who extend loans, sales on installments and other credit transactions.

Q: What are the items required to be disclosed?

A:

1. In credit sales:
   a. Cash price or delivered price;
   b. Credit for down-payment or trade-in;
   c. Total amount to be financed;
   d. Charges not incident to the sale;
   e. *Finance charges* – amounts to be paid by the debtor incident to the extension of credit such as interests, discounts, collection fees, credit investigation fees and attorney's fees;
   f. Percentage of the finance charges o the amount to be financed;
   g. Effective interest rate;
   h. Repayment program; and
   i. Default or delinquency charges or late payments. *(Sec. 4, TILA)*

2. In consumer loans:
   a. Amount of credit;
   b. Charges;
   c. Amount to be financed;
   d. Amount of finance charge;
   e. Effective interest rates;
   f. Percentage of finance charge and amount to be financed;
   g. Default or delinquency charges; and
   h. Description of security.

Q: When and how should disclosure be made?

A: Prior to the consummation of the transaction and in a clear statement in writing.

C. COVERED AND EXCLUDED TRANSACTIONS

Q: What are the credit transactions covered by TILA?

A:

1. Loans, mortgages, deeds of trust, advances and discounts;
2. Conditional sales contracts, any contract to sell, or sale or contract of sale of property or services, either for present or future delivery, under which part or all of the price is payable subsequent to the making of such sale or contract;
3. Any rental-purchase contract;
4. Any contract for the hire, bailment or leasing of property;
5. Any option, demand, lien, pledge or other claim against, or for delivery of, property or money;
6. Any purchase, or other acquisition of, or any credit upon the security of, any obligation or claim arising out of any of the foregoing; and
7. Any transaction or series of transactions having a similar purpose or effect. *(Sec. 3)*

Q: What transactions are not covered by TILA?

A:

1. Those which do not involve the payment of any finance charges by the debtor; and
2. Where the debtor is the one specifying a definite and fixed set of credit terms such as bank deposits, insurance contracts, sale of bonds, etc.

D. CONSEQUENCES OF NON-COMPLIANCE WITH OBLIGATION

Q: What is the effect of non-compliance with TILA?

A:

ON TRANSACTION	ON CREDITOR
Failure to disclose to any person any information in violation of TILA or any regulation issued. (Sec. 6 [a])	
Charges not itemized cannot be collected. If already paid, can be recovered	Liable in the amount of P100 or in an amount equal to twice the finance charged required by such creditor, whichever is the greater, however, such liability shall not

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	exceed P2,000 on any credit transaction.
Willful violation of any provision of TILA or any regulation issued.	
Except as provided in subsec. (a), nothing shall affect the validity or enforceability of any contract or transactions.	Shall be liable to a fine of not less than P1,000 or more than P5,000 or imprisonment for not less than 6 months, nor more than one year or both.

Q: When must an action for violation of the Truth in Lending Act be brought?

A: Within 1 year from the date of the occurrence of the violation.

IV. ANTI-MONEY LAUNDERING. ACT OF 2001 (R.A. 9160 AS AMENDED BY RA 9194)

A. POLICY OF THE LAW

Q: What is the policy for the enactment of the Anti-Money Laundering Act?

A: To protect and preserve the integrity and confidentiality of bank accounts and to ensure that the Philippines shall not be used as a money laundering site for the proceeds of any unlawful activity. *(Sec. 1 R.A. 9160, as amended)*

B. COVERED INSTITUTIONS

Q: What are the covered institutions?

A:

1. Banks
2. Non-banks
3. Quasi-banks
4. Trust entities
5. All other institutions, their subsidiaries and affiliates supervised or regulated by BSP
6. Insurance companies and all other institutions supervised and regulated by the Insurance Commission
7. Securities dealers, brokers, salesmen, investment houses and other similar entities managing securities or rendering services as investment agent, advisor, or consultant
8. Mutual funds, closed-end investment companies, common trust funds, pre-need companies and other similar entities
9. Foreign exchange, corporations, money changers, money payments, remittance and transfer companies and other similar entities; and
10. Other entities administering or otherwise dealing in currency, commodities or financial derivatives based thereon, valuable objects, cash substitutes, and other similar monetary instruments or property supervised or regulated by SEC. *(Sec. 3 R.A. 9160, as amended)*

C. OBLIGATION OF COVERED INSTITUTIONS

Q: What is the obligation of the covered institutions?

A: They are mandated by the AMLA to submit covered and suspicious transaction reports to the AMLC.

D. COVERED TRANSACTIONS

Q: What are Covered Transactions?

A: These are single transactions in cash or other equivalent monetary instrument involving a total amount in excess of 500,000.00 within 1 banking day.

Note: These transactions are required to be reported to the Anti-Money Laundering Council.

E. SUSPICIOUS TRANSACTIONS

Q: What are Suspicious Transactions?

A: Regardless of amount, if any of the following is present:

1. No underlying economic, trade or legal justification
2. Client not properly identified; numbered accounts are allowed provided client is identified
3. Transaction is not commensurate with financial capability of the client
4. Transaction is so structured that it cannot be reported to the AMLC
5. Transaction which deviates from usual profile of the client
6. Relates to unlawful activity as defined by law
7. Analogous transactions

F. WHEN IS MONEY LAUNDERING COMMITTED

Q: What is the meaning of Money Laundering?

A: A crime whereby the proceeds of unlawful activity are transacted, making them appear to have come from lawful transaction. *(Sec. 4 R.A. 9160, as amended)*

Q: How is money laundering committed?

A: It is committed by the following persons:

1. Any person knowing that the monetary instrument or property represents, involves, or relates to, the proceeds of any unlawful activity, transacts or attempts to transact said monetary instrument or property

2. Any person knowing that any monetary instrument or property involves the proceeds of any unlawful activity performs or fails to perform any act as a result of which he facilitates the offense referred to in No. 1 above

3. Any person knowing that any monetary instrument or property is required under this Act to be disclosed and filed with the Anti-Money Laundering Council (AMLC), fails to do so. *(Sec 4 R.A. 9160, as amended)*

G. UNLAWFUL ACTIVITIES OR PREDICATE CRIMES

Q: What are considered as unlawful activities or predicate crimes under AMLA?

A: These refer to any act or omission or series or combination thereof involving or having direct relation to the following:

1. Kidnapping for ransom
2. Drug trafficking and related offenses
3. Graft and corrupt practices
4. Plunder
5. Robbery and Extortion
6. Jueteng and Masiao
7. Piracy
8. Qualified theft
9. Swindling
10. Smuggling
11. Violations under the Electronic Commerce Act of 2000
12. Hijacking, destructive arson, and murder, including those perpetrated by terrorists against non-combatant persons and similar targets
13. Fraudulent practices and other violations under the SRC of 2000;
14. Felonies or offenses of a similar nature that are punishable under the penal laws of other countries. *(Sec. 3(i) R.A. 9160, as amended)*

Q: Alvin is jobless but is reputed to be a jueteng operator. He has never been charged or convicted of any crime. He maintains several bank accounts amounting to P100 Million. AMLC charged Alvin with violation of the Anti-Money Laundering Law. Can Alvin move to dismiss the case on the ground that he has no criminal record?

A: No. The contention of Alvin is not tenable because under AMLA, "money laundering crime" committed when the proceeds of an "unlawful activity," like jueteng operations, are made to appear as having originated from legitimate sources.

The money laundering crime is separate from the unlawful activity of being a jueteng operator, and requires no previous conviction for the unlawful activity. *(Sec. 3, AMLA)*

Q: In disclosing Alvin's bank accounts to the AMLC, did the bank violate any law?

A: No, the bank did not violate any law. The bank being specified as a "covered institution" under the Anti-Money Laundering Law, is obliged to report to the AMLC covered and suspicious transactions, without thereby violating any law. This is one of the exceptions to the Secrecy of Bank Deposit Act.

H. ANTI-MONEY LAUNDERING COUNCIL

Q: What is the purpose of the law on creating the AMLC?

A: AMLC is created to:
1. To protect and preserve the integrity and confidentiality of bank accounts;
2. To ensure that the Philippines shall not be used as a money laundering site for proceeds of any unlawful activity; and
3. To extend cooperation in transnational investigation and prosecution of person involved in money laundering activities wherever committed.

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I. FUNCTIONS

Q: What are the functions of AMLC?

A:

1. To require and receive reports of suspicious transactions from covered institutions

   Note: Covered institutions include, (banks and all other institutions and their subsidiaries and affiliates supervised or regulated by BSP; insurance companies and all other institutions supervised or regulated by the IC; and securities dealers and other entities supervised or regulated by the SEC)

2. To issue orders addressed to the Supervising Authority or the covered institution
3. To institute civil forfeiture proceedings and all other remedial proceedings through the OSG
4. To cause the filing of complaints with the DOJ or the Ombudsman for the prosecution of money laundering offenses
5. To investigate suspicious transactions and covered transactions deemed suspicious after an investigation by AMLC
6. To apply before the CA, *ex parte*, for the freezing of any monetary instrument/property alleged to be proceeds of any unlawful activity as defined in the AMLA
7. To implement such measures as may be necessary and justified to counteract money laundering
8. To receive and take action in respect of any request for assistance from foreign states in their own anti-money laundering operations
9. To develop educational programs on the pernicious effects of money laundering.
10. To enlist the assistance of any branch, department, bureau, office, agency or instrumentality of the government, including GOCCs in undertaking any and all anti-money laundering operations
11. To impose administrative sanctions for the violation of laws, rules, regulations and orders and resolutions issued pursuant thereto. *(Sec. 7 R.A. 9160, as amended)*
12. To examine or inquire into bank deposits/investments upon order of any competent court in cases of violation of the AMLA, when it has been established that there is probable cause that the deposits/investments are related to an unlawful activity. *(Sec. 11 R.A. 9160, as amended)*

Note: No court order, however, is necessary in cases involving kidnapping for ransom; narcotics offenses; and hijacking, destructive arson and murder, including those perpetrated by terrorists against non-combatant persons and similar targets.

J. FREEZING OF MONETARY INSTRUMENT OR PROPERTY

Q: Who has jurisdiction for violations of AMLA?
A:

1. *RTC* – all cases on money laundering
2. *Sandiganbayan* – Those committed by public officers and private persons in conspiracy with them. (*Sec. 5 R.A. 9160, as amended)*

Q: Which court has the jurisdiction to issue a freeze order?

A: It is solely the CA which has the authority to issue a freeze order upon application ex parte by the AMLC and after determination that probable cause exists.

It also has the exclusive jurisdiction to extend existing freeze orders previously issued by the AMLC *vis-à-vis* accounts and deposits related to money-laundering activities. *(Republic v. Cabrini Green & Ramos, G.R. No. 154522, May 5, 2006)*

K. AUTHORITY TO INQUIRE INTO BANK DEPOSITS

Q: When may the Anti-Money Laundering Council (AMLC) inquire into bank deposits?

A:
GR: Only upon order of any competent court in cases of violation of R.A. 9160, as amended.

XPN: No need of court order in cases of Kidnapping, Hijacking, Drugs, Arson, Murder. *(Sec. 11 R.A. 9160, as amended)*

V. FOREIGN INVESTMENTS ACT

A. POLICY OF THE LAW

Q: What is the state policy of the law?

A:

1. It is the policy of the State to attract, promote and welcome productive investments in activities which significantly contribute to national industrialization and socio-economic development to the extent that foreign investment is allowed in such activity by the Constitution and relevant laws from
    a. Foreign individuals
    b. Partnerships
    c. Corporations
    d. Governments, including their political subdivisions

2. Foreign investments shall be encouraged in the enterprises that significantly expand livelihood and employment opportunities for Filipinos by
    a. Enhancing economic value of farm products;
    b. Promoting the welfare of Filipino consumers;
    c. Expanding the scope, quality and volume of exports and their access to foreign markets;
    d. And/or transferring relevant technologies in agriculture, industry and support services.

3. Foreign investments shall be welcome as a supplement to Filipino capital and technology in those enterprises serving mainly the domestic market.

4. **GR:** There are no restrictions on extent of foreign ownership of export enterprises. In domestic market enterprises, foreigners can invest as much as 100% equity

    XPN: In areas included in the negative list.

5. Foreign-owned firms catering mainly to the domestic market shall be encouraged to undertake measures that will gradually increase Filipino participation in their businesses by
    a. Taking in Filipino partners,
    b. Electing Filipinos to the board of directors,
    c. Implementing transfer of technology to Filipinos,
    d. Generating more employment for the economy and
    e. Enhancing skills of Filipino workers. *(Sec. 2, RA 7042)*

B. DEFINITION OF TERMS

Q: What is foreign investment?

A: It is an equity investment made by non-Philippine national in the form of foreign exchange and/or other assets actually transferred to the Philippines and duly registered with the Central Bank which shall assess and appraise the value of such assets other than foreign exchange.

Q: What are considered as "doing or transacting business" in the Philippines for foreign corporations?

A:

1. Soliciting orders, service contracts, and opening offices
2. Appointing representatives, distributors domiciled in the Philippines or who stay for a period or periods totaling 180 days or more
3. Participating in the management, supervision or control of any domestic business, firm, entity, or corporation in the Philippines
4. Any act or acts that imply a continuity of commercial dealings or arrangements, and contemplate to some extent the performance of acts or works or the exercise of some functions normally incident to and in progressive prosecution of, the purpose and object of its organization *(Sec 3 (c), R.A. 7042).*

Q: What are considered as "NOT doing or transacting business" in the Philippines for foreign corporations?

A:

1. Mere investment as shareholder and exercise of rights as investor
2. Having a nominee director or officer to represent its interest in the corporation

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3. Appointing a representative or distributor which transacts business in its own name and for its own account
4. Publication of a general advertisement through any print or broadcast media
5. Maintaining a stock of goods in the Philippines solely for the purpose of having the same processed by another entity in the Philippines
6. Consignment by the foreign corporation of equipment with a local company to be used in the processing of products for export
7. Collecting information in the Philippines
8. Performing services auxiliary to an existing isolated contract of sale which are not on a continuing basis.

Q: What is Export Enterprise?

A: It is an enterprise wherein a manufacturer, processor or service [including tourism] enterprise exports sixty percent (60%) or more of its output, or wherein a trader purchases products domestically and exports sixty per cent (60%) or more of such purchases. *(Sec 3 (e), R.A. 7042).*

Q: What is domestic market enterprise?

A: It is an enterprise which produces goods for sale, or renders services to the domestic market entirely or if exporting a portion of its output fails to consistency export at least 60% thereof. *(Sec 3 (e), R.A. 7042).*

Non-Philippine nationals may own up to one hundred percent [100%] of domestic market enterprises unless foreign ownership therein is prohibited or limited by the Constitution and existing law or the Foreign Investment Negative. *(Sec. 7, R.A. 7042)*

C. REGISTRATION OF INVESTMENTS OF NON-PHILIPPINE NATIONALS

Q: Who are considered Philippine nationals?

A:

1. A citizen of the Philippines
2. A domestic partnership or association wholly owned by citizens of the Philippines;
3. Corporations organized under Philippine laws of which 60% of the capital stock outstanding and entitled to vote is owned and held by Filipino citizens;
4. Corporations organized abroad and registered as doing business in the Philippines under the Corporation Code of which 100% of the capital stock entitled to vote belong to Filipinos.

Note: However, it provides that where a corporation and its non-Filipino stockholders own stocks in a SEC-registered enterprise, at least 60% of the capital stock outstanding and entitled to vote of both corporations and at least 60% of the members of the board of directors of both corporations must be Filipino citizens (DOUBLE 60% RULE).

Q: Who are considered non-Philippine nationals?

A: Those who do not belong to the definition of a Philippine national.

Q: What is needed for a non-Philippine national but not disqualified by law may do business or invest in a domestic enterprise up to 100% of its capital without need of prior approval?

A: Register with the Securities and Exchange Commission (SEC) or with the Bureau of Trade Regulation and Consumer Protection (BTRCP) of the Department of Trade and Industry in the case of single proprietorship.

Q: May SEC or BTRCP impose any limitations on the extent of foreign ownership in an enterprise additional to those provided in *R.A. 7042*?

A:

GR: The SEC or BTRCP, as the case may be, shall not impose any limitations on the extent of foreign ownership in an enterprise additional to those provided in *R.A. 7042*.

XPNs:

1. That any enterprise seeking to avail of incentives under the Omnibus Investment Code of 1987 must apply for registration with the Board of Investments (BOI), which shall process such application for registration in accordance with the criteria for evaluation prescribed in said Code;

2. That a non-Philippine national intending to engage in the same line of business as an existing joint venture, in which he or his majority shareholder is a substantial partner, must disclose the fact and the names and addresses of the partners in the existing joint

venture in his application for registration with the SEC.

D. FOREIGN INVESTMENT IN EXPORT ENTERPRISES

Q: What are rules regarding foreign registration in export enterprises?

A:

1. Foreign investment in export enterprises whose products and services do not fall within Lists A and B of the Foreign Investment Negative List is allowed up to 100% ownership

2. Export enterprises which are non-Philippine nationals shall register with BOI and submit the reports that may be required to ensure continuing compliance of the export enterprise with its export requirement.

3. BOI shall advise SEC or BTRCP, as the case may be, of any export enterprise that fails to meet the export ratio requirement.

4. The SEC or BTRCP shall thereupon order the non-complying export enterprise to reduce its sales to the domestic market to not more than 40% of its total production; failure to comply with such SEC or BTRCP order, without justifiable reason, shall subject the enterprise to cancellation of SEC or BTRCP registration, and/or the penalties provided in this law. *(Sec 6, R.A. 7042)*

Q: What are the penalties provided under R.A. 7042?

A:

1. A person who violates any provision of *R.A. 7042* or of the terms and conditions of registration or of the rules and regulations issued pursuant thereto, or aids or abets in any manner any violation shall be subject to a fine not exceeding P100,000.

2. If the offense is committed by a juridical entity, it shall be subject to a fine in an amount not exceeding 1/2 of 1% of total paid-in capital but not more than P5,000,000.00 The president and/or officials responsible therefor shall also be subject to a fine not exceeding P200,000.00

3. In addition to the foregoing, any person, firm or juridical entity involved shall be subject to forfeiture of all benefits granted under R.A. 7042. *(Sec 14)*

E. FOREIGN INVESTMENT DOMESTIC MARKET ENTERPRISES

Q: What is the rule regarding foreign investment in domestic market enterprises?

A: Non-Philippine nationals may own up to 100% of domestic market enterprises unless foreign ownership therein is prohibited or limited by the Constitution and existing law or the Foreign Investment Negative List.

F. FOREIGN INVESTMENT NEGATIVE LIST

Q: What is Foreign Investment Negative List?

A: It is a list of areas of economic activity whose foreign ownership is limited to a maximum of 40% of the equity capital of the enterprises engaged therein.

Q: What are included in the List A?

A: See Appendix G

Q: What are included in the List B?

A:

1. Defense-related activities, requiring prior clearance and authorization from the Department of National Defense to engage in such activity, such as the :
   a. Manufacture
   b. Repair
   c. Storage
   d. Distribution of
      i. Firearms
      ii. Ammunition
      iii. Lethal weapons
      iv. Military ordnance
      v. Explosives
      vi. Pyrotechnics
      vii. Similar materials

   <u>**XPN:**</u> Such manufacturing or repair activity is specifically authorized, with a substantial export component, to a non Philippine national by the Secretary of National Defense; or

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2. Those that have implications on public health and morals, such as the manufacture and distribution of
   a. Dangerous drugs
   b. All forms of gambling
   c. Nightclubs
   d. Bars
   e. Beer houses
   f. Dance halls
   g. Sauna and steam bathhouses
   h. Massage clinics. *(Sec. 8)*

Note: There is no significant difference between List A and List B.

Q: What is the rule regarding small and medium-sized domestic market enterprises?

A:
GR: Small and medium-sized domestic market enterprises with paid-in equity capital less than the equivalent of US$200,000.00, are reserved to Philippine nationals.

XPN:
1. They involve advanced technology as determined by the DOST
2. They employ at 50 direct employees, then a minimum paid-in capital of US$100,000.00 .*(Sec. 8)*

APPENDIX A:

NEGOTIABLE WAREHOUSE RECEIPT AND NON-NEGOTIABLE WAREHOUSE RECEIPT

NEGOTIABLE WAREHOUSE RECEIPT	NON-NEGOTIABLE WAREHOUSE RECEIPT
May be acquired through negotiation	May be acquired through transfer or assignment
Rights of the holder of the receipt: 1. *If indorsed:* a. Acquires title to the goods as the person negotiating. *(Sec. 41)* b. Acquires the direct obligation of the warehouseman to hold possession of the goods for him as if the warehouseman directly contracted with him. *(Ibid.)* 2. *If not indorsed:* He may compel indorsement; otherwise, he would acquire title as that of an assignee (*Section 43).*	Rights of transferee: 1. Acquires title to the goods subject to the terms of any agreement with the transferor. *(Sec. 42)* 2. Acquires the right to notify the warehouseman of the transfer and thereby acquires the direct obligation of the warehouseman to hold possession of the goods for him. *(Sec. 42)* **Note:** Prior to notice, the title of the transferee may be defeated by the levy of an attachment or execution upon the goods by a creditor of the transferor or by a notification to the warehouseman by the transferor or a subsequent purchaser from the transferor of a subsequent sale of the goods by the transferor. *(Sec. 42)*
Defeats the lien of the seller of the goods covered thereby. *(Sec. 49)*	Acquires the title as that of his transferor.
Good covered cannot be garnished, attached or levied on execution by execution, unless: 1. Receipt is surrendered. 2. Its negotiation is enjoined by the court. 3. The goods are impounded by the court. *(Sec. 25)* **Note:** This shall not apply if the person depositing is not the owner of the goods or one who has no right to convey title to the goods binding upon the owner.	Pending notification to the warehouseman, goods can be. *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.
Protects the purchaser in good faith and for value.	The assignee only steps into the shoes of the assignor.

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APPENDIX B:

LIABILITIES OF THOSE SECONDARILY LIABLE

ABSOLUTE LIABILITY	LIMITED LIABILITY
1. Drawer of a BOE warrants: a. The existence of payee and his then capacity to indorse b. That the instrument will be accepted or paid by the party primarily liable; and c. That if dishonored, he pay the party entitled to be paid. *(Sec. 61)*	1. Qualified Indorser warrants that: a. Instrument is genuine; b. he has good title to it; c. capacity to contract of all prior parties; and d. no knowledge of any fact which would impair the validity of the instrument. *(Sec.65)* **Note:** He is liable to all parties who derive their title through his indorsement.
2. General indorser a. Warrants that: i. Instrument is genuine ii. He had good title to it iii. All prior parties had capacity to contract iv. Instrument, at the time of indorsement, was valid and subsisting; b. On due presentment, it shall be accepted or paid, or both according to its tenor c. if the instrument is dishonored and the necessary proceedings on dishonor be duly taken, he will pay the holder. *(Sec. 66)*	2. *Person negotiating by delivery* – Same warranties as a qualified indorser. Butunlike a qualified indorser, a person negotiating by mere delivery is liable only to his immediate transferee. *(par. 2, Sec. 65)* **Note:** Person negotiating by mere delivery and a qualified indorser's secondary liability is limited, namely, to their warranties
3. Irregular indorser a. In an order instrument, liable to the payee and all subsequent parties b. If bearer instrument or payable to order of maker or drawer, liable to all parties subsequent to the maker or drawer c. If he signs for accomodation of the payee, liable to all parties subsequent to payee. *(Sec. 64)*	

APPENDIX C

MARINE AND LIFE INSURANCE

LIFE INSURANCE	FIRE/MARINE INSURANCE
It is a contract of investment not contract of indemnity.	It is a contract of indemnity.
Always regarded as valued policy.	May be open or valued.
May be transferred or assigned to any person even if he has no insurable interest.	The transferee or assignee must have an insurable interest in the thing insured.
The consent of the insurer is not essential to the validity of the assignment of a life policy unless expressly required.	Consent, in the absence of waiver by the insurer, is essential in the assignment of the policy.
Insurable interest in the life or health of the person insured need not exist after the insurance takes effect or when loss occurs.	Insurable interest in the property insured must exist not only when the insurance takes effect but also when the loss occurs.
Insurable interest need not have any legal basis.	Insurable interest must have a legal basis.
Contingency that is contemplated is a certain event, the only uncertainty being the time when it will take place.	The contingency insured against may or may not occur.
The liability of the insurer to make payment is certain, the only uncertain element being when such payment must be made.	Liability is uncertain because the happening of the peril insured against is uncertain.
May be terminated by the insured but cannot be cancelled by the insurer and is usually a long term contract.	May be cancelled by either party and is usually for a term of one year
The "loss" to the beneficiary caused by the death of the insured can seldom be measured accurately in terms of cash value.	The reverse is generally true of the loss of property, i.e., it is capable of pecuniary estimation.
The beneficiary is under no obligation to prove actual financial loss as a result of the death of the insured in order to collect the insurance.	The insured is required to submit proof of his actual pecuniary loss as a condition precedent to collecting the insurance.

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APPENDIX D

CORPORATION AND PARTNERSHIP

PARTNERSHIP	CORPORATION
As to creation	
Created by mere agreement of the parties	Created by law or by operation of law
Commencement of juridical personality	
From the moment of meeting of minds of the partners	From the date of issuance of the certificate of incorporation by the SEC
Number of incorporators	
May be organized by at least two persons	**GR:** Requires at least 5 incorporators but not more than 15 **XPN:** Corporation sole
Powers	
GR: May exercise *any* power authorized by the partners. **XPN:** Acts which are contrary to: law, morals, good customs, public order, public policy	May exercise *only such* powers as may be granted by law and its articles of incorporation, implied therefrom or incidental thereto.
Management	
When management is not agreed upon, every partner is an agent of the partnership	Power to do business and manage its affairs is vested in the BOD/BOT
Effect of mismanagement	
A partner as such can sue a co-partner who mismanages	The suit against a member of the BOD or BOT who mismanages must be in the name of the corporation
Extent of liability to third persons	
GR: Partners are liable personally and subsidiarily (sometimes solidarily) for partnership debts to third persons **XPN:** Limited partner	Stockholders are liable only to the extent of the shares subscribed by them whether paid or not.
Right of Succession	
No right of succession	Has right of succession
Transferability of SH's interest	
Partner cannot transfer his interest in the partnership without the consent of all the other existing partners.	Stockholder has the right to transfer his shares without prior consent of the other stockholders unless the right of first refusal is embodied in the articles of incorporation.
Term of existence	
May be established for any period of time stipulated by the partners	May not be formed for a term in excess of 50 years. May be extendible to not more than 50 years in any one instance
Firm name	
In a limited partnership it is required by law to add the word "Ltd." to its name	May adopt any name provided: 1. it is not identical or deceptively similar to any registered firm name; 2. not contrary to existing law.
Dissolution	
May be dissolved at any time by the will of any or all of the partners. Death, civil interdiction and insolvency of a partner dissolves the partnership.	Can only be dissolved with the consent of the State Death or insolvency of shareholders can't dissolve the corporation.
Governing law	
Governed by the Civil Code	Governed by the Corporation Code

APPENDIX E:

VOTE REQUIREMENTS FOR CORPORATE ACTS

CORPORATE ACTS	VOTE REQUIREMENT	
	BOARD OF DIRECTORS	**STOCKHOLDERS**
1. Increase or decrease of capital stock	Majority vote of the BOD	Vote representing 2/3 of the outstanding capital stock
2. Incurring, creating or increasing bonded indebtedness	Majority vote of the BOD or trustees	Vote representing 2/3 of the outstanding capital stock
3. Investment of corporate funds in another corporation or business or for any other purpose	Majority vote of the BOD	Vote representing 2/3 of the outstanding capital stock
4. Issuance of stock dividends	Approval of the BOD	Vote representing 2/3 of the outstanding capital stock
5. Entering into management contract	Approval of the BOD	**GR:** Vote of the majority of the outstanding shares of stock of the managed corporation. **XPN:** Interlocking directors or Interlocking stockholders Vote representing 2/3 of the outstanding capital stock
6. The sale or other disposition of all or substantially all of the corporate assets	Approval of the board	Vote representing 2/3 of the outstanding capital stock
7. Removal of directors		Majority vote of the outstanding capital stock
8. Election of directors or trustees; Filling up of vacancies by stockholders		Majority of the outstanding capital stock
9. Amendments to by-laws	Majority vote of the BOD	Majority vote of the outstanding capital stock
10. Delegation of the power to amend by-laws to the board of directors		Vote representing 2/3 of the outstanding capital stock
11. Revocation of the delegation of the power to amend by-laws to the board		Majority vote of the outstanding capital stock
12. Extending or shortening the corporate term	Majority vote of the BOD	Vote representing 2/3 of the outstanding capital stock
13. Fixing the issued price of no-par value shares		Majority vote of the outstanding capital stock
14. Amendment to articles of incorporation		Vote representing 2/3 of the outstanding capital stock
15. Grant of compensation to directors	Approval of the Board	Majority vote of the outstanding capital stock
16. Ratification of corporate contract with a director		Vote representing 2/3 of the outstanding capital stock
17. Merger or consolidation	Majority vote of the BOD	Vote representing 2/3 of the outstanding capital stock
18. Voluntary dissolution	Majority vote of the BOD	Vote representing 2/3 of the outstanding capital stock

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APPENDIX F:

CONSERVATORSHIP, RECEIVERSHIP AND LIQUIDATION

CONSERVATORSHIP	RECEIVERSHIP	LIQUIDATION
Grounds		
1.Continuing inability 2.Unwilling-ness to maintain condition of liquidity	1. Inability to pay liabilities as they fall due e.g: bank run, rumors, etc. 2. Assets are less than its liabilities 3. Cannot continue business 4. without causing damage; 5. Violation of a cease and desist 6. "Bank holiday" for more than 30 days. *(Sec. 30)*	1. Insolvency 2. Bank cannot be rehabilitated
Effects:		
1.Juridical personality is retained. 2.Perfected transactions cannot be repudiated;	1. Juridical personality is retained 2. Suspension of operation /stoppage of business 3. Assets deemed in *custodia legis* (*Domingo v. NLRC, G.R. 156761, Oct 17, 2006*	Same with conservatorship

APPENDIX G:

UNIVERSAL BANKS, COMMERCIAL BANKS AND THRIFT BANKS

UNIVERSAL BANKS	COMMERCIAL BANKS	THRIFT BANKS
Governing laws		
General Banking Law (GBL)	GBL	Thrift Banks Act *(R.A. 7906)*
Powers		
1. Has the authority to exercise the powers of a commercial bank. 2. To act as an *investment house* – a corporation that sells and guarantees sale of securities and shares of stocks. *i.e.* Petron will tap an investment house in order to sell its stocks. 3. To engage in a *non-allied* undertaking – which is not related at all to banking. *e.g.* Realty	To engage in *allied undertakings* and, in addition to the general powers incident to a corporation, may exercise all such powers as may be necessary to carry on the business of commercial banking. **Note:** Allied undertakings are those activities or entities which enhance or complement banking.	All the powers of a commercial bank, *except*: 1. To issue imported LC 2. To accept or open checking account *except* with prior approval by the Monetary Board (MB requires at least a net asset worth of 28M)
Capitalization		
4.950 Billion	2.4 Billion	1. Manila- 3.25M 2. Elsewhere- 6.25M
Equity investment		
Can be a stock holder in both allied and non-allied undertaking	Only allied undertaking	Only allied undertaking
Non-allied transactions		
Can invest *but shall not* exceed 25% of the investee (receiving) corporation.	Cannot invest	Cannot invest
Total amount of investment equity		
Not to exceed 50% of the bank's net worth.	Not to exceed 35% of bank's net worth.	Not to exceed 35% of bank's net worth.
Single equity investment		
Not to exceed 25% of bank's net worth		

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APPENDIX H:

NATIONALIZED AND PARTLY NATIONALIZED BUSINESSES

1. *Zero percent (0%) foreign equity*
a. Mass media except recording; b. Practice of all professions i. Law ii. Medicine and allied professions iii. Accountancy, etc. c. Retail trade enterprises with paid-up capital of less than US$2.5 M *(Sec. 5, R.A. 8762)*; d. Cooperatives *(Ch. III, Art. 26, R.A. 6938)*; e. Private security agencies *(Sec. 4, R.A. 5487)*; f. Small-scale mining *(Sec. 3, R.A. 7076)*; g. Utilization of marine resources *(Art. XII, Sec. 2, Constitution)*; h. Cockpits *(Sec. 5, P.D. 449)*; i. Manufacture, repair, stockpiling and/or distribution of nuclear weapons *(Art. II, Sec. 8, Constitution)*; j. Manufacture, repair, stockpiling and/or distribution of biological, chemical and radiological weapons and anti-personnel mines *(Various treaties to which the Philippines is a signatory and conventions supported by the Philippines);* k. Manufacture of firecrackers and other pyrotechnic devices *(Sec. 5, R.A. 7183).*
2. *Up to sixty percent (60%) foreign equity*
a. Financing companies regulated by the SEC *(Sec. 6, R.A. 5980 as amended by R.A. 8556);* b. Investment houses regulated by the SEC *(Sec. 5, P.D. 129 as amended by R.A. 8366).*
3. *Up to forty percent (40%) foreign equity*
a. Exploration, development and utilization of natural resources *(Art. XII, Sec. 2 , Constitution);* b. Ownership of private lands *(Art. XII, Sec. 7, Constitution; Ch. 5, Sec. 22, CA 141; Sec. 4, R.A. 9182);* c. Operation and management of public utilities *(Art. XII, Sec. 11, Const.; Sec. 16 of CA 146);* d. Ownership/establishment and administration of educational institutions *(Art. XIV, Sec. 4, Constitution);* e. Culture, production, milling, processing, trading excepting retailing, of rice and corn and acquiring, by barter, purchase or otherwise, rice and corn and the by-products thereof *(Sec. 5, P.D. 194;Sec. 15, R.A. 8762);* f. Contracts for the supply of materials, goods and commodities to GOCC, agency or municipal corporation *(Sec. 1, R.A. 5183)* g. Project Proponent and Facility Operator of a BOT project requiring a public utilities franchise *(Art. XII, Sec. 11, Constitution; Sec. 2a, R.A. 7718);* h. Ownership of condominium units where the common areas in the condominium project are co-owned by the owners of the separate units or owned by a corporation *(Sec. 5, R.A. 4726).* i. Adjustment Companies *(Sec. 323, P.D. 613)* j. Manufacture, repair, storage and/ or distribution of products/ ingredients requiring PNP clearance *(R.A. 7042 as amended by R.A. 8179)* k. Operation of deep sea commercial fishing vessel *(Sec. 27, R.A. 8550)*
4. *Up to thirty percent (30%) foreign equity*
a. Advertising *(Art. XVI, Constitution).*
5. *Up to twenty-five percent (25%) foreign equity*
a. Private recruitment, whether for local or overseas employment *(Art. 27, P.D. 442);* b. Contracts for the construction and repair of locally-funded public works *(Sec. 1, CA 541, LOI 630)* except: i. infrastructure/development projects covered in R.A. 7718; and ii. projects which are foreign funded or assisted and required to undergo international competitive bidding *(Sec. 2[a] , R.A. 7718);* c. Contracts for the construction of defense-related structures *(Sec. 1, CA 541).*
6. *Up to twenty percent (20%) foreign equity*
a. Private radio communications network *(R.A. 3846).*

A. LETTERS OF CREDIT

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