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REPEALING CLAUSE

CIVIL LAW

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TITLE VIII. LEASE

Chapter 1

General Provisions

Art. 1642. The contract of lease may be of things, or of work and service. (1542)

Art. 1643. In the lease of things, one of the parties binds himself to give to another the enjoyment or use of a thing for a price certain, and for a period which may be definite or indefinite. However, no lease for more than ninety-nine years shall be valid. (1543a)

Art. 1644. In the lease of work or service, one of the parties binds himself to execute a piece of work or to render to the other some service for a price certain, but the relation of principal and agent does not exist between them. (1544a)

Art. 1645. Consumable goods cannot be the subject matter of a contract of lease, except when they are merely to be exhibited or when they are accessory to an industrial establishment. (1545a)

1. Concept

The contract of lease may be of *things*, or of *work and service (Art. 1642, Civil Code)*. In the lease of things, one of the parties binds himself to give to another the enjoyment or use of a thing for a price certain and for a period which may be definite or indefinite. However, no lease for more than ninety-nine years shall be valid *(Art. 1642, Civil Code)*. In the lease of work or service, one of the parties binds himself to execute a piece of work or to render to the other some service for a price certain, but the relation of principal and agent does not exist between

them *(Art. 1644, Civil Code)*. A lease of work and services includes: (a) household service, (b) contract of labor, (c) contract for a piece of work, and (d) contract with common carriers.

A *right* may also be the object of a lease, and the contract is more commonly known as a "license" and the consideration as a "royalty." Consumable goods cannot be the subject matter of a contract of lease, except when they are merely to be exhibited or when they are accessory to an industrial establishment *(Art. 1645, Civil Code)*; otherwise, the contract may instead partake the nature of *mutuum*.

2. Elements

a. *Consent*

The lease, being consensual, is perfected at the moment there is a meeting of the minds (offer and acceptance) upon the thing, right or service and the cause or consideration which are to constitute the contract (see *Art. 1319, Civil Code, supra.*). No specific form is required; hence, a lease for professional services may be express (written or verbal) or implied *(Dee vs. Court of Appeals, 176 SCRA 651)*. However, for enforceability, a lease of real property is covered by the Statute of Frauds (see *Art. 1405, Civil Code, supra.*). To bind third persons, a lease of realty may be recorded in the Registry of Property (see *Art. 1648,* in relation to *Arts. 708-709, Civil Code;* see *Yusay vs. Alojado, 107 Phil. 1156*).

Every lease of real estate may be recorded in the Registry of Property. Unless a lease is recorded, it shall not be binding upon third persons *(Art. 1648, Civil Code)*. If a lease is to be recorded in the Registry of Property, the following persons cannot constitute the same without proper authority: the husband with respect to the wife's paraphernal real estate, the father or guardian as to the property of the minor or ward, and the manager without special power *(Art. 1647, Civil Code)*. The disqualification

of parties under Article 1490 and Article 1491 in sales apply to lease of *things* (not *services*), and persons disqualified to buy are also disqualified to become lessees of things *(Art. 1646, Civil Code)*. Aliens, although disqualified from acquiring lands, may lease real property (see *Philippine Banking Corp. vs. Lui She, 21 SCRA 52; Krivenko vs. Register of Deeds, 79 Phil. 461*).

b. *Object*

Things, rights and works or services, within the commerce of man, may be the object of lease. A public street is for public use, and it may not be bargained away through a contract (see *Dacanay vs. Asistio, 208 SCRA 404*).

c. *Cause*

The cause or consideration in lease contracts refers to the rentals (for things), royalties (for rights), or compensation (for services). When money is used as a medium of exchange of values, it is invariably considered as the cause of the contract. The amount may be fixed by agreement, customs or usage or by the courts to avoid unjust enrichment or when the rental demanded is clearly exorbitant or unreasonable as a matter of equity (see *Ramon Magsaysay Award Foundation vs. Court of Appeals, 134 SCRA 136*), and it may be regulated such as in the case of public services and rental laws (see *Herrera vs. Herrera, 7 Phil. 274; Arroyo vs. Azur, 76 Phil. 493*).

Chapter 2

Lease of Rural and Urban Lands

Section 1 — General Provisions

Art. 1646. The persons disqualified to buy referred to in Articles 1490 and 1491, are also disqualified to become lessees of the things mentioned therein. (n)

Art. 1647. If a lease is to be recorded in the Registry of Property, the following persons cannot constitute the

same without proper authority; the husband with respect to the wife's paraphernal real estate, the father or guardian as to the property of the minor or ward, and the manager without special power. (1548a)

Art. 1648. Every lease of real estate may be recorded in the Registry of Property. Unless a lease is recorded, it shall not be binding upon third persons. (1549a)

Art. 1649. The lessee cannot assign the lease without the consent of the lessor, unless there is a stipulation to the contrary. (n)

Art. 1650. When in the contract of lease of things there is no express prohibition, the lessee may sublet the thing leased, in whole or in part, without prejudice to his responsibility for the performance of the contract toward the lessor. (1550)

Art. 1651. Without prejudice to his obligation toward the sublessor, the sublessee is bound to the lessor for all acts which refer to the use and preservation of the thing leased in the manner stipulated between the lessor and the lessee. (1551)

Art. 1652. The sublessee is subsidiary liable to the lessor for any rent due from the lessee. However, the sublessee shall not be responsible beyond the amount of rent due from him, in accordance with the terms of the sublease, at the time of the extra-judicial demand by the lessor.

Payments of rent in advance by the sublessee shall be deemed not to have been made, so far as the lessor's claim is concerned, unless said payments were effected in virtue of the custom of the place. (1552a)

Art. 1653. The provisions governing warranty, contained in the Title on Sales, shall be applicable to the contract of lease.

In the cases where the return of the price is required, reduction shall be made in proportion to the time during which the lessee enjoyed the thing. (1553)

Section 2 — Rights and Obligations of the Lessor and the Lessee

Art. 1654. The lessor is obliged:

(1) To deliver the thing which is the object of the contract in such a condition as to render it fit for the use intended;

(2) To make on the same during the lease all the necessary repairs in order to keep it suitable for the use to which it has been devoted, unless there is a stipulation to the contrary;

(3) To maintain the lessee in the peaceful and adequate enjoyment of the lease for the entire duration of the contract. (1554a)

Art. 1655. If the thing leased is totally destroyed by a fortuitous event, the lease is extinguished. If the destruction is partial, the lessee may choose between a proportional reduction of the rent and a rescission of the lease. (n)

Art. 1656. The lessor of a business or industrial establishment may continue engaging in the same business or industry to which the lessee devotes the thing leased, unless there is a stipulation to the contrary. (n)

Art. 1657. The lessee is obliged:

(1) To pay the price of the lease according to the terms stipulated;

(2) To use the thing leased as a diligent father of a family, devoting it to the use stipulated; and in the absence of stipulation, to that which may be inferred from the nature of the thing leased, according to the custom of the place;

(3) To pay the expenses for the deed of lease. (1555)

Art. 1658. The lessee may suspend the payment of the rent in case the lessor fails to make the necessary

repairs or to maintain the lessee in peaceful and adequate enjoyment of the property leased. (n)

Art. 1659. If the lessor or the lessee should not comply with the obligations set forth in Articles 1654 and 1657, the aggrieved party may ask for the rescission of the contract and indemnification for damages, or only the latter, allowing the contract to remain in force. (1556)

Art. 1660. If a dwelling place or any other building intended for human habitation is in such a condition that its use brings imminent and serious danger to life or health, the lessee may terminate the lease at once by notifying the lessor, even if at the time the contract was perfected the former knew of the dangerous condition or waived the right to rescind the lease on account of this condition. (n)

Art. 1661. The lessor cannot alter the form of the thing leased in such a way as to impair the use to which the thing is devoted under the terms of the lease. (1557a)

Art. 1662. If during the lease it should become necessary to make some urgent repairs upon the thing leased, which cannot be deferred until the termination of the lease, the lessee is obliged to tolerate the work, although it may be very annoying to him, and although during the same, he may be deprived of a part of the premises.

If the repairs last more than forty days the rent shall be reduced in proportion to the time — including the first forty days — and the part of the property of which the lessee has been deprived.

When the work is of such a nature that the portion which the lessee and his family need for their dwelling becomes uninhabitable, he may rescind the contract if the main purpose of the lease is to provide a dwelling place for the lessee. (1558a)

Art. 1663. The lessee is obliged to bring to the knowledge of the proprietor, within the shortest

possible time, every usurpation or untoward act which any third person may have committed or may be openly preparing to carry out upon the thing leased.

He is also obliged to advise the owner, with the same urgency, of the need of all repairs included in No. 2 of Article 1654.

In both cases the lessee shall be liable for the damages which, through his negligence, may be suffered by the proprietor.

If the lessor fails to make urgent repairs, the lessee, in order to avoid an imminent danger, may order the repairs at the lessor's cost. (1559a)

Art. 1664. The lessor is not obliged to answer for a mere act of trespass which a third person may cause on the use of the thing leased; but the lessee shall have a direct action against the intruder.

There is a mere act of trespass when the third person claims no right whatever. (1560a)

Art. 1665. The lessee shall return the thing leased, upon the termination of the lease, just as he received it, save what has been lost or impaired by the lapse of time, or by ordinary wear and tear, or from an inevitable cause. (1561a)

Art. 1666. In the absence of a statement concerning the condition of the thing at the time the lease was constituted, the law presumes that the lessee received it in good condition, unless there is proof to the contrary. (1562)

Art. 1667. The lessee is responsible for the deterioration or loss of the thing leased, unless he proves that it took place without his fault. This burden of proof on the lessee does not apply when the destruction is due to earthquake, flood, storm or other natural calamity. (1563a)

Art. 1668. The lessee is liable for any deterioration caused by members of his household and by guests and visitors. (1564a)

Art. 1669. If the lease was made for a determinate time. It ceases upon the day fixed, without the need of a demand. (1565)

Art. 1670. If at the end of the contract the lessee should continue enjoying the thing leased for fifteen days with the acquiescence of the lessor, and unless a notice to the contrary by either party has previously been given, it is understood that there is an implied new lease, not for the period of the original contract, but for the time established in Articles 1682 and 1687. The other terms of the original contract shall be revived. (1566a)

Art. 1671. If the lessee continues enjoying the thing after the expiration of the contract, over the lessor's objection, the former shall be subject to the responsibilities of a possessor in bad faith. (n)

Art. 1672. In case of an implied new lease, the obligations contracted by a third person for the security of the principal contract shall cease with respect to the new lease. (1567)

Art. 1673. The lessor may judicially eject the lessee for any of the following causes:

(1) When the period agreed upon, or that which is fixed for the duration of leases under Articles 1682 and 1687, has expired;

(2) Lack of payment of the price stipulated;

(3) Violation of any of the conditions agreed upon in the contract;

(4) When the lessee devotes the thing leased to any use or service not stipulated which causes the deterioration thereof; or if he does not observe the requirement in No. 2 of Article 1657, as regards the use thereof.

The ejectment of tenants of agricultural lands is governed by special laws. (1569a)

Art. 1674. In ejectment cases where an appeal is taken, the remedy granted in Article 539, second para-

graph, shall also apply, if the higher court is satisfied that the lessee's appeal is frivolous or dilatory, or that the lessor's appeal is *prima facie* meritorious. The period of ten days referred to in said article shall be counted from the time the appeal is perfected. (n)

Art. 1675. Except in cases stated in Article 1673, the lessee shall have a right to make use of the periods established in Articles 1682 and 1687. (1570)

Art. 1676. The purchaser of a piece of land which is under a lease that is not recorded in the Registry of Property may terminate the lease, save when there is a stipulation to the contrary in the contract of sale, or when the purchaser knows of the existence of the lease.

If the buyer makes use of this right, the lessee may demand that he be allowed to gather the fruits of the harvest which corresponds to the current agricultural year and that the vendor indemnify him for damages suffered.

If the sale is fictitious, for the purpose of extinguishing the lease, the supposed vendee cannot make use of the right granted in the first paragraph of this article. The sale is presumed to be fictitious if at the time the supposed vendee demands the termination of the lease, the sale is not recorded in the Registry of Property. (1571a)

Art. 1677. The purchaser in a sale with the right of redemption cannot make use of the power to eject the lessee until the end of the period for the redemption. (1572)

Art. 1678. If the lessee makes, in good faith, useful improvements which are suitable to the use for which the lease is intended, without altering the form or substance of the property leased, the lessor upon the termination of the lease shall pay the lessee one-half of the value of the improvements at that time. Should the lessor refuse to reimburse said amount, the lessee may remove the improvements, even though the principal thing may suffer damage thereby. He shall not, however, cause any more impairment upon the property leased than is necessary.

With regard to ornamental expenses, the lessee shall not be entitled to any reimbursement, but he may remove the ornamental objects, provided no damage is caused to the principal thing, and the lessor does not choose to retain them by paying their value at the time the lease is extinguished. (n)

Art. 1679. If nothing has been stipulated concerning the place and the time for the payment of the lease, the provisions of Article 1251 shall be observed as regards the place; and with respect to the time, the custom of the place shall be followed. (1574)

(1) *In General*

Obligations of the Lessor

The lessor is obliged: (1) to deliver the thing which is the object of the contract in such a condition as to render it fit for the use intended; (2) to make on the same during the lease all the necessary repairs in order to keep it suitable for the use to which it has been devoted, unless there is a stipulation to the contrary; and (3) to maintain the lessee in the peaceful and adequate enjoyment of the lease for the entire duration of the contract *(Art. 1654, Civil Code)*.

The lessor cannot alter the form of the thing leased in such a way as to impair the use to which the thing is devoted under the terms of the lease *(Art. 1661, Civil Code; Enriquez vs. Watson, 22 Phil. 623)*. If the thing leased is totally destroyed by a fortuitous event, the lease is extinguished. If the destruction is partial, the lessee may choose between a proportional reduction of the rent and a rescission of the lease *(Art. 1655, Civil Code)*.

The lessor of a business or industrial establishment may continue engaging in the same business or industry to which the lessee devotes the thing leased, unless there is a stipulation to the contrary *(Art. 1656, Civil Code)*.

The provisions governing warranty, contained in the Title on Sales, shall be applicable to the contract of lease.

In the cases where the return of the price is required, reduction shall be made in proportion to the time during which the lessee enjoyed the thing *(Art. 1653, Civil Code)*. The lessor is not obliged to answer for a mere act of trespass which a third person may cause on the use of the thing leased *(Guzman vs. Court of Appeals, 177 SCRA 604)*; but the lessee shall have a direct action against the intruder. There is a mere act of trespass when the intrusion is devoid of any juridic intention of the trespasser *(Liwayway vs. Union, 108 SCRA 161)* or when the third person claims no right whatever *(Art. 1664, Civil Code;* see *Goldstein vs. Roces, 34 Phil. 562)*.

If a dwelling place or any other building intended for human habitation is in such a condition that its use brings imminent and serious danger to life or health, the lessee may terminate the lease at once by notifying the lessor, even if at the time the contract was perfected the former knew of the dangerous condition or waived the right to rescind the lease on account of this condition *(Art. 1660, Civil Code)*.

If during the lease it should become necessary to make some urgent repairs upon the thing leased, which cannot be deferred until the termination of the lease, the lessee is obliged to tolerate the work, although it may be very annoying to him, and although during the same, he may be deprived of a part of the premises. If the repairs last more than forty days, the rent shall be reduced in proportion to the time including the first forty days and the part of the property of which the lessee has been deprived. When the work is of such a nature that the portion which the lessee and his family need for their dwelling becomes uninhabitable, he may rescind the contract if the main purpose of the lease is to provide a dwelling place for the lessee *(Art. 1662, Civil Code)*.

Obligations of the Lessee

The lessee is obliged: (1) to pay the price of the lease according to the terms stipulated; (2) to use the thing

leased as a diligent father of a family, devoting it to the use stipulated; and in the absence of stipulation, to that which may be inferred from the nature of the thing leased, according to the custom of the place; and (3) to pay the expenses for the deed of lease *(Art. 1657, Civil Code)*.

Where the lessee had occupied the premises and paid rentals without protest on the condition of the thing leased, he cannot unilaterally suspend payment on a belated claim of breach by the lessor *(Geronimo Realty Co. vs. Court of Appeals, 83 SCRA 542)*. The lessee may suspend the payment of the rent in case the lessor fails to make the necessary repairs or to maintain the lessee in peaceful and adequate enjoyment of the property leased *(Art. 1658, Civil Code; Guzman vs. Court of Appeals, 177 SCRA 604)*. Where repairs are undertaken by the lessor but the lessee is not satisfied, the latter's remedy is no longer to suspend payment but to make the urgent repairs himself at the lessor's cost (see *Banzon vs. Ubay, 94 SCRA 454*).

If nothing has been stipulated concerning the place and the time for the payment of the lease, the provisions of Article 1251 *(supra.)* shall be observed as regards the place; and with respect to the time, the custom of the place shall be followed *(Art. 1679, Civil Code;* see *Gomez vs. Ng, 76 Phil. 555)*.

The lessee is obliged to bring to the knowledge of the proprietor, within the shortest possible time, every usurpation or untoward act which any third person may have committed or may be openly preparing to carry out upon the thing leased. He is also obliged to advise the owner, with the same urgency, of the need of all repairs. In both cases the lessee shall be liable for the damages which, through his negligence, may be suffered by the proprietor. If the lessor fails to make urgent repairs, the lessee, in order to avoid an imminent danger, may order the repairs at the lessor's cost *(Art. 1663,* in relation to *Art. 1654, Civil Code)*.

The lessee shall return the thing leased upon the termination of the lease, just as he received it, save what has been lost or impaired by the lapse of time, or by ordinary wear and tear, or from an inevitable cause *(Art. 1665, Civil Code)*. In the absence of a statement concerning the condition of the thing at the time the lease was constituted, the law presumes that the lessee received it in good condition, unless there is proof to the contrary *(Art. 1666, Civil Code)*.

The lessee is responsible for the deterioration or loss of the thing leased, unless he proves that it took place without his fault. This burden of proof on the lessee does not apply when the destruction is due to earthquake, flood, storm or other natural calamity *(Art. 1667, Civil Code; Gonzales vs. Mateo, 74 Phil. 573)*. The lessee is liable for any deterioration caused by members of the household and by guests and visitors *(Art. 1668, Civil Code)*.

Parties to a lease contract are not prohibited from agreeing on certain mandatory provisions delineating their respective rights and obligations considering the legal precept that contracts are respected as being the law between the contracting parties. The only requirement is that these contractual stipulations, clauses, terms and conditions must not be contrary to law, morals, good customs, public policy or public order *(Campo Assets Corporation vs. Club X.O. Company, G.R. No. 134986, 17 March 2000, 123 SCAD 428)*.

Assignment / Sublease

The lessee cannot *assign* the lease without the consent of the lessor, unless there is a stipulation to the contrary *(Art. 1949, Civil Code;* see *Dakudao vs. Consolacion, 122 SCRA 877)*.

When in the contract of lease of things there is no express prohibition, the lessee may *sublet* the things leased, in whole or in part, without prejudice to his re-

sponsibility for the performance of the contract toward the lessor *(Art. 1650, Civil Code;* see *Manlapat vs. Salazar, 98 Phil. 356).* Without prejudice to his obligation toward the sublessor, the sublessee is bound to the lessor for all acts which refer to the use and preservation of the thing leased in the manner stipulated between the lessor and the lessee *(Art. 1651, Civil Code).* The lessee ceases to be liable if upon the termination of the lease he gives up possession but the sublessee continues enjoyment thereof. The lessor can instead eject the sublessee *(Syjuco vs. Court of Appeals, 172 SCRA 111).* Sublessees can invoke no right superior to that of their sublessor, for they merely derive their right from the latter whose termination of the contract with the lessor necessarily ends the sublease contract *(Jimenez vs. Patricia, Inc., 134 SCAD 29, 340 SCRA 525).*

The sublessee is subsidiarily liable to the lessor for any rent due from the lessee. The sublessee cannot thus be required to, nor should he, pay directly to the lessor *(Syjuco vs. Court of Appeals, 172 SCRA 111; Blas vs. Court of Appeals, 180 SCRA 60).* Relative to the subsidiary liability of the sublessee, the lessor may proceed against the sublessee without having to join the lessee in the action (see *Ortiz vs. Balgos, 54 Phil. 171; Dee vs. Court of Appeals, 176 SCRA 651*). A sublessee is bound by a judgment rendered against the lessee (see *Sevilla vs. Court of Appeals, 206 SCRA 559; Guevarra vs. Court of Appeals, 160 SCRA 478*). However, the sublessee shall not be responsible beyond the amount of rent due from him, in accordance with the terms of the sublease, at the time of the extra-judicial demand by the lessor. Payments of rent in advance by the sublessee shall be deemed not to have been made, so far as the lessor's claim is concerned, unless said payments were effected in virtue of the custom of the place *(Art. 1652, Civil Code;* see *Philippine Consolidated Freight Lines, Inc. vs. Ajon, 103 Phil. 318; Duellome vs. Gotico, 7 SCRA 841).*

Rescission / Damages

If the lessor or the lessee should not comply with the obligations set forth in Articles 1654 and 1657, the aggrieved party may ask for the rescission of the contract and indemnification for damages, or only the latter, allowing the contract to remain in force *(Art. 1659, Civil Code; Certified Clubs, Inc. vs. Court of Appeals, 149 SCRA 521; CMS Investment and Management Corporation vs. Intermediate Appellate Court, 139 SCRA 75; Pamintuan vs. Court of Appeals, 42 SCRA 344)*. The court may not grant a longer period for performance when rescission is properly asked *(Luna vs. Carandang, 26 SCRA 306)*. Damages may be awarded but not in the concept of rentals (see *Roa vs. Jacinto, 49 Phil. 7*).

The lessor may terminate the lease when rentals are not paid without the need of a court action but he does so at the risk of later being held judicially accountable if improperly exercised (see *Cruz vs. Intermediate Appellate Court, 180 SCRA 702*).

When a lease contract contains a right of first refusal, the lessor is under a legal duty to the lessee not to sell to anybody at any price until after he has made an offer to sell to the latter at a certain price and the lessee has failed to accept it. In fine, the lessee has a right that the lessor's first offer shall be in his favor *(Polytechnic University of the Philippines vs. Court of Appeals and Firestone Ceramics, Inc., G.R. No. 143513; National Development Corporation vs. Firestone Ceramics, Inc., G.R. No. 143590, 14 November 2001)*. A contract of sale entered into in violation of a right of first refusal of another person, while valid, has been held to be rescissible. In *Guzman, Bocaling & Co. vs. Bonnevie (206 SCRA 668)*, the Court sustained the decision of the lower court ordering the rescission of a deed of sale which violated the "right of first priority" granted to the lessees therein. Even if the lessees could not buy the subject property at the price quoted to them, nonetheless, the lessor could

not sell it to another for a much lower price and under more favorable terms and conditions. Said the Court:

> "x x x. Under Articles 1380 to 1381(3) of the Civil Code, a contract otherwise valid may nonetheless be subsequently rescinded by reason of injury to third persons, like creditors. The status of creditors could be validly accorded the Bonnevies for they had substantial interests that were prejudiced by the sale of the subject property to the petitioner without recognizing their right of first priority under the Contract of Lease.
>
> "According to Tolentino, rescission is a remedy granted by law to the contracting parties and even to *third persons*, to secure reparation for damages caused to them by a contract, even if this should be valid, by means of the restoration of things to their condition at the moment prior to the celebration of said contract. *(Tolentino, Commentaries and Jurisprudence on the Civil Code of the Philippines, Vol. IV, p. 571.)* It is a relief allowed for the protection of one of the contracting parties *and even third persons* from all injury and damage the contract may cause, or to protect some incompatible and preferent right created by the contract. *(Aquino v. Tañedo, 39 Phil. 517.)* Rescission implies a contract which, even if initially valid, produces a lesion or pecuniary damage to someone that justifies its invalidation for reasons of equity. *(Id., p. 572.)*
>
> "It is true that the acquisition by a third person of the property subject of the contract is an obstacle to the action for its rescission where it is shown that such third person is in lawful possession of the subject of the contract and that he did not act in bad faith. *(Cordovero and Alcazar v. Villaruz and Borromeo, 46 Phil. 473.)* However, this rule is not applicable in the case before us because the petitioner is not considered a third party in relation to the Contract of

Sale nor may its possession of the subject property be regarded as acquired lawfully and in good faith.

"Indeed, Guzman, Bocaling and Co. was the *vendee* in the Contract of Sale. Moreover, the petitioner cannot be deemed a purchaser in good faith for the record shows that it categorically admitted it was aware of the lease in favor of the Bonnevies, who were actually occupying the subject property at the time it was sold to it. Although the Contract of Lease was not annotated on the transfer certificate of title in the name of the late Jose Reynoso and Africa Reynoso, the petitioner cannot deny actual knowledge of such lease which was equivalent to and indeed more binding than presumed notice by registration.

"A purchaser in good faith and for value is one who buys the property of another without notice that some other person has a right to or interest in such property and pays a full and fair price for the same at the time of such purchase or before he has notice of the claim or interest of some other person in the property. *(De Santos v. Intermediate Appellate Court, 157 SCRA 295.)* Good faith connotes an honest intention to abstain from taking unconscientious advantage of another. *(De la Cruz v. Intermediate Appellate Court, 157 SCRA 660; Cui and Joven v. Henson, 51 Phil. 606.)* Tested by these principles, the petitioner cannot tenably claim to be a buyer in good faith as it had notice of the lease of the property by the Bonnevies and such knowledge should have cautioned it to look deeper into the agreement to determine if it involved stipulations that would prejudice its own interests."

In *Equatorial Realty and Development, Inc. vs. Mayfair Theater, Inc. (76 SCAD 407, 264 SCRA 483)*, the Court, *en banc*, ordered the rescission of the Deed of Absolute Sale between *Equatorial and Carmelo &*

Bauermann, Inc., as being violative of Mayfair's contractual right of first refusal. The Court reasoned that Mayfair could only exercise this right if the fraudulent sale were first rescinded and set aside. Held the Court:

> "What Carmelo and Mayfair agreed to, by executing the two lease contracts, was that Mayfair will have the right of first refusal in the event Carmelo sells the leased premises. It is undisputed that Carmelo did recognize this right of Mayfair, for it informed the latter of its intention to sell the said property in 1974. There was an exchange of letters evidencing the offer and counter-offers made by both parties. Carmelo, however, did not pursue the exercise to its logical end. While it initially recognized Mayfair's right of first refusal, Carmelo violated such right when without affording its negotiations with Mayfair the full process to ripen to at least an interface of a definite offer and a possible corresponding acceptance within the '30-day exclusive option' time granted Mayfair, Carmelo abandoned negotiations, kept a low profile for some time, and then sold, without prior notice to Mayfair, the entire Claro M. Recto property to Equatorial.
>
> "Since Equatorial is a buyer in bad faith, this finding renders the sale to it of the property in question rescissible. We agree with respondent Appellate Court that the records bear out the fact that Equatorial was aware of the lease contracts because its lawyers had, prior to the sale, studied the said contracts. As such, Equatorial cannot tenably claim to be a purchaser in good faith, and, therefore, rescission lies."

In *Litonjua vs. L & R Corporation (123 SCAD 687, 320 SCRA 405),* the Court has declared that while a mortgagor could still sell the mortgaged property notwithstanding the absence of the mortgagee's written consent thereto, the sale, nevertheless, can be rescinded

for ignoring the right of first refusal in favor of the mortgagee. The Court explained:

> "In the case at bar, PWHAS cannot claim ignorance of the right of first refusal granted to L & R Corporation over the subject properties since the Deed of Real Estate Mortgage containing such a provision was duly registered with the Register of Deeds. As such, PWHAS is presumed to have been notified thereof by registration, which equates to notice to the whole world.
>
> "We note that L & R Corporation had always expressed its willingness to buy the mortgaged properties on equal terms as PWHAS. Indeed, in its Answer to the Complaint filed, L & R Corporation expressed that it was ready, willing and able to purchase the subject properties at the same purchase price of P430,000.00, and was agreeable to pay the difference between such purchase price and the redemption price of P249,918.77, computed as of August 13, 1981, the expiration of the one-year period to redeem. That it did not duly exercise its right of first refusal at the opportune time cannot be taken against it, precisely because it was not notified by the spouses Litonjua of their intention to sell the subject property and thereby, to give it priority over other buyers.
>
> "All things considered, what then are the relative rights and obligations of the parties? To recapitulate: the sale between the spouses Litonjua and PWHAS is valid, notwithstanding the absence of L& R Corporation's prior written consent thereto. Inasmuch as the sale to PWHAS was valid, its offer to redeem and its tender of the redemption price, as successor-in-interest of the spouses Litonjua, within the one-year period should have been accepted as valid by L & R Corporation. However, while the sale is, indeed, valid, the same is rescissible because it ignored L & R Corporation's right of first refusal."

In *Parañaque Kings Enterprises, Inc. vs. Court of Appeals (79 SCAD 936, 268 SCRA 727)*, the Court has counseled that a complaint showing violation of a contractual right of "first option or priority to buy the properties subject of the lease" constitutes a valid cause of action, and the grantee of such right is entitled to be offered the same terms and conditions as those given to a third party who eventually bought such properties. Thus:

> "A careful examination of the complaint reveals that it sufficiently alleges an actionable contractual breach on the part of private respondents. Under paragraph 9 of the contract of lease between respondent Santos and petitioner, the latter was granted the 'first option or priority' to purchase the leased properties in case Santos decided to sell. If Santos never decided to sell at all, there can never be a breach, much less an enforcement of such 'right.' But on September 21, 1988, Santos sold said properties to Respondent Raymundo without first offering these to petitioner. Santos indeed realized her error, since she repurchased the properties after petitioner complained. Thereafter, she offered to sell the properties to petitioner for P15 million, which petitioner, however, rejected because of the 'ridiculous' price. But Santos again appeared to have violated the same provision of the lease contract when she finally resold the properties to respondent Raymundo for only P9 million without first offering them to petitioner *at such price*. Whether there was actual breach which entitled petitioner to damages and/or other just or equitable relief, is a question which can better be resolved after trial on the merits where each party can present evidence to prove their respective allegations and defenses. (Dulay, *supra*.)
>
> "The trial and appellate courts based their decision to sustain respondents' motion to dismiss on the allegations of Parañaque Kings Enterprises that Santos had actually offered the subject properties

> for sale to it prior to the final sale in favor of Raymundo, but that the offer was rejected. According to said courts, with such offer, Santos had verily complied with her obligation to grant the right of first refusal to petitioner."

A right of first refusal, in its proper usage, is not a contract; when parties instead make certain the object and the cause thereof and support their understanding with an adequate consideration, that juridical relation is not to be taken as just a right of first refusal but as a contract in itself, which is termed an "option." (See *Guzman, Bocaling & Co. vs. Bonnevie, 206 SCRA 668*). An obligation, and so a conditional obligation as well (*albeit* subject to the occurrence of the condition), in its context under Book IV of the Civil Code, can only be "a juridical necessity to give, to do or not to do" *(Art. 1156, Civil Code),* and one that is constituted by law, contracts, quasi-contracts, delicts and quasi-delicts *(Art. 1157, Civil Code)* which all have their respective legal significance rather well-settled in law. The law certainly must have meant to provide congruous, *albeit* contextual, consequences to its provisions. As a valid source of an obligation, a contract must have the concurrence of (a) consent of the contracting parties, (b) object certain (subject matter of the contract), and (c) cause *(Art. 1318, Civil Code).* These requirements, clearly defined, are essential. The consent contemplated by the law is that which is manifested by the meeting of the offer and of the acceptance upon the object and the cause of the obligation. The offer must be certain and the acceptance absolute *(Art. 1319, Civil Code).* Thus, a right of first refusal cannot have the effect of a contract because, by its very essence, certain basic terms would have yet to be determined and fixed. It is only when the elements concur that the juridical act would have the force of law between the contracting parties that must be complied with in good faith *(Art. 1159, Civil Code;* see also *Art. 1308, Civil Code),* and, in case of its breach, would allow the creditor or obligee (the pas-

sive subject) to invoke the remedy that specifically appertains to it.

In *Ang Yu Asuncion vs. Court of Appeals (238 SCRA 602)*, the Supreme Court has held:

> "In the law on sales, the so-called 'right of first refusal' is an innovative juridical relation. **Needless to point out, it cannot be deemed a perfected contract of sale under Article 1458 of the Civil Code.** Neither can the right of first refusal, understood in its normal concept, *per se* be brought within the purview of an option under the second paragraph of Article 1479, aforequoted, or possibly of an offer under Article 1319 of the same Code. An option or an offer would require, among other things, a clear certainty on both the object and the cause or consideration of the envisioned contract. **In a right of first refusal, while the object might be made determine, the exercise of the right, however, would be dependent not only on the grantor's eventual intention to enter into a binding juridical relation with another but also on terms, including the price, that obviously are yet to be later firmed up.** Prior thereto, it can at best be so described as merely belonging to a class of preparatory juridical relations governed not by contracts (since the essential elements to establish the *vinculum juris* would still be indefinite and inconclusive) but by, among other laws of general application, the pertinent scattered provisions of the Civil Code on human conduct."

A "breach" of the right of first refusal can only give rise to an action for specific performance set out under Book IV of the Code on "Obligations and Contracts." That right, standing by itself, is far distant from being the obligation referred to in Article 1159 of the Code which would have the force of law sufficient to compel compliance *per se* or to establish a creditor-debtor or obligee-obligor relation between the parties. If, as it is rightly so,

a right of first refusal cannot even be properly classed as an offer or as an option, certainly, and with much greater reason, it cannot be the equivalent of, nor be given the same legal effect as, a duly perfected contract. It is not possible to cross out, such as what the Court has said in *Ang Yu Asuncion vs. Court of Appeals (57 SCAD 163, 238 SCRA 602)*, the indispensable element of consensuality in the perfection of contracts. It is basic that without mutual consent on the object and on the cause, a contract cannot exist *(Art. 1305, Civil Code)*; corollary to it, no one can be forced, least of all perhaps by a court, into a contract against his will or compelled to perform thereunder.

Termination of Lease

In General

The lease made for a determinate time ceases upon the day fixed, without the need of a demand *(Art. 1669, Civil Code; San Juan vs. Tan, 116 SCRA 447)*. A lease is renewable *(Gustilo vs. Court of Appeals, 120 SCRA 927)*, and a renewal clause in favor of the lessee is valid but it is not deemed renewed until notice or positive act is made to indicate its exercise by the lessee. A general covenant to renew or extend a lease that makes no provision on the terms thereof implies a renewal or extension upon the same conditions as provided in the original lease *(Ledesma vs. Javellana, 121 SCRA 794,* citing *50 Am. Jur. 2nd, Sec. 1159, p. 45)*. The period in a lease contract, being essentially reciprocal, must be deemed to have been agreed upon for the benefit of both parties, absent a language showing otherwise. In fact, specific language is necessary to show an intent to grant a unilateral faculty to extend or renew the same to the lessee alone or the lessor alone *(Buce vs. Court of Appeals, 332 SCRA 151)*.

A lease renewable or extendible by *mutual agreement* would simply amount to a "right of first refusal" (but see *Cruz vs. Alberto, 39 Phil. 991,* overturned in *Carrascoso vs. De Vera, G.R. No. L-2525, 21 May 1951*)

since, being a reciprocal contract, the period of the lease must be deemed for the benefit of both parties absent a language showing that the benefit has been intended for one party alone *(Heirs of Dalisay vs. Court of Appeals, 126 SCAD 492, 201 SCRA 751; Fernandez vs. Court of Appeals, 166 SCRA 577)*.

If the lessee continues enjoying the thing after the expiration of the contract, over the lessor's objection, no implied new lease is created *(Gamboa vs. Court of Appeals, 72 SCRA 131)*, and the former shall be subject to the responsibilities of a possessor in bad faith *(Art. 1671, Civil Code)*. After the stipulated period, the Court cannot extend or make a new lease for the parties (see *Gandoy vs. Tapucar, 75 SCRA 131*). A lease contract "on a month-to-month basis" provides for a definite period, and it may be terminated at the end of any month *(Limpan vs. Lim, 159 SCRA 484; Madriaga vs. Court of Appeals, 163 SCRA 461; Cruz vs. Intermediate Appellate Court, 180 SCRA 702; Lesaca vs. Cuevas, 125 SCRA 384,* citing *Rantael vs. Court of Appeals, 97 SCRA 453;* and *Cruz vs. Puno, 120 SCRA 497)* but a notice to terminate it is essential, for it does not *automatically* expire at the end of each month *(Yap vs. Court of Appeals, 208 SCRA 692)*. In *Buce vs. Court of Appeals (126 SCAD 492, 332 SCRA 151)*, the Court said that it is the prerogative of the owner-lessor to terminate the lease at its expiration. The continuance, effectivity, and fulfillment of a contract of lease cannot be made to depend exclusively upon the free and uncontrolled choice of the lessee between continuing the payment of the rentals or not, completely depriving the owner of any say on the matter.

A lease is not essentially personal in character, and it is not therefore terminated by death. The contractual relation can extend to the heirs of the deceased (see *Heirs of Dimaculangan vs. Intermediate Appellate Court, 170 SCRA 393*).

The purchaser of a piece of land which is under a lease that is not recorded in the Registry of Property may

terminate the lease, save when there is a stipulation to the contrary in the contract of sale, or when the purchaser knows of the existence of the lease (see *Art. 1676,* and *Art. 1618* on the exercise of the right of redemption, *Civil Code; Bernabe vs. Luna, 148 SCRA 113*; *Plan vs. Court of Appeals, 160 SCRA 1; Tengco vs. Court of Appeals, 178 SCRA 608*). The court, however, under Article 1687, in relation to Article 1197, is accorded the power to fix a longer term, which power is potestative or discretionary (see *F.S. Divinagracia Agro-Commercial, Inc. vs. Court of Appeals, 104 SCRA 180*). If the buyer makes use of this right, the lessee may demand that he be allowed to gather the fruits of the harvest which correspond to the current agricultural year and that the vendor indemnify him for damages suffered. If the sale is fictitious, for the purpose of extinguishing the lease, the supposed vendee may not terminate the lease. The sale is presumed to be fictitious if at the time the supposed vendee demands the termination of the lease, the sale is not recorded in the Registry of Property (see *Art. 1676, Civil Code;* see *Barasi vs. Court of Appeals, 125 SCRA 798*). The purchaser in a sale with the right of redemption cannot make use of the power to eject the lessee until the end of the period for the redemption *(Art. 1677, Civil Code).*

The lessee may terminate the lease under the conditions stated in Article 1660 *(supra.)* of the Code.

Implied New Lease (Tacita Reconduccion)

If at the end of the contract the lessee should continue enjoying the thing leased for fifteen days with the acquiescence of the lessor, and unless a notice to the contrary by either party has previously been given, it is understood that there is an implied new lease, not for the period of the original contract, but for the time established in Articles 1682 and 1687 (see *Fermin vs. Court of Appeals, 196 SCRA 723*). The other terms of the original contract shall be revived *(Art. 1670, Civil Code;* see *Agaloos vs. Intermediate Appellate Court, 149 SCRA 546; Pulido*

vs. Lazaro, 158 SCRA 107) but only such as are necessary or incidental to the lease; hence, a stipulation granting to the lessee a priority as in the purchase of the leased premises is not deemed revived *(Dizon vs. Magsaysay, 57 SCRA 250).* The term of the implied new lease shall not be the original period but as provided for in Articles 1682 and 1687 of the Code (see *Miranda vs. Lim, 12 SCRA 605*). In case of an implied new lease, the obligations contracted by a third person for the security of the principal contract shall cease with respect to the new lease *(Art. 1672, Civil Code).* An implied new lease will not arise where there is an express stipulation to the contrary *(Ramon Magsaysay Award Foundation vs. Court of Appeals, 134 SCRA 136).*

Ejectment

The lessor may judicially eject the lessee, subject to special laws whenever applicable *(e.g., Batas Pambansa Blg. 25*, as amended by *Batas Pambansa Blg. 877, Republic Act No. 6828; Dionio vs. Intermediate Appellate Court, 147 SCRA 243; Bondoc vs. Court of Appeals, 177 SCRA 588; Santos vs. Court of Appeals, 128 SCRA 428)*, for any of the following causes:

(1) When the period agreed upon, or that which is fixed for the duration of leases under Article 1682 and Article 1687, has expired;

(2) Lack of payment of the price stipulated (also a ground for rescission and/or damages under Article 1659, *supra.*);

(3) Violation of any of the conditions agreed upon in the contract;

(4) When the lessee devotes the thing leased to any use or service not stipulated which causes the deterioration thereof; or if he does not observe the requirement in No. 2 of Article 1657, as regards the use thereof *(Art. 1673, Civil Code).* In the foregoing cases, the lessee shall

not have the right to make use of the periods established in Articles 1682 and 1687 *(infra.)* of the Code (see *Art. 1675, Civil Code*).

The principal remedies open to an obligee, upon the breach of an obligation, are generally judicial in nature and must be independently sought in litigation, *i.e*., an action for performance (specific, substitute or equivalent) or rescission (resolution) of a reciprocal obligation. The right to rescind (resolve) is recognized in reciprocal obligations; it is implicit, however, in third paragraph of Article 1191 of the Civil Code that the rescission there contemplated can only be invoked judicially. Hence, the mere failure of a party to comply with what is incumbent upon him does not *ipso jure* produce the rescission (resolution) of the obligation. Exceptionally, under the law and, to a limited degree, by agreement of the parties, extrajudicial remedies may become available such as, in the latter case, an option to rescind or terminate a contract upon the violation of a **resolutory facultative condition**. In the case of lease agreements, despite the absence of an explicit stipulation, that option has been reserved by law in favor of a lessee under Article 1673 of the Civil Code by providing that the lessor may, without first rescinding the lease contract, eject the lessee for, among other grounds, a violation of any of the conditions agreed upon in the contract. The provision, read in conjunction with Section 2, Rule 70, of the 1997 Rules of Civil Procedure, would, absent a contrary stipulation, merely require a written demand on the lessee to pay or to comply with the conditions of the lease and to vacate the premises prior to the institution of an action for ejectment. The above provisions, in effect, authorizes the lessor to terminate extrajudicially the lease (with the same effect as rescission) by simply serving due notice to the lessee. In this particular instance, therefore, the only relevant court jurisdiction involved is that of the first level court in the action for ejectment, an independent judicial action for rescission being unnecessary.

In ejectment cases where an appeal is taken, the remedy granted in Article 539, second paragraph, shall also apply if the higher court is satisfied that the lessee's appeal is frivolous or dilatory, or that the lessor's appeal is *prima facie* meritorious. The period of ten days referred to in said article shall be counted from the time the appeal is perfected *(Art. 1674, Civil Code;* see *Betts vs. Matias, 97 SCRA 439)*.

The mere failure to pay rentals does not make the possession unlawful *(Soriano vs. Court of Appeals, 177 SCRA 330)* but when a valid demand to vacate the premises is made by the lessor, the continued withholding of possession by the lessee becomes unlawful. The mere subsequent payment of rentals by the lessee and the receipt thereof by the lessor does not, absent any other circumstance that may dictate a contrary conclusion, legitimize the unlawful character of the possession, and the lessor may still pursue his demand for ejectment (see *Cursino vs. James, 176 SCRA 65; Guzman vs. Court of Appeals, 177 SCRA 604; LL and Company Development and Agro-Industrial Corporation vs. Huang Chao Chun, G.R. No. 142378, 07 March 2002*). A stipulation allowing the lessor to enter and take possession of the leased premises without need of judicial action upon a breach of the lease contract by the lessee is a valid contractual provision. The stipulation partakes of the nature of a resolutory condition *(Campo Assets Corporation vs. Club X.O. Company, G.R. No. 134986, 17 March 2000, 123 SCAD 428)*.

Nonpayment of rentals by the lessee is not justified on the ground of the lessor's refusal to accept payment. Article 1256 provides that if the creditor to whom tender of payment has been made refuses without just cause to accept it, the debtor shall be released from responsibility by the consignation of the thing or sum due. This provision is more explicit under the Rent Control Law, the pertinent provisions of which are similar to the Rent

Reform Act of 2002 (see *Sec. 7, R.A. No. 9161; LL and Company Development and Agro-Industrial Corporation vs. Huang Chao Chun, G.R. No. 142378, 07 March 2002*).

The ejectment of tenants of agricultural lands is governed by special laws (see *Art. 1673, Civil Code*).

Rule on Improvements

If the lessee makes, in good faith, useful improvements which are suitable to the use for which the lease is intended, without altering the form or substance of the property leased, the lessor upon the termination of the lease shall pay the lessee one-half of the value of the improvements at that time. Should the lessor refuse to reimburse said amount, the lessee may remove the improvements, even though the principal thing may suffer damage thereby. He shall not, however, cause any more impairment upon the property leased than necessary. With regard to ornamental expenses, the lessee shall not be entitled to any reimbursement, but he may remove the ornamental objects, provided no damage is caused to the principal thing, and the lessor does not choose to retain them by paying their value at the time the lease is extinguished *(Art. 1678, Civil Code;* see *Guiang vs. Samano, 196 SCRA 114; Balucanag vs. Francisco, 122 SCRA 948; Laureano vs. Adil, 72 SCRA 148)*. This right is available to the lessor, not the lessee (see *Lapena vs. Morfe, 53 O.G. 3207; Bocaling vs. Laguda, 54 SCRA 243*).

A provision in a contract of lease that the lessor becomes the owner of all improvements introduced by the lessee upon the termination of the lease is a valid stipulation. In *Lhuillier vs. Court of Appeals (140 SCAD 730, 348 SCRA 620)*, the Court has said the stipulation that all improvements introduced by the lessee would accrue to the benefit of the owner at the end of the lease without reimbursement binds its parties and is the law between them, the same not being contrary to law, morals, public order or public policy.

Section 3 — Special Provisions for Leases of Rural Lands

Art. 1680. The lessee shall have no right to a reduction of the rent on account of the sterility of the land leased, or by reason of the loss of fruits due to ordinary fortuitous events; but he shall have such right in case of the loss of more than one-half of the fruits through extraordinary and unforeseen fortuitous events, save always when there is a specific stipulation to the contrary.

Extraordinary fortuitous events are understood to be: fire, war, pestilence, unusual flood, locusts, earthquake, or others which are uncommon, and which the contracting parties could not have reasonably foreseen. (1575)

Art. 1681. Neither does the lessee have any right to a reduction of the rent if the fruits are lost after they have been separated from their stalk, root or trunk. (1576)

Art. 1682. The lease of a piece of rural land, when its duration has not been fixed, is understood to have been made for all the time necessary for the gathering of the fruits which the whole estate leased may yield in one year, or which it may yield once, although two or more years may have to elapse for the purpose. (1577a)

Art. 1683. The outgoing lessee shall allow the incoming lessee or the lessor the use of the premises and other means necessary for the preparatory labor for the following year; and, reciprocally, the incoming lessee or the lessor is under obligation to permit the outgoing lessee to do whatever may be necessary for the gathering or harvesting and utilization of the fruits, all in accordance with the custom of the place. (1578a)

Art. 1684. Land tenancy on shares shall be governed by special laws, the stipulations of the parties, the provisions on partnership and by the customs of the place. (1579a)

Art. 1685. The tenant on shares cannot be ejected except in cases specified by law. (n)

The lessee shall have no right to a reduction of the rent on account of the sterility of the land leased or by reason of the loss of fruits due to ordinary fortuitous events; but he shall have such right in case of the loss of more than one-half of the fruits through extraordinary and unforeseen fortuitous events, save always where there is a specific stipulation to the contrary. Extraordinary fortuitous events are understood to be: fire, war, pestilence, unusual flood, locusts, earthquake, or others which are uncommon, and which the contracting parties could not have reasonably foreseen *(Art. 1680, Civil Code)*. These provisions are applicable only to agricultural leases *(LTB vs. Manabat, 58 SCRA 650)*. Neither does the lessee have any right to a reduction of the rent if the fruits are lost after they have been separated from their stalk, root or trunk *(Art. 1681, Civil Code)*.

The lease of a piece of rural land, when its duration has not been fixed, is understood to have been made for all the time necessary for the gathering of the fruits which the whole estate leased may yield in one year, or which it may yield once, although two or more years may have to elapse for the purpose *(Art. 1682, Civil Code)* subject to the provisions of Article 1673 and Article 1675 of the Code *(supra.)*. The outgoing lessee shall allow the incoming lessee or the lessor the use of the premises and other means necessary for the preparatory labor for the following year; and, reciprocally, the incoming lessee or the lessor is under obligation to permit the outgoing lessee to do whatever may be necessary for the gathering or harvesting and utilization of the fruits, all in accordance with the customs of the place *(Art. 1683, Civil Code)*.

Land tenancy on shares shall be governed by special laws, the stipulation of the parties, the provisions on partnership and by the customs of the place *(Art. 1684, Civil Code)*. The tenant on shares cannot be ejected in cases specified by law *(Art. 1685, Civil Code)*.

Section 4 — Special Provisions for the Lease of Urban Lands

Art. 1686. In default of a special stipulation, the custom of the place shall be observed with regard to the kind of repairs on urban property for which the lessor shall be liable. In case of doubt it is understood that the repairs are chargeable against him. (1580a)

Art. 1687. If the period for the lease has not been fixed, it is understood to be from year to year, if the rent agreed upon is annual; from month to month, if it is monthly; from week to week, if the rent is weekly; and from day to day, if the rent is to be paid daily. However, even though a monthly rent is paid, and no period for the lease has been set, the courts may fix a longer term for the lease after the lessee has occupied the premises for over one year. If the rent is weekly, the courts may likewise determine a longer period after the lessee has been in possession for over six months. In case of daily rent, the courts may also fix a longer period after the lessee has stayed in the place for over one month. (1581a)

Art. 1688. When the lessor of a house, or part thereof, used as a dwelling for a family, or when the lessor of a store, or industrial establishment, also leases the furniture, the lease of the latter shall be deemed to be for the duration of the lease of the premises. (1582)

The custom of the place, in default of a special stipulation, shall be observed with regard to the kind of repairs on urban property for which the lessor shall be liable. In case of doubt, it is understood that the repairs are chargeable against him *(Art. 1686, Civil Code).*

If the duration of the lease has not been fixed by the parties or when an implied new lease is deemed established, the period is understood to be from year to year, if the rent agreed upon is annual; from month to month, if it is monthly; from week to week, if the rent is weekly; and from day to day, if the rent is to be paid daily. However, even though a monthly rent is paid, and no period

for the lease has been set, the courts may fix a longer term for the lease after the lessee has occupied the premises for over one year. If the rent is weekly, the courts may likewise determine a longer period after the lessee has been in possession for over six months. In case of daily rent, the courts may also fix a longer period after the lessee has stayed in the place for over one month *(Art. 1687, Civil Code; Francisco vs. Intermediate Appellate Court, 181 SCRA 781)*. A lessee, however, may not make use of these periods in the cases referred to in Article 1673 *(supra.; Art. 1675, Civil Code)*.

The potestative authority of the court may be exercised only when the duration of the lease is not fixed by the parties themselves that would thereby occasion the application of Article 1687 of the Civil Code. The court's power to extend, not reduce, the period is discretionary and may be so exercised when equity demands but always with due deference to the will and intent of the parties *(Divino vs. De Marcos, 4 SCRA 186; Rodriguez vs. Abrajano & Co., 27 SCRA 1269; Gregorio Araneta, Inc. vs. De Mesa, 35 SCRA 137; Prieto vs. Santos, 98 Phil. 509)*. In granting the extension of the contract of lease, the court may consider the length of time that the lessee has stayed in the premises, substantial or additional improvements made on the property, and the difficulty of looking for another place wherein the lessee can transfer *(Arquelada vs. Philippine Veterans Bank, 329 SCRA 536)*.

The Court, in *Yap vs. Court of Appeals (353 SCRA 714)*, exercised its discretion and denied extension of the term of the lease as the lessee did not actually or physically occupy or make use of the property but, in fact, subleased the same to a third person *sans* the knowledge and consent of the lessor. In *F.S. Divinagracia Agro-Commercial, Inc. vs. Court of Appeals (104 SCRA 180)*, the lessee and his ascendant had been occupying the premises for over 76 years and paying rentals on a monthly basis. Hence, the Court saw it fit to extend the period of lease for another 5 years.

A contract of lease, being impermanent, can only be either for a definite or for an indefinite period. It is definite where the contract itself specifies its duration. When no such duration is contractually stipulated or specified, it should instead be deemed to be for an indefinite term *(Inductivo vs. Court of Appeals, 47 SCAD 331, 229 SCRA 380)*. Where the lease specifies that it is on a month-to-month basis, it may be terminated at the end of any month *(Limpan vs. Lim, 159 SCRA 484; Cruz vs. Pano, 120 SCRA 497)*. Where a period is expressed by the parties themselves in their agreement, the courts are powerless to extend the period, Article 1687 being inapplicable. Thus, in *La Jolla, Inc. vs. Court of Appeals (G.R. No. 115851, 20 June 2001, 144 SCAD 612)*, the Supreme Court has reversed the Court of Appeals in extending the period of lease considering that the potestative authority of the courts to fix a longer term for a lease under Article 1687 of the Civil Code applies only to cases where there is no period fixed by the parties.

In *Inductivo vs. Court of Appeals (47 SCAD 331, 229 SCRA 380),* the Court was asked to resolve whether or not a lease contract not covered by a definite contract and with rentals paid on a month-to-month basis would fall under the exceptions stated in Batas Pambansa Blg. 877, otherwise known as the Rent Control Law, such that the lessee, under these given circumstances, could be validly ejected at the end of any given month. Citing its pronouncement in *Heirs of Dimaculangan vs. Intermediate Appellate Court (170 SCRA 393)*, the Court sustained the positive view and held that when rentals were paid monthly, a lease was deemed to be for a definite period, "expiring at the end of every monthly period," thereby granting the lessor the right to eject the lessee after prior notice of such termination and demand to vacate the leased premises (see also *Consolacion de Vera vs. Court of Appeals, G.R. No. 110297, 07 August 1996*).

There are rulings to the effect that an extension of time may be sought by the lessee before, but not after, the

termination or expiration of the lease (see *Yek vs. Court of Appeals, 205 SCRA 305; Alegre vs. De Laperal, 23 SCRA 934; Prieto vs. Santos, 98 Phil. 509*). This statement should not be taken out of context; it is valid and sound where the lease, in fact, had been terminated or had expired. But where the term of the lease is understood to be that which is provided for in Article 1687 because the contract itself has failed to state the period thereof, the mere notice by the lessor, without concurrence by the lessee, to terminate the lease is not enough to consider the lease as having expired that would thereby render powerless the courts to fix a term longer than the periods stated in the law. The periods set by Article 1687 are presumptive in nature and are clearly held subject to the potestative authority of the court in the event that the parties are unable to reach an agreement on a definitive term. If it were otherwise, then the power of the courts to grant an extended period becomes illusory since it is only when the lessor decides not to grant a longer period or refuses to grant an extended term that the lessee should and can be expected to seek court relief. Considering that the authority of the court is potestative and predicated not only on the presumed intention of the parties but on equity as well, the application and interpretation of the provision must not be too restrictive and limitative to the point of rendering the remedy of seeking for extension meaningless and useless such as by the simple and expedient process of the lessor promptly giving notice of termination and making the lessor, rather than the Court, the final arbiter on the presumptive period of the lease.

Article 1687 as thus construed would be consistent with the rule stated in Article 1197 of the Civil Code to the effect that when the parties to an obligation do not fix a period, but from the circumstances it can be inferred that a period has been intended, the courts, on the assumption that the parties are unable to come to an agreement thereon, may fix the duration thereof. The basic

difference between the two articles is that Article 1687 additionally expresses presumptive period which can be used not only by the parties but likewise by the courts, in case of disputes, for guidance in the proper appreciation and determination of the lease duration. In the exercise of its potestative authority, the courts may, however, only fix a period which can be longer, but not shorter, than the periods provided for by the article as the facts and circumstances surrounding each case warrant.

In *Ramirez vs. Chit (21 SCRA 1364)*, the lessor in June 1962 had made a demand on the lessee to vacate the premises. The demand not having been heeded, the lessor in September 1962 (shortly after a second demand to vacate the premises was also rejected) filed suit for ejectment. The lessee invoked Article 1687 of the Civil Code for an extension of the period of the lease (which was without a fixed term but payment of the rentals was on a monthly basis), having been in possession for over a year. In holding that the request for extension was a proper issue in the ejectment suit, the Supreme Court likewise ruled that the inferior court in said case had the potestative authority to extend the lease period.

Articles 1682 and 1687 have been held to be inapplicable to leases of public land (see *Agalo-os vs. Intermediate Appellate Court, 149 SCRA 546*).

Chapter 3

Work and Labor

Section 1 — Household Service

Art. 1689. Household service shall always be reasonably compensated. Any stipulation that household service is without compensation shall be void. Such compensation shall be in addition to the house helper's lodging, food, and medical attendance.

Art. 1690. The head of the family shall furnish, free of charge, to the house helper, suitable and sani-

tary quarters as well as adequate food and medical attendance.

Art. 1691. If the house helper is under the age of eighteen years, the head of the family shall give an opportunity to the house helper for at least elementary education. The cost of such education shall be a part of the house helper's compensation, unless there is a stipulation to the contrary.

Art. 1692. No contract for household service shall last for more than two years. However, such contract may be renewed from year to year.

Art. 1693. The house helper's clothes shall be subject to stipulation. However, any contract for household service shall be void if thereby the house helper cannot afford to acquire suitable clothing.

Art. 1694. The head of the family shall treat the house helper in a just and humane manner. In no case shall physical violence be used upon the house helper.

Art. 1695. House helpers shall not be required to work more than ten hours a day. Every house helper shall be allowed four days' vacation each month, with pay.

Art. 1696. In case of death of the house helper, the head of the family shall bear the funeral expenses if the house helper has no relatives in the place where the head of the family lives, with sufficient means therefore.

Art. 1697. If the period for household service is fixed neither the head of the family nor the house helper may terminate the contract before the expiration of the term, except for a just cause. If the house helper is unjustly dismissed, he shall be paid the compensation already earned plus that for fifteen days by way of indemnity. If the house helper leaves without justifiable reason, he shall forfeit any salary due him and unpaid, for not exceeding fifteen days.

Art. 1698. If the duration of the household service is not determined either by stipulation or by the nature of the service, the head of the family or the house

helper may give notice to put an end to the service relation, according to the following rules:

(1) If the compensation is paid by the day, notice may be given on any day that the service shall end at the close of the following day;

(2) If the compensation is paid by the week, notice may be given, at the latest, on the first business day of the week, that the service shall be terminated at the end of the seventh day from the beginning of the week;

(3) If the compensation is paid by the month, notice may be given, at the latest, on the fifth day of the month, that the service shall cease at the end of the month.

Art. 1699. Upon the extinguishment of the service relation, the house helper may demand from the head of the family a written statement on the nature and duration of the service and the efficiency and conduct of the house helper.

(1) *Household Service*

Household service shall always be reasonably compensated. Any stipulation that household service is without compensation shall be void. Such compensation shall be in addition to the house helper's lodging, food, and medical attendance *(Art. 1689, Civil Code)*. The head of the family shall furnish, free of charge, to the house helper, suitable and sanitary quarters as well as adequate food and medical attendance *(Art. 1690, Civil Code; Cuajo vs. Chua, 6 SCRA 136)*.

Other Terms and Conditions

If the house helper is under the age of eighteen years, the head of the family shall give an opportunity to the house helper for at least elementary education. The cost of such education shall be a part of the house helper's compensation, unless there is a stipulation to the contrary *(Art. 1691, Civil Code)*. The house helper's clothes shall be subject to stipulation. However, any contract for

household service shall be void if thereby the house helper cannot afford suitable clothing *(Art. 1693, Civil Code)*.

The head of the family shall treat the house helper in a just and humane manner. In no case shall physical violence be used upon the house helper *(Art. 1694, Civil Code)*. House helpers shall not be required to work more than ten hours a day. Every house helper shall be allowed four days' vacation each month, with pay *(Art. 1695, Civil Code)*.

In case of death of the house helper, the head of the family shall bear the funeral expenses if the house helper has no relatives in the place where the head of the family lives, with sufficient means therefore *(Art. 1696, Civil Code)*.

Duration

No contract for household service shall last for more than two years. However, such contract may be renewed from year to year *(Art. 1692, Civil Code)*. If the period for household service is fixed, neither the head of the family nor the house helper may terminate the contract before the expiration of the term, except for a just cause. If the house helper is unjustly dismissed, he shall be paid the compensation already earned plus that for fifteen days by way of indemnity. If the house helper leaves without justifiable reason, he shall forfeit any salary due him and unpaid, for not exceeding fifteen days *(Art. 1697, Civil Code)*. If the duration of the household service is not determined either by stipulation or by the nature of the service, the head of the family or the house helper may give notice to put an end to the service relation according to the following rules:

(1) If the compensation is paid by the day, notice may be given on any day that the service shall end at the close of the following day;

(2) If the compensation is paid by the week, notice may be given, at the latest, on the first business day of

the week, that the service shall be terminated at the end of the seventh day from the beginning of the week;

(3) If the compensation is paid by the month, notice may be given, at the latest, on the fifth day of the month, that the service shall cease at the end of the month *(Art. 1698, Civil Code)*.

Upon the extinguishment of the service relation, the house helper may demand from the head of the family a written statement on the nature and duration of the service and the efficiency and conduct of the house helper *(Art. 1699, Civil Code)*.

Section 2 — Contract of Labor

Art. 1700. The relation between capital and labor are not merely contractual. They are so impressed with public interest that labor contracts must yield to the common good. Therefore, such contracts are subject to the special laws on labor unions, collective bargaining, strikes and lockouts, closed shop, wages, working conditions, hours of labor and similar subjects.

Art. 1701. Neither capital nor labor shall act oppressively against the other, or impair the interest or convenience of the public.

Art. 1702. In case of doubt, all labor legislation and all labor contracts shall be construed in favor of the safety and decent living for the laborer.

Art. 1703. No contract which practically amounts to involuntary servitude, under any guise whatsoever, shall be valid.

Art. 1704. In collective bargaining, the labor union or members of the board or committee signing the contract shall be liable for non-fulfillment thereof.

Art. 1705. The laborer's wages shall be paid in legal currency.

Art. 1706. Withholding of the wages, except for a debt due, shall not be made by the employer.

Art. 1707. The laborer's wages shall be a lien on the goods manufactured or the work done.

Art. 1708. The laborer's wages shall not be subject to execution or attachment, except for debts incurred for food, shelter, clothing and medical attendance.

Art. 1709. The employer shall neither seize nor retain any tool or other articles belonging to the laborer.

Art. 1710. Dismissal of laborers shall be subject to the supervision of the Government, under special laws.

Art. 1711. Owners of enterprises and other employers are obliged to pay compensation for the death of or injuries to their laborers, workmen, mechanics or other employees, even though the event may have been purely accidental or entirely due to a fortuitous cause, if the death or personal injury arose out of and in the course of the employment. The employer is also liable for compensation if the employee contracts any illness or disease caused by such employment or as the result of the nature of the employment. If the mishap was due to the employee's own notorious negligence, or voluntary act, or drunkenness, the employer shall not be liable for compensation. When the employee's lack of due care contributed to his death or injury, the compensation shall be equitably reduced.

Art. 1712. If the death or injury is due to the negligence of a fellow-worker, the latter and the employer shall be solidarily liable for compensation. If a fellow-worker's intentional or malicious act is the only cause of the death or injury, the employer shall not be answerable, unless it should be shown that the latter did not exercise due diligence in the selection or supervision of the plaintiff's fellow-worker.

In General

The relations between capital and labor are not merely contractual. They are so impressed with public interest that labor contracts must yield to the common

good. Therefore, such contracts are subject to the special laws on labor unions, collective bargaining, strikes and lockouts, closed shop, wages, working conditions, hours of labor and similar matters *(Art. 1700, Civil Code;* see *Singapore Airlines, Ltd. vs. Paño, 122 SCRA 671)*. In determining the existence of employer-employee relationship, the following elements are generally considered, namely: (1) the selection and engagement of the employee; (2) the payment of wages; (3) the power to control the employee's conduct — although the latter is the most important element *(Viana vs. Al-Lagadan, 99 Phil. 408; 35 Am. Jur. 445)*; and (4) the power of dismissal *(Escano vs. NLRC, 201 SCRA 63)*. Neither capital nor labor shall act oppressively against the other, or impair the interest or convenience of the public *(Art. 1701, Civil Code)*.

An illegal and unjustifiable dismissal of an employee would be violative of this rule that can render the company employer and its officers who act with malice liable solidarily. A local recruiter has also been held solidarily liable with a foreign principal for damages sustained by an overseas worker in connection with the contract of employment *(Cruz vs. NLRC, 203 SCRA 286)*. But a purchaser of assets of an on-going concern is not required to absorb the latter's employees *(Sundowner Dev. Corp. vs. Drilon, 180 SCRA 14)*.

In case of doubt, all labor legislation and all labor contracts shall be construed in favor of the safety and decent living for the laborer *(Art. 1702, Civil Code)*. The employer shall neither seize nor retain any tool or other articles belonging to the laborer *(Art. 1709, Civil Code)*. Dismissal of laborers shall be subject to the supervision of the Government, under special laws *(Art. 1710, Civil Code)*.

Right to Wages

No contract which practically amounts to involuntary servitude, under any guise whatsoever, shall be valid *(Art. 1703, Civil Code)*.

The laborer's wages shall be paid in legal currency *(Art. 1705, Civil Code*). Withholding of wages, except for a debt due, shall not be made by the employer *(Art. 1706, Civil Code).* The laborer's wages shall be a lien on the goods manufactured or the work done *(Art. 1707, Civil Code).* The laborer's wages shall not be subject to execution or attachment, except for debts incurred for food, shelter, clothing and medical attendance *(Art. 1708, Civil Code).* In *Gaa vs. Court of Appeals (140 SCRA 304),* the Supreme Court held that this provision of Article 1708 does not operate in favor of one who occupies a managerial or supervisory position or its equivalent, "but (applies only to) those who are laboring men and women in the sense that their work is manual."

Liability of Employers for Death or Injury

Owners of enterprises and other employers (engaged in business or industry *[Alarcovi vs. Alarcon, 2 SCRA 473]*) are obliged to pay compensation for the death of or injuries to their laborers, workmen, mechanics or other employees, even though the event may have been purely accidental or entirely due to a fortuitous cause, if the death or personal injury arose out of and in the course of the employment. The employer is also liable for compensation if the employee contracts any illness or disease caused by such employment or as a result of the nature of the employment. If the mishap was due to the employee's own notorious negligence, or voluntary act, or drunkenness, the employer shall not be liable for compensation. When the employee's lack of care contributed to his death or injury, the compensation shall be equitably reduced *(Art. 1711, Civil Code;* see *Philippine Engineers' Syndicate, Inc. vs. Martin, 4 SCRA 356).*

An injured worker has a choice of either to recover from the employer the fixed amount set by the Workmen's Compensation Act or to prosecute an ordinary civil action against the tortfeasor for greater damages; but he

cannot pursue both courses of action simultaneously. Article 1711 of the Civil Code may be applied as against the Workmen's Compensation Act *(Floresca vs. Philex Mining Corporation, 136 SCRA 141; Ysmael Maritime Corp. vs. Avelino, 151 SCRA 333;* abandoning *Robles vs. Yap Wing, 41 SCRA 267; Severo vs. Vda. de Feliciano-Go, 157 SCRA 446).*

If the death or injury is due to the negligence of a fellow-worker, the latter and the employer shall be solidarily liable for compensation. If a fellow-worker's intentional or malicious act is the only cause of the death or injury, the employer shall not be answerable, unless it should be shown that the latter did not exercise due diligence in the selection or supervision of the plaintiff's fellow-worker *(Art. 1712, Civil Code).*

Section 3 — Contract for a Piece of Work

Art. 1713. By the contract for a piece of work the contractor binds himself to execute a piece of work for the employer, in consideration of a certain price or compensation. The contractor may either employ only his labor or skill, or also furnish the material. (1588a)

Art. 1714. If the contractor agrees to produce the work from material furnished by him, he shall deliver the thing produced to the employer and transfer dominion over the thing. This contract shall be governed by the following articles as well as by the pertinent provisions on warranty of title and against hidden defects and the payment of price in a contract of sale. (n)

Art. 1715. The contractor shall execute the work in such a manner that it has the qualities agreed upon and has no defects which destroy or lessen its value or fitness for its ordinary or stipulated use. Should the work be not of such quality, the employer may require that the contractor remove the defect or execute another work. If the contractor fails or refuses to comply with this obligation, the employer may have the defect removed or another work executed, at the contractor's cost. (n)

Art. 1716. An agreement waiving or limiting the contractor's liability for any defect in the work is void if the contractor acted fraudulently. (n)

Art. 1717. If the contractor bound himself to furnish the material, he shall suffer the loss if the work should be destroyed before its delivery, save when there has been delay in receiving it. (1589)

Art. 1718. The contractor who has undertaken to put only his work or skill, cannot claim any compensation if the work should be destroyed before its delivery, unless there has been delay in receiving it, or if the destruction was caused by the poor quality of the material, provided this fact was communicated in due time to the owner. If the material is lost through a fortuitous event, the contract is extinguished. (1590a)

Art. 1719. Acceptance of the work by the employer relieves the contractor of liability for any defect in the work, unless:

(1) The defect is hidden and the employer is not, by his special knowledge, expected to recognize the same; or

(2) The employer expressly reserves his rights against the contractor by reason of the defect. (n)

Art. 1720. The price or compensation shall be paid at the time and place of delivery of the work, unless there is a stipulation to the contrary. If the work is to be delivered partially, the price or compensation for each part having been fixed, the sum shall be paid at the time and place of delivery, in the absence of stipulation. (n)

Art. 1721. If, in the execution of the work, an act of the employer is required, and he incurs in delay or fails to perform the act, the contractor is entitled to a reasonable compensation.

The amount of the compensation is computed, on the one hand, by the duration of the delay and the amount of the compensation stipulated, and on the other hand, by what the contractor has saved in ex-

penses by reason of the delay, or is able to earn by a different employment of his time and industry. (n)

Art. 1722. If the work cannot be completed on account of a defect in the material furnished by the employer, or because of orders from the employer, without any fault on the part of the contractor, the latter has a right to an equitable part of the compensation proportionally to the work done, and reimbursement for proper expenses made. (n)

Art. 1723. The engineer or architect who drew up the plans and specifications for a building is liable for damages if within fifteen years from the completion of the structure, the same should collapse by reason of a defect in those plans and specifications, or due to the defects in the ground. The contractor is likewise responsible for the damages if the edifice falls, within the same period, on account of defects in the construction or the use of materials of inferior quality furnished by him, or due to any violation of the terms of the contract. If the engineer or architect supervises the construction, he shall be solidarily liable with the contractor.

Acceptance of the building, after completion, does not imply waiver of any of the causes of action by reason of any defect mentioned in the preceding paragraph.

The action must be brought within ten years following the collapse of the building. (n)

Art. 1724. The contractor who undertakes to build a structure or any other work for a stipulated price, in conformity with plans and specifications agreed upon with the landowner, can neither withdraw from the contract nor demand an increase in the price on account of the higher cost of labor or materials, save when there has been a change in the plans and specifications, provided:

(1) Such change has been authorized by the proprietor in writing; and

(2) The additional price to be paid to the contractor has been determined in writing by both parties. (1593a)

Art. 1725. The owner may withdraw at will from the construction of the work, although it may have been commenced, indemnifying the contractor for all the latter's expenses, work, and the usefulness which the owner may obtain therefrom, and damages. (1594a)

Art. 1726. When a piece of work has been entrusted to a person by reason of his personal qualifications, the contract is rescinded upon his death.

In this case the proprietor shall pay the heirs of the contractor in proportion to the price agreed upon, the value of the part of the work done, and of the materials prepared, provided the latter yield him some benefit.

The same rule shall apply if the contractor cannot finish the work due to circumstances beyond his control. (1595)

Art. 1727. The contractor is responsible for the work done by persons employed by him. (1596)

Art. 1728. The contractor is liable for all the claims of laborers and others employed by him, and of third persons for death or physical injuries during the construction. (n)

Art. 1729. Those who put their labor upon or furnish materials for a piece of work undertaken by the contractor have an action against the owner up to the amount owing from the latter to the contractor at the time the claim is made. However, the following shall not prejudice the laborers, employees and furnishers of materials:

(1) Payments made by the owner to the contractor before they are due;

(2) Renunciation by the contractor of any amount due him from the owner.

This article is subject to the provisions of special laws. (1597a)

Art. 1730. If it is agreed that the work shall be accomplished to the satisfaction of the proprietor, it is

understood that in case of disagreement the question shall be subject to expert judgment.

If the work is subject to the approval of a third person, his decision shall be final, except in case of fraud or manifest error. (1598a)

Art. 1731. He who has executed work upon a movable has a right to retain it by way of pledge until he is paid. (1600)

By the contract for a piece of work, the contractor binds himself to execute a piece of work for the employer, in consideration of a certain price or compensation. The contractor may either employ only his labor or skill, or also furnish the material *(Art. 1713, Civil Code)*. An employer-employee relationship would instead arise where the work to be done is directly or necessarily connected with the usual course of business of the owner *(Manila Railroad Company vs. Vda. de Oliveros, 2 SCRA 665)* or when the person for whom the services are performed reserves a right to control not only the end to be achieved but also the means to be used in reaching that end (see *LVN Pictures, Inc. vs. CIR, 110 Phil. 725*).

In the case of *Social Security System vs. Court of Appeals (156 SCRA 383)*, the Supreme Court said:

> "The Court took cognizance of the fact that the question of whether or not an employer-employee relationship exists in a certain situation continues to bedevil the courts. Some businessmen with the aid of lawyers have tried to avoid the bringing about of an employer-employee relationship in some of their enterprises because that juridical relation spawns obligations connected with workmen's compensation, social security, medicare, minimum wage, termination pay and unionism.
>
> "For this reason, in order to put the issue at rest, this Court has laid down in a formidable line of decisions the elements, to be generally considered in determining the existence of an employer-employee

relationship, as follows: a) selection and engagement of the employee; b) the payment of wages; c) the power of dismissal; and d) the employer's power to control the employee with respect to the means and method by which the work is to be accomplished. The last which is the so-called "control test" is the most important element *(Brotherhood Labor vs. Labor Unity Movement of the Phils., 147 SCRA 49 [1987]; Dy Ke Beng vs. International Labor and Marine Union of the Phils., 90 SCRA 162 [1979]; Mafinco Trading Corp. vs. Ople, 70 SCRA 141 [1976]; Social Security System vs. Court of Appeals, 37 SCRA 579 [1971])*."

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

Obligations and Liabilities of Contractor

If the contractor agrees to produce the work from material furnished by him, he shall deliver the thing produced to the employer and transfer dominion over the thing. This contract shall be governed by the law on contracts for a piece of work, as well as by the pertinent provisions on warranty of title and against hidden defects and the payment of price in a contract of sale *(Art. 1714, Civil Code)*.

The contractor shall execute the work in such a manner that it has the qualities agreed upon and has no defects which destroy or lessen its value or fitness for its ordinary or stipulated use. Should the work be not of such quality, the employer may require that the contractor remove the defect or execute another work. If the contractor fails or refuses to comply with this obligation,

the employer may have the defect removed or another work executed, at the contractor's cost *(Art. 1715, Civil Code)*. The contractor is responsible for the work done by persons employed by him *(Art. 1727, Civil Code)*.

If it is agreed that the work shall be accomplished to the satisfaction of the proprietor, it is understood that in case of disagreement the question shall be subject to expert judgment. If the work is subject to the approval of a third person, his decision shall be final, except in case of fraud or manifest error *(Art. 1730, Civil Code; Takao vs. Iturralde, 49 Phil. 957)*.

An agreement waiving or limiting the contractor's liability for any defect in the work is void if the contractor acted fraudulently *(Art. 1716, Civil Code)*.

Acceptance of the work by the employer relieves the contractor of liability for any defect in the work, unless:

(1) The defect is hidden and the employer is not, by his special knowledge, expected to recognize the same; or

(2) The employer expressly reserves his rights against the contractor by reason of the defect *(Art. 1719, Civil Code;* see *Limjap vs. Manchuca, 38 Phil. 451)*.

The engineer or architect who drew up the plans and specifications for a building is liable for damages if within fifteen years from the completion of the structure, the same should collapse by reason of a defect in those plans and specifications, or due to the defects in the ground. The contractor is likewise responsible for the damages if the edifice falls, within the same period, on account of defects in the construction or the use of materials of inferior quality furnished by him, or due to any violation of the terms of the contract. If the engineer or architect supervises the construction, he shall be solidarily liable with the contractor *(Juan F. Nakpil & Sons vs. Court of Appeals, 144 SCRA 596)*. Acceptance of the building, after completion, does not imply waiver of any of the causes of action by reason of any defect mentioned in the preced-

ing paragraph. The action must be brought within ten years following the collapse of the building *(Art. 1723, Civil Code)*.

Compensation Due the Contractor

The price or compensation shall be paid at the time and place of delivery of the work, unless there is a stipulation to the contrary. If the work is to be delivered partially, the price or compensation for each part having been fixed, the sum shall be paid at the time and place of delivery, in the absence of stipulation *(Art. 1720, Civil Code; Gonzales vs. Court of Appeals, 124 SCRA 630)*.

If the contractor bound himself to furnish the material, he shall suffer the loss if the work should be destroyed before its delivery, save when there has been delay in receiving it *(Art. 1717, Civil Code)*. The contractor who has undertaken to put only his work or skill cannot claim any compensation if the work should be destroyed before its delivery, unless there has been delay in receiving it, or if the destruction was caused by the poor quality of the material, provided this fact was communicated in due time to the owner. If the material is lost through a fortuitous event, the contract is extinguished *(Art. 1718, Civil Code)*.

If, in the execution of the work, an act of the employer is required, and he incurs in delay or fails to perform the act, the contractor is entitled to a reasonable compensation. The amount of the compensation is computed, on the one hand, by the duration of the delay and amount of the compensation stipulated, and on the other hand, by what the contractor has saved in expenses by reason of the delay, or is able to earn by a different employment of his time and industry *(Art. 1721, Civil Code)*. If the work cannot be completed on account of a defect in the material furnished by the employer, or because of orders from the employer, without any fault on the part of the contractor, the latter has a right to an equitable part of the compensation proportionally to the work done, and

reimbursement for proper expenses made *(Art. 1772, Civil Code)*.

The contractor who undertakes to build a structure or any other work for a stipulated price, in conformity with plans and specifications agreed upon with the landowner, can neither withdraw from the contract nor demand an increase in the price on account of the higher cost of labor or materials, save when there has been a change in the plans and specifications, provided:

(a) Such change has been authorized by the proprietor in writing; and

(b) The additional price to be paid to the contractor has been determined in writing by both parties *(Art. 1724, Civil Code)*.

This provision was held inapplicable to work done upon a vessel which is not erected on land (see *Royal Lines, Inc. vs. Court of Appeals, 143 SCRA 608*), and to fees of architects *(Arenas vs. Court of Appeals, 169 SCRA 558)*.

The owner may withdraw at will from the construction of the work, although it may have been commenced, indemnifying the contractor for all the latter's expenses, work, and the usefulness which the owner may obtain therefrom, and damages *(Art. 1725, Civil Code)*.

When a piece of work has been entrusted to a person by reason of his personal qualifications, the contract is rescinded upon his death. In this case the proprietor shall pay the heirs of the contractor in proportion to the price agreed upon, the value of the part of the work done, and of the materials prepared, provided the latter yield him some benefit. The same rule shall apply if the contractor cannot finish the work due to circumstances beyond his control *(Art. 1726, Civil Code)*.

The contractor who has executed work upon a *movable* has a right to retain it by way of pledge until he is paid *(Art. 1731, Civil Code)*.

Claims of Contractor's Laborers and Materialmen

The contractor is liable for all the claims of laborers and others employed by him, and of third persons for death or physical injuries during the construction *(Art. 1728, Civil Code)*.

Those who put their labor upon or furnish materials for a piece of work undertaken by the contractor have an action against the owner up to the amount owing from the latter to the contractor at the time the claim is made. However, the following shall not prejudice the laborers, employees and furnishers of materials:

(a) Payments made by the owner to the contractor before they are due; and

(b) Renunciation by the contractor of any amount due him from the owner.

The above rules are subject to the provisions of special laws *(Art. 1729, Civil Code;* see *The Labor Code; University of the Philippines vs. Gabriel, 154 SCRA 684; Velasco vs. Court of Appeals, 95 SCRA 616)*. Thus, a special law *(e.g., Act 3059)* requiring the contractor to furnish a bond and to submit an affidavit attesting that the laborer's wages have been paid before the employer makes a full payment would render the owner solidarily liable for such wages if the latter does not enforce those conditions (see *University of the Philippines vs. Gabriel, supra.; Castro vs. Yandoc, 70 Phil. 138*). Under Article 106 of the Labor Code, an employer is made solidarily liable with the independent contractor for unpaid wages to the extent of the work performed (see *San Miguel Corp. vs. NLRC, 209 SCRA 632*).

Section 4 — Common Carriers

Subsection 1 — General Provisions

Art. 1732. Common carriers are persons, corporations, firms or associations engaged in the business of carrying or transporting passengers or goods or

both, by land, water, or air, for compensation, offering there services to the public.

Art. 1733. Common carriers, from the nature of their business and for reasons of public policy, are bound to observe extraordinary diligence in the vigilance over the goods and for the safety of the passengers transported by them, according to all the circumstances of each case.

Such extraordinary diligence in the vigilance over the goods is further expressed in Articles 1734, 1735, and 1745, Nos. 5, 6, and 7, while the extraordinary diligence for the safety of the passengers is further set forth in Articles 1755 and 1756.

Subsection 2 — Vigilance Over Goods

Art. 1734. Common carriers are responsible for the loss, destruction, or deterioration of the goods, unless the same is due to any of the following causes only:

(1) Flood, storm, earthquake, lightning, or other natural disaster or calamity;

(2) Act of the public enemy in war, whether international or civil;

(3) Act or omission of the shipper or owner of the goods;

(4) The character of the goods or defects in the packing or in the containers;

(5) Order or act of competent public authority.

Art. 1735. In all cases other than those mentioned in Nos. 1, 2, 3, 4, and 5 of the preceding article, if the goods are lost, destroyed or deteriorated, common carriers are presumed to have been at fault or to have acted negligently, unless they prove that they observed extraordinary diligence as required in Article 1733.

Art. 1736. The extraordinary responsibility of the common carrier lasts from the time the goods are unconditionally placed in the possession of, and received

by the carrier for transportation until the same are delivered, actually or constructively, by the carrier to the consignee, or to the person who has a right to receive them, without prejudice to the provisions of Article 1738.

Art. 1737. The common carrier's duty to observe extraordinary diligence in the vigilance over the goods remains in full force and effect even when they are temporarily unloaded or stored in transit, unless the shipper or owner has made use of the right of stoppage *in transitu*.

Art. 1738. The extraordinary liability of the common carrier continues to be operative even during the time the goods are stored in a warehouse of the carrier at the place of destination, until the consignee has been advised of the arrival of the goods and has had reasonable opportunity thereafter to remove them or otherwise dispose of them.

Art. 1739. In order that the common carrier may be exempted from responsibility, the natural disaster must have been the proximate and only cause of the loss. However, the common carrier must exercise due diligence to prevent or minimize loss before, during and after the occurrence of flood, storm or other natural disaster in order that the common carrier may be exempted from liability for the loss, destruction, or deterioration of the goods. The same duty is incumbent upon the common carrier in case of an act of the public enemy referred to in Article 1734, No. 2.

Art. 1740. If the common carrier negligently incurs in delay in transporting the goods, a natural disaster shall not free such carrier from responsibility.

Art. 1741. If the shipper or owner merely contributed to the loss, destruction or deterioration of the goods, the proximate cause thereof being the negligence of the common carrier, the latter shall be liable in damages, which however, shall be equitably reduced.

Art. 1742. Even if the loss, destruction, or deterioration of the goods should be caused by the character of the goods, or the faulty nature of the packing or of

the containers, the common carrier must exercise due diligence to forestall or lessen the loss.

Art. 1743. If through order of public authority the goods are seized or destroyed, the common carrier is not responsible, provided said public authority had power to issue the order.

Art. 1744. A stipulation between the common carrier and the shipper or owner limiting the liability of the former for the loss, destruction, or deterioration of the goods to a degree less than extraordinary diligence shall be valid, provided it be:

(1) In writing, signed by the shipper or owner;

(2) Supported by a valuable consideration other than the service rendered by the common carrier; and

(3) Reasonable, just and not contrary to public policy.

Art. 1745. Any of the following or similar stipulations shall be considered unreasonable, unjust and contrary to public policy:

(1) That the goods are transported at the risk of the owner or shipper;

(2) That the common carrier will not be liable for any loss, destruction, or deterioration of the goods;

(3) That the common carrier need not observe any diligence in the custody of the goods;

(4) That the common carrier shall exercise a degree of diligence less than that of a good father of a family, or of a man of ordinary prudence in the vigilance over the movables transported;

(5) That the common carrier shall not be responsible for the acts or omissions of his or its employees;

(6) That the common carrier's liability for acts committed by thieves, or of robbers who do not act with grave or irresistible threat, violence or force, is dispensed with or diminished;

(7) That the common carrier is not responsible for the loss, destruction, or deterioration of goods on account of the defective condition of the car, vehicle, ship, airplane or other equipment used in the contract of carriage.

Art. 1746. An agreement limiting the common carrier's liability may be annulled by the shipper or owner if the common carrier refused to carry the goods unless the former agreed to such stipulation.

Art. 1747. If the common carrier, without just cause, delays the transportation of the goods or changes the stipulated or usual route, the contract limiting the common carrier's liability cannot be availed of in case of the loss, destruction, or deterioration of the goods.

Art. 1748. An agreement limiting the common carrier's liability for delay on account of strikes or riots is valid.

Art. 1749. A stipulation that the common carrier's liability is limited to the value of the goods appearing in the bill of lading, unless the shipper or owner declares a greater value, is binding.

Art. 1750. A contract fixing the sum that may be recovered by the owner or shipper for the loss, destruction, or deterioration of the goods is valid, if it is reasonable and just under the circumstances, and has been fairly and freely agreed upon.

Art. 1751. The fact that the common carrier has no competitor along the line or route, or a part thereof, to which the contract refers shall be taken into consideration on the question of whether or not a stipulation limiting the common carrier's liability is reasonable, just and in consonance with public policy.

Art. 1752. Even when there is an agreement limiting the liability of the common carrier in the vigilance over the goods, the common carrier is disputably presumed to have been negligent in case of their loss, destruction or deterioration.

Art. 1753. The law of the country to which the goods are to be transported shall govern the liability

of the common carrier for their loss, destruction or deterioration.

Art. 1754. The provisions of Articles 1733 to 1753 shall apply to the passenger's baggage which is not in his personal custody or in that of his employees. As to other baggage, the rules in Articles 1998 and 2000 to 2003 concerning the responsibility of hotel-keepers shall be applicable.

Subsection 3 — Safety of Passengers

Art. 1755. A common carrier is bound to carry the passengers safely as far as human care and foresight can provide, using the utmost diligence of very cautious persons, with a due regard for all the circumstances.

Art. 1756. In case of death of or injuries to passengers, common carriers are presumed to have been at fault or to have acted negligently, unless they prove that they observed extraordinary diligence as prescribed in Articles 1733 and 1755.

Art. 1757. The responsibility of a common carrier for the safety of passengers as required in Articles 1733 and 1755 cannot be dispensed with or lessened by stipulation, by the posting of notices, by statements on tickets, or otherwise.

Art. 1758. 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.

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

Art. 1759. Common carriers are liable for the death of or injuries to passengers through the negligence or willful acts of the former's employees, although such employees may have acted beyond the scope of their authority or in violation of the orders of the common carriers.

This liability of the common carriers does not cease upon proof that they exercised all the diligence

of a good father of a family in the selection and supervision of their employees.

Art. 1760. The common carrier's responsibility prescribed in the preceding article cannot be eliminated or limited by stipulation, by the posting of notices, by statements on the tickets or otherwise.

Art. 1761. The passenger must observe the diligence of a good father of a family to avoid injury to himself.

Art. 1762. The contributory negligence of the passenger does not bar recovery of damages for his death or injuries, if the proximate cause thereof is the negligence of the common carrier, but the amount of damages shall be equitably reduced.

Art. 1763. A common carrier is responsible for injuries suffered by a passenger on account of the willful acts or negligence of other passengers or of strangers, if the common carrier's employees through the exercise of the diligence of a good father of a family could have prevented or stopped the act or omission.

Common carriers are persons, corporations, firms or associations engaged in the business of carrying or transporting passengers or goods or both, by land, water, or by air, for compensation, offering their services to the public *(Art. 1732, Civil Code)*. The concept of common carrier under the Civil Code coincides neatly with the notion of public service under the Public Service Act *(Commonwealth Act No. 1416,* as amended; *Guzman vs. Court of Appeals, 168 SCRA 612)*. Under Section 13, paragraph (b) of the Public Service Act, "public service" includes:

> "x x x every person that now or hereafter may own, operate, manage, or control in the Philippines, for hire or compensation, *with general or limited clientele, whether permanent, occasional or accidental, and done for general business purposes, any common carrier,* railroad, street railway, traction rail-

way, subway motor vehicle, either for freight or passenger, or both, with or without fixed route and whatever may be its classification, freight or carrier service of any class, express service, steamboat, or steamship, or steamship line, pontines, ferries and water craft, engaged in the transportation of passengers or freight or both, shipyard, marine repair shop, wharf or dock, ice plant, ice-refrigeration plant, canal, irrigation system, gas, electric light, heat and power, water supply and power petroleum, sewerage system, wire or wireless communications systems, wire or wireless broadcasting stations and other similar public services. (Underscoring supplied.)"

Article 1732 of the Civil Code makes no distinction between one whose principal business activity is the carrying of persons or goods or both and one who does the same merely as an ancillary activity. It likewise makes no distinction between a person or enterprise offering transportation service on a regular or scheduled basis and one offering such service on an occasional, episodic or unscheduled basis. Neither does Article 1732 distinguish between a carrier offering its services to the general public and one who solicits business only from a narrow segment of the general population *(Guzman vs. Court of Appeals, 168 SCRA 612)*. Common carriers offer their services to the public, whether to the public in general or to a limited clientele in particular, but never on an exclusive basis. The true test of a common carrier is the carriage of passengers or goods, providing space for those who opt to avail themselves of its transportation service for a fee *(FGU Insurance Corporation vs. G.P. Sarmiento Trucking Corporation, G.R. No. 141910, 06 August 2002; National Steel Corporation vs. Court of Appeals, 89 SCAD 618, 283 SCRA 45)*.

The liability of a common carrier is not subject to whether or not it holds a certificate of public convenience; a contrary rule would be offensive to sound public policy *(Ibid.)*. The principle is that duties and liabilities are

imposed upon the common carriers for the safety of those who utilize their services, and the law cannot allow them in any way to render such duties and liabilities merely facultative by just failing to obtain the necessary permits and authorizations *(Loadstar Shipping Co., Inc. vs. Court of Appeals, 113 SCAD 142, 315 SCRA 339).*

Governing Laws

The operation of carriers is subject to governmental regulations. Among the laws that provide therefor are the Public Service Act, the Land Transportation and Traffic Code, the Tariff and Customs Code, and the Civil Aeronautics Act.

The private aspects of transportation, such as those arising from contracts or tort liabilities, are governed by the Civil Code, the Code of Commerce, Carriage of Goods by Sea Act and other private laws. On contractual scopes, the applicable law may, in an outline, be stated as follows:

1. Domestic (Overland, Air or Coastwise)
    a. *Contracts with common carriers*
        (1) Civil Code provisions (Arts. 1732-1766) on common carriers — primary law.
        (2) Code of Commerce provisions (Arts. 349, 379, 573-734, 580, 584, 806-845) — supplettory law.
    b. *Contracts with private carriers*

    The general provisions of the Civil Code govern (see *Art. 1307, Civil Code*).

2. Foreign (Air or Sea) — The law of the country of destination generally applies, hence —
    a. Transportation from a foreign port to a Philippine port — Philippine law applies *(Art. 1743, Civil Code; American Home Assn. vs. Court of*

Appeals, 208 SCRA 343; Maritime Company of the Phils. vs. Court of Appeals, 171 SCRA 61).

b. Transportation from a Philippine port to a foreign port — Law of the foreign country of destination applies *(Art. 1753, Civil Code).*

In foreign maritime trade, the Carriage of Goods by Sea Act (COGSA) applies in a suppletory character to the provisions of the Civil Code on common carriers and the Code of Commerce on Maritime Commerce (see *Art. 1766, Civil Code; National Development Company vs. Court of Appeals, 164 SCRA 593; Eastern Shipping Lines, Inc. vs. Intermediate Appellate Court, 150 SCRA 463;* see also *Alitalia vs. Intermediate Appellate Court, 192 SCRA 9, re* air carriers). For instance, the one-year prescriptive period in the COGSA can apply since the Civil Code *on common carriers* and the Code of Commerce have no equivalent or contrary provision thereon. Also applicable would be Sec. 4 of the law (COGSA) stating, among other things, that the liability of the common carrier for every package will not exceed $500 unless the nature and value of the package is otherwise declared in the bill of lading, not being opposed to, but accords, in fact, with Articles 1749-1750 of the Civil Code *(Eastern Shipping Lines, Inc. vs. Intermediate Appellate Court, 150 SCRA 463).*

In the illustrative case of *National Development Company vs. Court of Appeals (164 SCRA 593)*, the issues revolved on the question of preponderance in the application of the Civil Code, the Code of Commerce and the Carriage of Goods by Sea Act to the loss of goods destined for the Philippines resulting from a collision due to the fault of the captains of both vessels occurring outside Philippine waters. The Supreme Court ruling can be summed up, thus —

(a) For cargoes transported from a foreign port to the Philippines, the liability of the carrier is

governed primarily by the Civil Code on common carriers and in all matters not regulated by said Code, the Code of Commerce and special laws shall govern *(Art. 1766, Civil Code)*. The Carriage of Goods by Sea Act, a special law, is thus merely suppletory to both codes.

(b) Under the Civil Code, the carriers are bound to exercise extraordinary diligence in the vigilance over the goods *(Art. 1733)* and in all cases not mentioned in Article 1734, the carrier is presumed to have been at fault in the loss of cargoes *(Art. 1735)*. These rules also apply to foreign trade where the Philippines is the port of destination (reiterated in *Maritime Company of the Phils. vs. Court of Appeals, 171 SCRA 61*).

(c) In collisions particularly, Articles 826 to 839 of the Code of Commerce hold the shipowners liable for the fault or negligence of their personnel and provide that where the fault in the collision is imputable to both vessels, each carrier shall suffer its own loss or damage but both shall be solidarily liable to shippers for the loss of or damage to cargoes.

(d) The above provisions of the two codes subordinate the Carriage of Goods by Sea Act (see *Section 1, COGSA*) providing in Section 4(2) thereof that the carrier is not responsible for loss or damage resulting from the "act, neglect or default of the master, mariner, pilot or the servants of the carrier in the navigation or in the management of the ship."

To further exemplify the governing law, let us assume that a shipper contracted with Common Carrier "A" for the shipment of his goods from Hongkong to Manila. Midway from Hongkong to Manila, a collision occurs between Common Carrier "A" and a cargo ship "B" resulting in the loss of, or damage to, the shipper's goods. Since the goods were destined to a Philippine port, the Philippine law would apply. Neither the Civil Code *on*

common carriers nor the Code of Commerce provides for any prescriptive period. The Carriage of Goods by Sea Act which applies suppletorily to foreign maritime trade provides for a one-year prescriptive period but only as regards the liability of Common Carrier "A" with which the shipper had contracted for the shipment of his goods. Accordingly, the shipper may proceed in *culpa contractual* against Common Carrier "A" within the one-year prescriptive period. On a *tort claim* against the other carrier (Cargo ship "B"), COGSA not being applicable, the *general provisions* of the Civil Code can govern which prescribe a four year prescriptive period for torts (see *Kramer, Jr. vs. Court of Appeals, 178 SCRA 518*).

Diligence Requirement for Common Carriers

Common carriers, from the nature of their business and for reasons of public policy, are bound to observe extraordinary diligence in the vigilance over the goods and for the safety of the passengers transported by them, according to all the circumstances of each case. Particularly in reference to passengers, the law binds the common carrier to carry the passengers safely as far as human care and foresight can provide, using the utmost diligence of very cautious persons, with a due regard for all the circumstances *(Art. 1733,* in relation to *Art. 1755, Civil Code;* see *Vda. de Abeto vs. Philippine Air Lines, Inc., 115 SCRA 489).* Extraordinary diligence requires common carriers to render service with the greatest skill and foresight and "to use all reasonable means to ascertain the nature and characteristics of goods tendered for shipment, and to exercise due care in the handling and stowage, including such methods as their nature requires" *(Tabacalera Insurance Co. vs. North Front Shipping Services, Inc., 272 SCRA 527).*

The extraordinary diligence in the vigilance over the goods is further expressed in Articles 1734, 1735 and 1745, Nos. 5, 6 and 7, while the extraordinary diligence for the safety of the passengers is similarly elaborated in

Articles 1755 and 1756 *(Art. 1733, Civil Code)*. The provisions of Articles 1733 to 1753 shall apply to the passenger's baggage which is not in his personal custody or in that of his employees. As to the baggage in his custody, the rules in Articles 1988 and 2000 to 2008, concerning the responsibility of hotel-keepers, shall be applicable *(Art. 1754, Civil Code)*. In all matters not regulated by the Civil Code, the rights and obligations of common carriers shall be governed by the Code of Commerce and by special laws *(Art. 1766, Civil Code)*. To be precise, the governing laws are to be applied in the following order: the Civil Code on Common Carriers, the Code of Commerce on Overland and Maritime Commerce, special laws whenever applicable (*e.g.*, COGSA), and the general provisions of the Civil Code.

The Public Service Commission may, on its own motion or on petition of any interested party, after due hearing, cancel the certificate of public convenience granted to any common carrier that repeatedly fails to comply with his or its duty to observe the prescribed extraordinary diligence *(Art. 1765, Civil Code)*.

The law of the country to which the goods are to be transported shall govern the liability of the common carrier for their loss, destruction or deterioration *(Art. 1753, Civil Code)*.

The start of extraordinary diligence does not necessarily coincide with the birth of the contract nor end at the latter's extinguishment; although being predicated or premised on a contractual relationship, it is co-existent within the life thereof. In the carriage of goods, the extraordinary diligence lasts from the time the goods are surrendered to or unconditionally placed in the possession of, and received by, the carrier for transportation until delivered to, or until the lapse of a reasonable time for their acceptance by, the person entitled to receive them (see *Arts. 1736-1738, Civil Code; Sarkies Tours Philippines, Inc. vs. Court of Appeals, 87 SCAD 573, 280*

SCRA 58; Ganzon vs. Court of Appeals, 161 SCRA 646). The common carrier's duty to observe extraordinary diligence in the vigilance over the goods remains in full force and effect even when they are temporarily unloaded or stored in transit, unless the shipper or owner has made use of the right of stoppage *in transitu (Art. 1737, Civil Code)*, or even during the time the goods are stored in a warehouse of the carrier at the place of destination, until the consignee has been advised of the arrival of the goods and has had reasonable opportunity thereafter to remove them or otherwise dispose of them *(Art. 1738, Civil Code;* see *Kui Bai vs. Dollar Steamship Lines, 52 Phil. 863).* While no equivalent provisions exist in the carriage of passengers, it has been expressed that utmost diligence should start once the passenger places himself to and is accepted by, and while he remains under the proper care and charge of, the carrier *(10 Am. Jur. 27).* Mere proof of delivery of the goods in good order to a common carrier and of their arrival at the place of destination in bad order makes out *prima facie* case against the common carrier. It is incumbent upon the common carrier to prove that the loss was due to accident or some other circumstances inconsistent with its liability *(Tabacalera Insurance Co. vs. North Front Shipping Services, Inc., 82 SCAD 682, 272 SCRA 527).*

Illustrative Cases

In *Light Rail Transit Authority & Rodolfo Roman vs. Marjorie Navidad, Heirs of the Late Nicanor Navidad & Prudent Security Agency (G.R. No. 145804, 06 February 2003, 397 SCRA 75*), the Court said: The law requires common carriers to carry passengers safely using the utmost diligence of very cautious persons with due regard for all circumstances. Such duty of a common carrier to provide safety to its passengers so obligates it not only during the course of the trip but for so long as the passengers are within its premises and where they ought to be in pursuance to the contract of carriage. The

statutory provisions render a common carrier liable for death of or injury to passengers (a) through **the negligence or wilful acts of its employees or (b) on account of wilful acts or negligence of other passengers or of strangers if the common carrier's employees through the exercise of due diligence could have prevented or stopped the act or omission**. In case of such death or injury, a carrier is presumed to have been at fault or been negligent, and by simple proof of injury, the passenger is relieved of the duty to still establish the fault or negligence of the carrier or of its employees and the burden shifts upon the carrier to prove that the injury is due to an unforeseen event or to force majeure. In the absence of satisfactory explanation by the carrier on how the accident occurred, which petitioners, according to the appellate court, have failed to show, the presumption would be that it has been at fault, an exception from the general rule that negligence must be proved.

In *Samar Mining Co., Inc. vs. Nordeutcher Lloyd (132 SCRA 529)*, SM shipped imported merchandise through a vessel owned by NL, which shipment was covered by a bill of lading. Upon arrival of the ship in Manila, the importation was unloaded and delivered in good order and condition to the bonded warehouse. The goods were, however, never delivered to, nor received by, the consignee at the port of destination — Davao. A complaint for damages was filed against NL. The bill of lading shows that NL's liability as a common carrier was effective only for the transport of goods from Germany to Manila, the point of discharge. From Manila to Davao, upon transshipment of the same goods, the carrier, the court ruled, is transformed into an agent of the consignee and ceases to be liable as carrier for loss or damage to goods transshipped. After a common carrier's status has passed from that of carrier to that of agent of the consignee, the loss of goods in its hands for causes beyond its control and without its negligence being proved, relieves the carrier of civil liability for such loss or damage.

In *La Mallorca vs. Court of Appeals (17 SCRA 739)*, a couple and their children alighted from a passenger bus. The father, after leading his family to a shaded spot four or five meters away, returned to get a piece of baggage. The child, about 4 1/2 years old, followed back. The father was still on the running board waiting for the conductor to hand him the bag when the bus started to run so that the father had to jump down the moving vehicle. It was at this time when the child was run over and killed. The Supreme Court sanctioned the claim for damages based on *culpa contractual* and the carrier's failure to observe utmost diligence.

Citing the *La Mallorca* case with approbation, the Court, in *Aboitiz Shipping Corporation vs. Court of Appeals (179 SCRA 95)*, held: The rule is that the relation of carrier and passenger continues until the passenger has been landed at the port of destination and has left the vessel owner's dock or premises. Once created, the relationship will not ordinarily terminate until the passenger has, after reaching his destination, safely alighted from the carrier's conveyance and had a reasonable opportunity to leave the carrier's premises. Persons who remain on the premises a reasonable time after leaving the conveyance are still to be deemed passengers, and what is a reasonable time or a reasonable delay within this rule is to be determined from all the circumstances, and includes a reasonable time to see after their baggage and prepare for departure.

Rules on Presumption of Negligence

Fault or negligence consists in the omission of that diligence which is demanded by the nature of an obligation and corresponds with the circumstances of the person, of the time, and of the place. When the source of an obligation is derived from a contract, the mere breach or non-fulfillment of the prestation gives rise to the presumption of fault on the part of the obligor. This rule is no different in the case of common carriers in the carriage of

goods which, indeed, are bound to observe not just the due diligence of a good father of a family but that of "extraordinary" care in the vigilance over the goods *(Sabena Belgian World Airlines vs. Court of Appeals and Ma. Paula San Agustin, G.R. No. 104685, 14 March 1996, 255 SCRA 38).*

A common carrier's breach of its obligation to observe the required diligence can be presumed *(Arts. 1735* and *1756, Civil Code)*. In *Abeto vs. PAL (115 SCRA 489),* the presumption of fault on the part of the common carrier, in the absence of any evidence to the contrary, was deemed to have arisen from the mere failure of the carrier to safely transport goods and passengers (see also *PNR vs. Court of Appeals, 139 SCRA 87*). It is not necessary, the court continued, that there be an express finding of fault or negligence so as to hold the carrier liable for damages (see also *Metro Port Service vs. Court of Appeals [131 SCRA 365]*). This presumption of fault or negligence (in *culpa contractual*), it might be recalled, does not apply to *culpa aquiliana*.

In the *carriage of goods*, particularly, Article 1734 of the Code provides that common carriers are responsible for the loss, destruction, or deterioration of the goods, unless the same is due to any of the following causes only:

(1) Flood, storm, earthquake, lightning, or other natural disaster or calamity;

(2) Act of the public enemy in war, whether international or civil;

(3) Act or omission of the shipper or owner of the goods;

(4) The character of the goods or defects in the packing or in the containers;

(5) Order or act of competent public authority.

Except in the foregoing cases, if the goods are lost, destroyed or deteriorated, common carriers are presumed

to have been at fault or to have acted negligently, unless it is proved that extraordinary diligence was observed *(Art. 1735, Civil Code; Gatchalian vs. Delim, 203 SCRA 126; Eastern Shipping Lines, Inc. vs. Intermediate Appellate Court, 150 SCRA 463).* In *De Guzman vs. Court of Appeals (168 SCRA 612)*, the Supreme Court expounded, thus —

> "Common carriers, by the nature of their business and for reasons of public policy, are held to a very high degree of care and diligence ('extraordinary diligence') in the carriage of goods as well as of passengers. The specific import of extraordinary diligence in the care of goods transported by a common carrier is, according to Article 1733, 'further expressed in Articles 1734, 1735 and 1745, Numbers 5, 6 and 7' of the Civil Code.
>
> "Article 1734 establishes the general rule that common carriers are responsible for the loss, destruction or deterioration of the goods which they carry, *'unless'* the same is due to *any of the following causes only*:"
>
> It is important to point out that the above list of causes of loss, destruction or deterioration which exempt the carrier for responsibility therefor is a closed list. Causes falling outside the foregoing list, even if they appear to constitute a species of *force majeure*, fall within the scope of Article 1735, which provides as follows:
>
> > "*In all cases other than those mentioned in numbers 1, 2, 3, 4 and 5 of the preceding article*, if the goods are lost, destroyed or deteriorated, *common carriers are presumed to have been at fault or to have acted negligently, unless they prove that they observed extraordinary diligence* as required in Article 1733." (Underscoring supplied)

"Applying the above-quoted Articles 1734 and 1735, we note firstly that the specific cause alleged in the instant case — does not fall within any of the five (5) categories of exempting causes listed in Article 1734. It would follow, therefore, that the hijacking of the carrier's vehicle must be dealt with under the provisions of Article 1735, in other words, that the private respondent as common carrier is presumed to have been at fault or to have acted negligently. This presumption, however, may be overthrown by proof of extraordinary diligence on the part of private respondent.

"Petitioner insists that private respondent had not observed extraordinary diligence in the care of petitioner's goods. Petitioner argues that in the circumstances of this case, private respondent should have hired a security guard presumably to ride with the truck carrying the 600 cartons of Liberty filled milk. We do not believe, however, that in the instant case, the standard of extraordinary diligence required private respondent to retain a security guard to ride with the truck and to engage brigands in a firefight at the risk of his own life and the lives of the driver and his helper.

"The precise issue that we address here relate to the specific requirements of the duty or extraordinary diligence in the vigilance over the goods carried in the specific context of hijacking or armed robbery.

"As noted earlier, the duty of extraordinary diligence in the vigilance over goods is, under Article 1733, given additional specification not only by Articles 1734 and 1735 but also by Article 1745, Numbers 4, 5, and 6. Article 1745 provides in relevant part:

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

'x x x x x x x x x

'(5) That the common carrier shall not be responsible for the acts or omissions of 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; and

'(7) That the common carrier shall not be 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.' (Underscoring supplied)

"Under Article 1745(6) above, a common carrier is held responsible — and will not be allowed to divest or to diminish such responsibility — even for acts of strangers like thieves or robbers, *except* where such thieves or robbers in fact acted 'with grave or irresistible threat, violence or force.' We believe and so hold that the limits of the duty of extraordinary diligence in the vigilance over the goods carried are reached where the goods are lost as a result of a robbery which is attended by 'grave or irresistible threat, violence or force.'

"In the instant case, armed men held up the second truck owned by private respondent which carried petitioner's cargo. The record shows that an information for robbery in hand was filed in the Court of First Instance of Tarlac, Branch 2, in Criminal Case No. 198 entitled 'People of the Philippines vs. Felipe Boncorno, Napoleon Presno, Armando Mesina, Oscar Oria and one John Doe.' There, the accused were charged with willfully and unlawfully taking and carrying away with them the second truck, driven by Manuel Estrada and loaded with the 600 cartons

of Liberty filled milk destined for delivery at petitioner's store in Urdaneta, Pangasinan. The decision of the trial court shows that the accused acted with grave, if not irresistible, threat, violence or force. Three (3) of the five (5) hold-uppers were armed with firearms. The robbers not only took away the truck and its cargo but also kidnapped the driver and his helper, detaining them for several days and later releasing them in another province (in Zambales). The hijacked truck was subsequently found by the police in Quezon City. The Court of First Instance convicted all the accused of robbery, though not of robbery in band.

"In this circumstance, we hold that the occurrence of the loss must reasonably be regarded as *quite beyond the control of the common carrier and properly regarded as a fortuitous event*. It is necessary to recall that even common carriers are not made absolute insurers against all risks of travel and of transport of goods, and are not held liable for acts or event which cannot be foreseen or are inevitable, provided that they shall have complied with the rigorous standard of extraordinary diligence.

"We, therefore, agree with the result by the Court of Appeals that private respondent Cendana is not liable for the value of the undelivered merchandise which was lost because of an event entirely beyond private respondent's control."

In the *carriage of passengers*, the failure of the common carrier to bring the passengers safely to their destination immediately raises the presumption that such failure is attributable to the carrier's fault or negligence *(Batangas Laguna Tayabas Bus Company vs. Intermediate Appellate Court, 167 SCRA 379).* All that is required of the plaintiff is to prove the existence of the contract of carriage and its non-performance by the carrier *(Aboitiz Shipping Corporation vs. Court of Appeals, 179 SCRA 95;*

see also *Eastern Shipping Lines vs. Court of Appeals, 196 SCRA 570).* The exclusionary cases provided for in Article 1734 (*supra*., when the presumption of negligence does not warrant) only apply to the carriage of goods. In the carriage of passengers, the carrier must in every case prove its exercise, as well as those of its employees, of utmost diligence; or that the cause of death or injury was well beyond it, as the possible defenses against liability. In *Yobido vs. Court of Appeals (88 SCAD 403, 281 SCRA 1),* the Court has reiterated the rule that a common carrier may not be absolved from liability in case of *force majeure* or fortuitous event alone. The common carrier must still prove that it was negligent in causing the death or injury resulting from an accident.

A tire blowout, that causes a public utility jeep to jump into a ditch, has been held to be insufficient to overcome the presumption of negligence. The fact alone that the tire may have still been good because its grooves are still visible does not make the tire's explosion a fortuitous event. If there is no evidence that the driver has taken due precautions to compensate for any condition liable to cause accidents, such as the road condition, a tire blow out could be caused by overloading or speeding at the time of the accident *(Juntilla vs. Fontanar, 136 SCRA 624).* It is settled that an accident caused either by defects in the automobile or through the negligence of its driver is not a *caso fortuito* that would exempt the carrier from liability for damages *(Yobido vs. Court of Appeals, 88 SCAD 403, 281 SCRA 1).*

Like, however, in the carriage of goods, the common carrier is not an insurer of all risks *(Pilapil vs. Court of Appeals, 180 SCRA 546)*, and it may raise the defense of fortuitous event which, under Article 1174 of the Civil Code, can excuse liability *(Gacal vs. Phil. Air Lines, 183 SCRA 189).*

In air carriage, a passenger who failed to check-in or to confirm a flight on time in accordance with the ticket

condition was considered a forfeiture of his accommodation in favor of waitlisted passengers *(Philippine Airlines, Inc. vs. Ramos, 207 SCRA 461; Sarreal vs. Japan Airlines, 207 SCRA 359).*

Contributory Negligence

The contributory negligence of the passenger who dies or is injured, or that of the shipper whose goods are lost or deteriorated, does not preclude recovery of damages from the carrier if the proximate cause thereof is the latter's failure to observe the requisite diligence under the given circumstances but the amount of damages shall in each case be equitably reduced *(Art. 1762* and *Art. 1741, Civil Code).* In *Compania Maritima vs. Court of Appeals (164 SCRA 685)*, the act of the shipper in furnishing the common carrier with an inaccurate weight of the cargo (a payloader) was held not to be an excuse to avoid liability for the damage caused since the same could have been avoided by the carrier's utilizing a higher capacity lifting apparatus which was available. In not taking necessary precaution, the carrier was ruled to have failed in observing the extraordinary diligence. The contributory negligence of the shipper however, mitigated the carrier's liability for damages *(Arts. 1733, 1734, 1735* and *1741, Civil Code applied).*

Stipulations Reducing Extraordinary Diligence

In the carriage of goods, the common carrier and the shipper may agree on the carrier's observance of diligence to a degree less than extraordinary, provided that it be —

(a) In writing, signed by the shipper or owner;

(b) Supported by a valuable consideration other than the service rendered by the carrier; and

(c) Reasonable, just and not contrary to public policy *(Art. 1744, Civil Code).*

The fact that the common carrier has no competitor along the line or route, or a part thereof, to which the contract refers shall be taken into consideration on the question of whether or not a stipulation limiting the common carrier's liability is reasonable, just and in consonance with public policy *(Art. 1751, Civil Code)*.

Any of the following or similar stipulations are considered by law as unreasonable, unjust and contrary to public policy, *viz*.:

(a) That the goods are transported at the risk of the owner or shipper;

(b) That the common carrier will not be liable for any loss, destruction, or deterioration of the goods;

(c) That the common carrier need not observe any diligence in the custody of the goods;

(d) That the common carrier shall exercise a degree of diligence less than that of a good father of a family, or of a man of ordinary prudence in the vigilance over the movables transported;

(e) That the common carrier shall not be responsible for the acts or omissions of his or its employees; and

(f) That the common carrier's liability for acts committed by thieves, or of robbers who do not act with grave or irresistible threat, violence or force, is dispensed with or diminished *(Art. 1745, Civil Code)*.

This limitation on the common carrier's liability for the loss, destruction or deterioration of the goods to a degree less than extraordinary diligence is not to be confused with a stipulation limiting, instead, the common carrier's liability to an amount therein fixed, which the law merely requires to be fairly and freely agreed upon *(Arts. 1749-1750, Civil Code)* and may thus be valid even without the signature of the shipper or owner. Perhaps somewhat unmindful of this distinction, the Supreme Court, in *Servando, et al. vs. Philippine Steam Naviga-*

tion (117 SCRA 832), held as valid and binding a provision printed in fine letters at the back of a bill of lading, although not signed by the shipper, to the effect that "a carrier shall not be responsible for loss or damage to shipments billed as 'owner's risk' unless such loss or damage is due to the negligence of the carrier," the same not being, said the Court, contrary to law, morals, good customs, public order and public policy.

Any agreement limiting the common carrier's liability may be annulled if the carrier refuses to carry the goods unless the shipper or owner agreed to such stipulation *(Art. 1746, Civil Code).* 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, Civil Code).* But an agreement limiting the common carrier's liability for delay on account of strikes or riot is valid *(Art. 1748, Civil Code).*

Even when there is an agreement limiting the liability of the common carrier in the vigilance over the goods, the common carrier is disputably presumed to have been negligent in case of their loss, destruction or deterioration *(Art. 1752, Civil Code).* If the improper packing or defects in the container is known to the carrier or is apparent upon ordinary observation, but he nevertheless accepts the same without protest or exception notwithstanding such condition, said carrier is not relieved of liability for damage resulting therefrom *(Calvo vs. UCPB Insurance Co., Inc., G.R. No. 148496, 19 March 2002).*

In the carriage of passengers, the responsibility of a common carrier for the safety of passengers required in Articles 1733 and 1755 cannot be dispensed with or lessened by stipulation, by the posting of notices, by statements on tickets, or otherwise *(Art. 1757, Civil Code; Abeto vs. Philippine Air Lines, Inc., 115 SCRA 489).* A stipulation limiting the liability of the common carrier

for negligence is not allowed even where there is a reduction of the fare. In the case of a passenger who is carried gratuitously, such a stipulation is permitted but not for willful acts or gross negligence *(Art. 1758, Civil Code)*. In this case, the common carrier should still be bound to exercise ordinary diligence (see *Lara vs. Valencia, G.R. No. L-9907, 30 June 1958*).

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. This liability of the common carriers does not cease upon proof that they exercised all the diligence of a good father of a family in the selection and supervision of their employees *(Art. 1759, Civil Code;* see *Maranan vs. Perez, 20 SCRA 412)*. This responsibility cannot be eliminated or limited by stipulation, by the posting of notices, by statements on the tickets or otherwise *(Art. 1760, Civil Code)*. Moral damages are recoverable in a damage suit predicated upon a breach of contract of carriage where (a) the mishap results in the death of a passenger and (b) it is proved that the carrier has been guilty of fraud and bad faith even if death does not result *(Morris vs. Court of Appeals, G.R. No. 127957, 21 February 2001)*.

Rule for Private Carriers

The above rules on common carriers are inapplicable to a private or special carrier. Thus, a private carrier, conformably with the general rules on obligations and contracts, is bound to merely observe ordinary diligence. Similarly, the private carrier and the passenger or owner may stipulate against the former's liability for the negligent acts of the driver, or his own, but not, of course, for gross negligence or bad faith which would be contrary to public policy. In *Valenzuela Hardwood and Industrial Supply, Inc. vs. Court of Appeals (84 SCAD 105, 274 SCRA 642)*, the Court has said that parties in a contract of

private carriage may freely stipulate their duties and obligations which perforce would be binding on them. Unlike in a contract involving common carrier, private carriage does not involve the general public. Public policy is not contravened by stipulations in a charter party that lessen or remove the protection given by law in contracts involving common carriers. The parties may thus validly stipulate that responsibility for the cargo rests solely on the charterer, exempting the ship-owner from liability for loss of or damage to the cargo caused even by the negligence of the ship captain.

Liabilities of Common Carriers

1. *In General*

Whether the contract is one of the carriage of passengers or for the shipment of goods, the common carrier is not an insurer of all risks. Thus, the carrier was held not liable for injury to a passenger caused by an unidentified man who hurled a stone at the passenger bus *(Pilapil vs. Court of Appeals, 180 SCRA 546)* or for the loss of goods caused by armed men who acted with irresistible threat or violence quite beyond the control of the carrier (see *De Guzman vs. Court of Appeals, 168 SCRA 612*).

In an action based upon a breach of contract of carriage, the carrier is liable for the willful act or negligence of its employees although the latter may have acted beyond the scope of their authority or even in violation of the instructions of the carrier *(Litonjua Shipping Co., Inc. vs. National Seamen Board, 176 SCRA 189)*. The common carrier's liability is absolute (the minority view in common law of "respondent superior" that would make the employer liable only when the act of the employee is within the scope of his authority has been held, in *Maranan vs. Perez [20 SCRA 412]* and other cases, to be inapplicable in this jurisdiction), and the usual *culpa aquiliana* defense of due diligence in the selection and supervision of employees is unavailable to the common

carrier (see *Art. 1759, Civil Code; Maranan vs. Perez, supra.; Sweet Lines, Inc. vs. Court of Appeals, 121 SCRA 769*). The rule is applicable to passenger jeepneys being operated under the "boundary system" *(Magboo vs. Bernardo, 7 SCRA 952).*

The rules on the possible liability under *culpa contractual* of common carriers, specifically in the carriage of goods, for events or for acts of others, in correlation with the rules on the presumption of negligence or their abatement, may be summarized, as follows:

a. *For natural disasters.* — The common carrier is not liable if the natural disaster should be the proximate and only cause but the carrier must exercise diligence to prevent or minimize the loss prior to, during and after the occurrence thereof *(Arts. 1739* and *1734, Civil Code; Servando vs. Philippine Steam Navigation, 117 SCRA 832)*. The peril of fire is not comprehended by the term "natural disaster" or "calamity" which can overcome the presumption of fault. Fire can very well be caused by the negligence of the carrier or its employees *(Eastern Shipping Lines, Inc. vs. Intermediate Appellate Court, 150 SCRA 463)*. If the common carrier negligently incurs in delay in transporting the goods, a natural disaster shall not free such carrier from responsibility *(Art. 1740, Civil Code)*. If the shipper or owner merely contributed to the loss, destruction or deterioration of the goods, the proximate cause thereof being the negligence of the common carrier, the latter shall be liable in damages which, however, shall be equitably reduced *(Art. 1741, Civil Code).*

b. *For acts of a public enemy in war (international or civil), other passengers or third persons* (faults, for instance, of the driver of the other vehicle) *or competent public authority.* — The common carrier is not liable unless the carrier's employ-

ees could have prevented the act or omission by exercising due diligence *(Arts. 1734* and *1743;* see also *Art. 1763, Civil Code; Gacal vs. PAL, 183 SCRA 189; Estrada vs. Consolacion, 71 SCRA 523)*. If *through the order of public authority* the goods are seized or destroyed, the common carrier is not responsible, provided said public authority has power to issue the order *(Art. 1743, Civil Code)*.

c. *For acts attributable to the shipper or owner, or character of the goods.* — The common carrier is not liable *(Art. 1734;* see also *Arts. 1742* and *1761, Civil Code; Nocum vs. LTB, 30 SCRA 70)*. Even if the loss, destruction, or deterioration of the goods should be caused by the character of the goods or the faulty nature of the packing or of the containers, the common carrier must exercise due diligence to forestall or lessen the loss *(Art. 1742, Civil Code)*.

d. *For acts of employees.* — The common carrier's liability is absolute (the minority view in common law of "respondent superior" that would render the employer liable only when the act of the employee is within the scope of his authority has been held to be inapplicable in this jurisdiction (see *Maranan vs. Perez [20 SCRA 412],* and the usual *culpa aquiliana* defense of due diligence in the selection and supervision of employees is unavailable to the common carrier [see *Art. 1759, Civil Code; Maranan vs. Perez, supra.; Sweet Lines, Inc. vs. Court of Appeals, 121 SCRA 769*]). Passenger jeepneys being operated under the "boundary system" are covered by this rule *(Magboo vs. Bernardo, 7 SCRA 952)*.

Although the codal provisions governing the liability of a common carrier under its obligation to safely

transport passengers, on the one hand, and cargo, on the other, at times vary, as can be gleaned from the earlier discussions, the principles that said provisions enunciate, nevertheless, could well apply to both instances given the proper factual settings therefor. To illustrate, if a natural disaster should be the proximate and only cause of the common carrier's failure to bring its cargo safely to its destination, the carrier, under Article 1739 of the Code, incurs no liability. There is no cogent reason for not applying the same rule to the carriage of passengers. A common carrier, whether of goods or of passengers, is not itself an insurer. As stated elsewhere above, however, the rules differ in that in the carriage of goods, the occurrence of a natural disaster would no longer render applicable the presumption of negligence on the part of the common carrier *(Art. 1734, Civil Code)*; in the carriage of passengers, the common carrier must still live with that presumption and prove in every case that it has nonetheless discharged the duty of utmost diligence to its passengers.

There can be some borderline cases; for instance, an accident caused by defective parts of a vehicle, although detectable only by a metal X-ray machine, the Supreme Court said in one case, is not *caso fortuito* and not enough to overcome the presumption of fault. The court added that the passenger or shipper has neither the choice nor control in the selection and use of the equipment, as well as the fact that, unlike the common carrier, there exists no privity between him and the equipment manufacturer (see *Necessito vs. Paras, 104 Phil. 75; Landingin vs. Pantranco, 33 SCRA 284*). In *Nocum vs. LTB (30 SCRA 70)*, the carrier was held not responsible for firecrackers that were brought in by a passenger in a well-packed bag, but this rule would not apply to air transportation because air carriers are duty bound to make an inspection on all packages for shipment. A "stowaway," being a trespasser, assumes the risk of damage (see *Pontillas vs. Cebu Autobus Co., 13 CA Reps. 211*).

In *Philippine Air Lines vs. Court of Appeals (106 SCRA 143)*, the Supreme Court laid down the rule that the duty of utmost diligence in the carriage of passengers by a common carrier applies equally well to the carrier's duty towards the crew or complement operating the carrier. The decision is doctrinal in the sense of the court's setting aside the employer's liability under Article 1712 of the Civil Code and construing, in effect, the term "passenger," to which common carriers statutorily owe an exercise of utmost diligence under Article 1755 of the Civil Code, to more than just its layman's concept. (An old case *[Nueca vs. Manila Railroad Company, 65 O.G. 3153],* adopting Webster's dictionary, defined a "passenger" as one who travels in a public conveyance under an express or implied contract for a consideration).

The case involved a co-pilot injured by the crash landing of a passenger aircraft. The accident was attributed to the slow reaction and judgment of the pilot because of an ailment he was then suffering from and to which fact the carrier's attention was earlier called. In awarding moral damages to the injured co-pilot, the Supreme Court held the negligence of the carrier as "clearly (constituting) a quasi-delict justifying the application of Article 2219(2) of the Civil Code." (This pronouncement is not the first time the Supreme Court had ruled that a quasi-delict can exist even where the parties are contractually bound and that, indeed, tort can be the cause for breaching the contract. The test would appear to be that where, without a pre-existing contract between two parties, an act or omission can nonetheless constitute an actionable tort between them, then the bare contractual relationship between said parties should be no bar to the application of the rules on tort to the case. Among the notable cases are *Singson vs. Bank of P.I. [23 SCRA 1117]* and *Air France vs. Carrascoso [18 SCRA 155]*). Even assuming, the court continued, that the cause of action is one of *culpa contractual*, the carrier's negligence in permitting the pilot to fly the plane despite his poor physical

and mental condition constituted bad faith or malice within the meaning of Article 2220 which permits recovery of moral damages even in breach of contracts. (It had to be *culpa contractual*; otherwise, the application of extraordinary diligence to the carrier would have had no sound legal premise).

Liability of Successive Air Carriers

An airline ticket providing that carriage by successive air carriers is to be regarded as a "single operation" is to make the issuer carrier liable for the tortious conduct of the other carriers. A printed provision in the ticket limiting liability only to its own conduct is not enough to rebut that liability (*KLM vs. Court of Appeals, 65 SCRA 237;* the same rule applies to carriers under the IATA *[Ortigas vs. Lufthansa, 64 SCRA 610]*; on overland transportation, however, see Sec. 373, Code of Commerce, that additionally holds the last carrier responsible to the shipper or consignee, leaving to said carrier the right to proceed against the carrier at fault).

Liability of Actual and Registered Owners

In *Jereos vs. Court of Appeals (117 SCRA 795),* the Supreme Court reiterated the often-repeated rule that both the real and registered *owners,* as well as operators, of common carriers are solidarily liable in an action for damages against them involving such vehicle (see also *Zamboanga Transportation vs. Court of Appeals [30 SCRA 719]; MYC Agro-Industrial Corporation vs. Caldo [132 SCRA 10]*). The registered owner of any vehicle, even if not used for public service, would primarily be responsible to the public or to third persons for injuries sustained by the latter while the vehicle was being driven on the highways or streets *(St. Mary's Academy vs. Carpitanos, G.R. No. 143363, 06 February 2002).* This is true even if the vehicle is leased to a third person *(Aguilar vs. Commercial Savings Bank, G.R. No. 128705, 29 June 2001).* 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. vs. Court of Appeals, 83 SCAD 482, 273 SCRA 562)*. As to solidarity, Article 2194 of the Civil Code expressly provides that the responsibility of two or more persons who are liable for a quasi-delict is solidary. The employer's recourse, however, once the judgment has been satisfied by it, is to recover what he has paid from its employee who committed fault or negligence which gave rise to an action based on quasi-delict *(Article 2181, Civil Code)*. But a common-law wife is not a co-owner of a public utility registered in the name of the common-law husband so as to make her co-liable *(Juaniza vs. Jose, 89 SCRA 306)*.

In *Santos vs. Sibug, et al. (104 SCRA 520),* the Supreme Court held as proper the levy on a *"jeepney"* under what is known in ordinary parlance as the "*kabit* system." In this case, it appeared that Vidad was a duly authorized passenger jeepney operator. Santos, who himself was not a holder of a Certificate of Public Convenience, transferred his jeepney to the name of Vidad so that it could be operated under the latter's certificate. For the protection of Santos, a private document was executed by Vidad re-transferring the vehicle to Santos presumably to be registered once it was to be withdrawn from the system. Meanwhile a jeepney likewise being operated by Vidad, met with an accident causing injuries to Sibug. A case for injuries was filed against Vidad and judgment was rendered against said defendant. For non-settlement of the judgment, the jeepney owned by Santos was levied on execution. Under these circumstances, the Supreme Court aptly ruled that the levy was proper and, in contemplation of law as regards the public and third persons, the vehicle should be considered the property of the registered operator. But what could be an oversight was the *obiter dictum* which said that had Santos been impleaded as a party defendant, he could have been jointly

and severally (solidarily) liable with Vidad. It would appear that the unit involved in the accident was not the jeepney owned by Santos. One might take note that the tort arose from the accident and not the "*kabit* system" *per se*. On the accident itself, Santos may not exactly be deemed a jointfeasor upon which basis solidary liability can exist under Article 2194 of the Civil Code.

Government-owned common carriers are not exempt from the operation of Articles 1762 to 1766 of the Civil Code and are not immune from suit *(Malong vs. Phil. National Railways, 138 SCRA 63)*.

2. *Causes of Action*

While the cause of action of a passenger or shipper against the common carrier is founded on *culpa contractual*, the basis of liability on the part of the driver is either *culpa delictual* or *culpa aquiliana*. The driver of the carrier, not being its agent but an employee, has himself no contractual relationship with the passenger. When the employer contracts with others, the employees do not themselves become parties thereto. When, however, the same act or omission gives rise to both causes of action, as is normally the case, their liability could be solidary to the concurrent amount thereof (see *Gutierrez vs. Gutierrez, 56 Phil. 177; Vinluan vs. Court of Appeals, 16 SCRA 742; Gelison vs. Alday, 154 SCRA 388;* but see *Philippine Rabbit Bus Lines, Inc. vs. Intermediate Appellate Court, 189 SCRA 158*).

It may be observed that the "doctrine of last clear chance" applies only to parties guilty of the antecedent and supervening negligence who, as joint tortfeasors, may be held solidarily liable to innocent third persons (see discussions, *infra.*, on *"Quasi-Delicts"*).

Liability under *culpa delictual* of the driver renders the common carrier subsidiarily liable (see *Arts. 100-103, Revised Penal Code*).

The following illustration can amplify or exemplify the above rules.

Facts

Two taxicabs, one owned and operated by "X and Co." and the other by "Y & Co.," figured in a collision. Both drivers of the taxicabs were negligent. As a result of the incident, "A," a passenger of the taxicab owned and operated by "X & Co." suffered injuries. He instituted a civil action for damages against "X & Co.," "Y & Co.," and the two drivers.

Discussions

(a) Although the cause of action against "X & Co." is basically one of breach of contract *(culpa contractual),* the factual circumstances, however, would also point to the existence of tort as a mode of breach. As expressed elsewhere above, where, without a pre-existing contract between two parties, an act or omission could have nevertheless constituted an actionable tort between them, the mere existence of a contract between such parties will not militate against the application of tort rules (see *Singson vs. Bank of P.I., 23 SCRA 1117; Air France vs. Carrascoso, 18 SCRA 155*). Accordingly, "X & Co." becomes a joint tortfeasor with the other defendants, rendering themselves all solidarily liable (*Art. 2194, Civil Code*). Likewise, the possibility of "X and Co." being liable for moral damages for the *injury* of "A" because of *quasi-delict* under Article 2219 of the Civil Code cannot be discounted *(Philippine Air Lines vs. Court of Appeals, 106 SCRA 143).*

(b) While "X and Co." may not raise the defense of due diligence in the selection and supervision of its employees as against its passenger "A" (the latter's cause of action still being basically one of *culpa contractual*), the proof of such diligence, however, is not all that immaterial. Once established, that due diligence will work to operate an extenuation of the tort liability, and "X & Co."

could no longer then be considered a joint tortfeasor. In this case, neither solidary liability under Article 2194 of the Civil Code nor liability for moral damages to "A" under Article 2219 of the same Code (in the absence of gross negligence amounting to bad faith) would be applicable. "X & Co.," however, would still be liable but purely on the basis of *culpa contractual*.

(c) In case the evidence is bereft of the existence or non-existence of negligence, "X & Co." can still be held liable to its passenger, "A," since fault or negligence is presumed in *culpa contractual*; in *culpa aquiliana*, however, fault or negligence must be established.

(d) If the drivers of the colliding vehicles were convicted for their negligence, "X & Co." and "Y & Co.," both being engaged in an industry, can be held liable subsidiarily for their respective drivers' civil liability *(Arts. 100-103, Revised Penal Code)*.

Waivers

Waivers, after the liability attaches, should be clear and convincing to bind the passenger or shipper. A mere expression of desire to waive their rights is not enough *(Yepes vs. Samar Express Transit, 17 SCRA 91)*.

3. *Measure of Damages*

Actual, compensatory and consequential damages may be recovered by an aggrieved passenger or shipper. In the absence of fraud or bad faith, the common carrier is liable for those that are the natural and probable consequences of the breach, and which the parties have foreseen or could have reasonably foreseen at the time the obligation was constituted *(China Airlines, Inc. vs. Intermediate Appellate Court, 169 SCRA 226)*. In case of fraud or bad faith, malice, gross or reckless negligence, or wanton attitude, the carrier can be held liable for all damages which can be reasonably attributed, although unforeseen, to the non-performance of the obligation (see *Art. 2201,*

in relation to *Art. 1764, Civil Code; Mendoza vs. Philippine Airlines, 90 Phil. 836*), as well as exemplary damages *(Litonjua Shipping Company, Inc. vs. National Seamen Board, 176 SCRA 189).*

In case of death or permanent disability of a passenger in a common carrier, the compensatory damage is the annual earning capacity, less deductible living and other expenses of the deceased or disabled, multiplied by the number of years of his life expectancy *(MD Transit vs. Court of Appeals, 90 SCRA 542).* While moral damages are not generally recoverable in *culpa contractual* except when there is fraud or bad faith, in the breach of contract of carriage, however, such moral damages may be predicated from a mishap not only where the carrier is guilty of gross negligence, fraud or bad faith *(Gatchalian vs. Delim, 203 SCRA 126)* but also where it results in the death of a passenger *(Sabena Belgian World Airlines vs. Court of Appeals, 171 SCRA 620; Art. 1764, Civil Code)* unless (regarding such moral damages) the latter is "chargeable with contributory negligence" (see *Compania Maritima vs. Court of Appeals, 164 SCRA 685*).

An injured passenger suing on *culpa aquiliana* or *culpa delictual* against the driver of the carrier could be entitled to moral damages *(Art. 2219, Civil Code).* In general, a person suing under *culpa aquiliana* or *culpa delictual* can be entitled to recover damages from a defendant which are the natural and probable consequences of the act or omission complained of, and it is not essential that such damages have been foreseen or could have reasonably been foreseen *(Art. 2202, Civil Code).*

The passenger must observe the diligence of a good father of a family to avoid injury to himself *(Art. 1761, Civil Code).* His contributory negligence does not bar recovery of damages for his death or injuries if the proximate cause thereof is the negligence of the common carrier, but the amount of damages shall be equitably reduced *(Art. 1762,* in relation to *Art. 1755, Civil Code).*

4. *Stipulations Limiting the Carrier's Liability to a Certain Amount*

The liability of a common carrier may be limited to the value of the goods appearing in a bill of lading *(Art. 1749, Civil Code)*, and a stipulation fixing the sum that may be recovered by the owner or shipper for the loss, destruction or deterioration over said goods is valid as long as it is reasonable and just under the circumstances and it has been fairly and freely agreed upon *(Art. 1750, Civil Code)*. The rationale for this rule is really to conclude the shipper by his agreement on the value (maximum valuation) of his goods. The stipulation may be said to have been fairly agreed upon if the shipper or owner is given an opportunity to declare a higher or the true value of the goods shipped. A statement in the bill of lading that the carrier's liability is limited to a certain amount per package cannot hold, however, against the *declared* value stated in said bill of lading *(National Development Corporation vs. Court of Appeals, 164 SCRA 593)*.

In *Eastern and Australian Steamship vs. Great American Insurance Co. (108 SCRA 248)*, the Supreme Court cited with approval the common law rule that a stipulation limiting the common carrier's liability to a ceiling will still govern even where the loss or damage is due to the carrier's fault. In *National Development Company vs. Court of Appeals (164 SCRA 593;* see also *American Home Assn. vs. Court of Appeals, 208 SCRA 343)*, however, the Court reverted to its earlier ruling in the case of *Ysmael vs. Barreto (51 Phil. 90)*, where it held that a stipulation limiting the carrier's liability is inapplicable where an injury or loss was established (not merely presumed) to have been caused by the carrier's own fault. This rule would be sound if the carrier's fault were willful or one amounting to bad faith (see *PAL vs. Court of Appeals, 207 SCRA 100; Alitalia vs. Intermediate Appellate Court, 192 SCRA 9*). But whatever may be one's perceptions on the impact of the above cases, the basic rule is still that the real legal consequence of the

stipulation is in precluding the shipper from proving a higher value of his goods than the stipulated ceiling more than in exempting the carrier from its negligence.

In the said case of *Eastern and Australian Steamship vs. Great American Insurance Company (supra.)*, the efficacy of a stipulation limiting the liability of a common carrier to the value of the goods fixed in the bill of lading at £100 Sterling (P1,544) was put in issue. Given the general guidelines under Article 1749 and Article 1750 of the Civil Code authorizing such stipulation provided that it is "reasonable and just under the circumstances, and it has been fairly and freely agreed upon," the Supreme Court considered the stipulation to be valid. The Court rejected the theory of the shipper that under the Carriage of Goods by Sea Act, the parties are precluded from limiting the liability of the carrier to less than US$500 per package. Said the Court: "The part of Section 4(5) of the Act, limiting the maximum amount that may be recovered by the shipper, in the absence of an agreement as to the nature and value of the goods shipped, to US$500 per package, *a contrario* would permit an agreement overriding such a ceiling, whether for more or less than that amount. The second part of Section 4(5) of said Act prescribing that the maximum amount shall not be less than US$500 per package should be construed to refer only to a situation where there is an agreement, other than as set forth in a Bill of Lading, providing for a maximum higher than US$500 per package."

We might add that the provisions of Article 1766 of the Civil Code ordains the preponderance of the Civil Code provisions on common carriers over those of the Code of Commerce and special laws.

In maritime commerce, whenever the Carriage of Goods by Sea Act applies, by stipulation or implication, the limited liability of the carrier is deemed contained in the bill of lading *(Phoenix Assn. Co. vs. Macondray & Co., 64 SCRA 122)*. In *Eastern Shipping Lines, Inc. vs. Interme-*

diate Appellate Court (150 SCRA 463), the Supreme Court held:

> "Petitioner Carrier avers that its liability, if any, should not exceed US$500 per package as provided in Section 4(5) of the COGSA, which reads:
>
> > '(5) Neither the carrier nor the ship shall in any event be or become liable for any loss or damage to or in connection with the transportation of goods in an amount exceeding $500 per package lawful money of the United States, or in case of goods not shipped in packages, per customary freight unit, or the equivalent of that sum in other currency, unless the nature and value of such goods have been declared by the shipper before the shipment and inserted in bill of lading. This declaration if embodied in the bill of lading shall be *prima facie* evidence, but shall not be conclusive on the carrier.
> >
> > 'By agreement between the carrier, master or agent of the carrier, and the shipper another maximum amount than that mentioned in this paragraph may be fixed; *Provided*, That such maximum shall not be less than the figure above named. In no event shall the carrier be liable for more than the amount of damage actually sustained.'
>
> "Article 1749 of the New Civil Code also allows the limitations of liability in this wise:
>
> > "Article 1749. A stipulation that the common carrier's liability is limited to the value of the goods appearing in the bill of lading, unless the shipper or owner declares a greater value, is binding.
>
> "It is to be noted that the Civil Code does not of itself limit the liability of the common carrier to a fixed amount per package although the Code ex-

pressly permits a stipulation limiting such liability. Thus, the COGSA, which is suppletory to the provisions of the Civil Code, steps in and supplements the Code by establishing a statutory provision limiting the carrier's liability in the absence of a declaration of a higher value of the goods by the shipper in the bill of lading. The provisions of the Carriage of Goods by Sea Act on limited liability are as much a part of a bill of lading as though physically in it and as much a part thereof as though placed therein by agreement of the parties.

"In G.R. No. 69044, there is no stipulation in the respective Bills of Lading (Exhibits "C-2" and "I-3") limiting the carrier's liability for the loss or destruction of the goods. Nor is there a declaration of a higher value of the goods. Hence, Petitioner Carrier's liability should not exceed US$500 per package, or its peso equivalent, at the time of payment of the value of the goods lost, but in no case 'more than the amount of damages actually sustained.'

On the question of whether the US$500 limit is on individual crates or cartons or on the containers in which such crates or cartons are placed, the Court continued —

"Considering, therefore, that the Bill of Lading clearly disclosed the contents of the containers, the number of cartons or units, as well as the nature of the goods, and applying the ruling in the Mitsui and Burgenes cases it is clear that the 128 cartons, not the two (2) containers should be considered as the shipping unit subject to the $500 limitation of liability.

"True, the evidence does not disclose whether the containers involved herein were carrier-furnished or not. Usually, however, containers are provided by the carrier. In this case, the probability is that they were so furnished for Petitioner Carrier was at liberty to pack and carry the goods in containers if they

were not so packed. Thus, at the dorsal side of the Bill of Lading (Exhibit "A") appears the following stipulation in fine print:

> "11. (Use of Container) Where the goods receipt of which is acknowledged on the face of this Bill of Lading are not already packed into container(s) at the time of receipt, the Carrier shall be at liberty to pack and carry them in any type of container(s)."

A printed stipulation limiting the carrier's liability is binding even if unsigned by the shipper or owner. In *Ong Yiu vs. Court of Appeals (91 SCRA 223),* that rule was enunciated despite the owner's illiteracy and old age, the Court holding that it devolved not on the carrier, but on the owner to see to it that the document (airplane ticket) she accepted was understood by her (see also *Servando vs. Philippine Steam Navigation, 117 SCRA 832;* but see *Shewaram vs. PAL, 17 SCRA 606*).

Stipulation on Venue of Actions

A provision in a passage ticket on an inter-island shipping limiting the venue of actions to a particular place was held null and void for being contrary to public policy *(Sweet Lines, Inc. vs. Teves, L-37750, 19 May 1978).*

Rules with Regard to Private Carriers

Private carriers are governed by the ordinary rules and general principles on obligations and contracts. Hence, a stipulation exempting the owner of a private carrier from liability for the negligence of the driver would be valid for not being contrary to law, morals, good customs, public order and public policy. It has also been said that such a stipulation would be binding in the case of a common carrier acting not as such but as a private carrier, as in a charter party (see *Home Insurance Co. vs. American Steamship Agencies, Inc., 23 SCRA 24*). It is believed, however, that the above statement, except as the term

"charter party" is understood and used in maritime commerce, may well be qualified in the following sense: Where the common carrier entering into a charter party does so in the ordinary course of business, the provisions of the Civil Code on common carriers should still apply. Hence, a charter party for the transportation of goods should not be held to cause the common carrier to so shed its true character as a common carrier where it is engaged in the business of carrying goods; but a conversion from a common to a private carrier can take place where it is, for instance, engaged instead in the business of carrying passengers. And where a common carrier is engaged in carrying passengers, a charter party solely for the transport of goods may not then be governed by the law on common carriers. These qualificatory rules would seem to be in greater consonance with the definition of a common carrier under the Civil Code. The nature of the carrier's principal undertaking should thus count more than how the contract is termed or the way it is designated by the parties.

Subsection 4 — Common Provisions

Art. 1764. Damages in cases comprised in this Section shall be awarded in accordance with Title XVIII of this Book, concerning Damages. Article 2206 shall also apply to the death of a passenger caused by the breach of contract by a common carrier.

Art. 1765. The Public Service Commission may, on its own motion or on petition of any interested party, after due hearing, cancel the certificate of public convenience granted to any common carrier that repeatedly fails to comply with his or its duty to observe extraordinary diligence as prescribed in this Section.

Art. 1766. In all matters not regulated by this Code, the rights and obligations of common carriers shall be governed by the Code of Commerce and by special laws.

TITLE IX. PARTNERSHIP

Chapter 1

General Provisions

Art. 1767. By the contract of partnership two or more persons bind themselves to contribute money, property, or industry to a common fund, with the intention of dividing the profits among themselves.

Two or more persons may also form a partnership for the exercise of a profession. (1665a)

Art. 1768. The partnership has a juridical personality separate and distinct from that of each of the partners, even in case of failure to comply with the requirements of Article 1772, first paragraph. (n)

Art. 1769. In determining whether a partnership exists, these rules shall apply:

(1) Except as provided by Article 1825, persons who are not partners as to each other are not partners as to third persons;

(2) Co-ownership or co-possession does not of itself establish a partnership, whether such co-owners or co-possessors do or do not share any profits made by the use of the property;

(3) The sharing of gross returns does not of itself establish a partnership, whether or not the persons sharing them have a joint or common right or interest in any property from which the returns are derived;

(4) The receipt by a person of a share of the profits of a business is *prima facie* evidence that he is a partner in the business, but no such inference shall be drawn if such profits were received in payment:

(a) As a debt by installments or otherwise;

(b) As wages of an employee or rent to a landlord;

(c) As an annuity to a widow or representative of a deceased partner;

(d) As interest on a loan, though the amount of payment vary with the profits of the business;

(e) As the consideration for the sale of a goodwill of a business or other property by installments or otherwise. (n)

Art. 1770. A partnership must have a lawful object or purpose, and must be established for the common benefit or interest of the partners.

When an unlawful partnership is dissolved by a judicial decree, the profits shall be confiscated in favor of the State, without prejudice to the provisions of the Penal Code governing the confiscation of the instruments and effects of a crime. (1666a)

Art. 1771. A partnership may be constituted in any form, except where immovable property or real rights are contributed thereto, in which case a public instrument shall be necessary. (1667a)

Art. 1772. Every contract of partnership having a capital of three thousand pesos or more, in money or property, shall appear in a public instrument, which must be recorded in the Office of the Securities and Exchange Commission.

Failure to comply with the requirements of the preceding paragraph shall not affect the liability of the partnership and the members thereof to third persons. (n)

Art. 1773. A contract of partnership is void, whenever immovable property is contributed thereto, if an inventory of said property is not made, signed by the parties, and attached to the public instrument. (1668a)

Art. 1774. Any immovable property or an interest therein may be acquired in the partnership name. Title

so acquired can be conveyed only in the partnership name. (n)

Art. 1775. Associations and societies, whose articles are kept secret among the members, and wherein any one of the members may contract in his own name with third persons, shall have no juridical personality, and shall be governed by the provisions relating to co-ownership. (1669)

Art. 1776. As to its object, a partnership is either universal or particular.

As regards the liability of the partners, a partnership may be general or limited. (1671a)

Art. 1777. A universal partnership may refer to all the present property or to all the profits. (1672)

Art. 1778. A partnership of all present property is that in which the partners contribute all the property which actually belongs to them to a common fund, with the intention of dividing the same among themselves, as well as all the profits which they may acquire therewith. (1673)

Art. 1779. In a universal partnership of all present property, the property which belonged to each of the partners at the time of the constitution of the partnership, becomes the common property of all the partners, as well as all the profits which they may acquire therewith.

A stipulation for the common enjoyment of any other profits may also be made; but the property which the partners may acquire subsequently by inheritance, legacy, or donation cannot be included in such stipulations, except the fruits thereof. (1674a)

Art. 1780. A universal partnership of profits comprises all that the partners may acquire by their industry or work during the existence of the partnership.

Movable or immovable property which each of the partners may possess at the time of the celebration of the contract shall continue to pertain exclusively to each, only the usufruct passing to the partnership. (1675)

Art. 1781. Articles of universal partnership, entered into without specification of its nature, only constitute a universal partnership of profits. (1676)

Art. 1782. Persons who are prohibited from giving each other any donation or advantages cannot enter into universal partnership. (1677)

Art. 1783. A particular partnership has for its object determinate things, their use or fruits, or a specific undertaking, or the exercise of a profession or vocation. (1678)

1. Concept

As a Contract

By the contract of partnership two or more persons bind themselves to contribute money, property, or industry to a common fund, with the intention of dividing the profits among themselves. Two or more persons may also form a partnership for the exercise of a profession *(Art. 1767, Civil Code).* It is of the essence then that there be: (a) an agreement of the parties to contribute money, property or industry to a common fund; and (b) an intent to divide the profits among themselves *(Fue Leung vs. Intermediate Appellate Court, 169 SCRA 746; Evangelista vs. Collector of Internal Revenue, 102 Phil. 140).* While the essence of a partnership is the sharing in the profits and losses among the partners *(Heirs of Tan Eng Kee vs. Court of Appeals, 135 SCAD 60, 341 SCRA 740),* a deferment, however, of sharing in the profits is perfectly plausible especially if excellent relations exist among the partners at the start of the business and all the partners are more interested in seeing the firm grow rather than get immediate returns *(Fue Leung vs. Intermediate Appellate Court, supra.).*

The existence of partnership requires the character of habituality peculiar to business transaction for the purpose of gain. Where the transactions are isolated, in the absence of other circumstances showing a contrary

intention, the case can only give rise to co-ownership. The sharing of returns does not itself establish a partnership which is but a consequence of a joint or common interest in the property *(Pascual vs. CIR, 166 SCRA 560).* In *Sardane vs. Court of Appeals (167 SCRA 524),* the Supreme Court has ruled that no partnership is created where the so-called share in the profits are in reality "wages" and where the recipient thereof has no voice in the management. But a demand for periodic accounting is evidence of a partnership *(Heirs of Tan Eng Kee vs. Court of Appeals, supra.).*

A partnership must have a lawful object or purpose (see *Jo Chung Cang vs. Pacific Commercial, 45 Phil. 142*), and must be established for the common benefit or interest of the partners *(R.B. Industrial Development Co. Ltd. vs. Enage, 24 SCRA 365; Art. 1770, Civil Code).* When an unlawful partnership is dissolved by a judicial decree, the profit (not necessarily the contributions *[Arbes vs. Polistico, 53 Phil. 489]*) shall be confiscated in favor of the State, without prejudice to the provision of the Penal Code governing the confiscation of the instruments and effects of a crime *(Art. 1770, Civil Code).*

As an Entity

The partnership has a juridical personality separate and distinct from that of each of the partners (see *Art. 1768, Civil Code; Commissioner vs. Suter, 27 SCRA 152; Hongkong Bank vs. Jurado & Co., 2 Phil. 671*). Associations and societies, whose articles are kept secret among the members, and wherein any one of the members may contract in his own name with third persons, shall have no juridical personality and shall be governed by the provisions relating to co-ownership *(Art. 1775, Civil Code).* Estoppel, however, may prevent a person from questioning the lack of personality of a supposed partnership (see *Behn Meyer & Co. vs. Rosatzin, 5 Phil. 660; MacDonald vs. National City Bank of New York, 99 Phil. 156*).

In determining whether a partnership exists, it is helpful to consider that —

(1) Except as provided by Article 1825 (*infra*., *re* Partnership by Estoppel), persons who are not partners as to each other are not partners as to third persons;

(2) Co-ownership or co-possession does not itself establish a partnership, whether such co-owners or co-possessors do or do not share any profits made by the use of the property;

(3) The sharing of gross returns does not of itself establish a partnership, whether or not the persons sharing them have a joint or common right or interest in any property from which the returns are derived;

(4) The receipt by a person of a share of the profits of a business is *prima facie* evidence that he is a partner in the business, but no such inference shall be drawn if such profits were received in payment: (a) as debt by installments or otherwise; (b) as wages of an employee or rent to a landlord; (c) as an annuity to a widow or representative of a deceased partner; (d) as interest on a loan, though the amount of payment vary with the profits of the business; (e) as the consideration for the sale of a goodwill of a business or other property by installments or otherwise *(Art. 1769, Civil Code;* see *Obillos vs. Commissioner of Internal Revenue, 139 SCRA 436).*

In *Pascual vs. Commissioner of Internal Revenue (166 SCRA 560)*, the purchase of two, later followed by an additional three, parcels of land, and their subsequent sale at a profit by two individuals, without further evidence that they have entered into an agreement to contribute money, property or industry to a common fund and that they have intended to divide the profits between themselves, are insufficient to hold them as having formed an unregistered partnership. The character of habituality peculiar to business transaction for the purpose of gain, said the Court, must be present to hold them so. Where the transactions are isolated, in the absence of other cir-

cumstances showing a contrary intention, the case can only give rise to co-ownership. The sharing of returns does not in itself establish a partnership which is but a consequence of a joint or common interest in the property.

A corporate joint venture, a unique creation that defies ordinary business vehicles defined and specifically regulated by law, has features of a joint account between individuals, of a partnership and of a corporation. It is not exactly a partnership because instead of pursuing an interest as a regular business or habitual undertaking, it oftentimes is concentrated only to certain identified or isolated transactions (similar to a joint account of merchants). Neither is it a corporation in itself since it does not undergo the essential formalities and elements required to vest it with corporate existence considering its *ad hoc* character. The ruling in *Aurbach vs. Sanitary Wares Manufacturing Corp. (180 SCRA 130)* by the Supreme Court is instructive —

> In the United States, many courts have taken a realistic approach to joint venture corporations and have not rightly applied principles of corporation law designed primarily for public issue corporations. These courts have indicated that express arrangements between corporate joint ventures should be construed with less emphasis on the ordinary rules of law usually applied to corporate entities and with more consideration given to the nature of the agreement between the joint venturers.
>
> Just as in close corporations, shareholders' agreements in joint venture corporations often contain provisions which do one or more of the following: (1) require greater than majority vote for shareholder and director action; (2) give certain shareholders or groups of shareholders power to select a specified number of directors; (3) give to the shareholders control over the selection and retention of employees; and (4) set up a procedure for the settlement of disputes by arbitration.

> The legal concept of a joint venture is of common law origin. It has no precise definition, but it has been generally understood to mean an organization formed for some temporary purpose. It is hardly distinguishable from the partnership, since their elements are similar — community of interest in the business, sharing of profits and losses, and a mutual right of control. The main distinction cited by most opinions in common law jurisdiction is that the partnership contemplates a general business with some degree of continuity, while the joint venture is formed for the execution of a single transaction, and is thus of a temporary nature. This observation is not entirely accurate in this jurisdiction, since under the Civil Code, a partnership may be particular or universal, and a particular partnership may have for its object a specific undertaking. It would seem therefore that under Philippine law, a joint venture is a form of partnership and should thus be governed by the law of partnership.
>
> Although a corporation cannot enter into a partnership contract, it may, however, engage in a joint venture with others.

A joint venture may thus simply be treated like any other contract, innominate in nature to be regulated and governed primarily by the stipulations of the parties thereto and suppletorily by the general provisions of the Civil Code on obligations and contracts, by the rules governing the most analogous contract (*e.g.,* law on partnership), and by the customs of the place (see *Art. 1307, Civil Code*).

Persons who attempt, but fail, to form a corporation can become in legal effect partners *inter se* when necessary to do justice *(Pioneer Insurance vs. Court of Appeals, 175 SCRA 668)*. Persons who assume to act as a corporation, knowing it to be without authority to do so, are liable as *general partners*, and the legal consequence of

estoppel can apply (see *Sec. 21, Corporation Code; Christian Children's Fund vs. National Labor Relations Commission, 174 SCRA 681*). There being no real partnership created, however, the mutual agency rule does not apply *(Pioneer Insurance vs. Court of Appeals, 175 SCRA 668).*

Kinds of Partnerships

As to its object, a partnership is either *universal* or *particular*, and as regards the liability of the partners, a partnership may be *general* or *limited (Art. 1776, Civil Code).*

A *universal* partnership may refer to all the present property or to all the profits *(Art. 1777, Civil Code).* A partnership of all present property is that in which the partners contribute all the property which actually belongs to them to a common fund, with the intention of dividing the same among themselves, as well as all the profits which they may acquire therewith *(Art. 1778, Civil Code).* In a universal partnership of all present property, the property which belonged to each of the partners at the time of the constitution of the partnership becomes the common property of all the partners, as well as all the profits which they may acquire therewith. A stipulation for the common enjoyment of any other profits may also be made; but the property which the partners may acquire subsequently by inheritance, legacy, or donation cannot be included in such stipulation, except the fruits thereof *(Art. 1779, Civil Code).*

A universal partnership of profits comprises all that the partners may acquire by their industry or work during the existence of the partnership *(Art. 1780, Civil Code).* Articles of universal partnership, entered into without specification of its nature, only constitute a universal partnership of profits *(Art. 1781, Civil Code).*

Movable or immovable property which each of the partners may possess at the time of the celebration of the contract shall continue to pertain exclusively to each,

only the usufruct passing to the partnership *(Art. 1780, Civil Code; Jackson vs. Blum, 1 Phil. 4).*

A *particular* partnership has for its object determinate things, their use or fruits, or a specific undertaking, or the exercise of a profession or vocation *(Art. 1783, Civil Code).*

A *general* partnership is one where all the partners are general partners who thereby hold themselves liable with their property after all the partnership assets would have been exhausted (see *Art. 1816, Civil Code*). A *limited* partnership is one formed, subject to the formalities prescribed by the Code, having as members one or more general partners *and* one or more limited partners who (limited partners) are not bound beyond their contributions by the obligations of the partnership (see *Art. 1843, Civil Code*).

Partnership at Will

The birth and life of a partnership *at will* is predicated on the mutual desire and consent of the partners. The right to choose with whom a person wishes to associate himself is the very foundation and essence of that partnership. Its continued existence is, in turn, dependent on the constancy of that mutual resolve, along with each partner's capability to give it, and the absence of a cause for dissolution provided by the law itself. Verily, any one of the partners may, at his sole pleasure, dictate a dissolution of the partnership at will. He must, however, act in good faith, not that the attendance of bad faith can prevent the dissolution of the partnership but that it can result in a liability for damages.

Neither would the presence of a period for its specific duration or the statement of a particular purpose for its creation prevent the dissolution of any partnership by an act or will of a partner. Among partners, mutual agency arises and the doctrine of *delectus personae* allows them to have the *power,* although not necessarily the *right,* to

dissolve the partnership. An unjustified dissolution by the partner can subject him to a possible action for damages *(Gregorio F. Ortega, Tomas O. Del Castillo, Jr., and Benjamin T. Bacorro vs. Court of Appeals, Securities and Exchange Commission and Joaquin L. Misa, G.R. No. 109248, 03 July 1995, 245 SCRA 529).*

Chapter 2

Obligations of the Partners

Section 1 — Obligations of the Partners among Themselves

Art. 1784. A partnership begins from the moment of the execution of the contract, unless it is otherwise stipulated. (1679)

Art. 1785. When a partnership for a fixed term or particular undertaking is continued after the termination of such term or particular undertaking without any express agreement, the rights and duties of the partners remain the same as they were at such termination, so far as is consistent with a partnership at will.

A continuation of the business by the partners or such of them as habitually acted therein during the term, without any settlement or liquidation of the partnership affairs, is *prima facie* evidence of a continuation of the partnership. (n)

2. Elements (as a contract)

a. *Consent*

A partnership begins from the moment of the execution of the contract, unless it is otherwise stipulated *(Art. 1784, Civil Code)*. The partnership may be constituted in any form, except where immovable property or real rights are contributed thereto, in which case a public instrument shall be necessary *(Art. 1771, Civil Code; Magalona vs. Pesayco, 59 Phil. 453)*. The contract of partnership is void, whenever immovable property is *contributed* thereto, if

an inventory of said property is not made, signed by the parties, and attached to the public instrument *(Art. 1773, Civil Code;* see *Agad vs. Mabato, etc., 23 SCRA 1223).* The Supreme Court, however, in *Estanislao vs. Court of Appeals (160 SCRA 830,* but see *Arts. 1356* and *1357, Civil Code, supra.)* affirmed a lower court's decision ordering the execution of a public instrument embodying the provision of a partnership agreement in accordance with Article 1771 of the Civil Code, which prescribes a public instrument where real property is contributed to the common fund. A contract of partnership having a capital of three thousand pesos or more, in money or property, shall appear in a public instrument, which must be recorded in the Office of the Securities and Exchange Commission, but failure to comply with these requirements shall not affect the personality or liability of the partnership and the members thereof to third persons *(Art. 1772,* in relation to *Art. 1768, Civil Code).*

Persons who are prohibited from giving to each other any donation or advantage cannot enter into universal partnership *(Art. 1782, Civil Code),* but they can enter into a particular partnership *(Commissioner vs. Suter, 27 SCRA 152).* The prevailing view is that for reasons of public policy that would otherwise bind the corporation by the acts of parties other than its board of directors or its officers (see *40 Am. Jur., Sec. 22*), as well as because of the personal liability that the law attaches to the partner's property (beyond what they contribute to the partnership), corporations may not become members of the partnership; this view must then be understood as not disqualifying such corporations from being limited partners simply since those incompatibilities would not necessarily arise. In *Tuason vs. Bolaños (95 Phil. 106),* the Supreme Court has held that while "a corporation may not enter into a partnership, it may nevertheless enter into a joint venture with another where the nature of that venture is in line with the business authorized by its charter" (see also *Aurbach vs. Sanitary Wares, supra.*).

Among general partners (not limited partners), where mutual agency exists, coupled with the possible personal liability that could ensue, continuing utmost good faith and confidence is required. To them, therefore, the *"delectus personae"* (one's personal choice to become or accept a partner) rule applies; hence, it has been said that while they may not always have the right, they, nonetheless, have the power to dissolve the partnership (see *Rojas vs. Maglana, 192 SCRA 110*)

b. *Object*

The object of the contract is the common fund which the parties agree to create. Those who contribute money or property to the common fund are called *capitalist* partners and those who contribute industry or their services (see *Evangelista & Co. vs. Abad Santos, 51 SCRA 416*) are referred to as *industrial* partners.

c. *Cause*

The mutual undertaking and prestations of the parties constitute the cause of the contract of partnership.

1. Effects

a. *Among the Partners Themselves*

Art. 1786. Every partner is a debtor of the partnership for whatever he may have promised to contribute thereto.

He shall also be bound for warranty in case of eviction with regard to specific and determinate things which he may have contributed to the partnership, in the same cases and in the same manner as the vendor is bound with respect to the vendee. He shall also be liable for the fruits thereof from the time they should have been delivered, without the need of any demand. (1681a)

Art. 1787. When the capital or a part thereof which a partner is bound to contribute consists of goods, their appraisal must be made in the manner prescribed

in the contract of partnership, and in the absence of stipulation, it shall be made by experts chosen by the partners, and according to current prices, the subsequent changes thereof being for the account of the partnership. (n)

Art. 1788. A partner who has undertaken to contribute a sum of money and fails to do so becomes a debtor for the interest and damages from the time he should have complied with his obligation.

The same rule applies to any amount he may have taken from the partnership coffers, and his liability shall begin from the time he converted the amount to his own use. (1682)

Art. 1789. An industrial partner cannot engage in business for himself, unless the partnership expressly permits him to do so; and if he should do so, the capitalist partners may either exclude him from the firm or avail themselves of the benefits which he may have obtained in violation of this provision, with a right to damages in either case. (n)

Art. 1790. Unless there is a stipulation to the contrary, the partners shall contribute equal shares to the capital of the partnership. (n)

Art. 1791. If there is no agreement to the contrary, in case of an imminent loss of the business of the partnership, any partner who refuses to contribute an additional share to the capital, except an industrial partner, to save the venture, shall be obliged to sell his interest to the other partners. (n)

Art. 1792. If a partner authorized to manage collects a demandable sum, which was owed to him in his own name, from a person who owed the partnership another sum also demandable, the sum thus collected shall be applied to the two credits in proportion to their amounts, even though he may have given a receipt for his own credit only; but should he have given it for the account of the partnership credit, the amount shall be fully applied to the latter.

The provisions of this article are understood to be without prejudice to the right granted to the debtor

by Article 1252, but only if the personal credit of the partner should be more onerous to him. (1684)

Art. 1793. A partner who has received, in whole or in part, his share of a partnership credit, when the other partners have not collected theirs, shall be obliged, if the debtor should thereafter become insolvent, to bring to the partnership capital what he received even though he may have given receipt for his share only. (1685a)

Art. 1794. Every partner is responsible to the partnership for damages suffered by it through his fault, and he cannot compensate them with the profits and benefits which he may have earned for the partnership by his industry. However, the courts may equitably lessen this responsibility if through the partner's extraordinary efforts in other activities of the partnership, unusual profits have been realized. (1686a)

Art. 1795. The risk of specific and determinate things, which are not fungible, contributed to the partnership so that only their use and fruits may be for the common benefit, shall be borne by the partner who owns them.

If the things contributed are fungible, or cannot be kept without deteriorating, of if they were contributed to be sold, the risk shall be borne by the partnership. In the absence of stipulation, the risk of the things brought and appraised in the inventory, shall also be borne by the partnership, and in such case the claim shall be limited to the value at which they were appraised. (1687)

Art. 1796. The partnership shall be responsible to every partner for the amounts he may have disbursed on behalf of the partnership and for the corresponding interest, from the time the expenses are made; it shall also answer to each partner for the obligations he may have contracted in good faith in the interest of the partnership business, and for risks in consequence of its management. (1688a)

Art. 1797. The losses and profits shall be distributed in conformity with the agreement. If only the share of each partner in the profits has been agreed upon,

the share of each in the losses shall be in the same proportion.

In the absence of stipulation, the share of each partner in the profits and losses shall be in proportion to what he may have contributed, but the industrial partner shall not be liable for the losses. As for the profits, the industrial partner shall receive such share as may be just and equitable under the circumstances. If besides his services he has contributed capital, he shall also receive a share in the profits in proportion to his capital. (1689a)

Art. 1798. If the partners have agreed to intrust to a third person the designation of the share of each one in the profits and losses, such designation may be impugned only when it is manifestly inequitable. In no case may a partnership who has begun to execute the decision of the third person, or who has not impugned the same within a period of three months from the time he had knowledge thereof, complain of such decision.

The designation of losses and profits cannot be intrusted to one of the partners. (1690)

Art. 1799. A stipulation which excludes one or more partners from any share in the profits or losses is void. (1691)

Art. 1800. The partner who has been appointed manager in the articles of partnership may execute all acts of administration despite the opposition of his partners, unless he should act in bad faith; and his power is irrevocable without just or lawful cause. The vote of the partners representing the controlling interest shall be necessary for such revocation of power.

A power granted after the partnership has been constituted may be revoked at any time. (1692a)

Art. 1801. If two or more partners have been intrusted with the management of the partnership without specification of their respective duties, or without a stipulation that one of them shall not act without the consent of all the others, each one may separately execute all acts of administration, but if any of them should

oppose the acts of the others, the decision of the majority shall prevail. In case of a tie, the matter shall be decided by the partners owning the controlling interest. (1693a)

Art. 1802. In case it should have been stipulated that none of the managing partners shall act without the consent of the others, the concurrence of all shall be necessary for the validity of the acts, had the absence or disability of anyone of them cannot be alleged, unless there is imminent danger of grave or irreparable injury to the partnership. (1694)

Art. 1803. When the manner of management has not been agreed upon, the following rules shall be observed:

(1) All the partners shall be considered agents and whatever anyone of them may do alone shall bind the partnership, without prejudice to the provisions of Article 1801.

(2) None of the partners may, without the consent of the others, make any important alteration in the immovable property of the partnership, even if it may be useful to the partnership. But if the refusal of consent by the other partners is manifestly prejudicial to the interest of the partnership, the court's intervention may be sought. (1695a)

Art. 1804. Every partner may associate another person with him in his share, but the associate shall not be admitted into the partnership without the consent of all the other partners, even if the partner having an associate should be a manager. (1696)

Art. 1805. The partnership books shall be kept, subject to any agreement between the partners, at the principal place of business of the partnership, and every partner shall at any reasonable hour have access to and may inspect and copy any of them. (n)

Art. 1806. Partners shall render on demand true and full information of all things affecting the partnership to any partner or the legal representative of any deceased partner or of any partner under legal disability. (n)

Art. 1807. Every partner must account to the partnership for any benefit, and hold as trustee for it any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property. (n)

Art. 1808. The capitalist partners cannot engage for their own account in any operation which is of the kind of business in which the partnership is engaged, unless there is a stipulation to the contrary.

Any capitalist partner violating this prohibition shall bring to the common funds any profits accruing to him from his transactions, and shall personally bear all the losses. (n)

Art. 1809. Any partner shall have the right to a formal account as to partnership affairs:

(1) If he is wrongfully excluded from the partnership business or possession of its property by his co-partners;

(2) If the right exists under the terms of any agreement;

(3) As provided by Article 1807;

(4) Whenever other circumstances render it just and reasonable. (n)

Section 2 — Property Rights of a Partner

Art. 1810. The property rights of a partner are:

(1) His rights in specific partnership property;

(2) His interest in the partnership; and

(3) His right to participate in the management. (n)

Art. 1811. A partner is co-owner with his partners of specific partnership property.

The incidents of this co-ownership are such that:

(1) A partner, subject to the provisions of this Title and to any agreement between the partners, has

an equal right with his partners to possess specific partnership property for partnership purposes; but he has no right to possess such property for any other purpose without the consent of his partners;

(2) A partner's right in specific partnership property is not assignable except in connection with the assignment of rights of all the partners in the same property;

(3) A partner's right in specific partnership property is not subject to attachment or execution, except on a claim against the partnership. When partnership property is attached for a partnership debt the partners, or any of them, or the representatives of a deceased partner, cannot claim any right under the homestead or exemption laws;

(4) A partner's right in specific partnership property is not subject to legal support under Article 291.[1] (n)

Art. 1812. A partner's interest in the partnership is his share of the profits and surplus. (n)

Art. 1813. A conveyance by a partner of his whole interest in the partnership does not of itself dissolve the partnership, or, as against the other partners in the absence of agreement, entitle the assignee, during the continuance of the partnership, to interfere in the management or administration of the partnership business or affairs, or to require any information or account of partnership transactions, or to inspect the partnership books; but it merely entitles the assignee to receive in accordance with his contract the profits to which the assigning partners would otherwise be entitled. However, in case of fraud in the management of the partnership, the assignee may avail himself of the usual remedies.

In case of a dissolution of the partnership, the assignee is entitled to receive his assignor's interest and may require an account from the date only of the last account agreed to by all the partners. (n)

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[1]Now Title VIII, Art. 195, E.O. No. 209, as amended.

Art. 1814. Without prejudice to the preferred rights of partnership creditors under Article 1827, on due application to a competent court by any judgment creditor of a partner, the court which entered the judgment, or any other court, may charge the interest of the debtor partner with payment of the unsatisfied amount of such judgment debt with interest thereon; and may then or later appoint a receiver of his share of the profits, and of any other money due or to fall due to him in respect of the partnership, and make all other orders, directions, accounts and inquiries which the debtor partner might have made, or which the circumstances of the case may require.

The interest charged may be redeemed at any time before foreclosure, or in case of a sale being directed by the court, may be purchased without thereby causing a dissolution:

(1) With separate property, by any one or more of the partners; or

(2) With partnership property, by any one or more of the partners with the consent of all the partners whose interests are not so charged or sold.

Nothing in this Title shall be held to deprive a partner of his right, if any, under the exemption laws, as regards his interest in the partnership. (n)

(1) *Contribution to Partnership*

Every partner is a debtor of the partnership for whatever he may have promised to contribute thereto. He shall also be bound for warranty in case of eviction with regard to specific and determinate things which he may have contributed to the partnership, in the same cases and in the same manner as the vendor is bound with respect to the vendee. He shall also be liable for the fruits thereof from the time they should have been delivered, without the need of any demand *(Art. 1786, Civil Code)*. Article 1191 (resolution) has been held to be inapplicable *(Sancho vs. Lizarraga, 55 Phil. 601)* so as to rescind the

partnership contract because of a partner's failure to comply with his promised contribution.

When the capital or a part thereof which a partner is bound to contribute consists of goods, their appraisal must be made in the manner prescribed in the contract of partnership, and in the absence of stipulation, it shall be made by experts chosen by the partners, and according to current prices, the subsequent changes thereof being for the account of the partnership *(Art. 1787, Civil Code)*.

A partner who has undertaken to contribute a sum of money and fails to do so becomes a debtor for the interest and damages from the time he should have complied with his obligation. The same rule applies to any amount he may have taken from the partnership coffers, and his liability shall begin from the time he converted the amount to his own use *(Art. 1788, Civil Code;* see *Colbert vs. Bachrach, 12 Phil. 83)*.

Unless there is a stipulation to the contrary, the partners shall contribute equal shares to the capital of the partnership *(Art. 1790, Civil Code)*.

(2) *Certain Prohibitions on Partners*

The capitalist partners cannot engage for their own account in any operation which is of the kind of business in which the partnership is engaged, unless there is a stipulation to the contrary. Any capitalist partner violating this prohibition shall bring to the common funds any profits accruing to him from his transactions and shall personally bear all the losses *(Art. 1808, Civil Code)*.

An industrial partner cannot engage in business for himself, unless the partnership expressly permits him to do so; and if he should do so, the capitalist partners may either exclude him from the firm or avail themselves of the benefits which he may have obtained in violation of this provision, with a right to damages in either case *(Art. 1789, Civil Code)*.

(3) *Mutual Accounting*

If a partner authorized to manage collects a demandable sum, which was owed to him in his own name, from a person who owed the partnership another demandable sum, the sum thus collected shall be applied to the two credits in proportion to their amounts, even though he may have given a receipt for his own credit only; but should he have given it for the account of the partnership credit, the amount shall be fully applied to the latter. The provisions of this article are understood to be without prejudice to the right granted to the debtor by Article 1252, but only if the personal credit of the partner should be more onerous to him *(Art. 1792, Civil Code)*.

A partner who has received, in whole or in part, his share of a partnership credit, when the other partners have not collected theirs, shall be obliged, if the debtor should thereafter become insolvent, to bring to the partnership capital what he received even though he may have given receipt for his share only *(Art. 1793, Civil Code)*.

Every partner is responsible to the partnership for damages suffered by it through his fault, and he cannot compensate them with the profits and benefits which he may have earned for the partnership by his industry. However, the courts may equitably lessen this responsibility if through the partner's extraordinary efforts in other activities of the partnership, unusual profits have been realized *(Art. 1794, Civil Code)*.

The risk of specific and determinate things which are not fungible, contributed to the partnership so that only their use and fruits may be for common benefit, shall be borne by the partner who owns them. If the things contributed are fungible, or cannot be kept without deteriorating, or if they were contributed to be sold, the risk shall be borne by the partnership. In the absence of stipulation, the risk of things brought and appraised in the inventory shall also be borne by the partnership, and

in such case the claim shall be limited to the value at which they were appraised *(Art. 1795, Civil Code).*

The partnership shall be responsible to every partner for the amounts he may have disbursed on behalf of the partnership and for the corresponding interest, from the time the expenses are made; it shall also answer to each partner for the obligations he may have contracted in good faith in the interest of the partnership business and for risks in consequence of his management *(Art. 1796, Civil Code;* see *Munasque vs. Court of Appeals, 139 SCRA 533; Sumaya vs. De Luna, 67 Phil. 646).*

Partners shall render on demand true and full information of all things affecting the partnership to any partner or the legal representative of any deceased partner or of any partner under legal disability *(Art. 1806, Civil Code).*

Every partner must account to the partnership for any benefit and hold as trustee for it any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property *(Art. 1807, Civil Code;* see *Pang Lim vs. Lo Song, 42 Phil. 282; Teague vs. Martin, 53 Phil. 504).*

Any partner shall have the right to a formal account as to partnership affairs: (a) if he is wrongly excluded from the partnership business or possession of its property by his co-partners; (b) if the right exists under the terms of any agreement; (c) as provided by Article 1807; (d) whenever other circumstances render it just and reasonable *(Art. 1809, Civil Code).*

The ten-year prescriptive period to demand an accounting by a partner, said the court in one case, begins at the dissolution of the partnership *(Fue Leung vs. Intermediate Appellate Court, supra.).*

The partnership books shall be kept, subject to any agreement between the partners, at the principal place of

business of the partnership, and every partner shall at any reasonable hour have access to and may inspect and copy any of them *(Art. 1805, Civil Code)*.

(4) *Property Rights of Partners*

The property rights of a partner are:

(a) His rights in specific partnership property;

(b) His interest in the partnership; and

(c) His right to participate in the management *(Art. 1810, Civil Code)*.

Rights in Specific Partnership Property

A partner is co-owner with his partners of specific partnership property. The incidents of this co-ownership are such that:

(1) A partner, subject to the provisions of the Code on Partnership and to any agreement between the partners, has an equal right with his partners to possess specific partnership property for partnership purposes; but he has no right to possess such property for any other purpose without the consent of his partners;

(2) A partner's right in specific partnership property is not assignable except in connection with the assignment of rights of all the partners in the same property;

(3) A partner's right in specific partnership property is not subject to attachment or execution, except on a claim against the partnership. When partnership property is attached for a partnership debt, the partners, or any of them, or the representatives of a deceased partner, cannot claim any right under the homestead or exemption laws;

(4) A partner's right in specific partnership property is not subject to legal support under Article

291, now contained in Article 195 and Article 196 of the Family Code (see *Art. 1811, Civil Code*).

Any immovable property or an interest therein may be acquired in the partnership name. The title so acquired can be conveyed only in the partnership name *(Art. 1774, Civil Code)* subject, however, to the provisions of Article 1819 of the Code (see *infra*.).

Interest in the Partnership

A partner's interest in the partnership is his share of the profits and surplus *(Art. 1812, Civil Code)*. When an action is to recover the agreed profits, the prescriptive period of 10 years under Article 1144, in relation to Article 1155, said the Court in *Dan Fue Leung vs. Intermediate Appellate Court (supra.),* should be applied in conjunction with Article 1842 stating that the right to demand an accounting accrues, in the absence of a contrary agreement, at the dissolution of the partnership.

The losses and profits shall be distributed in conformity with the agreement. If only the share of each partner in the profits has been agreed upon, the share of each in the losses shall be in the same proportion. In the absence of stipulation, the share of each partner in the profits and losses shall be in proportion to what he may have contributed, but the industrial partner shall not be liable for the losses (but he still holds himself liable as regards third persons [see (*Arts. 1816-1817, Civil Code; Duterte vs. Rallo, 2 Phil. 502; Chavez vs. Linan, 2 Phil. 12; Compaña Maritima vs. Muñoz, 9 Phil. 326*]). As for the profits, the industrial partner shall receive such share as may be just and equitable under the circumstances. If besides his services he has contributed capital, he shall also receive a share in the profits in proportion to his capital *(Art. 1797, Civil Code)*. These provisions do not affect the liability of the partners as regards persons dealing with the partnership *(Compaña Maritima vs. Muñoz, 9 Phil. 326)*.

If the partners have agreed to intrust to a third person the designation of the share of each one in the profits and losses, such designation may be impugned only when it is manifestly inequitable. In no case may a partner who has begun to execute the decision of the third person, or who has not impugned the same within a period of three months from the time he had knowledge thereof, complain of such decision. The designation of losses and profits cannot be intrusted to one of the partners *(Art. 1798, Civil Code)*.

A stipulation which excludes one or more partners from any share in the profits or losses is void *(Art. 1799, Civil Code),* except an exemption from losses of the industrial partner since his unpaid services could well be the equivalent of his contribution to such losses (see *Art. 1797, Civil Code*).

If there is no agreement to the contrary, in case of an imminent loss of the business of the partnership, any partner who refuses to contribute an additional share to the capital, except an industrial partner, to save the venture, shall be obliged to sell his interest to the other partners *(Art. 1791, Civil Code)*.

A conveyance by a partner of his whole interest in the partnership does not of itself dissolve the partnership, or, as against the other partners in the absence of agreement, entitle the assignee, during the continuance of the partnership, to interfere in the management or administration of the partnership business or affairs, or to require any information or account of partnership transactions or to inspect the partnership books; but it merely entitles the assignee to receive in accordance with his contract the profits to which the assigning partner would otherwise be entitled (see *Machuca vs. Chuidian, Buenaventura & Co., 2 Phil. 210*). However, in case of fraud in the management of the partnership, the assignee may avail himself of the usual remedies. In case of dissolution of the partnership, the assignee is entitled to

receive his assignor's interest and may require an account from the date only of the last account agreed to by all the partners *(Art. 1813, Civil Code)*.

Without prejudice to the preferred rights of partnership creditors under Article 1827 (see *infra*.) on due application to a competent court by any judgment creditor of a partner, the court which entered the judgment, or any other court, may charge the interest of the debtor partner with payment of the unsatisfied amount of such judgment debt with interest thereon; and may then or later appoint a receiver of his share of the profits, and of any other money due or to fall due to him in respect of the partnership, and make all other orders, directions, accounts and inquiries which the debtor partner might have made, or which the circumstances of the case may require. The interest charged may be redeemed at any time before foreclosure, or in case of a sale being directed by the court, may be purchased without thereby causing a dissolution:

(1) With separate property, by any one or more of the partners; or

(2) With partnership property, by any one or more of the partners with the consent of all the partners whose interests are not so charged or sold.

A partner may not be deprived, however, of his right, if any, under the exemption laws, as regards his interest in the partnership (see *Art. 1814, Civil Code*).

Management of Partnership

The manner of management may be provided for in the partnership agreement. Where a partner has been appointed manager in the articles of partnership, he may execute all *acts of administration* despite the opposition of his partners, unless he should act in bad faith; and his power is irrevocable without just or lawful cause. The vote of the partners representing the controlling interest shall be necessary for such revocation of power. A power

granted after the partnership has been constituted may be revoked at any time *(Art. 1800, Civil Code).* If two or more partners have been instructed with the management of the partnership without specification of their respective duties, or without a stipulation that one of them shall not act without the consent of all the others, each one may separately execute all acts of administration, but if any of them should oppose the acts of the others, the decision of the majority shall prevail. In case of a tie, the matter shall be decided by the partners owning the controlling interest *(Art. 1801, Civil Code;* see *Litton vs. Hill & Ceron, 67 Phil. 509).* In case it should have been stipulated that none of the managing partners shall act without the consent of the others, the concurrence of all shall be necessary for the validity of the acts, and the absence or disability of any one of them cannot be alleged, unless there is imminent danger of grave irreparable injury to the partnership *(Art. 1802, Civil Code).*

When the manner of management has not been agreed upon, the following rules shall be observed:

(1) All the partners shall be considered agents and whatever any one of them may do alone shall bind the partnership, without prejudice to the provision of Article 1801 *(supra.).*

(2) None of the partners may, without the consent of the others, make any important alteration in the immovable property of the partnership, even if it may be useful to the partnership. But if the refusal of consent by the other partners is manifestly prejudicial to the interest of the partnership, the court's intervention may be sought *(Art. 1803, Civil Code;* see *Bachrach vs. La Protectora, 37 Phil. 441).*

Every partner may associate another person with him in his share, but the associate shall not be admitted into the partnership without the consent of all the other partners, even if the partner having an associate should be a manager *(Art. 1804, Civil Code).*

b. *As Regards Third Persons*

Section 3 — Obligations of the Partners with Regard to Third Persons

Art. 1815. Every partnership shall operate under a firm name, which may or may not include the name of one or more of the partners.

Those who, not being members of the partnership, include their names in the firm name, shall be subject to the liability of a partner. (n)

Art. 1816. All partners, including industrial ones, shall be liable *pro rata* with all their property and after all the partnership assets have been exhausted, for the contracts which may be entered into in the name and for the account of the partnership, under its signature and by a person authorized to act for the partnership. However, any partner may enter into a separate obligation to perform a partnership contract. (n)

Art. 1817. Any stipulation against the liability laid down in the preceding article shall be void, except as among the partners. (n)

Art. 1818. Every partner is an agent of the partnership for the purpose of its business, and the act of every partner, including the execution in the partnership name of any instrument, for apparently carrying on in the usual way the business of the partnership of which he is a member binds the partnership, unless the partner so acting has in fact no authority to act for the partnership in the particular matter, and the person with whom he is dealing has knowledge of the fact that he has no such authority.

An act of a partner which is not apparently for the carrying on of business of the partnership in the usual way does not bind the partnership unless authorized by the other partners.

Except when authorized by the other partners or unless they have abandoned the business, one or more but less than all the partners have no authority to:

(1) Assign the partnership property in trust for creditors or on the assignee's promise to pay the debts of the partnership;

(2) Dispose of the goodwill of the business;

(3) Do any other act which would make it impossible to carry on the ordinary business of a partnership;

(4) Confess a judgment;

(5) Enter into a compromise concerning a partnership claim or liability;

(6) Submit a partnership claim or liability to arbitration;

(7) Renounce a claim of the partnership.

No act of a partner in contravention of a restriction on authority shall bind the partnership to persons having knowledge of the restriction. (n)

Art. 1819. Where title to real property is in the partnership name, any partner may convey title to such property by a conveyance executed in the partnership name; but the partnership may recover such property unless the partner's act binds the partnership under the provisions of the first paragraph of Article 1818, or unless such property has been conveyed by the grantee or a person claiming through such grantee to a holder for value without knowledge that the partner, in making the conveyance, has exceeded his authority.

Where title to real property is in the name of the partnership, a conveyance executed by a partner, in his own name, passes the equitable interest of the partnership, provided the act is one within the authority of the partner under the provisions of the first paragraph of Article 1818.

Where title to real property is in the name of one or more but not all the partners, and the record does not disclose the right of the partnership, the partners in whose name the title stands may convey title to such property, but the partnership may recover such property if the partners' act does not bind the partner-

ship under the provisions of the first paragraph of Article 1818, unless the purchaser of his assignee, is a holder for value, without knowledge.

Where the title to real property is in the name of one or more or all the partners, or in a third person in trust for the partnership, a conveyance executed by a partner in the partnership name, or in his own name, passes the equitable interest of the partnership, provided the act is one within the authority of the partner under the provisions of the first paragraph of Article 1818.

Where the title to real property is in the names of all the partners a conveyance executed by all the partners passes all their rights in such property. (n)

Art. 1820. An admission or representation made by any partner concerning partnership affairs within the scope of his authority in accordance with this Title is evidence against the partnership. (n)

Art. 1821. Notice to any partner of any matter relating to partnership affairs, and the knowledge of the partner acting in the particular matter, acquired while a partner or then present to his mind, and the knowledge of any other partner who reasonably could and should have communicated it to the acting partner, operate as notice to or knowledge of the partnership, except in the case of a fraud on the partnership, committed by or with the consent of that partner. (n)

Art. 1822. Where, by any wrongful act or omission of any partner acting in the ordinary course of the business of the partnership or with the authority of his co-partners, loss or injury is caused to any person, not being a partner in the partnership, or any penalty is incurred, the partnership is liable therefor to the same extent as the partner so acting or omitting to act. (n)

Art. 1823. The partnership is bound to make good the loss:

(1) Where one partner acting within the scope of his apparent authority receives money or property of a third person and misapplies it; and

(2) Where the partnership in the course of its business receives money or property of a third person and the money or property so received is misapplied by any partner while it is in the custody of the partnership. (n)

Art. 1824. All partners are liable solidarily with the partnership for everything chargeable to the partnership under Articles 1822 and 1823. (n)

Art. 1825. When a person, by words spoken or written or by conduct, represents himself, or consents to another representing him to anyone, as a partner in an existing partnership or with one or more persons not actual partners, he is liable to any such persons to whom such representation has been made, who has, on the faith of such representation, given credit to the actual or apparent partnership, and if he has made such representation or consented to its being made in a public manner he is liable to such person, whether the representation has or has not been made or communicated to such person so giving credit by or with the knowledge of the apparent partner making the representation or consenting to its being made:

(1) When a partnership liability results, he is liable as though he were an actual member of the partnership;

(2) When no partnership liability results, he is liable *pro rata* with the other persons, if any, so consenting to the contract or representation as to incur liability, otherwise separately.

When a person has been thus represented to be a partner in an existing partnership, or with one or more persons not actual partners, he is an agent of the persons consenting to such representation to bind them to the same extent and in the same manner as though he were a partner in fact, with respect to persons who rely upon the representation. When all the members of the existing partnership consent to the representation, a partnership act or obligation results; but in all other cases it is the joint act or obligation of the person act-

ing and the persons consenting to the representation. (n)

Art. 1826. A person admitted as a partner into an existing partnership is liable for all the obligations of the partnership arising before his admission as though he had been a partner when such obligations were incurred, except that this liability shall be satisfied only out of the partnership property, unless there is a stipulation to the contrary. (n)

Art. 1827. The creditors of the partnership shall be preferred to those of each partner as regards the partnership property. Without prejudice to this right, the private creditors of each partner may ask the attachment and public sale of the share of the latter in the partnership assets. (n)

Every partnership shall operate under a firm name, which may or may not include the name of one or more of the partners. Those who, not being members of the partnership, include their names in the firm name shall be subject to the liability of a partner *(Art. 1815, Civil Code)*.

All partners, including industrial ones, shall be liable *pro rata* with all their property and after all the partnership assets have been exhausted for the contracts which may be entered into in the name and for the account of the partnership, under its signature and by a person authorized to act for the partnership. However, any partner may enter into a separate obligation to perform a partnership contract *(Art. 1816, Civil Code)*. Any stipulation against the liability shall be void, except as among the partners (see *Art. 1817, Civil Code;* see also *Compaña Maritima vs. Muñoz, 9 Phil. 326*).

A person admitted as a partner into an existing partnership is liable for all the obligations of the partnership arising before his admission as though he had been a partner when such obligations were incurred, except that this liability shall be satisfied only out of partnership property, unless there is a stipulation to the contrary *(Art. 1826, Civil Code)*.

The creditors of the partnership shall be preferred to those of each partner as regards the partnership property. Without prejudice to this right, the private creditors of each partner may ask for the attachment and public sale of the share of the latter in the partnership assets *(Art. 1827, Civil Code)*.

Mutual Agency Rule

Every partner is an agent of the partnership for the purpose of its business, and the act of every partner, including the execution in the partnership name of any instrument, for *apparently carrying on in the usual way the business of the partnership* of which he is a member binds the partnership (see *Munasque vs. Court of Appeals, 139 SCRA 533; Goquiolay vs. Sycip, 9 SCRA 663*), *unless* the partner so acting has in fact no authority to act for the partnership in the particular matter, *and* the person with whom he is dealing has knowledge of the fact that he has no such authority. Third persons, however, are not bound to inquire into the existence of the restriction but they may rely on the presumption that a partner may bind the partnership *(Litton vs. Hill & Coron, 67 Phil. 509)*. An act of a partner which is not apparently for the carrying on of business of the partnership in the usual way does not bind the partnership unless authorized by the other partners. Except when authorized by the other partners or unless they have abandoned the business, one or more but less than all the partners have no authority to: (1) assign the partnership property in trusts for creditors or on the assignee's promise to pay the debts of the partnership; (2) dispose of the goodwill of the business; (3) do any other act which would make it impossible to carry on the ordinary business of a partnership; (4) confess a judgment; (5) enter into a compromise concerning a partnership claim or liability; (6) submit a partnership claim of liability to arbitration; and (7) renounce a claim of the partnership. No act of a partner in contravention of a restriction on authority shall bind the

partnership to persons having knowledge of the restriction *(Art. 1818, Civil Code)*.

An admission or representation made by any partner concerning partnership affairs within the scope of his authority is evidence against the partnership (see *Art. 1820, Civil Code*). Notice to any partner of any matter, relating to partnership affairs, and the knowledge of the partner acting in the particular matter, acquired while a partner or then present to his mind, and the knowledge of any other partner who reasonably could and should have communicated it to the acting partner, operate as notice to or knowledge of the partnership except in the case of a fraud on the partnership committed by or with the consent of that partner *(Art. 1821, Civil Code)*.

Liability for Wrongful Act or Omission

Where, by any wrongful act or omission of any partner acting *in the ordinary course of the business* of the partnership *or with the authority of his co-partners*, loss or injury is caused to any person, not being a partner in the partnership, or any penalty is incurred, the partnership is liable therefor to the same extent as the partner so acting or omitting to act *(Art. 1822, Civil Code)*. The partnership is bound to make good the loss: (1) where one partner acting within the scope of his apparent authority receives money or property of a third person and misapplies it; and (2) where the partnership in the course of its business receives money or property of a third person and the money or property so received is misapplied by any partner while it is in the custody of the partnership *(Art. 1823, Civil Code)*.

All partners are liable *solidarily* with the partnership for everything chargeable to the partnership under the foregoing provisions of Articles 1822 and 1823 *(Art. 1824, Civil Code)*.

The provision of Article 1816 should be construed in the light of Article 1824. Thus, while the liability of the

partners are merely joint in transactions entered into by the partnership, a third person who transacted with said partnership can hold the partners solidarily liable for the whole obligation if the case of the third person falls under either Article 1822 or Article 1823 *(Elmo Muñasque vs. Court of Appeals, 139 SCRA 533).*

In *Muñasque vs. Court of Appeals (supra.),* the partnership of petitioner and respondent Celestino Galan entered into a contract with *Tropical Commercial Co., Inc.* for the remodeling of part of the latter's building. The partnership was to be paid in installments. Two checks representing two installments were encashed by Galan. After the work was finished, the petitioner sued Galan and Tropical for payment of the amount represented by the two checks, which money, the petitioner alleged, was malversed by Galan. Two suppliers, to which the partnership owed money, intervened. After trial the CFI, ruled that the petitioner and Galan were liable jointly and severally to the suppliers. The Court of Appeals ruled that the partners were liable *pro rata*. The case reached the Supreme Court, which held:

> "While it is true that under Article 1816 of the Civil Code, 'all partners, including industrial ones, shall be liable *pro rata* with all their property and after all the partnership assets have been exhausted, for the contracts which may be entered into the name and for the account of the partnership, under its signature and by a person authorized to act for the partnership x x x,' this provision should be construed together with Article 1824 which provide that: 'All partners are liable solidarily with the partnership for everything chargeable to the partnership under Arts. 1822 and 1823.' In short, while the liability of the partners are merely joint in transactions entered into by the partnership, a third person who transacted with said partnership can hold the partners solidarily liable for the whole obligation if the

case of the third person falls under Arts. 1822 and 1823."

When a person, by words spoken or written or by conduct, represents himself or consents to another representing him to anyone as a partner in an existing partnership or with one or more persons not actual partners, he is liable to any such persons to whom such representation has been made, who has, on the faith of such representation, given credit to the actual or apparent partnership, and if he has made such representation or consented to its being made in public manner he is liable to such person, whether the representation has or has not been made or communicated to such persons so giving credit by or with the knowledge of the apparent partner making the representation or consenting to its being made:

(1) When a partnership liability results, he is liable as though he were an actual member of the partnership;

(2) When no partnership liability results, he is liable *pro rata* with the other persons, if any, so consenting to the contract or representation as to incur liability, otherwise separately.

When a person has been thus represented to be a partner in an existing partnership, or with one or more persons not actual partners, he is an agent of the persons consenting to such representation to bind them to the same extent and in the same manner as though he were a partner in fact, with respect to persons who rely upon the representation. When all the members of the existing partnership consent to the representation, a partnership act or obligation results; but in all other cases it is the joint act or obligation of the person acting and the persons consenting to the representation *(Art. 1825, Civil Code;* see *MacDonald vs. National City Bank of New York, 99 Phil. 156).*

In fine

The liability of general partners (in a general partnership) is laid down in Article 1816 which posits that all partners shall be liable *pro rata* beyond the partnership assets for all the contracts which may have been entered into in its name, under its signature, and by a person authorized to act for the partnership. This rule is to be construed along with other provisions of the Civil Code which postulate that the partners can be held **solidarily** liable with the partnership specifically in these instances — (1) where, by any wrongful act or omission of any partner acting in the ordinary course of the business of the partnership or with the authority of his co-partners, loss or injury is caused to any person, not being a partner in the partnership, or any penalty is incurred, the partnership is liable therefor to the same extent as the partner so acting or omitting to act; (2) where one partner acting within the scope of his apparent authority receives money or property of a third person and misapplies it; and (3) where the partnership in the course of its business receives money or property of a third person and the money or property so received is misapplied by any partner while it is in the custody of the partnership — consistently with the rules on the nature of civil liability in *delicts* and *quasi-delicts (see Lim Tong Lim vs. Philippine Fishing Gear Industries, Inc., G.R. No. 136448, 03 November 1999, 317 SCRA 728).*

Conveyances of Title to Real Property

In the conveyance of title to real property, the following rules can govern:

> (a) Where title to real property is in the partnership name, any partner may convey title to such property by a conveyance executed in the partnership name; but the partnership may recover such property unless the partner's act binds the partnership under the mutual agency rule or when authorized to so act, or unless such property has been con-

veyed by the grantee or a person claiming through such grantee to a holder for value without knowledge that the partner, in making the conveyance, has exceeded his authority. A conveyance executed by a partner, in his own name, passes the equitable interest of the partnership, provided the act is one without the authority of the partner.

(b) Where title to real property is in the name of one or more but not all the partners, and the record does not disclose the right of the partnership, the partners in whose name the title stands may convey title to such property, but the partnership may recover such property if the partners' act does not bind the partnership, unless the purchaser or his assignee, is a holder for value without knowledge.

(c) Where the title to real property is in the name of one or more or all partners, or in a third person in trust for the partnership, a conveyance executed by a partner in the partnership name, or in his own name, passes the equitable interest of the partnership, provided the act is one within the authority of the partner.

(d) Where the title to real property is in the names of all the partners, a conveyance executed by all the partners passes all their rights in such property (see *Art. 1819,* in relation to *Art. 1818, Civil Code*).

Chapter 3

Dissolution and Winding Up

Art. 1828. The dissolution of a partnership is the change in the relation of the partners caused by any partner ceasing to be associated in the carrying on as distinguished from the winding up of the business. (n)

Art. 1829. On dissolution the partnership is not terminated, but continues until the winding up of partnership affairs is completed. (n)

Art. 1830. Dissolution is caused:

(1) Without violation of the agreement between the partners:

(a) By the termination of the definite term or particular undertaking specified in the agreement;

(b) By the express will of any partner, who must act in good faith, when no definite term or particular undertaking is specified;

(c) By the express will of all the partners who have not assigned their interests or suffered them to be charged for their separate debts, either before or after the termination of any specified term or particular undertaking;

(d) By the expulsion of any partner from the business *bona fide* in accordance with such a power conferred by the agreement between the partners;

(2) In contravention of the agreement between the partners, where the circumstances do not permit a dissolution under any other provision of this article, by the express will of any partner at any time;

(3) By any event which makes it unlawful for the business of the partnership to be carried on or for the members to carry it on in partnership;

(4) When a specific thing, which a partner had promised to contribute to the partnership, perishes before the delivery; in any case by the loss of the thing, when the partner who contributed it having reserved the ownership thereof, has only transferred to the partnership the use or enjoyment of the same; but the partnership shall not be dissolved by the loss of the thing when it occurs after the partnership has acquired the ownership thereof;

(5) By the death of any partner;

(6) By the insolvency of any partner or of the partnership;

(7) By the civil interdiction of any partner;

(8) By decree of court under the following article. (1700a and 1701a)

Art. 1831. On application by or for a partner the court shall decree a dissolution whenever:

(1) A partner has been declared insane in any judicial proceeding or is shown to be of unsound mind;

(2) A partner becomes in any other way incapable of performing his part of the partnership contract;

(3) A partner has been guilty of such conduct as tends to affect prejudicially the carrying on of the business;

(4) A partner willfully or persistently commits a breach of the partnership agreement, or otherwise so conducts himself in matters relating to the partnership business that it is not reasonably practicable to carry on the business in partnership with him;

(5) The business of the partnership can only be carried on at a loss;

(6) Other circumstances render a dissolution equitable.

On the application of the purchaser of a partner's interest under Article 1813 or 1814:

(1) After the termination of the specified term or particular undertaking;

(2) At any time if the partnership was a partnership at will when the interest was assigned or when the charging order was issued. (n)

Art. 1832. Except so far as may be necessary to wind up partnership affairs or to complete transactions begun but not then finished, dissolution terminates all authority of any partner to act for the partnership:

(1) With respect to the partners,

(a) When the dissolution is not by the act, insolvency or death of a partner; or

(b) When the dissolution is by such act,

insolvency or death of a partner, in cases where Article 1833 so requires;

(2) With respect to persons not partners, as declared in Article 1834. (n)

Art. 1833. Where the dissolution is caused by the act, death or insolvency of a partner, each partner is liable to his co-partners for his share of any liability created by any partner acting for the partnership as if the partnership had not been dissolved unless:

(1) The dissolution being by act of any partner, the partner acting for the partnership had knowledge of the dissolution; or

(2) The dissolution being by the death or insolvency of a partner, the partner acting for the partnership had knowledge or notice of the death or insolvency.

Art. 1834. After dissolution, a partner can bind the partnership, except as provided in the third paragraph of this article:

(1) By any act appropriate for winding up partnership affairs or completing transactions unfinished at dissolution;

(2) By any transaction which would bind the partnership if dissolution had not taken place, provided the other party to the transaction:

(a) Had extended credit to the partnership prior to dissolution and had no knowledge or notice of the dissolution; or

(b) Though he had not so extended credit, had nevertheless known of the partnership prior to dissolution, and, having no knowledge or notice of dissolution, the fact of dissolution had not been advertised in a newspaper of general circulation in the place (or in each place if more than one) at which the partnership business was regularly carried on.

The liability of a partner under the first paragraph, No. 2, shall be satisfied out of partnership assets alone when such partner had been prior to dissolution:

(1) Unknown as a partner to the person with whom the contract is made; and

(2) So far unknown and inactive in partnership affairs that the business reputation of the partnership could not be said to have been in any degree due to his connection with it.

The partnership is in no case bound by any act of a partner after dissolution:

(1) Where the partnership is dissolved because it is unlawful to carry on the business, unless the act is appropriate for winding up partnership affairs; or

(2) Where the partner has become insolvent; or

(3) Where the partner has no authority to wind up partnership affairs; except by a transaction with one who —

(a) Had extended credit to the partnership prior to dissolution and had no knowledge or notice of his want of authority; or

(b) Had not extended credit to the partnership prior to dissolution, and, having no knowledge or notice of his want of authority has not been advertised in the manner provided for advertising the fact of dissolution in the first paragraph, No. 2(b).

Nothing in this article shall affect the liability under Article 1825 of any person who after dissolution represents himself or consents to another representing him as a partner in a partnership engaged in carrying on business. (n)

Art. 1835. The dissolution of the partnership does not of itself discharge the existing liability of any partner.

A partner is discharged from any existing liability upon the dissolution of the partnership by an agreement to that effect between himself, the partnership creditor and the person or partnership continuing the business; and such agreement may be inferred from the course of dealing between the creditor having

knowledge of the dissolution and the person or partnership continuing the business.

The individual property of a deceased partner shall be liable for all obligations of the partnership incurred while he was a partner, but subject to the prior payment of his separate debts. (n)

Art. 1836. Unless otherwise agreed, the partners who have not wrongfully dissolved the partnership or the legal representative of the last surviving partner, not insolvent, has the right to wind up the partnership affairs, provided, however, that any partner, his legal representative or his assignee, upon cause shown, may obtain winding up by the court. (n)

Art. 1837. When dissolution is caused in any way, except in contravention of the partnership agreement, each partner, as against his co-partners and all persons claiming through them in respect of their interests in the partnership, unless otherwise agreed, may have the partnership property applied to discharge its liabilities, and the surplus applied to pay in cash the net amount owning to the respective partners. But if dissolution is caused by expulsion of a partner, *bona fide* under the partnership agreement and if the expelled partner is discharged from all partnership liabilities, either by payment or agreement under the second paragraph of Article 1835, he shall receive in cash only the net amount due him from the partnership.

When dissolution is caused in contravention of the partnership agreement the rights of the partners shall be as follows:

(1) Each partner who has not caused dissolution wrongfully shall have:

(a) All the rights specified in the first paragraph of this article; and

(b) The right, as against each partner who has caused the dissolution wrongfully, to damages for breach of the agreement.

(2) The partners who have not caused the dissolution wrongfully, if they all desire to continue the

business in the same name either by themselves or jointly with others, may do so, during the agreed term for the partnership and for that purpose may possess the partnership property, provided they secure the payment by bond approved by the court, or pay to any partner who has caused the dissolution wrongfully, the value of his interest in the partnership at the dissolution, less any damages recoverable under the second paragraph, No. 1(b) of this article, and in like manner indemnify him against all present or future partnership liabilities.

(3) A partner who has caused the dissolution wrongfully shall have:

(a) If the business is not continued under the provisions of the second paragraph, No. 2, all the rights of a partner under the first paragraph, subject to liability for damages in the second paragraph, No. 1(b), of this article.

(b) If the business is continued under the second paragraph, No. 2, of this article, the right as against his co-partners and all claiming through them in respect of their interests in the partnership, to have the value of his interest in the partnership, less any damage caused to his co-partners by the dissolution, ascertained and paid to him in cash, or the payment secured by a bond approved by the court, and to be released from all existing liabilities of the partnership; but in ascertaining the value of the partner's interest the value of the goodwill of the business shall not be considered. (n)

Art. 1838. Where a partnership contract is rescinded on the ground of the fraud or misrepresentation of one of the parties thereto, the party entitled to rescind is, without prejudice to any other right, entitled:

(1) To a lien on, or right of retention of, the surplus of the partnership property after satisfying the partnership liabilities to third persons for any sum of money paid by him for the purchase of an interest in

the partnership and for any capital or advances contributed by him;

(2) To stand, after all liabilities to third persons have been satisfied, in the place of the creditors of the partnership for any payment made by him in respect of the partnership liabilities; and

(3) To be indemnified by the person guilty of the fraud or making the representation against all debts and liabilities of the partnership. (n)

Art. 1839. In settling accounts between the partners after dissolution, the following rules shall be observed, subject to any agreement to the contrary:

(1) The assets of the partnership are:

(a) The partnership property;

(b) The contributions of the partners necessary for the payment of all the liabilities specified in No. 2.

(2) The liabilities of the partnership shall rank in order of payment, as follows:

(a) Those owing to creditors other than partners,

(b) Those owing to partners other than for capital and profits,

(c) Those owing to partners in respect of capital,

(d) Those owing to partners in respect of profits.

(3) The assets shall be applied in the order of their declaration in No. 1 of this article to the satisfaction of the liabilities.

(4) The partners shall contribute, as provided by Article 1797, the amount necessary to satisfy the liabilities.

(5) An assignee for the benefit of creditors or any person appointed by the court shall have the right

to enforce the contributions specified in the preceding number.

(6) Any partner or his legal representative shall have the right to enforce the contributions specified in No. 4, to the extent of the amount which he has paid in excess of his share of the liability.

(7) The individual property of a deceased partner shall be liable for the contributions specified in No. 4.

(8) When partnership property and the individual properties of the partners are in possession of a court for distribution, partnership creditors shall have priority on partnership property and separate creditors on individual property, saving the rights of lien or secured creditors.

(9) Where a partner has become insolvent or his estate is insolvent, the claims against his separate property shall rank in the following order:

(a) Those owing to separate creditors;

(b) Those owing to partnership creditors;

(c) Those owing to partners by way of contribution. (n)

Art. 1840. In the following cases creditors of the dissolved partnership are also creditors of the person or partnership continuing the business:

(1) When any new partner is admitted into an existing partnership, or when any partner retires and assigns (or the representative of the deceased partner assigns) his rights in partnership property to two or more of the partners, or to one or more of the partners and one or more third persons, if the business is continued without liquidation of the partnership affairs;

(2) When all but one partner retire and assign (or the representative of a deceased partner assigns) their rights in partnership property to the remaining partner, who continues the business without liquidation of partnership affairs, either alone or with others;

(3) When any partner retires or dies and the business of the dissolved partnership is continued as set forth in Nos. 1 and 2 of this article, with the consent of the retired partners or the representative of the deceased partner, but without any assignment of his right in partnership property;

(4) When all the partners or their representatives assign their rights in partnership property to one or more third persons who promise to pay the debts and who continue the business of the dissolved partnership;

(5) When any partner wrongfully causes a dissolution and the remaining partners continue the business under the provisions of Article 1837, second paragraph, No. 2, either alone or with others, and without liquidation of the partnership affairs;

(6) When a partner is expelled and the remaining partners continue the business either alone or with others without liquidation of the partnership affairs.

The liability of a third person becoming a partner in the partnership continuing the business, under this article, to the creditors of the dissolved partnership shall be satisfied out of the partnership property only, unless there is a stipulation to the contrary.

When the business of a partnership after dissolution is continued under any conditions set forth in this article the creditors of the dissolved partnership, as against the separate creditors of the retiring or deceased partner or the representative of the deceased partner, have a prior right to any claim of the retired partner or the representative of the deceased partner against the person or partnership continuing the business, on account of the retired or deceased partner's interest in the dissolved partnership or on account of any consideration promised for such interest or for his right in partnership property.

Nothing in this article shall be held to modify any right of creditors to set aside any assignment on the ground of fraud.

The use by the person or partnership continuing the business of the partnership name, or the name of a deceased partner as part thereof, shall not of itself make the individual property of the deceased partner liable for any debts contracted by such person or partnership. (n)

Art. 1841. When any partner retires or dies, and the business is continued under any of the conditions set forth in the preceding article, or in Article 1837, second paragraph, No. 2, without any settlement of accounts as between him or his estate and the person or partnership continuing the business, unless otherwise agreed, he or his legal representative as against such person or partnership may have the value of his interest at the date of dissolution ascertained, and shall receive as an ordinary creditor an amount equal to the value of his interest in the dissolved partnership with interest, or, at his option or at the option of his legal representative, in lieu of interest, the profits attributable to the use of his right in the property of the dissolved partnership; provided that the creditors of the dissolved partnership as against the separate creditors, or the representative of the retired or deceased partner, shall have priority on any claim arising under this article, as provided by Article 1840, third paragraph. (n)

Art. 1842. The right to an account of his interest shall accrue to any partner, or his legal representative as against the winding up partners or the surviving partners or the person or partnership continuing the business, at the date of dissolution, in the absence of any agreement to the contrary. (n)

Dissolution and Winding Up

The dissolution of a partnership is the change in the relation of the partners caused by any partner ceasing to be associated in the carrying on, as distinguished from the winding up, of the business *(Art. 1828, Civil Code)*. On dissolution the partnership is not terminated, but continues until the winding up of partnership affairs is completed *(Art. 1828, Civil Code)*.

Dissolution is caused:

(1) Without violation of the agreement between the partners:

(a) By the termination of the definite term or particular undertaking specified in the agreement; but when a partnership for a fixed term or particular undertaking is continued after the termination of such term or particular undertaking without any express agreement, the rights and duties of the partners remain the same as they were at such termination, so far as is consistent with a partnership at will; and a continuation of the business by the partners or such of them as habitually acted therein during the term, without any settlement or liquidation of the partnership affairs, is *prima facie* evidence of a continuation of the partnership *(Art. 1785, Civil Code);*

(b) By the express will of any partner who must act in good faith, when no definite term or particular undertaking is specified (see *Lichauco vs. Soriano, 26 Phil. 593; Rojas vs. Maglana, 192 SCRA 110*);

(c) By the express will of all the partners who have not assigned their interests or suffering them to be charged for their separate debts, either before or after the termination of any specified term or particular undertaking;

(d) By the expulsion of any partner from the business *bona fide* in accordance with such a power conferred by the agreement between the partners;

(2) In contravention of the agreement between the partners, where the circumstances do not permit a dissolution under any other provision of this Article, by the express will of any partner at any time (see *Deluao vs. Casteel, 26 SCRA 475*);

(3) By any event which makes it unlawful for the business of the partnership to be carried on or for the

members to carry it on in partnership (see *Deluao vs. Casteel, supra*.);

(4) When a specific thing, which a partner had promised to contribute to the partnership, perishes before the delivery; in any case by the loss of the thing, when the partner who contributed it having reserved the ownership thereof has only transferred to the partnership the use or enjoyment of the same; but the partnership shall not be dissolved by the loss of the thing when it occurs after the partnership has acquired the ownership thereof;

(5) By death of any partner;

(6) By the insolvency of any partner or of the partnership;

(7) By the civil interdiction of any partner;

(8) By decree of court (see *Art. 1830,* also *Art. 1860, Civil Code*).

The parties may agree to expand the foregoing ground but not to delimit them (see *Lichauco vs. Lichauco [33 Phil. 350]* which rationale could apply equally well under the new Civil Code).

On application by or for a partner the court shall decree a dissolution whenever:

(1) A partner has been declared insane in any judicial proceeding or is shown to be of unsound mind;

(2) A partner becomes in any other way incapable of performing his part of the partnership contract;

(3) A partner has been guilty of such conduct as tends to affect prejudicially the carrying on of the business;

(4) A partner willfully or persistently commits a breach of the partnership agreement, or otherwise

so conducts himself in matters relating to the partnership business that it is not reasonably practicable to carry on the business in partnership with him;

(5) The business of the partnership can only be carried on at a loss;

(6) Other circumstances render a dissolution equitable.

(2) On the application of the purchaser of a partner's interest, dissolution may be decreed under Article 1813 or Article 1814: (1) after the termination of the specified term or particular undertaking; (2) at any time if the partnership was a partnership at will when the interest was assigned or when the charging order was issued *(Art. 1831, Civil Code;* see *Dan Fue Leung vs. Intermediate Appellate Court, 169 SCRA 746).* When so decreed by the court, the presiding judge may place the partnership under receivership and direct an accounting to be made towards winding up the partnership affairs *(Recentes vs. CFI, 123 SCRA 778).*

Effects of Dissolution

Except so far as may be necessary to wind up partnership affairs or to complete transactions begun but not then finished, dissolution terminates all authority of any partner to act for the partnership.

(1) With respect to the partners;

(a) When the dissolution is not by the act, insolvency or death of a partner; or

(b) When the dissolution is by such act, insolvency or death of a partner, in cases where Article 1833 *(infra.)* so requires.

(2) With respect to persons not partners, as declared in Article 1834 *(infra., Art. 1832, Civil Code).*

Where the dissolution is caused by the act, death or insolvency of a partner, each partner is liable to his co-

partners for his share of any liability created by any partner acting for the partnership as if the partnership had not been dissolved unless:

(1) The dissolution being by act of any partner, the partner acting for the partnership had knowledge of the dissolution; or

(2) The dissolution being by the death or insolvency of a partner, the partner acting for the partnership had knowledge or notice of the death or insolvency *(Art. 1933, Civil Code)*.

After dissolution, a partner can bind the partnership:

(1) By any act appropriate for winding up partnership affairs or completing transactions unfinished at dissolution;

(2) By any transaction which would bind the partnership if dissolution had not taken place, provided the other party to the transaction:

(a) Had extended credit to the partnership prior to dissolution and had no knowledge or notice of the dissolution; or

(b) Though he had not so extended credit, had nevertheless known of the partnership prior to dissolution, and, having no knowledge or notice of dissolution, the fact of dissolution had not been advertised in a newspaper of general circulation in the place (or in each place if more than one) at which the partnership business was regularly carried on.

The liability of a partner under item (2) above shall be satisfied out of partnership assets alone when such partner had been prior to dissolution:

(1) Unknown as a partner to the person with whom the contract is made; and

(2) So far unknown and inactive in partnership affairs that the business reputation of the partnership could

not be said to have been in any degree due to his connection with it.

The partnership, however, is in no case bound by any act of a partner after dissolution:

(1) Where the partnership is dissolved because it is unlawful to carry on the business, unless the act is appropriate for winding up partnership affairs; or

(2) Where the partner has become insolvent; or

(3) Where the partner has no authority to wind up partnership affairs, except by a transaction with one who —

(a) Had extended credit to the partnership prior to dissolution and had no knowledge or notice of his want of authority; or

(b) Had not extended credit to the partnership prior to dissolution, and, having no knowledge or notice of his want of authority, the fact of his want of authority has not been advertised in the manner provided (see above) for advertising the fact of dissolution.

Nothing in the foregoing shall affect the liability under Article 1825 *(supra.)* of any person who, after dissolution, represents himself or consents to another representing him as a partner in a partnership engaged in carrying on business *(Art. 1834, Civil Code)*.

The dissolution of the partnership does not of itself discharge the existing liability of any partner. A partner is discharged from any existing liability upon dissolution of the partnership by an agreement to that effect between himself, the partnership creditor and the person or partnership continuing the business; and such agreement may be inferred from the course of dealing between the creditor having knowledge of the dissolution and the person or partnership continuing the business. The individual property of a deceased partner shall be liable for

all obligations of the partnership incurred while he was a partner, but subject to the prior payment of his separate debts *(Art. 1835, Civil Code;* see *Testate Estate of Mota vs. Serra, 47 Phil. 464).*

Unless otherwise agreed, the partners who have not wrongfully dissolved the partnership or the legal representative of the last surviving partner, not insolvent, has the right to wind up the partnership affairs, provided, however, that any partner, his legal representative or his assignee, upon cause shown, may obtain winding up by the court *(Art. 1836, Civil Code).*

When dissolution is caused in any way, except in contravention of the partnership agreement, each partner, as against his co-partners and all persons claiming through them in respect of their interests in the partnership, unless otherwise agreed, may have the partnership property applied to discharge its liabilities, and the surplus applied to pay in cash the net amount owing to the respective partners. But if dissolution is caused by expulsion of a partner, *bona fide* under the partnership agreement and if the expelled partner is discharged from all partnership liabilities, either by payment or agreement under the second paragraph of Article 1835 *(supra.),* he shall receive in cash only the net amount due him from the partnership. When dissolution is caused in contravention of the partnership agreement the rights of the partners shall be as follows:

(1) Each partner who has not caused dissolution wrongfully shall have:

(a) All the rights specified in the foregoing paragraph; and

(b) The right, as against each partner who has caused the dissolution wrongfully, to damages for breach of the agreement.

(2) The partners who have not caused the dissolution wrongfully, if they all desire to continue the business

in the same name either by themselves or jointly with others, may do so, during the agreed term for the partnership and for that purpose may possess the partnership property, provided they secure the payment by bond approved by the court, or pay to any partner who has caused the dissolution wrongfully, the value of his interest in the partnership at the dissolution, less any damages recoverable under item (1)(b) above, and in like manner indemnify him against all present or future partnership liabilities.

(3) A partner who has caused the dissolution wrongfully shall have:

(a) If the business is not continued under item (2) above, all the rights of a partner herein mentioned, subject to liability for damages in item (1)(b) above.

(b) If the business is continued under item (2) above, the right as against his co-partners and all claiming through them in respect of their interests in the partnership, to have the value of his interest in the partnership, less any damage caused to his co-partners by the dissolution, ascertained and paid to him in cash or the payment secured by a bond approved by the court, and to be released from all existing liabilities of the partnership; but in ascertaining the value of the partner's interest, the value of the goodwill of the business shall not be considered *(Art. 1837, Civil Code;* see *Goquiolay vs. Sycip, 9 SCRA 663).*

An unjustified dissolution by a partner can subject him to action for damages because by the mutual agency that arises in a partnership, the doctrine of *delectus personae* allows the partners to have the power, although not necessarily the right, to dissolve the partnership *(Tocao vs. Court of Appeals, 135 SCAD 149, 342 SCRA 20).*

Where a partnership contract is rescinded on the ground of the fraud or misrepresentation of one of the parties thereto, the party entitled to rescind is, without prejudice to any other right, entitled:

(1) To a lien on, or right of retention of, the surplus of the partnership property after satisfying the partnership liabilities to third persons for any sum of money paid by him for the purchase of an interest in the partnership and for any capital or advance contributed by him;

(2) To stand, after all liabilities to third persons have been satisfied, in the place of the creditors of the partnership for any payments made by him in respect of the partnership liabilities; and

(3) To be indemnified by the person guilty of the fraud or making the representation against all debts and liabilities of the partnership *(Art. 1838, Civil Code)*.

Settlement of Accounts

In settling accounts between the partners after dissolution, the following rules shall be observed, subject to any agreement to the contrary:

(1) The assets of the partnership are:

(a) The partnership property;

(b) The contributions of the partners necessary for the payment of all liabilities specified in No. 2.

(2) The liabilities of the partnership shall rank in order of payment, as follows:

(a) Those owing to creditors other than partners;

(b) Those owing to partners other than for capital and profits;

(c) Those owing to partners in respect of capital; and

(d) Those owing to partners in respect of profits.

(3) The assets shall be applied in the order of their declaration in item (1) above to the satisfaction of the liabilities.

(4) The partners shall contribute, as provided by Article 1797 *(supra.)*, the amount necessary to satisfy the liabilities.

(5) An assignee for the benefit of creditors or any person appointed by the court shall have the right to enforce the contributions specified in the preceding number.

(6) Any partner or his legal representative shall have the right to enforce the contributions specified in No. (4), to the extent of the amount which he has paid in excess of his share of the liability.

(7) The individual property of a deceased partner shall be liable for the contributions specified in No. (4).

(8) When partnership property and the individual properties of the partners are in possession of a court for distribution, partnership creditors shall have priority on partnership property and separate creditors on individual property, saving the rights of lien or secured creditors.

(9) Where a partner has become insolvent or his estate is insolvent, the claims against his separate property shall rank in the following order:

(a) Those owing to separate creditors;

(b) Those owing to partnership creditors;

(c) Those owing to partners by way of contribution *(Art. 1839, Civil Code;* see *Magdusa vs. Albaran, 5 SCRA 511).*

In the following cases, creditors of the dissolved partnership are also creditors of the person or partnership continuing the business:

(1) When any new partner is admitted into an existing partnership, or when any partner retires and assigns (or the representative of the deceased partner assigns) his rights in partnership property to two or more of the partners, or to one or more of the partners and one or more third persons, if the business is continued without liquidation of the partnership affairs;

(2) When all but one partner retire and assign (or the representative of a deceased partner assigns) their rights in partnership property to the remaining partner, who continues the business without liquidation of partnership affairs, either alone or with others;

(3) When any partner retires or dies and the business of the dissolved partnership is continued as set forth in items (1) and (2) above, with the consent of the retired partners or the representative of the deceased partner, but without any assignment of his right in partnership property (see *Goquiolay vs. Sycip, 9 SCRA 663*);

(4) When all the partners or their representatives assign their rights in partnership property to one or more third persons who promise to pay the debts and who continue the business of the dissolved partnership;

(5) When any partner wrongfully causes a dissolution and the remaining partners continue the business under the provisions of Article 1837, second paragraph, No. 2, either alone or with others, and without liquidation of the partnership affairs;

(6) When a partner is expelled and the remaining partners continue the business either alone or with others without liquidation of the partnership affairs.

The liability of a third person becoming a partner in the partnership continuing the business, as herein provided, to the creditors of the dissolved partnership shall be satisfied out of the partnership property only, unless there is a stipulation to the contrary. When the business of a partnership after dissolution is continued, the credi-

tors of the dissolved partnership, as against the separate creditors of the retiring or deceased partner or the representative of the deceased partner, have a prior right to any claim of the retired partner or the representative of the deceased partner against the person or partnership continuing the business, on account of the retired or deceased partner's interest in the dissolved partnership or on account of any consideration promised for such interest or for his right in partnership property. Nothing herein provided, however, shall be held to modify any right of creditors to set aside any assignment on the ground of fraud. The use by the person or partnership continuing the business of the partnership name, or the name of a deceased partner as part thereof, shall not of itself make the individual property of the deceased partner liable for any debts contracted by such person or partnership *(Art. 1840, Civil Code)*.

When any partner retires or dies and the business is continued under any of the conditions set forth in the preceding paragraph, or in item (2) of Article 1837 *(supra.),* without any settlement of accounts as between him or his estate and the person or partnership continuing the business, unless otherwise agreed, he or his legal representative as against such person or partnership may have the value of his interest at the date of dissolution ascertained and shall receive as an ordinary creditor an amount equal to the value of his interest in the dissolved partnership with interest, or, at his option or at the option of his legal representative, in lieu of interest, the profits attributable to the use of his right in the property of the dissolved partnership; the creditors, however, of the dissolved partnership as against the separate creditors, or the representative of the retired or deceased partner, shall have priority on any claim arising under this Article, as provided by Article 1840, third paragraph *(Art. 1841, Civil Code; Goquiolay vs. Sycip, 108 Phil. 947; Lota vs. Tolentino, 90 Phil. 929)*.

The right to an account of his interest shall accrue to any partner or his legal representative as against the winding up partners or the surviving partners or the person or partnership continuing the business, at the date of dissolution, in the absence of any agreement to the contrary *(Art. 1842, Civil Code)*.

Chapter 4

Limited Partnership

Art. 1843. A limited partnership is one formed by two or more persons under the provisions of the following article, having as members one or more general partners and one or more limited partners. The limited partners as such shall not be bound by the obligations of the partnership.

Art. 1844. Two or more persons desiring to form a limited partnership shall:

(1) Sign and swear to a certificate, which shall state —

(a) The name of the partnership, adding thereto the word "Limited;"

(b) The character of the business;

(c) The location of the principal place of business;

(d) The name and place of residence of each member, general and limited partners being respectively designated;

(e) The term for which the partnership is to exist;

(f) The amount of cash and a description of and the agreed value of the other property contributed by each limited partner;

(g) The additional contributions, if any, to be made by each limited partner and the times at which or events on the happening of which they shall be made;

(h) The time, if agreed upon, when the contribution of each limited partner is to be returned;

(i) The share of the profits of the other compensation by way of income which each limited partner shall receive by reason of his contribution;

(j) The right, if given, of a limited partner to substitute an assignee as contributor in his place, and the terms and conditions of the substitution;

(k) The right, if given, of the partners to admit additional limited partners;

(l) The right, if given, of one or more of the limited partners to priority over other limited partners, as to contributions or as to compensation by way of income, and the nature of such priority;

(m) The right, if given, of the remaining general partner or partners to continue the business on the death, retirement, civil interdiction, insanity or insolvency of a general partner; and

(n) The right, if given, of a limited partner to demand and receive property other than cash in return for his contribution.

(2) File for record the certificate in the Office of the Securities and Exchange Commission.

A limited partnership is formed if there has been substantial compliance in good faith with the foregoing requirements.

Art. 1845. The contributions of a limited partner may be cash or other property, but not services.

Art. 1846. The surname of a limited partner shall not appear in the partnership name unless:

(1) It is also the surname of a general partner, or

(2) Prior to the time when the limited partner became such, the business had been carried on under a name in which his surname appeared.

A limited partner whose surname appears in a partnership name contrary to the provisions of the first paragraph is liable as a general partner to partnership creditors who extend credit to the partnership without actual knowledge that he is not a general partner.

Art. 1847. If the certificate contains a false statement, one who suffers loss by reliance on such statement may hold liable any party to the certificate who knew the statement to be false:

(1) At the time he signed the certificate, or

(2) Subsequently, but within a sufficient time before the statement was relied upon to enable him to cancel or amend the certificate, or to file a petition for its cancellation or amendment as provided in Article 1865.

Art. 1848. A limited partner shall not become liable as a general partner unless, in addition to the exercise of his rights and powers as a limited partner, he takes part in the control of the business.

Art. 1849. After the formation of a limited partnership, additional limited partners may be admitted upon filing an amendment to the original certificate in accordance with the requirements of Article 1865.

Art. 1850. A general partner shall have the rights and powers and be subject to all the restrictions and liabilities of a partner in a partnership without limited partners. However, without the written consent or ratification of the specific act by all the limited partners, a general partner or all of the general partners have no authority to:

(1) Do any act in contravention of the certificate;

(2) Do any act which would make it impossible to carry on the ordinary business of the partnership;

(3) Confess a judgment against the partnership;

(4) Possess partnership property, or assign their rights in specific partnership property, for other than a partnership purpose;

(5) Admit a person as a general partner;

(6) Admit a person as a limited partner, unless the right so to do is given in the certificate;

(7) Continue the business with partnership property on the death, retirement, insanity, civil interdiction or insolvency of a general partner, unless the right so to do is given in the certificate.

Art. 1851. A limited partner shall have the same rights as a general partner to:

(1) Have the partnership books kept at the principal place of business of the partnership, and at a reasonable hour to inspect and copy any of them;

(2) Have on demand true and full information of all things affecting the partnership, and a formal account of partnership affairs whenever circumstances render it just and reasonable; and

(3) Have dissolution and winding up by decree of court.

A limited partner shall have the right to receive a share of the profits or other compensation by way of income, and to the return of his contribution as provided in Articles 1856 and 1857.

Art. 1852. Without prejudice to the provisions of Article 1848, a person who has contributed to the capital of a business conducted by a person or partnership erroneously believing that he has become a limited partner in a limited partnership, is not, by reason of his exercise of the rights of a limited partner, a general partner with the person or in the partnership carrying on the business, or bound by the obligations of such person or partnership, provided that on ascertaining the mistake he promptly renounces his interest in the profits of the business or other compensation by way of income.

Art. 1853. A person may be a general partner and a limited partner in the same partnership at the same time, provided that this fact shall be stated in the certificate provided for in Article 1844.

A person who is a general, and also at the same time a limited partner, shall have all the rights and powers and be subject to all the restrictions of a general partner; except that, in respect to his contribution, he shall have the rights against the other members which he would have had if he were not also a general partner.

Art. 1854. A limited partner also may loan money to and transact other business with the partnership, and, unless he is also a general partner, receive on account of resulting claims against the partnership, with general creditors, a *pro rata* share of the assets. No limited partner shall in respect to any such claim:

(1) Receive or hold as collateral security any partnership property, or

(2) Receive from a general partner or the partnership any payment, conveyance, or release from liability, if at the time the assets of the partnership are not sufficient to discharge partnership liabilities to persons not claiming as general or limited partners.

The receiving of collateral security, or a payment, conveyance, or release in violation of the foregoing provisions is a fraud on the creditors of the partnership.

Art. 1855. Where there are several limited partners the members may agree that one or more of the limited partners shall have a priority over other limited partners as to the return of their contributions, as to their compensation by way of income, or as to any other matter. If such an agreement is made it shall be stated in the certificate, and in the absence of such a statement all the limited partners shall stand upon equal footing.

Art. 1856. A limited partner may receive from the partnership the share of the profits or the compensation by way of income stipulated for in the certificate; provided, that after such payment is made, whether from the property of the partnership or that of a general partner, the partnership assets are in excess of all liabilities of the partnership except liabilities to limited

partners on account of their contributions and to general partners.

Art. 1857. A limited partner shall not receive from a general partner or out of partnership property any part of his contributions until:

(1) All liabilities of the partnership, except liabilities to general partners and to limited partners on account of their contributions, have been paid or there remains property of the partnership sufficient to pay them;

(2) The consent of all members is had, unless the return of the contribution may be rightfully demanded under the provisions of the second paragraph; and

(3) The certificate is cancelled or so amended as to set forth the withdrawal or reduction.

Subject to the provisions of the first paragraph, a limited partner may rightfully demand the return of his contribution:

(1) On the dissolution of a partnership; or

(2) When the date specified in the certificate for its return has arrived; or

(3) After he has given six months' notice in writing to all other members, if no time is specified in the certificate, either for the return of the contribution or for the dissolution of the partnership.

In the absence of any statement in the certificate to the contrary or the consent of all members, a limited partner, irrespective of the nature of his contribution, has only the right to demand and receive cash in return for his contribution.

A limited partner may have the partnership dissolved and its affairs wound up when:

(1) He rightfully but unsuccessfully demands the return of his contribution, or

(2) The other liabilities of the partnership have not been paid, or the partnership property is insufficient for their payment as required by the first para-

graph, No. 1, and the limited partner would otherwise be entitled to the return of his contribution.

Art. 1858. A limited partner is liable to the partnership:

(1) For the difference between his contribution as actually made and that stated in the certificate as having been made, and

(2) For any unpaid contribution which he agreed in the certificate to make in the future at the time and on the conditions stated in the certificate.

A limited partner holds as trustee for the partnership:

(1) Specific property stated in the certificate as contributed by him, but which was not contributed or which has been wrongfully returned, and

(2) Money or other property wrongfully paid or conveyed to him on account of his contribution.

The liabilities of a limited partner as set forth in this article can be waived or compromised only by the consent of all members; but a waiver or compromise shall not affect the right of a creditor of a partnership who extended credit or whose claim arose after the filing and before a cancellation or amendment of the certificate, to enforce such liabilities.

When a contributor has rightfully received the return in whole or in part of the capital of his contribution, he is nevertheless liable to the partnership for any sum, not in excess of such return with interest, necessary to discharge its liabilities to all creditors who extended credit or whose claims arose before such return.

Art. 1859. A limited partner's interest is assignable.

A substituted limited partner is a person admitted to all the rights of a limited partner who has died or has assigned his interest in a partnership.

An assignee, who does not become a substituted limited partner, has no right to require any information

or account of the partnership transactions or to inspect the partnership books; he is only entitled to receive the share of the profits or other compensation by way of income, or the return of his contribution, to which his assignor would otherwise be entitled.

An assignee shall have the right to become a substituted limited partner if all the members consent thereto or if the assignor, being thereunto empowered by the certificate, gives the assignee that right.

An assignee becomes a substituted limited partner when the certificate is appropriately amended in accordance with Article 1865.

The substituted limited partner has all the rights and powers, and is subject to all the restrictions and liabilities of his assignor, except those liabilities of which he was ignorant at the time he became a limited partner and which could not be ascertained from the certificate.

The substitution of the assignee as a limited partner does not release the assignor from liability to the partnership under Articles 1847 and 1858.

Art. 1860. The retirement, death, insolvency, insanity or civil interdiction of a general partner dissolves the partnership, unless the business is continued by the remaining general partners:

(1) Under a right so to do stated in the certificate, or

(2) With the consent of all members.

Art. 1861. On the death of a limited partner his executor or administrator shall have all the rights of a limited partner for the purpose of settling his estate, and such power as the deceased had to constitute his assignee a substituted limited partner.

The estate of a deceased limited partner shall be liable for all his liabilities as a limited partner.

Art. 1862. On due application to a court of competent jurisdiction by any creditor of a limited partner,

the court may charge the interest of the indebted limited partner with payment of the unsatisfied amount of such claim, and may appoint as receiver, and make all other orders, directions, and inquiries which the circumstances of the case may require.

The interest may be redeemed with the separate property of any general partner, but may not be redeemed with partnership property.

The remedies conferred by the first paragraph shall not be deemed exclusive of others which may exist.

Nothing in this Chapter shall be held to deprive a limited partner of his statutory exemption.

Art. 1863. In settling accounts after dissolution the liabilities of the partnership shall be entitled to payment in the following order:

(1) Those to creditors, in the order of priority as provided by law, except those to limited partners on account of their contributions, and to general partners;

(2) Those to limited partners in respect to their share of the profits and other compensation by any of income on their contributions;

(3) Those to limited partners in respect to the capital of their contributions;

(4) Those to general partners other than for capital and profits;

(5) Those to general partners in respect to profits;

(6) Those to general partners in respect to capital.

Subject to any statement in the certificate or to subsequent agreement, limited partners share in the partnership assets in respect to their claims for capital, and in respect to their claims for profits or for compensation by way of income on their contribution respectively, in proportion to the respective amounts of such claims.

Art. 1864. The certificate shall be cancelled when the partnership is dissolved or all limited partners cease to be such.

A certificate shall be amended when:

(1) There is a change in the name of the partnership or in the amount or character of the contribution of any limited partner;

(2) A person is substituted as a limited partner;

(3) An additional limited partner is admitted;

(4) A person is admitted as a general partner;

(5) A general partner retires, dies, becomes insolvent or insane, or is sentenced to civil interdiction and the business is continued under Article 1860;

(6) There is a change in the character of the business of the partnership;

(7) There is a false or erroneous statement in the certificate;

(8) There is change in the time as stated in the certificate for the dissolution of the partnership or for the return of a contribution;

(9) A time is fixed for the dissolution of the partnership, or the return of a contribution, no time having been specified in the certificate; or

(10) The members desire to make a change in any other statement in the certificate in order that it shall accurately represent the agreement among them.

Art. 1865. The writing to amend a certificate shall:

(1) Conform to the requirements of Article 1844 as far as necessary to set forth clearly the change in the certificate which it is desired to make; and

(2) Be signed and sworn to by all members, and an amendment substituting a limited partner or adding a limited or general partner shall be signed also by the member to be substituted or added, and when a limited partner is to be substituted, the amendment shall also be signed by the assigning limited partner.

The writing to cancel a certificate shall be signed by all members.

A person desiring the cancellation or amendment of a certificate, if any person designated in the first and second paragraphs as a person who must execute the writing refuses to do so, may petition the court to order a cancellation or amendment thereof.

If the court finds that the petitioner has a right to have the writing executed by a person who refuses to do so, it shall order the Office of the Securities and Exchange Commission where the certificate is recorded, to record the cancellation or amendment of the certificate; and when the certificate is to be amended, the court shall also cause to be filed for record in said office a certified copy of its decree setting forth the amendment.

A certificate is amended or cancelled when there is filed for record in the Office of the Securities and Exchange Commission, where the certificate is recorded:

(1) A writing in accordance with the provisions of the first or second paragraph; or

(2) A certified copy of the order of court in accordance with the provisions of the fourth paragraph;

(3) After the certificate is duly amended in accordance with this article, the amended certificate shall thereafter be for all purposes the certificate provided for in this Chapter.

Art. 1866. A contributor, unless he is a general partner, is not a proper party to proceedings by or against a partnership, except where the object is to enforce a limited partner's right against or liability to the partnership.

Art. 1867. A limited partnership formed under the law prior to the effectivity of this Code, may become a limited partnership under this Chapter by complying with the provisions of Article 1844, provided the certificate sets forth:

(1) The amount of the original contribution of each limited partner, and the time when the contribution was made; and

(2) That the property of the partnership exceeds the amount sufficient to discharge its liabilities to persons not claiming as general or limited partners by an amount greater than the sum of the contributions of its limited partners.

A limited partnership formed under the law prior to the effectivity of this Code, until or unless it becomes a limited partnership under this Chapter, shall continue to be governed by the provisions of the old law.

Limited Partnership

A limited partnership is one formed by two or more persons, having as members one or more general partners and one or more limited partners. The limited partners as such shall not be bound by the obligations of the partnership *(Art. 1843, Civil Code; Collector vs. Isasi, 107 Phil. 247)*, unless, in addition to the exercise of his rights and powers as a limited partner, he takes part in the control of the business *(Art. 1848, Civil Code; Goquiolay vs. Sycip, 108 Phil. 947)*. A limited partnership may be formed by executing *a certificate*, which should contain such particulars and data as are required to be stated in Article 1844 of the Civil Code. The certificate shall be filed with the Office of the Securities and Exchange Commission. A limited partnership is formed if there has been substantial compliance in good faith with the formal requirements of the law *(Art. 1844, Civil Code; Jo Chung Cang vs. Pacific Commercial Co., 45 Phil. 142)*. If the certificate contains a false statement, one who suffers loss by reliance on such statement may hold liable any party to the certificate who knew the statement to be false:

(1) At the time he signed the certificate, or

(2) Subsequently, but within a sufficient time before the statement was relied upon to enable him to can-

cel or amend the certificate, or to file a petition for its cancellation or amendment as provided in Article 1865 (see *infra*.; *Art. 1947, Civil Code*). After the formation of a limited partnership, additional limited partners may be admitted upon filing an amendment to the original certificate in accordance with the requirements of Article 1865 (see *infra*.; *Art. 1849, Civil Code*).

The contributions of a limited partner may be cash or other property, but not services *(Art. 1845, Civil Code)*. The surname of a limited partner shall not appear in the partnership name unless: (1) it is also the surname of a general partner, or (2) prior to the time when the limited partner became such, the business had been carried on under a name in which his surname appeared. A limited partner whose surname appears in a partnership name contrary to the provisions of the first paragraph is liable as a general partner to partnership creditors who extend credit to the partnership without actual knowledge that he is not a general partner *(Art. 1946, Civil Code)*.

Rights and Powers of Partners in Limited Partnerships

A general partner shall have all the rights and powers and be subject to all the restrictions and liabilities of a partner in a partnership without limited partners. However, without the written consent or ratification of the specific act by all the limited partners, a general partner or all of the general partners have no authority to: (1) do any act in contravention of the certificate; (2) do any act which would make it impossible to carry on the ordinary business of the partnership; (3) confess a judgment against the partnership; (4) possess partnership property, or assign their rights in specific partnership property, for other than a partnership purpose; (5) admit a person as a general partner; (6) admit a person as a limited partner unless the right so to do is given in the certificate; (7) continue the business with partnership property on the death, retirement, insanity, civil interdiction or insolvency

of a general partner, unless the right so to do is given in the certificate *(Art. 1850, Civil Code)*.

A limited partner has the same rights as a general partner to: (a) have the partnership books kept at the principal place of business of the partnership, and at a reasonable hour to inspect and copy any of them; (b) have on demand true and full information of all things affecting the partnership, and a formal account of partnership affairs whenever circumstances render it just and reasonable; and (c) have dissolution and winding up by decree of court. A limited partner shall have the right to receive a share of the profits or other compensation by way of income, and to the return of his contribution as provided in Article 1856 and Article 1857 *(Art. 1857, Civil Code)*.

Without prejudice to the provisions of Article 1848 *(supra.),* a person who has contributed to the capital of a business conducted by a person or partnership erroneously believing that he has become a limited partner in a limited partnership, is not, by reason of his exercise of the rights of a limited partner, a general partner with the person or in the partnership carrying on the business, or bound by the obligations of such person or partnership; *Provided,* That on ascertaining the mistake he promptly renounces his interest in the profits of the business or other compensation by way of income *(Art. 1852, Civil Code)*.

A person may be a general partner and a limited partner in the same partnership at the same time, provided that this fact shall be stated in the certificate provided for in Article 1844. A person who is a general and limited partner at the same time shall have all the rights and powers and be subject to all the restrictions of a general partner; except that, in respect to his contribution, he shall have the rights against the other members which he would have had if he were not also a general partner *(Art. 1853, Civil Code)*. A limited partner may

also loan money to and transact other business with the partnership and, unless he is likewise a general partner, receive on account of resulting claims against the partnership with general creditors a *pro rata* share of the assets. No limited partner shall, however, in respect to any such claim: (a) receive or hold as collateral security any partnership property, or (b) receive from a general partner or the partnership any payment, conveyance, or release from liability, if at the time the assets of the partnership are not sufficient to discharge partnership liabilities to persons not claiming as general or limited partners. The receiving of collateral security, or a payment, conveyance, or release in violation of the foregoing provisions is deemed to be an act of fraud on the creditors of the partnership *(Art. 1854, Civil Code)*.

Where there are several limited partners the members may agree that one or more of the limited partners shall have a priority over other limited partners as to the return of their contributions, as to their compensation by way of income, or as to any other matter. If such an agreement is made, it shall be stated in the certificate, and in the absence of such a statement, all the limited partners shall stand upon equal footing *(Art. 1855, Civil Code)*. A limited partner may receive from the partnership the share of the profits or the compensation by way of income stipulated for in the certificate: *Provided*, That after such payment is made, whether from the property of the partnership or that of a general partner, the partnership assets are in excess of all liabilities of the partnership except liabilities to limited partners on account of their contributions and to general partners *(Art. 1856, Civil Code)*.

A limited partner shall not receive from a general partner or out of partnership property any part of his contributions until: (1) all liabilities of the partnership, except liabilities to general partners and to limited partners on account of their contributions, have been paid or

there remains property of the partnership sufficient to pay them; (2) the consent of all members is had, unless the return of the contribution may be rightfully demanded under the provisions of the succeeding paragraph; and (3) the certificate is cancelled or so amended as to set forth the withdrawal or reduction.

Subject to the foregoing conditions, a limited partner may rightfully demand the return of his contribution:

(1) On the dissolution of a partnership, or

(2) When the date specified in the certificate for its return has arrived, or

(3) After he has given six months' notice in writing to all other members, if no time is specified in the certificate, either for the return of the contribution or for the dissolution of the partnership. In the absence of any statement in the certificate to the contrary or the consent of all members, a limited partner, irrespective of the nature of his contribution, has only the right to demand and receive cash in return for his contribution.

A limited partner may have the partnership dissolved and its affairs wound up when:

(1) He rightfully but unsuccessfully demands the return of his contribution, or

(2) The other liabilities of the partnership have not been paid or the partnership property is insufficient for their payment as required by the first paragraph, No. 1, and the limited partner would otherwise be entitled to the return of his contribution *(Art. 1857, Civil Code).*

Liabilities of Limited Partners

A limited partner is liable to the partnership for the difference between his contribution as actually made and that stated in the certificate as having been made and for any unpaid contribution which he agreed in the certificate to make in the future at the time and on the condi-

tions stated in the certificate. He holds as trustee for the partnership specific property stated in the certificate as contributed by him, but which was not contributed or which has been wrongfully returned, and money or other property wrongfully paid or conveyed to him on account of his contribution. These liabilities can be waived or compromised only by the consent of all members; but a waiver or compromise shall not affect the right of a creditor of a partnership who extended credit or whose claim arose after the filing and before a cancellation or amendment of the certificate, to enforce such liabilities. When a contributor has rightfully received the return in whole or in part of the capital of his contribution, he is nevertheless liable to the partnership for any sum, not in excess of such return with interest, necessary to discharge its liabilities to all creditors who extended credit or whose claims arose before such return *(Art. 1858, Civil Code).*

Assignment of Interest

A limited partner's interest is assignable. A *substituted limited partner* is a person admitted to all the rights of a limited partner who has died or has assigned his interest in a partnership. An *assignee*, who does not become a substituted limited partner, has no right to require any information or account of the partnership transactions or to inspect the partnership books; he is only entitled to receive the share of the profits or other compensation by way of income, or the return of his contributions, to which his assignor would otherwise be entitled. An assignee shall have the right to become a substituted limited partner if all the members consent thereto or if the assignor, being thereunto empowered by the certificate, gives the assignee that right. An assignee becomes a substituted limited partner when the certificate is appropriately amended in accordance with Article 1865. The substituted limited partner has all the rights and powers and is subject to all the restrictions and liabilities of his assignor, except those liabilities of which he was ignorant

at the time he became a limited partner and which could not be ascertained from the certificate. The substitution of the assignee as a limited partner does not release the assignor from liability to the partnership under Article 1847 and Article 1858 *(Art. 1859, Civil Code)*.

Dissolution

The retirement, death, insolvency, insanity or civil interdiction of a general partner dissolves the partnership, unless the business is continued by the remaining general partners:

(1) Under a right so to do stated in the certificate, or

(2) With the consent of all members *(Art. 1860, Civil Code)*.

On the death of a limited partner, his executor or administrator shall have all the rights of a limited partner for the purpose of settling his estate and such power as the deceased had to constitute his assignee a substituted limited partner. The estate of a deceased limited partner shall be liable for all his liabilities as a limited partner *(Art. 1861, Civil Code)*.

On due application to a court of competent jurisdiction by any creditor of a limited partner, the court may charge the interest of the indebted limited partner with payment of the unsatisfied amount of such claim, may appoint a receiver, and make all other orders, directions, and inquiries which the circumstances of the case may require. The interest may be redeemed with the separate property of any general partner, but may not be redeemed with partnership property. The remedies conferred by the first paragraph shall not be deemed exclusive of others which may exist. A limited partner shall not be deprived, however, of his statutory exemption (see *Art. 1862, Civil Code*).

Settlement of Accounts

In settling accounts after dissolution, the liabilities of the partnership shall be entitled to payment in the following order:

(1) Those to creditors, in the order of priority as provided by law, except those to limited partners on account of their contributions and to general partners;

(2) Those to limited partners in respect to their share of the profits and other compensation by way of income on their contributions;

(3) Those to limited partners in respect to the capital of their contributions;

(4) Those to general partners other than for capital and profits;

(5) Those to general partners in respect to capital.

Subject to any statement in the certificate or to subsequent agreement, limited partners share in the partnership assets in respect to their claims for capital, and in respect to their claims for profits or for compensation by way of income on their contribution respectively, in proportion to the respective amounts of such claims *(Art. 1863, Civil Code)*.

Cancellation or Amendment of Certificate

The certificate shall be cancelled when the partnership is dissolved or all limited partners cease to be such. A certificate shall be amended when —

(1) There is a change in the name of the partnership or in the amount or character of the contribution of any limited partner;

(2) A person is substituted as limited partner;

(3) An additional limited partner is admitted;

(4) A person is admitted as a general partner;

(5) A general partner retires, dies, becomes insolvent or insane, or is sentenced to civil interdiction and the business is continued under Article 1860 *(supra.);*

(6) There is a change in the character of the business of the partnership;

(7) There is a false or erroneous statement in the certificate;

(8) There is a change in the time as stated in the certificate for the dissolution of the partnership or for the return of a contribution;

(9) A time is fixed for the dissolution of the partnership, or the return of a contribution, no time having been specified in the certificate; or

(10) The members desire to make a change in any other statement in the certificate in order that it shall accurately represent the agreement among them *(Art. 1864, Civil Code).*

The writing to amend a certificate shall: (1) conform to the requirements of Article 1844 *(supra.)* as far as necessary to set forth clearly the change in the certificate which it is desired to make; and (2) be signed and sworn to by all members. An amendment substituting a limited partner or adding a limited or general partner shall be signed also by the member to be substituted or added, and when a limited partner is to be substituted, the amendment shall be signed by the assigning limited partner. The writing to cancel a certificate shall be signed by all members. A person desiring the cancellation or amendment of a certificate, if any person designated in the first and second paragraphs as a person who must execute the writing refuses to do so, may petition the court to order a cancellation or amendment thereof. If the court finds that the petitioner has a right to have the writing executed by a person who refuses to do so, it shall order the Office of the Securities and Exchange Commission where the certificate is recorded to record the cancellation or amend-

ment of the certificate; and when the certificate is to be amended, the court shall also cause to be filed for record in said office a certified copy of its decree setting forth the amendment. *(Art. 1865, Civil Code).*

A contributor, unless he is a general partner, is not a proper party to proceedings by or against a partnership, except where the object is to enforce a limited partner's right against or liability to the partnership *(Art. 1866, Civil Code).*

TITLE X. AGENCY

Chapter 1

Nature, Form and Kinds of Agency

Art. 1868. By the contract of agency a person binds himself to render some service or to do something in representation or on behalf of another, with the consent or authority of the latter. (1709a)

Art. 1869. Agency may be express, or implied from the acts of the principal, from his silence or lack of action, or his failure to repudiate the agency, knowing that another person is acting on his behalf without authority.

Agency may be oral, unless the law requires a specific form. (1710a)

Art. 1870. Acceptance by the agent may also be express, or implied from his acts which carry out the agency, or from his silence or inaction according to the circumstances. (n)

Art. 1871. Between persons who are present, the acceptance of the agency may also be implied if the principal delivers his power of attorney to the agent and the latter receives it without any objection. (n)

Art. 1872. Between persons who are absent, the acceptance of the agency cannot be implied from the silence of the agent, except:

(1) When the principal transmits his power of attorney to the agent, who receives it without any objection;

(2) When the principal entrusts to him by letter or telegram a power of attorney with respect to the

business in which he is habitually engaged as an agent, and he did not reply to the letter or telegram. (n)

Art. 1873. If a person specially informs another or states by public advertisement that he has given a power of attorney to a third person, the latter thereby becomes a duly authorized agent, in the former case with respect to the person who received the special information, and in the latter case with regard to any person.

The power shall continue to be in full force until the notice is rescinded in the same manner in which it was given. (n)

Art. 1874. When a sale of a piece of land or any interest therein is through an agent, the authority of the latter shall be in writing; otherwise, the sale shall be void. (n)

Art. 1875. Agency is presumed to be for a compensation, unless there is proof to the contrary. (n)

Art. 1876. An agency is either general or special.

The former comprises all the business of the principal. The latter, one or more specific transactions. (1712)

Art. 1877. An agency couched in general terms comprises only acts of administration, even if the principal should state that he withholds no power or that the agent may execute such acts as he may consider appropriate, or even though the agency should authorize a general and unlimited management. (n)

Art. 1878. Special powers of attorney are necessary in the following cases:

(1) To make such payments as are not usually considered as acts of administration;

(2) To effect novations which put an end to obligations already in existence at the time the agency was constituted;

(3) To compromise, to submit questions to arbitration, to renounce the right to appeal from a judgment,

to waive objections to the venue of an action or to abandon a prescription already acquired;

(4) To waive any obligation gratuitously;

(5) To enter into any contract by which the ownership of an immovable is transmitted or acquired either gratuitously or for a valuable consideration;

(6) To make gifts, except customary ones for charity or those made to employees in the business managed by the agent;

(7) To loan or borrow money, unless the latter act be urgent and indispensable for the preservation of the things which are under administration;

(8) To lease any real property to another person for more than one year;

(9) To bind the principal to render some service without compensation;

(10) To bind the principal in a contract of partnership;

(11) To obligate the principal as a guarantor or surety;

(12) To create or convey real rights over immovable property;

(13) To accept or repudiate an inheritance;

(14) To ratify or recognize obligations contracted before the agency;

(15) Any other act of strict dominion. (n)

Art. 1879. A special power to sell excludes the power to mortgage; and a special power to mortgage does not include the power to sell. (n)

Art. 1880. A special power to compromise does not authorize submission to arbitration. (1713a)

Art. 1881. The agent must act within the scope of his authority. He may do such acts as may be conducive to the accomplishment of the purpose of the agency. (1714a)

Art. 1882. The limits of the agent's authority shall not be considered exceeded should it have been performed in a manner more advantageous to the principal than that specified by him. (1715)

Art. 1883. If an agent acts in his own name, the principal has no right of action against the persons with whom the agent has contracted; neither have such persons against the principal.

In such case the agent is the one directly bound in favor of the person with whom he has contracted, as if the transaction were his own, except when the contract involves things belonging to the principal.

The provisions of this article shall be understood to be without prejudice to the actions between the principal and agent. (1717)

1. Concept

By the contract of agency, a person (the agent) binds himself to render some service or to do something in representation or on behalf of another (the principal), with the consent or authority of the latter *(Art. 1868, Civil Code)*. The basis of agency is representation, and its most distinguishing factor is control — the agent agrees to act under the control or direction of the principal— *(Victorias Milling Co., Inc. vs. Court of Appeals, 128 SCAD 1, 333 SCRA 663)*. The principal must have an actual intention to appoint or an intention naturally inferable from his words or actions while the agent must have an intention to accept the appointment and act on it; in the absence of such intent, there is generally no agency *(ibid.)*.

While both agency and lease of services involve the rendition of services, agency is distinguished from lease of work or service, however, in that the basis of agency is *representation*, whereas in lease of work or services the basis is *employment*. An agent is destined to execute, for and in behalf of a principal, *juridical acts*, such as the creation, modification or extinction of juridical relations,

with third parties. Lease of work or services contemplates the performance of material (non-juridical) acts *(Nielson & Co., Inc. vs. Lepanto Consolidated Mining Co., Inc., 26 SCRA 540*, citing *"An Outline of Philippine Civil Law"* by Reyes and Puno, *Vol. V, p. 277; Guardex vs. NLRC*, *191 SCRA 487),* either by an employee or servant who is subject to the control of his employer (see *Africa vs. Caltex, Inc., 16 SCRA 448; Luzon Stevedoring vs. Trinidad, 43 Phil. 803*), or an independent contractor who abides by the will of the employer only as to the results of his work and not as to the means by which it is accomplished *(Commissioner of Internal Revenue vs. Engineering Equipment and Supply Co., 64 SCRA 590).*

In *Sevilla vs. Court of Appeals (160 SCRA 171),* the Court has observed that there is no uniform standard used to determine the existence of an employer-employee relation, although, in general, courts have relied on the so-called right of control test "where the person for whom the services are performed reserves a right to control not only the end to be achieved but also the means to be used in reaching such end" (quoting *LVN Pictures, Inc. vs. Philippine Musicians Guild [1 SCRA 132]*). Subsequently, the Court additionally used the existing economic conditions prevailing between the parties, like the inclusion of the employee in the payrolls and the like *(Visayan Stevedore Trans. Co. vs. Court of Industrial Relations, 19 SCRA 426)*. Thus, a person, while having been designated as a "branch manager" but who, however, (a) assumed personal and solidary liability with the "employer" in pursuance of the latter's business, and (b) does not earn a fixed salary but gets compensated on the basis of the volume of business she is able to give, is not an employee. These circumstances indeed appear to suggest a principal-agent relationship, rather than of an employer-employee relationship nor of a joint management or partnership. The agency having been created for the mutual interest of the agent and the principal, the contract is coupled with an interest that prevents it from being revocable at will.

An agency to sell is distinguished from that of a contract of sale in that, unlike in the former, a sale gives rise to a transfer of ownership of the object (a thing, not services) of the contract, creating a debtor-creditor relationship over the consideration (the price) while still unpaid (see *Lim vs. People, 133 SCRA 333; Gonzalo Puyat & Sons, Inc. vs. Arco Amusement Co., 72 Phil. 402*).

While a broker, being an intermediary between normally a seller and buyer, is not an agent *(Pacific Commercial Co. vs. Yatco, 68 Phil. 398),* he may bear, however, the responsibilities of an agent to his employer (see *Arts. 1891* and *1909, Civil Code; Domingo vs. Domingo, 42 SCRA 131*).

2. Elements

a. *Consent*

Like any other contract, persons or entities having juridical capacity and capacity to act and not otherwise disqualified, may enter into an agency. But as regards the party with whom the agent acts or contracts, the legal capacity of the principal, rather than the agent, is of the greater import (see *Mendoza vs. Guzman, 33 O.G. 1505*). Agency may be express or implied from the acts of the principal, from his silence or lack of action, or from his failure to repudiate the agency, knowing that another person is acting on his behalf without authority *(Art. 1869, Civil Code; Johnlo Trading Co. vs. Flores and Florentino & Co., Ltd., 88 Phil. 741; De la Peña vs. Hidalgo, 16 Phil. 450).* In an implied agency, the principal can be bound by the acts of the implied agent *(Macke vs. Camps, 7 Phil. 553),* which should not be confused with an agency by estoppel, which arises when a person wrongly represents himself as an agent of another that does not render the latter accountable for the acts of the agent by estoppel.

Acceptance by the agent may also be express or implied from his acts which carry out the agency, or from

his silence or inaction according to the circumstances *(Art. 1870, Civil Code)*. Between persons who are absent, the acceptance of the agency cannot be implied from the silence of the agent, except:

(1) When the principal transmits his power of attorney to the agent, who receives it without any objection;

(2) When the principal entrusts to him by letter or telegram a power of attorney with respect to the business in which he is habitually engaged as an agent and he did not reply to the letter or telegram *(Art. 1872, Civil Code)*.

In case a person declines an agency, he is bound to observe the diligence of a good father of a family in the custody and preservation of the goods forwarded to him by the owner until the latter should appoint an agent. The owner shall as soon as practicable either appoint an agent or take charge of the goods *(Art. 1885, Civil Code)*.

b. *Object*

The services to be undertaken by the agent constitute the objects of the contract of agency that may cover *all the acts pertaining to a business* of the principal, in which case it is called a *general agency*, or one or more specific transactions, in which case it is referred to as a *special agency* (see *Art. 1876, Civil Code; Siasat vs. Intermediate Appellate Court, 139 SCRA 238*).

The extent of the agent's *authority to act*, whether it be a general or a special agency, depends on how the agency is couched. An agency couched in general terms comprises only acts of administration, not acts of dominion, even if the principal should state that he withholds no power or that the agent may execute such acts as he may consider appropriate, or even though the agency should authorize a general and unlimited management *(Art. 1877, Civil Code;* see *Strong vs. Gutierrez Repide, 6 Phil. 680; Goquiolay vs. Sycip, 108 Phil. 947)*.

c. *Cause*

The agency may be onerous or gratuitous but it is presumed to be for a compensation, unless there is proof to the contrary *(Art. 1975, Civil Code)*. The agent may not be deprived of this right by an unjustified revocation of the agency (see *Infante vs. Cunanan, 93 Phil. 691*).

Form of the Agency

Agency may be oral, unless the law requires a specific form *(Art. 1869, Civil Code)*. But when a sale of a piece of land or any interest therein is through an agent, the authority of the latter shall be in writing, otherwise the sale shall be *void (Art. 1874, Civil Code);* the sale itself should be in writing in order to be enforceable *(Art. 1403, Civil Code)*.

Article 1409 has grouped together contracts which have theretofore been jurisprudentially considered void *ab initio* under the old code. The nullity of these contracts is rather definitive in nature and cannot thereby be cured by ratification *(Arsenal vs. Intermediate Appellate Court, 143 SCRA 40; Tongoy vs. Court of Appeals, 123 SCRA 99)*. There are, however, other juridical relations which are specifically declared to be void by law under separate provisions of the Code like, such as here, the sale of a piece of land or any interest therein made through an agent whose authority is not reduced in writing *(Art. 1874, Civil Code)* or when the agent exceeds the scope of his authority *(Art. 1898, Civil Code)*. In these special instances, it would be important and prudent to take a minute longer to look at the law for, at times, the *rationale* for their being can justify a divergence from the standard rules governing void contracts in general.

The susceptibility to ratification could prompt one to say that the contract should, in essence, be deemed merely unenforceable. That, too, may not be totally accurate for outside that feature, other principles of a void contract

could, nevertheless, be apt and relevant. To exemplify, the rule in evidence to the effect that the unenforceable character of a contract is lost by a failure to object at the first opportunity to the presentation of oral evidence to prove the questioned transaction would not necessarily be applicable to contracts specially declared void under Article 1874 of the Code which sanctions ratification only if done by an act of affirmation by the principal.

Special powers of attorney (which need not be acknowledged before a notary public *[Barretto vs. Tuason, 59 Phil. 845]* but where it is executed and acknowledged in a foreign country, it cannot be admitted in evidence unless it is certified as such in accordance with the Rules of Court by an officer in the foreign service of the Philippines stationed in that country *[Lopez vs. Court of Appeals, 156 SCRA 838]*), are necessary in the following cases:

(1) To make such payments as are not usually considered as acts of administration;

(2) To effect novations which put an end to obligations already in existence at the time the agency was constituted;

(3) To compromise, to submit questions to arbitration, to renounce the right to appeal from a judgment, to waive objections to the venue of an action or to abandon prescription already acquired;

(4) To waive any obligation gratuitously;

(5) To enter into any contract by which the ownership of an immovable is transmitted or acquired either gratuitously or for a valuable consideration;

(6) To make gifts, except customary ones for charity or those made to employees in the business managed by the agent;

(7) To loan or borrow money, unless the latter act be urgent and indispensable for the preservation of the things which are under administration;

(8) To lease any real property to another person for more than one year;

(9) To bind the principal to render some service without compensation;

(10) To bind the principal in a contract of partnership;

(11) To obligate the principal as a guarantor or surety;

(12) To create or convey real rights over immovable property;

(13) To accept or repudiate an inheritance;

(14) To ratify or recognize obligations contracted before the agency;

(15) Any other act of strict dominion *(Art. 1878, Civil Code)*.

A special power to sell excludes the power to mortgage; and a special power to mortgage does not include the power to sell *(Art. 1879, Civil Code)* but it includes the power to allow the extra-judicial foreclosure of the mortgaged property *(Bicol Savings and Loan Assn. vs. Court of Appeals, 171 SCRA 630)*. A special power to compromise does not authorize submission to arbitration *(Art. 1880, Civil Code)*. Absent a special power of attorney, whenever required, the act would be unenforceable.

Chapter 2

Obligations of the Agent

Art. 1884. The agent is bound by his acceptance to carry out the agency, and is liable for the damages which, through his non-performance, the principal may suffer.

He must also finish the business already begun on the death of the principal, should delay entail any danger. (1718)

Art. 1885. In case a person declines an agency, he is bound to observe the diligence of a good father of a family in the custody and preservation of the goods forwarded to him by the owner until the latter should appoint an agent. The owner shall as soon as practicable either appoint an agent or take charge of the goods. (n)

Art. 1886. Should there be a stipulation that the agent shall advance the necessary funds, he shall be bound to do so except when the principal is insolvent. (n)

Art. 1887. In the execution of the agency, the agent shall act in accordance with the instructions of the principal.

In default thereof, he shall do all that a good father of a family would do, as required by the nature of the business. (1719)

Art. 1888. An agent shall not carry out an agency if its execution would manifestly result in loss or damage to the principal. (n)

Art. 1889. The agent shall be liable for damages if, there being a conflict between his interests and those of the principal, he should prefer his own. (n)

Art. 1890. If the agent has been empowered to borrow money, he may himself be the lender at the current rate of interest. If he has been authorized to lend money at interest, he cannot borrow it without the consent of the principal. (n)

Art. 1891. Every agent is bound to render an account of his transactions and to deliver to the principal whatever he may have received by virtue of the agency, even though it may not be owing to the principal.

Every stipulation exempting the agent from the obligation to render an account shall be void. (1720a)

Art. 1892. The agent may appoint a substitute if the principal has not prohibited him from doing so; but he shall be responsible for the acts of the substitute:

(1) When he was not given the power to appoint one;

(2) When he was given such power, but without designating the person, and the person appointed was notoriously incompetent or insolvent.

All acts of the substitute appointed against the prohibition of the principal shall be void. (1721)

Art. 1893. In the cases mentioned in Nos. 1 and 2 of the preceding article, the principal may furthermore bring an action against the substitute with respect to the obligations which the latter has contracted under the substitution. (1722a)

Art. 1894. The responsibility of two or more agents, even though they have been appointed simultaneously, is not solidary, if solidarity has not been expressly stipulated. (1723)

Art. 1895. If solidarity has been agreed upon, each of the agents is responsible for the non-fulfillment of the agency, and for the fault or negligence of his fellow agents, except in the latter case when the fellow agents acted beyond the scope of their authority. (n)

Art. 1896. The agent owes interest on the sums he has applied to his own use from the day on which he did so, and on those which he still owes after the extinguishment of the agency. (1724a)

Art. 1897. The agent who acts as such is not personally liable to the party with whom he contracts, unless he expressly binds himself or exceeds the limits of his authority without giving such party sufficient notice of his powers. (1725)

Art. 1898. If the agent contracts in the name of the principal, exceeding the scope of his authority, and the principal does not ratify the contract, it shall be void if the party with whom the agent contracted is aware of the limits of the power granted by the principal. In this

case, however, the agent is liable if he undertook to secure the principal's ratification. (n)

Art. 1899. If a duly authorized agent acts in accordance with the orders of the principal, the latter cannot set up the ignorance of the agent as to circumstances whereof he himself was, or ought to have been, aware. (n)

Art. 1900. So far as third persons are concerned, an act is deemed to have been performed within the scope of the agent's authority, if such act is within the terms of the power of attorney, as written, even if the agent has in fact exceeded the limits of his authority according to an understanding between the principal and the agent. (n)

Art. 1901. A third person cannot set up the fact that the agent has exceeded his powers, if the principal has ratified, or has signified his willingness to ratify the agent's acts. (n)

Art. 1902. A third person with whom the agent wishes to contract on behalf of the principal may require the presentation of the power of attorney, or the instructions as regards the agency. Private or secret orders and instructions of the principal do not prejudice third persons who have relied upon the power of attorney or instructions shown them. (n)

Art. 1903. The commission agent shall be responsible for the goods received by him in the terms and conditions and as described in the consignment, unless upon receiving them he should make a written statement of the damage and deterioration suffered by the same. (n)

Art. 1904. The commission agent who handles goods of the same kind and mark, which belong to different owners, shall distinguish them by countermarks, and designate the merchandise respectively belonging to each principal. (n)

Art. 1905. The commission agent cannot, without the express or implied consent of the principal, sell on credit. Should he do so, the principal may demand

from him payment in cash, but the commission agent shall be entitled to any interest or benefit, which may result from such sale. (n)

Art. 1906. Should the commission agent, with authority of the principal, sell on credit, he shall so inform the principal, with a statement of the names of the buyers. Should he fail to do so, the sale shall be deemed to have been made for cash insofar as the principal is concerned. (n)

Art. 1907. Should the commission agent receive on a sale, in addition to the ordinary commission, another called a guarantee commission, he shall bear the risk of collection and shall pay the principal the proceeds of the sale on the same terms agreed upon with the purchaser. (n)

Art. 1908. The commission agent who does not collect the credits of his principal at the time when they become due and demandable shall be liable for damages, unless he proves that he exercised due diligence for that purpose. (n)

Art. 1909. The agent is responsible not only for fraud, but also for negligence, which shall be judged with more or less rigor by the courts, according to whether the agency was or was not for a compensation. (1726)

Chapter 3

Obligations of the Principal

Art. 1910. The principal must comply with all the obligations which the agent may have contracted within the scope of his authority.

As for any obligation wherein the agent has exceeded his power, the principal is not bound except when he ratifies it expressly or tacitly. (1727)

Art. 1911. Even when the agent has exceeded his authority, the principal is solidarily liable with the agent if the former allowed the latter to act as though he had full powers. (n)

Art. 1912. The principal must advance to the agent, should the latter so request, the sums necessary for the execution of the agency.

Should the agent have advanced them, the principal must reimburse him therefor, even if the business or undertaking was not successful, provided the agent is free from all fault.

The reimbursement shall include interest on the sums advanced, from the day on which the advance was made. (1728)

Art. 1913. The principal must also indemnify the agent for all the damages which the execution of the agency may have caused the latter, without fault or negligence on his part. (1729)

Art. 1914. The agent may retain in pledge the things which are the object of the agency until the principal effects the reimbursement and pays the indemnity set forth in the two preceding articles. (1730)

Art. 1915. If two or more persons have appointed an agent for a common transaction or undertaking, they shall be solidarily liable to the agent for all the consequences of the agency. (1731)

Art. 1916. When two persons contract with regard to the same thing, one of them with the agent and the other with the principal, and the two contracts are incompatible with each other, that of prior date shall be preferred, without prejudice to the provisions of Article 1544. (n)

Art. 1917. In the case referred to in the preceding article, if the agent has acted in good faith, the principal shall be liable in damages to the third person whose contract must be rejected. If the agent acted in bad faith, he alone shall be responsible. (n)

Art. 1918. The principal is not liable for the expenses incurred by the agent in the following cases:

(1) If the agent acted in contravention of the principal's instructions, unless the latter should wish

to avail himself of the benefits derived from the contract;

(2) When the expenses were due to the fault of the agent;

(3) When the agent incurred them with knowledge that an unfavorable result would ensue, if the principal was not aware thereof;

(4) When it was stipulated that the expenses would be borne by the agent, or that the latter would be allowed only a certain sum. (n)

3. Effects of the Agency

a. Between the Principal and the Agent

(1) *The Agent*

The agent must act within the scope of his *authority*. He may do such acts as may be conducive to the accomplishment of the purpose of the agency *(Art. 1881, Civil Code;* see *Amigo vs. Teves, 96 Phil. 252)*. In the execution of the agency, the agent shall also act in accordance with the *instructions* of the principal. In default thereof, he shall do all that a good father of a family would do, as required by the nature of the business *(Art. 1887, Civil Code)*. An agent who acts in accordance with the authority and instructions of the principal incurs no liability *(Gutierrez Hermanos vs. Oria Hermanos, 30 Phil. 491)*. An agent shall not carry out an agency if its execution would manifestly result in loss or damage to the principal *(Art. 1888, Civil Code)*. The agent is responsible not only for fraud, but also for negligence, which shall be judged with more or less rigor by the courts, according to whether the agency was or was not for a compensation *(Art. 1909, Civil Code)*. Absent such fault on the part of the agent, the latter incurs no liability *(Gutierrez Hermanos vs. Oria Hermanos, supra.)* and the principal bears any risk of loss or damage (see *Jai-alai vs. Bank of Philippine Islands, 66 SCRA 29*).

The limits of the agent's authority shall not be considered exceeded should it have been performed in a manner more advantageous to the principal than that specified by him *(Art. 1882, Civil Code).*

The agent has a fiduciary relation to his principal *(Thomas vs. Pineda, 89 Phil. 312; Vda. De Luna vs. Valle, 48 SCRA 361),* and he is liable for the damages which, through his non-performance, the principal may suffer. He must also finish the business already began on the death of the principal, should delay entail any danger *(Art. 1884, Civil Code).*

The agent shall be liable for damages if, there being a conflict between his interests and those of the principal, he should prefer his own *(Art. 1889, Civil Code).*

Should there be a stipulation that the agent shall advance the necessary funds, he shall be bound to do so except when the principal is insolvent *(Art. 1886, Civil Code).* If the agent has been empowered to borrow money, he may himself be the lender at the current rate of interest. If he has been authorized to lend money at interest, he cannot borrow it without the consent of the principal *(Art. 1890, Civil Code).*

Every agent is bound to render an account of his transactions and to deliver to the principal whatever he may have received by virtue of the agency (whose retention can constitute a breach of trust *[U.S. vs. Reyes, 36 Phil. 971]*), even though it may not be owing to the principal. Every stipulation exempting the agent from the obligation to render an account shall be void *(Art. 1891, Civil Code).* The agent owes interest on the sums he has *applied* (conversion) to his own use from the day on which he did so and on those which he still owes after the extinguishment of the agency *(Art. 1896, Civil Code; Borja vs. Borja, 58 Phil. 811; Lyons vs. Rosentock, 56 Phil. 632).*

The responsibility of two or more agents, even though they have been appointed simultaneously, is not solidary if solidarity has not been expressly stipulated *(Art. 1894,*

Civil Code; Martinez vs. Ong Pong Co., 14 Phil. 726). If solidarity has been agreed upon, each of the agents is responsible for the non-fulfillment of the agency, and for the fault or negligence of his fellow agents except in the latter case when the fellow agents acted beyond the scope of their authority *(Art. 1895, Civil Code)*.

Sub-Agency

The agent may appoint a substitute if the principal has not prohibited him from doing so; but he shall be responsible for the acts of the substitute: (1) when he was not given the power to appoint one; and (2) when he was given such power, but without designating the person, and the person appointed was notoriously incompetent or insolvent. In these two cases, the principal may furthermore bring an action against the substitute with respect to the obligations which the latter has contracted under the substitution. All acts of the substitute appointed against the prohibition of the principal shall be void *(Arts. 1892 and 1893, Civil Code)*.

Commission Agents

Commission agents (or factors whose business is to receive, handle and sell goods for a commission [see *Pacific Commercial Co. vs. Yatco, 68 Phil. 398*]) are subject to the following rules:

(a) The commission agent shall be responsible for the goods received by him in the terms and conditions and as described in the consignment, unless upon receiving them, he should make a written statement of the damage and deterioration suffered by the same *(Art. 1903, Civil Code)*.

(b) The commission agent who handles goods of the same kind and mark, which belong to different owners, shall distinguish them by countermarks and designate the merchandise respectively belonging to each principal *(Art. 1904, Civil Code)*.

(c) The commission agent cannot, without the express or implied consent of the principal, sell on credit. Should he do so, the principal may demand from him payment in cash, but the commission agent shall be entitled to any interest or benefit which may result from such sale *(Art. 1905, Civil Code; Green Valley Poultry & Allied Products, Inc. vs. Intermediate Appellate Court, 133 SCRA 697)*.

(d) Should the commission agent, with authority of the principal, sell on credit, he shall so inform the principal, with a statement of the names of the buyers. Should he fail to do so the sale shall be deemed to have been made for cash insofar as the principal is concerned *(Art. 1906, Civil Code)*.

(e) Should the commission agent receive on a sale, in addition to the ordinary commission, another called a guarantee commission, he shall bear the risk of collection and shall pay the principal the proceeds of the sale on the same terms agreed upon with the purchaser *(Art. 1907, Civil Code)*.

(f) The commission agent who does not collect the credits of his principal at the time when they become due and demandable shall be liable for damages unless he proves that he exercised due diligence for that purpose *(Art. 1908, Civil Code)*.

(2) *The Principal*

The principal must advance to the agent, should the latter so request, the sums necessary for the execution of the agency. Should the agent have advanced them, the principal must reimburse him therefor, even if the business or undertaking was not successful, provided the agent is free from all fault. The reimbursement shall include interest on the sums advanced from the day on which the advance was made *(Art. 1912, Civil Code)*. The principal must also indemnify the agent for all the damages which the execution of the agency may have caused the latter,

without fault or negligence on his part *(Art. 1913, Civil Code; Baguisi vs. Adriano, 70 Phil. 237)*. The agent may retain in pledge the things which are the object of the agency until the principal effects the reimbursement and pays the indemnity *(Art. 1914, Civil Code)*.

If two or more persons have appointed an agent for a common transaction or undertaking, they shall be solidarily liable to the agent for all the consequences of the agency *(Art. 1915, Civil Code)*.

The principal is not liable for the expenses incurred by the agent in the following cases:

(1) If the agent acted in contravention of the principal's instructions, unless the latter should wish to avail himself of the benefits derived from the contract;

(2) When the expenses were due to the fault of the agent;

(3) When the agent incurred them with knowledge that an unfavorable result would ensue, if the principal was not aware thereof;

(4) When it was stipulated that the expenses would be borne by the agent, or that the latter would be allowed only a certain sum *(Art. 1918, Civil Code)*.

b. As Regards Third Persons

If a person specially informs another or states by advertisement that he has given a power of attorney to a third person, the latter thereby becomes a duly authorized agent, in the former case with respect to the person who received the special information, and in the latter case with regard to any person. The power shall continue to be in full force until the notice is rescinded in the same manner in which it was given *(Art. 1873, Civil Code;* see *Rallos vs. Yangco, 20 Phil. 269)*.

The agent who acts as such is not personally liable to the party with whom he contracts, unless he: (a) ex-

pressly binds himself, or (b) exceeds the limits of his authority without giving such party sufficient notice of his powers (see *Art. 1897, Civil Code; E. Macias & Co. vs. Warner Barnes & Co., 443 Phil. 155*). The principal must comply with all the obligations which the agent may have contracted within the scope of his authority *(Art. 1910, Civil Code; Lopez vs. Alvendia, 12 SCRA 634)*. Even when the agent has exceeded his authority, the principal is solidarily liable with the agent if the former allowed the latter to act as though he had full powers *(Art. 1911, Civil Code)*.

As for any obligation wherein the agent has exceeded his power, the principal is not bound except when he ratifies it expressly or tacitly *(Art. 1910, Civil Code; Gonzales vs. Haberer, 47 Phil. 380)*. Where an agent acts without or in excess of authority, the resulting contract by the agent is unenforceable under the provisions of Article 1403 (see *Frias vs. Esquivel, 67 SCRA 487*) but where the third party with whom the agent had contracted was aware of the limit of the agent's authority that had been exceeded, then the contract, unless the principal ratifies the contract, is void under the provisions of Article 1898. It has been said that because of the susceptibility of ratification of the contract, the contract entered into by the agent even with the knowledge by the third party of the agent's lack or excess of authority, must still be understood as merely being unenforceable. This view appears sound since a void contract is never susceptible to ratification; the fact, therefore, that it can be ratified, suggests that the contract is in reality an unenforceable, rather than a void, agreement. In *National Merchandising Corporation vs. National Power Corporation (117 SCRA 789),* however, the Supreme Court has stuck literally to the provisions of Article 1898 and held the unratified contract void. Nevertheless, the agent can be held liable if he undertakes to secure the principal's ratification *(Art. 1898, Civil Code)*. If a duly authorized agent acts in accordance with the orders of the principal, the latter cannot set up the ignorance of

the agent as to circumstances whereof he himself was, or ought to have been, aware *(Art. 1899, Civil Code)*. So far as third persons are concerned, an act is deemed to have been performed within the scope of the agent's authority if such act is within the terms of the power of attorney, as written, even if the agent has in fact exceeded the limits of his authority according to an understanding between the principal and the agent *(Art. 1900, Civil Code)*.

In one case, the principal's claim that it should not be held solidarily liable with its agent for damages arising from a double sale of land made by the latter was held untenable where the principal, by negligence, permitted the agent to exercise powers not theretofore granted (termed "authority by estoppel"). The fact that the principal might had no actual knowledge of the agent's misdeed was considered of no moment *(Manila Remnant Co., Inc. vs. Court of Appeals, 191 SCRA 622)*.

A third person cannot set up the fact that the agent has exceeded his powers if the principal has ratified or has signified his willingness to ratify the agent's acts *(Art. 1901, Civil Code)*.

A third person with whom the agent wishes to contract on behalf of the principal may require the presentation of the power of attorney, or the instructions as regards the agency *(Art. 1902, Civil Code)*. Persons dealing with agents are "bound at their peril, if they would hold the principal, to ascertain not only the fact of the agency but the nature and extent of the authority, and in case either is controverted, the burden of proof is upon them to establish it" *(Harry E. Keeler Electric Co. vs. Rodriquez, 44 Phil. 19,* reiterated in *Velasco vs. Urbana, 58 Phil. 681)*. But private or secret orders and instructions of the principal do not prejudice third persons who have relied upon the power of attorney or instructions shown them *(Art. 1902, Civil Code)*.

If an agent acts in his own name, the principal has no right of action against the persons with whom the

agent has contracted; neither have such persons against the principal. In such a case, the agent is the one directly bound in favor of the person with whom he has contracted, as if the transaction were his own, *except when the contract involves things belonging to the principal*. These provisions shall be understood to be without prejudice to the actions between the principal and agent (see *Art. 1883, Civil Code; Smith, Bell & Co. vs. Sotelo Matti, 44 Phil. 874; Award vs. Filma Mercantile Co., 49 Phil. 816; Gold Star Mining Co., Inc. vs. Lim-Jimeina, 25 SCRA 597*).

When two persons contract with regard to the same thing, one of them with the agent and the other with the principal, and the two contracts are incompatible with each other, that of prior date shall be preferred, without prejudice to the provisions of Article 1544 *(supra.)* on double sales *(Art. 1916, Civil Code; Buason vs. Panuyas, 105 Phil. 795).* If the agent has acted in good faith, the principal shall be liable in damages to the third person whose contract must be rejected. If the agent acted in bad faith, he alone shall be responsible *(Art. 1917, Civil Code).*

Chapter 4

Modes of Extinguishment of Agency

Art. 1919. Agency is extinguished:

(1) By its revocation;

(2) By the withdrawal of the agent;

(3) By the death, civil interdiction, insanity or insolvency of the principal or of the agent;

(4) By the dissolution of the firm or corporation which entrusted or accepted the agency;

(5) By the accomplishment of the object or purpose of the agency;

(6) By the expiration of the period for which the agency was constituted. (1732a)

Art. 1920. The principal may revoke the agency at will, and compel the agent to return the document evidencing the agency. Such revocation may be express or implied. (1733a)

Art. 1921. If the agency has been entrusted for the purpose of contracting with specified persons, its revocation shall not prejudice the latter if they were not given notice thereof. (1734)

Art. 1922. If the agent had general powers, revocation of the agency does not prejudice third persons who acted in good faith and without knowledge of the revocation. Notice of the revocation in a newspaper of general circulation is a sufficient warning to third persons. (n)

Art. 1923. The appointment of a new agent for the same business or transaction revokes the previous agency from the day on which notice thereof was given to the former agent, without prejudice to the provisions of the two preceding articles. (1735a)

Art. 1924. The agency is revoked if the principal directly manages the business entrusted to the agent, dealing directly with third persons. (n)

Art. 1925. When two or more principals have granted a power of attorney for a common transaction, any one of them may revoke the same without the consent of the others. (n)

Art. 1926. A general power of attorney is revoked by a special one granted to another agent, as regards the special matter involved in the latter. (n)

Art. 1927. An agency cannot be revoked if a bilateral contract depends upon it, or if it is the means of fulfilling an obligation already contracted, or if a partner is appointed manager of a partnership in the contract of partnership and his removal from the management is unjustifiable. (n)

Art. 1928. The agent may withdraw from the agency by giving due notice to the principal. If the latter should suffer any damage by reason of the withdrawal, the agent must indemnify him therefor, unless the agent

should base his withdrawal upon the impossibility of continuing the performance of the agency without grave detriment to himself. (1736a)

Art. 1929. The agent, even if he should withdraw from the agency for a valid reason, must continue to act until the principal has had reasonable opportunity to take the necessary steps to meet the situation. (1737a)

Art. 1930. The agency shall remain in full force and effect even after the death of the principal, if it has been constituted in the common interest of the latter and of the agent, or in the interest of a third person who has accepted the stipulation in his favor. (n)

Art. 1931. Anything done by the agent, without knowledge of the death of the principal or of any other cause which extinguishes the agency, is valid and shall be fully effective with respect to third persons who may have contracted with him in good faith. (1738)

Art. 1932. If the agent dies, his heirs must notify the principal thereof, and in the meantime adopt such measures as the circumstances may demand in the interest of the latter. (1739)

4. Extinguishment of Agency

Agency is extinguished by its revocation; the withdrawal of the agent; the death, civil interdiction, insanity or insolvency of the principal or of the agent; the dissolution of the firm or corporation which entrusted or accepted the agency; the accomplishment of the object or purpose of the agency; or the expiration of the period for which the agency was constituted *(Art. 1919, Civil Code)*.

Revocation

An agency being a contract premised on confidence, the principal may revoke the agency at will and compel the agent to return the document evidencing the agency regardless of the term of the agreement (see *Barretto vs. Santa Marina, 26 Phil. 440*) but such revocation does

not preclude the possibility of damages accruing against the principal if he abuses this right (see *Art. 19, Civil Code;* see also *Valenzuela vs. Court of Appeals, 191 SCRA 1; Damon vs. Brimo, 42 Phil. 133; Dioloso vs. Court of Appeals, 130 SCRA 350*). The principal cannot deprive the agent of the latter's commission by canceling the agency after having closed the deal pursuant to the agency (see *Siasat vs. Intermediate Appellate Court, 139 SCRA 238*).

The revocation may be express or implied (see *Art. 1920, Civil Code*). The appointment of a new agent for the same business or transaction revokes the previous agency from the day on which notice thereof was given to the former agent *(Art. 1923, Civil Code)*. A general power of attorney is revoked by a special one granted to another agent, as regards the special matter involved in the latter *(Art. 1926, Civil Code)*. The agency is likewise revoked if the principal directly manages the business entrusted to the agent, dealing directly with third persons *(Art. 1924, Civil Code; CMS Logging, Inc. vs. Court of Appeals, 211 SCRA 374)*. If the agency has been entrusted for the purpose of contracting with specified persons, however, its revocation shall not prejudice the latter if they were not given notice thereof *(Art. 1921, Civil Code;* see *Rallos vs. Yangco, 20 Phil. 269)*. If the agent had general powers, revocation of the agency does not also prejudice third persons who acted in good faith and without knowledge of the revocation. Notice of the revocation in a newspaper of general circulation is a sufficient warning to third persons *(Art. 1922, Civil Code)*.

When two or more principals have granted a power of attorney for a common transaction, any one of them may revoke the same without the consent of the others *(Art. 1925, Civil Code)*, since their liability is solidary in nature (see *Art. 1915, Civil Code*).

An agency cannot be revoked if it is coupled with an interest such as: (a) when a bilateral contract depends

upon it, (b) when it is the means of fulfilling an obligation already contracted, or (c) when a partner is appointed manager of a partnership in the contract of partnership and his removal from the management is unjustifiable (see *Art. 1927, Civil Code;* see also *Valenzuela vs. Court of Appeals, 191 SCRA 1; Pasno vs. Ravina, 54 Phil. 378*). In these cases, the agency merely becomes a part of another obligation or agreement, or an incidental element thereof (*e.g.,* a right granted to a mortgagee in a deed of real estate mortgage to extra-judicially foreclose the encumbered property in the event of default); in much the same way that an obligor may not unilaterally renege from the obligation so also must the rule be followed in respect of all its accessory undertakings. In one case, however, the Supreme Court has made a sweeping statement that coupled with an interest or not, the authority (agency) can certainly be revoked for a just cause *(Coleongco vs. Claparals, 10 SCRA 577).*

Withdrawal by Agent

The agent may withdraw from the agency by giving due notice to the principal. If the latter should suffer any damage by reason of the withdrawal, the agent must indemnify him therefor, unless the agent should base his withdrawal upon the impossibility of continuing the performance of the agency without grave detriment to himself *(Art. 1928, Civil Code),* such as for reasons of health *(De la Peña vs. Hidalgo, 16 Phil. 450)*. The agent, even if he should withdraw from the agency for a valid reason, must continue to act until the principal has had reasonable opportunity to take the necessary steps to meet the situation *(Art. 1929, Civil Code).*

Death of a Principal or Agent

The agency shall remain in full force and effect even after the death of the principal if it has been constituted in the common interest of the latter and of the agent, or in the interest of a third person who has accepted the

stipulation in his favor *(Art. 1930, Civil Code)*. Anything done by the agent, *without knowledge of the death* of the principal or of any other cause which extinguishes the agency, is valid and shall be fully effective with respect to third persons who may have contracted with him in good faith *(Art. 1931, Civil Code; Rallos vs. Felix Go Chan & Sons Realty Corp., 81 SCRA 251)*.

If the agent dies, the agency is extinguished, except when it is coupled with an interest *(Paso vs. Ravina, 54 Phil. 378; Laviña vs. Court of Appeals, 171 SCRA 691),* and his rights and objections are not transmitted to his heir (see *Terrado vs. Court of Appeals, 131 SCRA 373*). His heirs must notify the principal thereof, and in the meantime adopt such measures as the circumstances may demand in the interest of the latter (see *Art. 1932, Civil Code*).

TITLE XI. LOAN

General Provisions

Art. 1933. By the contract of loan, one of the parties delivers to another, either something not consumable so that the latter may use the same for a certain time and return it, in which case the contract is called a commodatum; or money or other consumable thing, upon the condition that the same amount of the same kind and quality shall be paid, in which case the contract is simply called a loan or mutuum.

Commodatum is essentially gratuitous.

Simple loan may be gratuitous or with a stipulation to pay interest.

In commodatum the bailor retains the ownership of the thing loaned, while in simple loan, ownership passes to the borrower. (1740a)

Art. 1934. An accepted promise to deliver something by way of commodatum or simple loan is binding upon the parties, but the commodatum or simple loan itself shall not be perfected until the delivery of the object of the contract. (n)

1. Concept

By the contract of loan, one of the parties delivers to another, either something not consumable so that the latter may use the same for a certain time and return it, in which case the contract is called a *commodatum*; or money or other consumable things, upon the condition that the same amount of the same kind and quality shall be paid, in which case the contract is simply called a loan or *mutuum (Art. 1933, Civil Code)*. Fixed, savings, and

current deposits of money in banks, and similar institutions are also considered simple loans to said institutions and are thus governed accordingly (see *Art. 1980, Civil Code; Guingona vs. City Fiscal of Manila, 128 SCRA 577*).

The bailee in *commodatum* acquires the use of the thing loaned but not its fruits; if any compensation is to be paid by him who acquires the use, the contract ceases to be a *commodatum (Art. 1935, Civil Code; Aquino vs. Deala, 63 Phil. 582)*. A stipulation that the bailee may *make use* of the fruits of the thing loaned is valid *(Art. 1940, Civil Code)*. *Commodatum* is purely personal in character. Consequently, the death of either the bailor or the bailee extinguishes the contract; and the bailee can neither lend nor lease the object of the contract to a third person. The members of the bailee's household, however, may make use of the thing loaned, unless there is a stipulation to the contrary or unless the nature of the thing forbids such use *(Art. 1939, Civil Code)*.

2. Elements

a. *Consent*

Any person who is *sui juris* and has capacity to act and not otherwise disqualified may enter into a contract of loan. In *commodatum*, the bailor need not be the owner of the thing since merely its use is transmitted; in *mutuum*, however, the lender must be the owner of the object thereof since ownership is acquired by the borrower (see *Arts. 1933, 1935, 1938,* and *1953, Civil Code*).

An accepted promise to deliver something by way of *commodatum* or simple loan is binding upon the parties, but the *commodatum* or simple loan itself shall not be perfected until the delivery of the object of the contract *(Art. 1934, Civil Code)*.

In *Bonnevie vs. Court of Appeals (125 SCRA 122),* the Supreme Court sustained the foreclosure under a real estate mortgage executed at the same time as the contract of loan secured by the mortgage. The foreclosure

was questioned on the ground that the mortgage, an accessory contract, was made prior to the perfection of the loan since the amount under the loan was received from the mortgagee bank a few days after the mortgage was executed. The spouses Lozano mortgaged on 6 December 1966 a piece of land in favor of the Philippine Bank of Commerce to secure payment of a P75,000 loan they were yet to receive from the bank. On 8 December 1966, the spouses executed in favor of Bonnevie a deed of sale with assumption of mortgage in consideration of P100,000, P25,000 being payable to them upon the execution of the document and the balance of P75,000 being payable to the bank. It was only on 12 December 1966 that the Lozano spouses signed the promissory note in favor of the bank upon receipt of the loan amount. The failure of the mortgagors to pay the full amount due to the bank constrained the latter to apply for the foreclosure of the mortgage. Bonnevie filed an action for annulment of the deed of mortgage and the extrajudicial foreclosure, contending that the mortgage was invalid because when it was executed there was yet no principal obligation to secure as the loan had not yet been received by the Lozanos. The fact, the Supreme Court ruled, that the Lozano spouses did not collect from the bank the consideration of the mortgage on the date it was executed is immaterial since a contract of loan, being a consensual contract, was perfected at the same time when the contract of mortgage was executed.

Article 1933, in relation to Article 1319, of the Civil Code, however, clearly considers a loan, as distinguished from a mere promise to loan, as a real contract perfected only upon the delivery of the object of the agreement. It might have then been preferable to hold *either* that an accessory obligation of mortgage may subsist conditionally, that is to say that the obligation under the mortgage, in effect, would be subject to the birth of the principal obligation, a recourse on which may ultimately be made upon a breach of the principal undertaking (see *Art. 2091, Civil Code*), or that an accepted promise to

loan, which is consensual *(Art. 1934, Civil Code)*, may be secured at least conditionally (see *Central Bank vs. Court of Appeals, 139 SCRA 46*). A guaranty, it is noteworthy, itself an accessory contract, can secure a conditional obligation (see *Art. 2053, Civil Code; Smith Bell & Co. vs. National Bank, 42 Phil. 733)*. Except for fruits and interests, the fulfillment of the condition retroacts in its effects to the day of the constitution of the obligation (see *Art. 1187, Civil Code*).

b. *Object*

Movable or immovable property (non-fungible) may be the object of *commodatum (Art. 1937, Civil Code)*. The bailor in *commodatum* need not be the owner of the thing loaned *(Art. 1938, Civil Code)*. Consumable goods may be the subject of *commodatum* if the purpose of the contract is not the consumption of the object, as when it is merely for exhibition *(Art. 1936, Civil Code)*.

Only money or any other fungible thing may be the object of *mutuum* (see *Arts. 1933, 1953* and *1954, Civil Code*).

c. *Cause*

Commodatum is essentially gratuitous *(Mina vs. Pascual, 25 Phil. 540)* but a simple loan may be gratuitous or with a stipulation to pay interest *(Art. 1933, Civil Code)*. No interest shall be due unless it has been expressly stipulated in writing *(Art. 1956, Civil Code)*. This rule does not apply to awards of interests as damages under Article 2209 of the Civil Code *(Integrated Realty Corp. vs. Philippine National Bank, 174 SCRA 295)*.

Contracts and stipulations, under any cloak or device whatever, intended to circumvent any law against usury shall be void. The borrower may recover in accordance with the laws on usury *(Art. 1957, Civil Code)*. In the determination of the interest, if it is payable in kind, its value shall be appraised at the current price of the products or goods at the time and place of payment *(Art.*

1958, Civil Code). Without prejudice to the provisions of Article 2212 *(infra.),* interest due and unpaid shall not earn interest; the contracting parties, however, may by stipulation capitalize the interest due and unpaid, which as added principal, shall earn new interest (see *Art. 1959, Civil Code*). If the borrower pays interest when there has been no stipulation therefor, the provisions of the Code concerning *solutio indebiti* or natural obligations shall be applied, as the case may be *(Art. 1960, Civil Code).*

Usurious contracts shall be governed by the Usury Law and other special laws, so far as they are not inconsistent with the Code *(Art. 1961, Civil Code).* In *Briones vs. Cammayo (41 SCRA 404)*, the ruling in *Angel Jose vs. Chelda Enterprises (23 SCRA 119)* was reiterated — that in a contract of loan providing for usurious interest, only the interest stipulation, not the loan itself, is illegal and void and thus renders the borrower still liable for the principal amount but not for any interest payment, and if such interest has been paid, to permit the entire recovery thereof in accordance with the laws on usury (see also *Sanchez vs. Buenviaje, 126 SCRA 208*). Under Central Bank Circular No. 905, issued conformably with Presidential Decree No. 116, as amended, authorizing the Monetary Board to fix interest rates, the ceiling rates under the Usury Law *(Act No. 2655,* as amended) have been abolished.

3. Effects

Chapter 1

Commodatum

Section 1 — Nature of Commodatum

Art. 1935. The bailee in commodatum acquires the use of the thing loaned but not its fruits; if any compensation is to be paid by him who acquires the use, the contract ceases to be a commodatum. (1941a)

Art. 1936. Consumable goods may be the subject of commodatum if the purpose of the contract is not the consumption of the object, as when it is merely for exhibition. (n)

Art. 1937. Movable or immovable property may be the object of commodatum. (n)

Art. 1938. The bailor in commodatum need not be the owner of the thing loaned. (n)

Art. 1939. Commodatum is purely personal in character. Consequently:

(1) The death of either the bailor or the bailee extinguishes the contract;

(2) The bailee can neither lend nor lease the object of the contract to a third person. However, the members of the bailee's household may make use of the thing loaned, unless there is a stipulation to the contrary, or unless the nature of the thing forbids such use. (n)

Art. 1940. A stipulation that the bailee may make use of the fruits of the thing loaned is valid. (n)

Section 2 — Obligations of the Bailee

Art. 1941. The bailee is obliged to pay for the ordinary expenses for the use and preservation of the thing loaned. (1743a)

Art. 1942. The bailee is liable for the loss of the thing, even if it should be through a fortuitous event:

(1) If he devotes the thing to any purpose different from that for which it has been loaned;

(2) If he keeps it longer than the period stipulated, or after the accomplishment of the use for which the commodatum has been constituted;

(3) If the thing loaned has been delivered with appraisal of its value, unless there is a stipulation exempting the bailee from responsibility in case of a fortuitous event;

(4) If he lends or leases the thing to a third person, who is not a member of his household;

(5) If, being able to save either the thing borrowed or his own thing, he chose to save the latter. (1744a and 1745)

Art. 1943. The bailee does not answer for the deterioration of the thing loaned due only to the use thereof and without his fault. (1746)

Art. 1944. The bailee cannot retain the thing loaned on the ground that the bailor owes him something, even though it may be by reason of expenses. However, the bailee has a right of retention for damages mentioned in Article 1951. (1747a)

Art. 1945. When there are two or more bailees to whom a thing is loaned in the same contract, they are liable solidarily. (1748a)

Section 3 — Obligations of the Bailor

Art. 1946. The bailor cannot demand the return of the thing loaned till after the expiration of the period stipulated, or after the accomplishment of the use for which the commodatum has been constituted. However, if in the meantime, he should have urgent need of the thing, he may demand its return or temporary use.

In case of temporary use by the bailor, the contract of commodatum is suspended while the thing is in the possession of the bailor. (1749a)

Art. 1947. The bailor may demand the thing at will, and the contractual relation is called a — *precarium*, in the following cases:

(1) If neither the duration of the contract nor the use to which the thing loaned should be devoted, has been stipulated; or

(2) If the use of the thing is merely tolerated by the owner. (1750a)

Art. 1948. The bailor may demand the immediate return of the thing if the bailee commits any act of ingratitude specified in Article 765. (n)

Art. 1949. The bailor shall refund the extraordinary expenses during the contract for the preservation of the thing loaned, provided the bailee brings the same to the knowledge of the bailor before incurring them, except when they are so urgent that the reply to the notification cannot be awaited without danger.

If the extraordinary expenses arise on the occasion of the actual use of the thing by the bailee, even though he acted without fault, they shall be borne equally by both the bailor and the bailee, unless there is a stipulation to the contrary. (1751a)

Art. 1950. If, for the purpose of making use of the thing, the bailee incurs expenses other than those referred to in Articles 1941 and 1949, he is not entitled to reimbursement. (n)

Art. 1951. The bailor who, knowing the flaws of the thing loaned, does not advise the bailee of the same, shall be liable to the latter for the damages which he may suffer by reason thereof. (1752)

Art. 1952. The bailor cannot exempt himself from the payment of expenses or damages by abandoning the thing to the bailee. (n)

Chapter 2

Simple Loan or Mutuum

Art. 1953. A person who receives a loan of money or any other fungible thing acquires the ownership thereof, and is bound to pay to the creditor an equal amount of the same kind and quality. (1753a)

Art. 1954. A contract whereby one person transfers the ownership of non-fungible things to another with the obligation on the part of the latter to give things of the same kind, quantity, and quality shall be considered a barter. (n)

Art. 1955. The obligation of a person who borrows money shall be governed by the provisions of Articles 1249 and 1250 of this Code.

If what was loaned is a fungible thing other than money, the debtor owes another thing of the same kind, quantity and quality, even if it should change in value. In case it is impossible to deliver the same kind, its value at the time of the perfection of the loan shall be paid. (1754a)

Art. 1956. No interest shall be due unless it has been expressly stipulated in writing. (1755a)

Art. 1957. Contracts and stipulations, under any cloak or device whatever, intended to circumvent the laws against usury shall be void. The borrower may recover in accordance with the laws on usury. (n)

Art. 1958. In the determination of the interest, if it is payable in kind, its value shall be appraised at the current price of the products or goods at the time and place of payment. (n)

Art. 1959. Without prejudice to the provisions of Article 2212, interest due and unpaid shall not earn interest. However, the contracting parties may by stipulation capitalize the interest due and unpaid, which as added principal, shall earn new interest. (n)

Art. 1960. If the borrower pays interest when there has been no stipulation therefor, the provisions of this Code concerning *solutio indebiti*, or natural obligations, shall be applied, as the case may be. (n)

Art. 1961. Usurious contracts shall be governed by the Usury Law and other special laws, so far as they are not inconsistent with this Code. (n)

a. *In Commodatum*

(1) *Expenses*

The bailee is obliged to pay for the ordinary expenses for the use and preservation of the thing loaned *(Art. 1941, Civil Code)*. The bailor bears the extraordinary expenses during the contract for the preservation of the thing loaned, and he shall refund said expenses if made by the bailee (but the latter has no right of retention *(Art. 1944, Civil Code)* provided that he brings the same to the

knowledge of the bailor before incurring them except when they are so urgent that the reply to the notification cannot be awaited without danger. If the extraordinary expenses arise on the occasion of the actual use of the thing by the bailee, even though he acted without fault, they shall be borne equally by both the bailor and the bailee, unless there is a stipulation to the contrary *(Art. 1949, Civil Code)*. If, for the purpose of making use of the thing, the bailee incurs other expenses (other than those referred to in Arts. 1941 and 1949), he is not entitled to reimbursement (see *Art. 1950, Civil Code*).

(2) *Losses and Damages*

The bailee is not responsible for the loss of or damage to the thing loaned which is not due to his fault or negligence, although being in the possession or control of the property, the burden of proof lies with him to show his exercise of due diligence. Exceptionally, however, the bailee is liable for the loss of the thing, even if it should be through a fortuitous event:

(1) If he devotes the thing to any purpose different from that for which it has been loaned;

(2) If he keeps it longer than the period stipulated, or after the accomplishment of the use for which the *commodatum* has been constituted;

(3) If the thing loaned has been delivered with appraisal of its value, unless there is a stipulation exempting the bailee from responsibility in case of a fortuitous event;

(4) If he lends or leases the thing to a third person, who is not a member of his household;

(5) If, being able to save either the thing borrowed or his own thing, he chose to save the latter *(Art. 1942, Civil Code;* see *Republic vs. Bagtas, 6 SCRA 262)*. When there are two or more bailees to whom a thing is loaned in the same contract, they are liable solidarily *(Art. 1945, Civil Code)*.

The bailor who, knowing the flaws of the thing loaned, does not advise the bailee of the same, shall be liable to the latter for the damages which he may suffer by reason thereof *(Art. 1951, Civil Code),* and he may retain the thing loaned until he is paid *(Art. 1944, Civil Code).* The bailor cannot exempt himself from the payment of expenses (see *Art. 1950, supra*.) or damages *(Art. 1951, supra.)* by abandoning the thing to the bailee *(Art. 1952, Civil Code).*

(6) *Duration*

The bailor cannot demand the return of the thing loaned until after the expiration of the period stipulated, or after the accomplishment of the use for which the *commodatum* has been constituted. If in the meantime, however, he should have urgent need of the thing, he may demand its return or temporary use. In case of temporary use by the bailor, the contract of *commodatum* is suspended while the thing is in the possession of the bailor *(Art. 1946, Civil Code).* The bailor, in the following cases, may demand the thing at will and the contractual relation is called a *precarium*:

(1) If neither the duration of the contract nor the use to which the thing loaned should be devoted has been stipulated; or

(2) If the use of the thing is merely tolerated by the owner *(Art. 1947, Civil Code;* see *Quintos & Arnaldo vs. Beck, 69 Phil. 108; Mina vs. Pascual, 25 Phil. 540).*

The bailor may demand the immediate return of the thing if the bailee commits any act of ingratitude specified in Article 765 *(Art. 1948, Civil Code).*

The bailee cannot retain the thing loaned on the ground that the bailor owes him something, even though it may be by reason of expenses. The bailee, however, has a right of retention for damages mentioned in Article 1951 *(supra.,* see *Art. 1944, Civil Code).*

b. *In Mutuum*

In *mutuum*, the person who receives the loan of money or any other fungible thing acquires the ownership thereof and is bound to pay to the creditor an equal amount of the same kind and quality *(Art. 1953, Civil Code; Tolentino vs. Gonzales, 50 Phil. 558)*. A contract whereby one person transfers the ownership of non-fungible things to another with the obligation on the part of the latter to give things of the same kind, quantity, and quality shall be considered a barter *(Art. 1954, Civil Code)*.

The obligation of a person who borrows money shall be governed by the provisions of Article 1249 and Article 1250 of this Code. If what was loaned is a fungible thing other than money, the debtor owes another thing of the same kind, quantity and quality, even if it should change in value. In case it is impossible to deliver the same kind, its value at the time of the perfection of the loan shall be paid *(Art. 1255, Civil Code)*.

Bank deposits are governed by the provisions on simple loan *(Art. 1280, Civil Code);* accordingly, such deposits may be set-off against the depositor's obligations to the bank *(Philippine National Bank vs. Court of Appeals, 112 SCRA 553),* and a failure to pay back the invested sum to the depositor does not constitute a breach of trust (estafa) of deposit *(Guingona vs. City Fiscal of Manila, 128 SCRA 577; Serrano vs. Central Bank, 96 SCRA 96)*.

TITLE XII. DEPOSIT

Chapter 1

Deposit in General and Its Different Kinds

Art. 1962. A deposit is constituted from the moment a person receives a thing belonging to another, with the obligation of safely keeping it and of returning the same. If the safekeeping of the thing delivered is not the principal purpose of the contract, there is no deposit but some other contract. (1758a)

Art. 1963. An agreement to constitute a deposit is binding, but the deposit itself is not perfected until the delivery of the thing. (n)

Art. 1964. A deposit may be constituted judicially or extra-judicially. (1759)

Art. 1965. A deposit is a gratuitous contract, except when there is an agreement to the contrary, or unless the depositary is engaged in the business of storing goods. (1760a)

Art. 1966. Only movable things may be the object of a deposit. (1761)

Art. 1967. An extra-judicial deposit is either voluntary or necessary. (1762)

1. Concept

A deposit is constituted from the moment a person receives a thing belonging to another, with the obligation of safely keeping it and of returning the same. If the safekeeping of the thing delivered is not the principal purpose of the contract, there is no deposit but some other contract *(Art. 1262, Civil Code)*. Fixed, savings, and

current deposits of money in banks and similar institutions are governed by the provisions concerning simple loan (see *Art. 1980, Civil Code; Philippine National Bank vs. Court of Appeals, 112 SCRA 553*). Exceptionally, the depositary may make use of the thing deposited without the concept of the deposit being necessarily lost so long as *safekeeping* is still the principal purpose of the contract (see *Arts. 1977* and *1978, Civil Code, infra.*), and the juridical relation is commonly referred to as an "irregular deposit." This deposit is distinguished from a contract of loan in that: (a) in an irregular deposit, the real benefit is that which accrues to the depositor, whereas in a loan the essence is the need of the borrower; (b) in an irregular deposit, the depositor always maintains full title and rights over the thing totally unaffected by the depositary's creditors, whereas in a simple loan the lender becomes a mere creditor of the borrower; and (c) in an irregular deposit, the depositor can demand the return of the article at any time, whereas that right is not granted as a matter of course by the lender in a loan (see *Rogers vs. Smith, Bell & Co., 10 Phil. 319,* citing *Manresa*).

A deposit may be constituted judicially or extrajudicially *(Art. 1964, Civil Code)*. A *judicial* deposit or sequestration takes place when an attachment or seizure of property in litigation is ordered *(Art. 2005, Civil Code)*. An *extra-judicial* deposit is either voluntary or necessary *(Art. 1267, Civil Code)*. A *voluntary* deposit is that wherein the delivery is made by the will of the depositor. A deposit may also be made by two or more persons each of whom believes himself entitled to the thing deposited with a third person, who shall deliver it in a proper case to the one to whom it belongs *(Art. 1268, Civil Code)*. A deposit is *necessary:* (1) when it is made in compliance with a legal obligation; (2) when it takes place on the occasion of any calamity, such as fire, storm, flood, pillage, shipwreck, or other similar events *(Art. 1996, Civil Code);* and (3) when it is of effects made by travellers in hotels or inns *(Art. 1998, Civil Code)*.

Chapter 2

Voluntary Deposit

Section 1 — General Provisions

Art. 1968. A voluntary deposit is that wherein the delivery is made by the will of the depositor. A deposit may also be made by two or more persons each of whom believes himself entitled to the thing deposited with a third person, who shall deliver it in a proper case to the one to whom it belongs. (1763)

Art. 1969. A contract of deposit may be entered into orally or in writing. (n)

Art. 1970. If a person having capacity to contract accepts a deposit made by one who is incapacitated, the former shall be subject to all the obligations of a depositary, and may be compelled to return the thing by the guardian, or administrator, of the person who made the deposit, or by the latter himself if he should acquire capacity. (1764)

Art. 1971. If the deposit has been made by a capacitated person with another who is not, the depositor shall only have an action to recover the thing deposited while it is still in the possession of the depositary, or to compel the latter to pay him the amount by which he may have enriched or benefited himself with the thing or its price. However, if a third person who acquired the thing acted in bad faith, the depositor may bring an action against him for its recovery. (1765a)

2. Elements (Voluntary Deposits)

a. *Consent*

Any person who has capacity to act and not otherwise disqualified by law may enter into a contract of deposit. It may be entered into orally or in writing *(Art. 1969, Civil Code)*. An agreement to constitute a deposit is binding, but the deposit itself is not perfected until the delivery of the thing *(Art. 1963, Civil Code)*.

If a person having capacity to contract accepts a deposit made by one who is incapacitated, the former shall be subject to all the obligations of a depositary and may be compelled to return the thing by the guardian, or administrator of the person who made the deposit, or by the latter himself if he should acquire capacity *(Art. 1970, Civil Code)*. If the deposit has been made by a capacitated person with another who is not, the depositor shall only have an action to recover the thing deposited while it is in the possession of the depositary, or to compel the latter to pay him the amount by which he may have enriched or benefited himself with the thing or its price. However, if a third person who has acquired the thing acted in bad faith, the depositor may bring an action against him for its recovery *(Art. 1971, Civil Code)*. If the third person has acted in good faith, Article 559 on the subject of "possession" and Article 1506 on "sales" could, in appropriate cases, be pertinent and applicable.

b. *Object*

Only movable things may be the object of an extrajudicial deposit *(Art. 1966, Civil Code)*. Movable as well as immovable property, however, may be the object of sequestration *(Art. 2006, Civil Code)*.

c. *Cause*

A deposit is a gratuitous contract, except when there is an agreement to the contrary, or unless the depositary is engaged in the business of storing goods *(Art. 1965, Civil Code; Manila Railroad Co. vs. Rodriguez, 29 Phil. 336)*.

3. Effects

Section 2 — Obligations of the Depositary

Art. 1972. The depositary is obliged to keep the thing safely and to return it, when required, to the depositor, or to his heirs and successors, or to the person who may have been designated in the contract.

His responsibility, with regard to the safekeeping and the loss of the thing, shall be governed by the provisions of Title I of this Book.

If the deposit is gratuitous, this fact shall be taken into account in determining the degree of care that the depositary must observe. (1766a)

Art. 1973. Unless there is a stipulation to the contrary, the depositary cannot deposit the thing with a third person. If deposit with a third person is allowed, the depositary is liable for the loss if he deposited the thing with a person who is manifestly careless or unfit. The depositary is responsible for the negligence of his employees. (n)

Art. 1974. The depositary may change the way of the deposit if under the circumstances he may reasonably presume that the depositor would consent to the change if he knew of the facts of the situation. However, before the depositary may make such change, he shall notify the depositor thereof and wait for his decision, unless delay would cause danger. (n)

Art. 1975. The depositary holding certificates, bonds, securities or instruments which earn interest shall be bound to collect the latter when it becomes due, and to take such steps as may be necessary in order that the securities may preserve their value and the rights corresponding to them according to law.

The above provision shall not apply to contracts for the rent of safety deposit boxes. (n)

Art. 1976. Unless there is a stipulation to the contrary, the depositary may commingle grain or other articles of the same kind and quality, in which case the various depositors shall own or have a proportionate interest in the mass. (n)

Art. 1977. The depositary cannot make use of the thing deposited without the express permission of the depositor.

Otherwise, he shall be liable for damages.

However, when the preservation of the thing deposited requires its use, it must be used but only for that purpose. (1767a)

Art. 1978. When the depositary has permission to use the thing deposited, the contract loses the concept of a deposit and becomes a loan or commodatum, except where safekeeping is still the principal purpose of the contract.

The permission shall not be presumed, and its existence must be proved. (1768a)

Art. 1979. The depositary is liable for the loss of the thing through a fortuitous event:

(1) If it is so stipulated;

(2) If he uses the thing without the depositor's permission;

(3) If he delays its return;

(4) If he allows others to use it, even though he himself may have been authorized to use the same. (n)

Art. 1980. Fixed, savings, and current deposits of money in banks and similar institutions shall be governed by the provisions concerning simple loan. (n)

Art. 1981. When the thing deposited is delivered closed and sealed, the depositary must return it in the same condition, and he shall be liable for damages should the seal or lock be broken through his fault.

Fault on the part of the depositary is presumed, unless there is proof to the contrary.

As regards the value of the thing deposited, the statement of the depositor shall be accepted, when the forcible opening is imputable to the depositary, should there be no proof to the contrary. However, the courts may pass upon the credibility of the depositor with respect to the value claimed by him.

When the seal or lock is broken, with or without the depositary's fault, he shall keep the secret of the deposit. (1769a)

Art. 1982. When it becomes necessary to open a locked box or receptacle, the depositary is presumed authorized to do so, if the key has been delivered to him; or when the instructions of the depositor as regards the deposit cannot be executed without opening the box or receptacle. (n)

Art. 1983. The thing deposited shall be returned with all its products, accessories and accessions.

Should the deposit consist of money, the provisions relative to agents in Article 1896 shall be applied to the depositary. (1770)

Art. 1984. The depositary cannot demand that the depositor prove his ownership of the thing deposited.

Nevertheless, should he discover that the thing has been stolen and who its true owner is, he must advise the latter of the deposit.

If the owner, in spite of such information, does not claim it within the period of one month, the depositary shall be relieved of all responsibility by returning the thing deposited to the depositor.

If the depositary has reasonable grounds to believe that the thing has not been lawfully acquired by the depositor, the former may return the same. (1771a)

Art. 1985. When there are two or more depositors, if they are not solidary, and the thing admits of division, each one cannot demand more than his share.

When there is solidarity or the thing does not admit of division, the provisions of Articles 1212 and 1214 shall govern. However, if there is a stipulation that the thing should be returned to one of the depositors, the depositary shall return it only to the person designated. (1772a)

Art. 1986. If the depositor should lose his capacity to contract after having made the deposit, the thing cannot be returned except to the persons who may have the administration of his property and rights. (1773)

Art. 1987. If at the time the deposit was made a place was designated for the return of the thing, the

depositary must take the thing deposited to such place; but the expenses for transportation shall be borne by the depositor.

If no place has been designated for the return, it shall be made where the thing deposited may be, even if it should not be the same place where the deposit was made, provided that there was no malice on the part of the depositary. (1774)

Art. 1988. The thing deposited must be returned to the depositor upon demand, even though a specified period or time for such return may have been fixed.

This provision shall not apply when the thing is judicially attached while in the depositary's possession, or should he have been notified of the opposition of a third person to the return or the removal of the thing deposited. In these cases, the depositary must immediately inform the depositor of the attachment or opposition. (1775)

Art. 1989. Unless the deposit is for a valuable consideration, the depositary who may have justifiable reasons for not keeping the thing deposited may, even before the time designated, return it to the depositor; and if the latter should refuse to receive it, the depositary may secure its consignation from the court. (1776a)

Art. 1990. If the depositary by *force majeure* or government order loses the thing and receives money or another thing in its place, he shall deliver the sum or other thing to the depositor. (1777a)

Art. 1991. The depositor's heir who in good faith may have sold the thing which he did not know was deposited, shall only be bound to return the price he may have received or to assign his right of action against the buyer in case the price has not been paid him. (1778)

Section 3 — Obligations of the Depositor

Art. 1992. If the deposit is gratuitous, the depositor is obliged to reimburse the depositary for the ex-

penses he may have incurred for the preservation of the thing deposited. (1779a)

Art. 1993. The depositor shall reimburse the depositary for any loss arising from the character of the thing deposited, unless at the time of the constitution of the deposit the former was not aware of, or was not expected to know the dangerous character of the thing, or unless he notified the depositary of the same, or the latter was aware of it without advice from the depositor. (n)

Art. 1994. The depositary may retain the thing in pledge until the full payment of what may be due him by reason of the deposit. (1780)

Art. 1995. A deposit is extinguished:

(1) Upon the loss or destruction of the thing deposited;

(2) In case of a gratuitous deposit, upon the death of either the depositor or the depositary. (n)

a. *In Voluntary Deposits*

The depositary is obliged *to keep the thing safely* and *to return it*, when required, to the depositor or to his heirs and successors, or to the person who may have been designated in the contract. His responsibility, with regard to the safekeeping and the loss of the thing, shall be governed by the provisions on **Obligations and Contracts** in general. The fact that the deposit is gratuitous shall be taken into account in determining the degree of care that the depositary must observe *(Art. 1972, Civil Code)*. The depositary is responsible for the negligence of his employees. Unless there is a stipulation to the contrary, the depositary cannot deposit the thing with a third person. If deposit with a third person is allowed, the depositary is liable for the loss if he deposited the thing with a person who is manifestly careless or unfit *(Art. 1973, Civil Code)*.

The depositary may change the way of the deposit if under the circumstances he may reasonably presume that

the depositor would consent to the change if he knew of the facts of the situation. However, before the depositary may make such change, he shall notify the depositor thereof and wait for his decision, unless delay would cause danger *(Art. 1974, Civil Code)*.

The depositary holding certificates, bonds, securities or instruments which earn interest shall be bound to collect the latter when it becomes due and to take such steps as maybe necessary in order that the securities may preserve their value and the rights corresponding to them according to law. This provision shall not apply to contracts for the rent of safety deposit boxes *(Art. 1975, Civil Code)*.

Unless there is a stipulation to the contrary, the depositary may commingle grain or other articles of the same kind and quality, in which case the various depositors shall own or have a proportionate interest in the mass *(Art. 1976, Civil Code)*.

When the thing deposited is delivered closed and sealed, the depositary must return it in the same condition, and he shall be liable for damages should the seal or lock be broken through his fault. Fault on the part of the depositary is presumed, unless there is proof to the contrary. As regards the value of the thing deposited, the statement of the depositor shall be accepted when the forcible opening is imputable to the depositary, should there be no proof to the contrary. The courts, however, may pass upon the credibility of the depositor with respect to the value claimed by him. When the seal or lock is broken with or without the depositary's fault, he shall keep the secret of the deposit *(Art. 1981, Civil Code)*. When it becomes necessary to open a locked box or receptacle, the depositary is presumed authorized to do so if the key has been delivered to him, or when the instructions of the depositor as regards the deposit cannot be executed without opening the box or receptacle *(Art. 1982, Civil Code)*.

The depositary *cannot make use of the thing* deposited without the express permission of the depositor; otherwise, he shall be liable for damages. When, however, the preservation of the thing deposited requires its use, it must be used for that purpose (see *Art. 1977, Civil Code; Rivera vs. Ocampo, 93 Phil. 588*). When the depositary has permission to use the thing deposited, the contract loses the concept of a deposit and becomes a loan or *commodatum*, except where safekeeping is still the principal purpose of the contract. The permission shall not be presumed, and its existence must be proved *(Art. 1978, Civil Code; Javellana vs. Lim, 11 Phil. 141).*

The depositary is *liable for any loss or damage that may arise if due to his fault* (see *Obejera vs. Sy, 76 Phil. 580*) which fault shall be presumed until the contrary is proved *(Palacio vs. Sudario, 7 Phil. 275).* The depositary is liable for the loss of the thing even through a fortuitous event if it is so stipulated; if he uses the thing without the depositor's permission; if he delays its return; or if he allows others to use it, even though he himself may have been authorized to use the same (see *Art. 1979, Civil Code*).

The thing deposited shall be *returned with all its products, accessories* and *accessions*. Should the deposit consist of money, the provisions relative to agents in Article 1986 *(supra.)* shall be applied to the depositary *(Art. 1983, Civil Code)*. The depositary cannot demand that the depositor prove his ownership of the thing deposited. Nevertheless, should he discover that the thing has been stolen and who its true owner is, he must advise the latter of the deposit. If the owner, in spite of such information, does not claim it within the period of one month, the depositary shall be relieved of all responsibility by returning the thing deposited to the depositor. If the depositary has reasonable grounds to believe that the thing has not been lawfully acquired by the depositor, the former may return the same *(Art. 1984, Civil Code).*

When there are two or more depositors, if they are not solidary, and the thing admits of division, each one

cannot demand more than his share. Where there is solidarity or the thing does not admit of division, the provisions of Article 1212 and Article 1214 *(supra.)* shall govern. However, if there is a stipulation that the thing should be returned to one of the depositors, the depositary shall return it only to the person designated *(Art. 1985, Civil Code)*.

If the depositor should lose his capacity to contract after having made the deposit, the thing cannot be returned except to the persons who may have the administration of his property and rights *(Art. 1986, Civil Code)*.

If at the time the deposit was made a place was designated for the return of the thing, the depositary must take the thing deposited to such place; but the expenses for transportation shall be borne by the depositor. If no place has been designated for the return, it shall be made where the thing deposited may be, even if it should not be the same place where the deposit was made, provided that there was no malice on the part of the depositary *(Art. 1987, Civil Code)*.

The thing deposited must be returned to the depositor upon demand even though a specified period or time for such return may have been fixed (see *Aboitiz vs. Oquiñena & Co., 39 Phil. 926*). This provision shall not apply when the thing is judicially attached while in the depositary's possession, or should he have been notified of the opposition of a third person to the return or the removal of the thing deposited. In these cases, the depositary must immediately inform the depositor of the attachment or opposition *(Art. 1988, Civil Code)*. Unless the deposit is for a valuable consideration, the depositary who may have justifiable reasons for not keeping the thing deposited may, even before the time designated, return it to the depositor; and if the latter should refuse to receive it, the depositary may secure its consignation from the court *(Art. 1989, Civil Code)*.

If the depositary by *force majeure* or government order loses the thing and receives money or another thing

in its place, he shall deliver the sum or other thing to the depositor *(Art. 1990, Civil Code)*.

The depositor's heir, who in good faith may have sold the thing which he did not know was deposited, shall only be bound to return the price he may have received or to assign his right of action against the buyer in case the price has not been paid him *(Art. 1991, Civil Code)*.

If the deposit is gratuitous, the depositor is obliged to reimburse the depositary for the expenses he may have incurred for the preservation of the thing deposited *(Art. 1992, Civil Code)*.

The depositor shall reimburse the depositary for any loss arising from the character of the thing deposited, unless at the time of the constitution of the deposit the former was not aware of, or was not expected to know the dangerous character of the thing, or unless he notified the depositary of the same, or the latter was aware of it without advice from the depositor *(Art. 1993, Civil Code)*.

The depositary may retain the thing in pledge until the full payment of what may be due him by reason of the deposit *(Art. 1994, Civil Code)*.

Extinguishment of a voluntary deposit

A voluntary deposit is extinguished —

(a) Upon the loss or destruction of the thing deposited;

(b) In case of a gratuitous deposit, upon the death of either the depositor or the depositary *(Art. 1995, Civil Code)*.

Chapter 3

Necessary Deposit

Art. 1996. A deposit is necessary:

(1) When it is made in compliance with a legal obligation;

(2) When it takes place on the occasion of any calamity, such as fire, storm, flood, pillage, shipwreck, or other similar events. (1781a)

Art. 1997. The deposit referred to in No. 1 of the preceding article shall be governed by the provisions of the law establishing it, and in case of its deficiency, by the rules on voluntary deposit.

The deposit mentioned in No. 2 of the preceding article shall be regulated by the provisions concerning voluntary deposit and by Article 2168. (1782)

Art. 1998. The deposit of effects made by travellers in hotels or inns shall also be regarded as necessary. The keepers of hotels or inns shall be responsible for them as depositaries, provided that notice was given to them, or to their employees, of the effects brought by the guests and that, on the part of the latter, they take the precautions which said hotel-keepers or their substitutes advised relative to the care and vigilance of their effects. (1783)

Art. 1999. The hotel-keeper is liable for the vehicles, animals and articles which have been introduced or placed in the annexes of the hotel. (n)

Art. 2000. The responsibility referred to in the two preceding articles shall include the loss of, or injury to the personal property of the guests caused by the servants or employees of the keepers of hotels or inns as well as by strangers; but not that which may proceed from any *force majeure*. The fact that travellers are constrained to rely on the vigilance of the keeper of the hotel or inn shall be considered in determining the degree of care required of him. (1784a)

Art. 2001. The act of a thief or robber, who has entered the hotel is not deemed *force majeure*, unless it is done with the use of arms or through an irresistible force. (n)

Art. 2002. The hotel-keeper is not liable for compensation if the loss is due to the acts of the guest, his family, servants or visitors, or if the loss arises from the character of the things brought into the hotel. (n)

Art. 2003. The hotel-keeper cannot free himself from responsibility by posting notices to the effect that he is not liable for the articles brought by the guest. Any stipulation between the hotel-keeper and the guest whereby the responsibility of the former as set forth in Articles 1998 to 2001 is suppressed or diminished shall be void. (n)

Art. 2004. The hotel-keeper has a right to retain the things brought into the hotel by the guest, as a security for credits on account of lodging, and supplies usually furnished to hotel guests. (n)

b. *In Necessary Deposits*

A deposit made in compliance with a legal obligation shall be governed by the provisions of the law establishing it, and in case of its deficiency, by the rules on voluntary deposit. A deposit that takes place on the occasion of a calamity shall be regulated by the provisions concerning voluntary deposit and by Article 2168 *(infra.; Art. 1997, Civil Code)*.

The keepers of hotels or inns shall be responsible as depositaries for the deposit of effects made by travellers, provided that notice was given to them, or to their employees, of the effects brought by the guests and that, on the part of the latter, they take the precautions which said hotel-keepers or their substitutes advised relative to the care and vigilance of their effects (see *Art. 1998, Civil Code*). The hotel-keeper is liable for the vehicles, animals and articles which have been introduced or placed in the annexes of the hotel *(Art. 1999, Civil Code)*. This responsibility shall include the loss of, or injury to the personal property of the guests caused by the servants or employees of the keepers of hotels or inns as well as by strangers; but not that which may proceed from any *force majeure*. The fact that travellers are constrained to rely on the vigilance of the keeper of the hotel or inn shall be considered in determining the degree of care required of him (see *Art. 2000, Civil Code*). The act of a thief or

robber who has entered the hotel is not deemed *force majeure*, unless it is done with the use of arms or through an irresistible force *(Art. 2001, Civil Code)*.

The hotel-keeper is not liable for compensation if the loss is due to the acts of the guest, his family, servants or visitors, or if the loss arises from the character of the things brought into the hotel *(Art. 2002, Civil Code)*.

The hotel-keeper cannot free himself from responsibility by posting notices to the effect that he is not liable for the articles brought by the guest. Any stipulation between the hotel-keeper and the guest whereby the responsibility of the former as set forth in Articles 1998 to 2001 is suppressed or diminished shall be void *(Art. 2002, Civil Code)*.

The hotel-keeper has a right to retain the things brought into the hotel by the guest, as a security for credits on account of lodging and supplies usually furnished to hotel guests *(Art. 2004, Civil Code)*.

Chapter 4

Sequestration or Judicial Deposit

Art. 2005. A judicial deposit or sequestration takes place when an attachment or seizure of property in litigation is ordered. (1785)

Art. 2006. Movable as well as immovable property may be the object of sequestration. (1786)

Art. 2007. The depositary of property or objects sequestrated cannot be relieved of his responsibility until the controversy which gave rise thereto has come to an end, unless the court so orders. (1787a)

Art. 2008. The depositary of property sequestrated is bound to comply, with respect to the same, with all the obligations of a good father of a family. (1788)

Art. 2009. As to matters not provided for in this Code, judicial sequestration shall be governed by the Rules of Court. (1789a)

c. *In Judicial Deposit*

The depositary of property or objects sequestrated cannot be relieved of his responsibility until the controversy which gave rise thereto has come to an end, unless the court so orders *(Art. 2007, Civil Code)*. The depositary of property sequestrated is bound to comply, with respect to the same, with all the obligations of a good father of a family *(Art. 2008, Civil Code)*.

As to matters not provided for in the Civil Code, judicial sequestration shall be governed by the Rules of Court *(Art. 2009, Civil Code)*.

TITLE XIII. ALEATORY CONTRACTS

General Provisions

Art. 2010. By an aleatory contract, one of the parties or both reciprocally bind themselves to give or to do something in consideration of what the other shall give or do upon the happening of an event which is uncertain, or which is to occur at an indeterminate time. (1790)

By an aleatory contract, one of the parties or both reciprocally bind themselves to give or to do something in consideration of what the other shall give or do upon the happening of an event which is uncertain or which is to occur at an indeterminate time *(Art. 2010, Civil Code).* Unlike conditional contracts whose binding effect or obligatory force is itself dictated by the fulfillment of a stated condition or occurrence of an uncertain event, aleatory contracts are at once effective upon their perfection although the occurrence of an uncertain event (*e.g.,* insurance and gambling) or arrival of a term (*e.g*., life annuity) may later dictate the demandability, the loss, or the extent of certain covenants therein.

An agreement by two bank depositors that either may withdraw from their deposit and that upon the death of one of them the survivor shall become sole owner of any balance remaining in said deposit has been held to be a valid aleatory contract of survivorship *(Rivera vs. People's Bank & Trust Co., 73 Phil. 546; Vitug vs. Court of Appeals, 183 SCRA 755;* see also *Macam vs. Gatmaitan, 64 Phil. 187), albeit* opposed to the general principle that, except for the applicable rules on testamentary succession and to some degree in the case of donation *propter*

nuptias, a person may not exercise a juridical act which shall take effect only upon his death, premised on the fact that death may extinguish, but not create, the effects of juridical tie.

The "purchase" of a sweepstakes ticket is also an aleatory contract *(Santiago vs. Millar, 68 Phil. 39)*.

The Code provides for three *nominate* aleatory contracts, namely: insurance, gambling and life annuity.

Chapter 1

Insurance

Art. 2011. The contract of insurance is governed by special laws. Matters not expressly provided for in such special laws shall be regulated by this Code. (n)

Art. 2012. Any person who is forbidden from receiving any donation under Article 739 cannot be named beneficiary of a life insurance policy by the person who cannot make any donation to him, according to said article. (n)

Insurance

The contract of insurance is governed by special laws. Matters not expressly provided for in such special laws shall be regulated by the Code *(Art. 2011, Civil Code; Grecio vs. Sun Life Assurance, 48 Phil. 53)*. For instance, the rules under the Civil Code on agency, in the case of insurance agents, apply suppletorily. Thus, the insurer can be bound by the conduct or misconduct of its agents that should not, in any case, prejudice an insured acting in good faith (see *Insular Life Assn. Co. vs. Feliciano, 40 O.G. 2842*). The Insurance Code, to the extent that it is pertinent, can apply to contracts of insurance even if the insurer is not engaged in that business, since Article 2011 of the Civil Code does not distinguish between an insurance undertaken as a business or as an isolated transaction.

Any person who is forbidden from receiving any donation under Article 739 cannot be named beneficiary of a life insurance policy by the person who cannot make any donation to him, according to said article *(Art. 2012, Civil Code)*. Unless disqualified, anyone may in good faith be designated a beneficiary. Article 739, in relation to Article 2012, of the Civil Code states the following disqualifications:

(1) Those made between persons who were guilty of adultery or concubinage at the time of the donation;

(2) Those made between persons found guilty of the same criminal offense, in consideration thereof;

(3) Those made to a public officer or his wife, descendants and ascendants, by reason of his office.

In the case referred to in No. 1, the action for declaration of nullity may be brought by the spouse of the donor or donee; and the guilt of the donor and donee may be proved by preponderance of evidence in the same action.

A common-law wife of a married man, if the former is aware of the latter's married status, cannot be the beneficiary of his life insurance, being disqualified under Article 739 in relation to Article 2012 of Civil Code *(Insular Life Assurance vs. Ebrado, 80 SCRA 181)*. But where the insured is single, he can validly designate his common-law wife, who herself is unmarried, as such beneficiary.

The *designation* of a disqualified beneficiary is void but the insurance itself, which is otherwise valid, is not avoided, and the estate of the insured may recover.

Chapter 2

Gambling

Art. 2013. A game of chance is that which depends more on chance or hazard than on skill or ability. For the purposes of the following articles, in case of doubt a game is deemed to be one of chance. (n)

Art. 2014. No action can be maintained by the winner for the collection of what he has won in a game of chance. But any loser in a game of chance may recover his loss from the winner, with legal interest from the time he paid the amount lost, and subsidiarily from the operator or manager of the gambling house. (1799a)

Art. 2015. If cheating or deceit is committed by the winner, he, and subsidiarily the operator or manager of the gambling house, shall pay by way of exemplary damages, not less than the equivalent of the sum lost, in addition to the latter amount. If both the winner and the loser have perpetrated fraud, no action for recovery can be brought by either. (n)

Art. 2016. If the loser refuses or neglects to bring an action to recover what has been lost, his or her creditors, spouse, descendants or other persons entitled to be supported by the loser may institute the action. The sum thereby obtained shall be applied to the creditors' claims, or to the support of the spouse or relatives, as the case may be. (n)

Art. 2017. The provisions of Articles 2014 and 2016 apply when two or more persons bet in a game of chance, although they take no active part in the game itself. (1799a)

Art. 2018. If a contract which purports to be for the delivery of goods, securities or shares of stock is entered into with the intention that the difference between the price stipulated and the exchange or market price at the time of the pretended delivery shall be paid by the loser to the winner, the transaction is null and void. The loser may recover what he has paid. (n)

Art. 2019. Betting on the result of sports, athletic competitions, or games of skill may be prohibited by local ordinances. (n)

Art. 2020. The loser in any game which is not one of chance, when there is no local ordinance which prohibits betting therein, is under obligation to pay his loss, unless the amount thereof is excessive under the circumstances. In the latter case, the court shall reduce the loss to the proper sum. (1801a)

Gambling

A game of chance is that which depends more on chance or hazard than on skill or ability (see *Art. 2013, Civil Code; Cf. Caltex Philippines, Inc. vs. Palomar, 18 SCRA 247*).

No action can be maintained by the winner for the collection of what he has won in a game of chance. But any loser in a game of chance may recover (within three years *[Act No. 1757]*) his loss from the winner, with legal interest from the time he paid the amount lost, and subsidiarily from the operator or manager of the gambling house *(Art. 2014, Civil Code;* see *Ban vs. Intermediate Appellate Court, 145 SCRA 133; Leung Ben vs. O'Brien, 38 Phil. 182).* If cheating or deceit is committed by the winner, he, and subsidiarily the operator or manager of the gambling house, shall pay by way of exemplary damages, not less than the equivalent of the sum lost, in addition to the latter amount. If both the winner and the loser have perpetrated fraud, no action for recovery can be brought by either *(Art. 2015, Civil Code)*. For the above purposes, in case of doubt a game is deemed to be one of chance (see *Art. 2013, Civil Code*).

If the loser refuses or neglects to bring an action to recover what has been lost, his or her creditors, spouse, descendants or other persons entitled to be supported by the loser may institute the action. The sum thereby obtained shall be applied to the creditors' claims, or to the support of the spouse or relatives, as the case may be *(Art. 2016, Civil Code)*. This provision, as well as Article 2014 *(supra.),* apply when two or more persons bet in a game of chance, although they take no active part in the game itself *(Art. 2017, Civil Code)*.

If a contract which purports to be for the delivery of goods, securities or shares of stock is entered into with the intention that the difference between the price stipulated and the exchange or market price at the time of the pretended delivery shall be paid by the loser to the win-

ner, the transaction is null and void. The loser may recover what he has paid *(Art. 2018, Civil Code)*.

Betting on the result of sports, athletic competitions, or games of skill may be prohibited by local ordinance *(Art. 2019, Civil Code)*. The loser in any game which is not one of chance, when there is no local ordinance which prohibits betting therein, is under obligation to pay his loss, unless the amount thereof is excessive under the circumstances. In the latter case, the court shall reduce the loss to the proper sum *(Art. 2020, Civil Code)*.

The above provisions are subject to whatever may be provided for by special laws.

Chapter 3

Life Annuity

Art. 2021. The aleatory contract of life annuity binds the debtor to pay an annual pension or income during the life of one or more determinate persons in consideration of a capital consisting of money or other property, whose ownership is transferred to him at once with the burden of the income. (1802a)

Art. 2022. The annuity may be constituted upon the life of the person who gives the capital, upon that of a third person, or upon the lives of various persons, all of whom must be living at the time the annuity is established.

It may also be constituted in favor of the person or persons upon whose life or lives the contract is entered into, or in favor of another or other persons. (1803a)

Art. 2023. Life annuity shall be void if constituted upon the life of a person who was already dead at the time the contract was entered into, or who was at that time suffering from an illness which caused his death within twenty days following said date. (1804)

Art. 2024. The lack of payment of the income due does not authorize the recipient of the life annuity to

demand the reimbursement of the capital or to retake possession of the property alienated, unless there is a stipulation to the contrary; he shall have only a right judicially to claim the payment of the income in arrears and to require a security for the future income, unless there is a stipulation to the contrary. (1805a)

Art. 2025. The income corresponding to the year in which the person enjoying it dies shall be paid in proportion to the days during which he lived; if the income should be paid by installments in advance, the whole amount of the installment which began to run during his life shall be paid. (1806)

Art. 2026. He who constitutes an annuity by gratuitous title upon his property, may provide at the time the annuity is established that the same shall not be subject to execution or attachment on account of the obligations of the recipient of the annuity. If the annuity was constituted in fraud of creditors, the latter may ask for the execution or attachment of the property. (1807a)

Art. 2027. No annuity shall be claimed without first proving the existence of the person upon whose life the annuity is constituted. (1808)

Life Annuity

The aleatory contract of life annuity binds the debtor to pay an annual pension or income during the life of one or more determinate persons in consideration of a capital consisting of money or other property, whose ownership is transferred to him at once with the burden of the income *(Art. 2021, Civil Code)*.

The annuity may be constituted upon the life of the person who gives the capital, upon that of a third person, or upon the lives of various persons, all of whom must be living at the time the annuity is established. It may also be constituted in favor of the person or persons upon whose life or lives the contract is entered into, or in favor of another or other persons *(Art. 2022, Civil Code)*.

Life annuity shall be void if constituted upon the life of a person who was already dead at the time the contract was entered into, or who was at that time suffering from an illness which caused his death within twenty days following said date *(Art. 2023, Civil Code)*. No annuity shall be claimed without first proving the existence of the person upon whose life the annuity is constituted *(Art. 2027, Civil Code)*.

The lack of payment of the income due does not authorize the recipient of the life annuity to demand the reimbursement of the capital or to retake possession of the property alienated, unless there is a stipulation to the contrary; he shall have only a right judicially to claim the payment of the income in arrears and to require a security for the future income, unless there is a stipulation to the contrary *(Art. 2024, Civil Code)*.

The income corresponding to the year in which the person enjoying it dies shall be paid in proportion to the days during which he lived; if the income should be paid by installments in advance, the whole amount of the installment which began to run during his life shall be paid *(Art. 2025, Civil Code)*.

He who constitutes an annuity by gratuitous title upon his property may provide at the time the annuity is established that the same shall not be subject to execution or attachment on account of the obligations of the recipient of the annuity. If the annuity was constituted in fraud of creditors, the latter may ask for the execution or attachment of the property *(Art. 2026, Civil Code)*.

TITLE XIV. COMPROMISES AND ARBITRATIONS

Chapter 1

Compromises

Art. 2028. A compromise is a contract whereby the parties, by making reciprocal concessions, avoid a litigation or put an end to one already commenced. (1809a)

Art. 2029. The court shall endeavor to persuade the litigants in a civil case to agree upon some fair compromise. (n)

Art. 2030. Every civil action or proceeding shall be suspended:

(1) If willingness to discuss a possible compromises is expressed by one or both parties; or

(2) If it appears that one of the parties, before the commencement of the action or proceeding, offered to discuss a possible compromise but the other party refused the offer.

The duration and terms of the suspension of the civil action or proceeding and similar matters shall be governed by such provisions of the rules of court as the Supreme Court shall promulgate. Said rules of court shall likewise provide for the appointment and duties of amicable compounders. (n)

Art. 2031. The courts may mitigate the damages to be paid by the losing party who has shown a sincere desire for a compromise. (n)

Art. 2032. The court's approval is necessary in compromises entered into by guardians, parents,

absentee's representatives, and administrators or executors of decedent's estates. (1810a)

Art. 2033. Juridical persons may compromise only in the form and with the requisites which may be necessary to alienate their property. (1812a)

Art. 2034. There may be a compromise upon the civil liability arising from an offense; but such compromise shall not extinguish the public action for the imposition of the legal penalty. (1813)

Art. 2035. No compromise upon the following questions shall be valid:

(1) The civil status of persons;

(2) The validity of a marriage or a legal separation;

(3) Any ground for legal separation;

(4) Future support;

(5) The jurisdiction of courts;

(6) Future legitime. (1841a)

Art. 2036. A compromise comprises only those objects which are definitely stated therein, or which by necessary implication from its terms should be deemed to have been included in the same.

A general renunciation of rights is understood to refer only to those that are connected with the dispute which was the subject of the compromise. (1815)

Art. 2037. A compromise has upon the parties the effect and authority of *res judicata*; but there shall be no execution except in compliance with a juridical compromise. (1816)

Art. 2038. A compromise in which there is mistake, fraud, violence, intimidation, undue influence, or falsity of documents, is subject to the provisions of Article 1330 of this Code.

However, one of the parties cannot set up a mistake of fact as against the other if the latter, by virtue of the compromise, has withdrawn from a litigation already commenced. (1817a)

Art. 2039. When the parties compromise generally on all differences which they might have with each other, the discovery of documents referring to one or more but not to all of the questions settled shall not itself be a cause for annulment or rescission of the compromise, unless said documents have been concealed by one of the parties.

But the compromise may be annulled or rescinded if it refers only to one thing to which one of the parties has no right, as shown by the newly-discovered documents. (n)

Art. 2040. If after a litigation has been decided by a final judgment, a compromise should be agreed upon, either or both parties being unaware of the existence of the final judgment, the compromise may be rescinded.

Ignorance of a judgment which may be revoked or set aside is not a valid ground for attacking a compromise. (1819a)

Art. 2041. If one of the parties fails or refuses to abide by the compromise, the other party may either enforce the compromise or regard it as rescinded and insist upon his original demand. (n)

1. Compromises

A compromise is a contract whereby the parties avoid a litigation or put an end to one already commenced by making *reciprocal concessions (Art. 2028, Civil Code; Barreras vs. Garcia, 169 SCRA 401; Rovero vs. Amparo, 91 Phil. 228)*. A compromise may thus be *judicial* in order to terminate a suit already instituted or *extra-judicial* so as to avoid the provocation thereof *(Yboleon vs. Sison, 59 Phil. 290)*.

It is then an agreement between two or more persons who, for preventing or putting an end to a lawsuit, adjust their respective positions by mutual consent in the way they feel they can live with. Reciprocal concessions are the very heart and life of every compromise

agreement, where each party approximates and concedes in the hope of gaining balance by the danger of losing. It is, in essence, a contract. Law and jurisprudence recite three minimum elements for any valid contract — (a) consent; (b) object certain which is the subject matter of the contract; and (c) cause of the obligation which is established. Consent is manifested by the meeting of the offer and the acceptance upon the thing and the cause which are to constitute the agreement. The offer, however, must be certain and the acceptance seasonable and absolute; if qualified, the acceptance would merely constitute a counter-offer.

Like any other contract, an extrajudicial compromise agreement is not excepted from the rules and principles of a contract. It is a consensual contract, perfected by mere consent. It may be perfectly valid or defective if it suffers from any impediment that, depending on the nature of its flaw, could render it void, unenforceable, voidable or rescissible.

A compromise agreement that is basically intended to resolve a matter already under litigation is what would normally be termed a judicial compromise. Once stamped with judicial *imprimatur,* it becomes more than a mere contract binding upon the parties, having the sanction of the court and entered as its determination of the controversy, it has the force and effect of any other judgment. A judicial compromise is circumscribed by the rules of procedure *(Armed Forces of the Philippines Mutual Benefit Association, Inc. vs. Court of Appeals and EBR Realty, Inc., G.R. No. 126745, 26 July 1999, 311 SCRA 143).*

The court shall endeavor to persuade the litigants in a civil case to agree upon some fair compromise *(Art. 2029, Civil Code)*. The law not merely authorizes, but even encourages, the settlement of cases in court (see *Art. 2029*), and it does not limit such compromises to cases about to be filed or cases already pending in courts *(Jesalva vs. Hon. Bautista, 105 Phil. 348).* But the courts

cannot impose on the parties a judgment different from their compromise agreement or from the terms and conditions thereof *(Philippine Bank of Communications vs. Echiverri, 99 SCRA 508)*. The courts may mitigate the damages to be paid by the losing party who has shown a sincere desire for a compromise *(Art. 2031, Civil Code)*.

Every civil action or proceeding shall be suspended: (1) if willingness to discuss a possible compromise is expressed by one or both parties; or (2) if it appears that one of the parties, before the commencement of the action or proceeding, offered to discuss a possible compromise but the other party refused the offer. The duration and terms of the suspension of the civil action or proceeding and similar matters shall be governed by such provisions of the rules of court as the Supreme Court shall promulgate. Said rules of court shall likewise provide for the appointment and duties of amicable compounders *(Art. 2030, Civil Code; Philippine National Bank vs. De la Cruz, 103 Phil. 341)*.

Authorities and Approvals

A lawyer needs a power of attorney to compromise his client's cause *(Monte de Piedad vs. Rodrigo, 56 Phil. 310),* the lack of which renders the agreement unenforceable (see *Bumanlag vs. Alzate, 144 SCRA 480; Art. 1403, Civil Code*). The compromise may, however, be ratified expressly or impliedly by the principal such as by his failure to repudiate it promptly (see *Dungo vs. Lopez, 6 SCRA 1007*). No special authority would be necessary where the compromise entered into would be in full satisfaction of the client's cause such as may have been prayed for in the complaint or answer and counterclaim, as the case may be.

The court's approval is necessary in compromises entered into by guardians, parents, absentee's representatives, and administrators or executors of decedents' estates *(Art. 2032, Civil Code)*.

Juridical persons may compromise only in the form and with the requisites which may be necessary to alienate their property *(Art. 2033, Civil Code; Vicente vs. Geraldez, 52 SCRA 210; Herman vs. Radio Corp., 50 Phil. 490; Ferrer vs. Ignacio, 30 Phil. 446).*

Objects of Compromise

A compromise comprises only those objects which are definitely stated therein, or which by necessary implication from its terms should be deemed to have been included in the same. A general renunciation of rights is understood to refer only to those that are connected with the dispute subject-matter of the compromise *(Art. 2036, Civil Code;* see *Tiongson vs. Court of Appeals, 49 SCRA 429).*

A final judgment may still be compromised so long as it is not fully satisfied *(Gatchalian vs. Arlegui, 75 SCRA 234;* see also *Art. 2040, Civil Code, infra.)*, and the compromise shall have the effect of novation of the judgment obligation (see *Dormitorio vs. Fernandez, 72 SCRA 38*).

There may be a compromise upon the civil liability arising from an offense; but such compromise shall not extinguish the public action for the imposition of the legal penalty *(Art. 2034, Civil Code)*. But no compromise upon the following questions shall be valid:

(1) The civil status of persons;

(2) The validity of a marriage or a legal separation;

(3) Any ground for legal separation;

(4) Future support;

(5) The jurisdiction of courts;

(6) Future legitime *(Art. 2035, Civil Code).*

A compromise on the foregoing matters is void *(Castelvi vs. Castelvi, 77 SCRA 88;* see also *Mendoza vs. Court of Appeals, 19 SCRA 756).* A compromise, being in

the nature of an agreement, must not be contrary to law, morals, good customs, public order and public policy. A compromise awarding to one party inalienable public property is void (see *Maneclang vs. Intermediate Appellate Court, 144 SCRA 553*). A collective bargaining against which includes the withdrawal of the union's complaint with respect to the employees' claim for increased emergency cost of living under P.D. 1614 is not contrary to law *(Monte de Piedad vs. Minister of Labor, 137 SCRA 474)*. Unfair labor practice cases, however, in view of public interest involved, are not subject to compromise *(CLLC E.G. Gochangco Workers Union vs. NLRC, 161 SCRA 656)*.

Effects of Compromise

A compromise is binding upon the parties and has the effect and authority of *res judicata*; but there shall be no execution except in compliance with a judicial compromise (see *Art. 2037, Civil Code; Berg vs. National City Bank of New York, 102 Phil. 309; McCarthy vs. Barber SS Lines, 45 Phil. 468*). A judicial compromise, approved by the court, is not appealable and is immediately executory; it also has all the effects of a judgment of the court *(Lacson vs. Delgado, 111 Phil. 952;* see also *Campos vs. Phodaca-Ambrosio, 32 SCRA 279)* and may be enforced by a writ of execution *(Osmeña vs. CAR, 17 SCRA 282),* provided the court has jurisdiction over the case *(Damasco vs. Montemayor, 87 Phil. 766)*. The judgment may be set aside, however, by motion on the ground of fraud, mistake or duress, in which case an appeal may be taken from an order denying the same *(Mobil Oil vs. CFI, 208 SCRA 523; De Guzman vs. Court of Appeals, 137 SCRA 730)*.

Persons who are not formal parties to a case but who voluntarily bind themselves to a compromise become quasi-parties upon whom execution may issue in the event of their failure of compliance *(Rodriguez vs. Alikpala, 57 SCRA 455)*.

If one of the parties fails or refuses to abide by the compromise, the other party may either enforce the compromise or regard it as rescinded and insist upon his original demand *(Art. 2041, Civil Code)*. Under this provision, one of the parties has two options: (1) to enforce the compromise; or (2) to rescind the same and insist upon his original demand. Said party cannot avail himself of these two options, but he must choose one *(Pasay City Government vs. CFI of Manila, 132 SCRA 156)*. In a judicial compromise, if the party opts to enforce it, instead of rescinding it, he may ask for a writ of execution *(Mabale vs. Apalisok, 88 SCRA 234)*. Rescission does not require a court action (see *Leonor vs. Sycip, 111 Phil. 859*) but it cannot be invoked by a party who theretofore has enjoyed the benefits of the compromise *(Sanchez vs. Court of Appeals, 87 SCAD 463, 279 SCRA 647)*.

Annulment or Rescission of Compromise

A compromise in which there is mistake, fraud, violence, intimidation, undue influence, or falsity of documents is subject to the provisions of Article 1330 *(supra.)* of the Code; however, one of the parties cannot set up a mistake of fact as against the other if the latter, by virtue of the compromise, has withdrawn from a litigation already commenced *(Art. 2038, Civil Code;* see *De los Reyes vs. Ugarte, 75 Phil. 505)*. But the compromise may be annulled or rescinded if it refers only to one thing to which one of the parties has no right, as shown by the newly discovered documents *(Art. 2039, Civil Code)*. If after a litigation has been decided by a *final* judgment, a compromise should be agreed upon, either or both parties being unaware of the existence of the final judgment, the compromise may be rescinded. Ignorance of a judgment which may be revoked or set aside is not a valid ground for attacking a compromise *(Art. 2040, Civil Code; Medina vs. Cabahug, 73 Phil. 498)*.

A compromise may also be rescinded on grounds of justice, equity and due process (see *Heirs of Cruz vs.*

Court of Industrial Relations, 30 SCRA 918). Neither can a compromise settlement work to confirm or ratify a void contract (see *Lao vs. Genato, 137 SCRA 77*).

Chapter 2

Arbitrations

Art. 2042. The same persons who may enter into a compromise may submit their controversies to one or more arbitrators for decision. (1820a)

Art. 2043. The provisions of the preceding Chapter upon compromises shall also be applicable to arbitrations. (1821a)

Art. 2044. Any stipulation that the arbitrators' award or decision shall be final, is valid, without prejudice to Articles 2038, 2039, and 2040. (n)

Art. 2045. Any clause giving one of the parties power to choose more arbitrators than the other is void and of no effect. (n)

Art. 2046. The appointment of arbitrators and the procedure for arbitration shall be governed by the provisions of such rules of courts as the Supreme Court shall promulgate. (n)

2. Arbitrations

The same persons who may enter into a compromise may submit their controversies to one or more arbitrators for decision *(Art. 2042, Civil Code)*. The provisions of the Code on compromises shall also be applicable to arbitrations *(Art. 2043, Civil Code)*. Where the parties have agreed to submit their controversies to arbitration instead of, or as a condition precedent to, the institution of a court suit, such agreement is binding and must be respected *(Vega vs. San Carlos Milling Co., 51 Phil. 908; Mindanao Portland Cement vs. McDonough Construction Co., 19 SCRA 808;* see also *Bayview Hotel vs. Ker & Co., 116 SCRA 327)*.

Any stipulation that the arbitrators' award or decision shall be final is valid, without prejudice to Articles 2038, 2039, and 2040 *(Art. 2044, Civil Code),* accordingly overturning the case of *Manila Electric Co. vs. Pasay Transportation Co. (57 Phil. 600).* In *Philippine Long Distance Telephone vs. Voluntary Arbitrator Montemayor (190 SCRA 427),* it has been ruled that while decisions of voluntary arbitrators are accorded a measure of finality, such decisions, however, are not beyond the authority of the Supreme Court's power of review particularly as they involve an interpretation of law or when the arbitrator has committed a grave abuse of discretion. By the nature of their functions, arbitrators act in a quasi-judicial capacity and, therefore, their decisions cannot be beyond judicial review *(Chong vs. Court of Appeals, 206 SCRA 545).*

Any clause giving one of the parties power to choose more arbitrators than the other is void and of no effect *(Art. 2045, Civil Code).*

The appointment of arbitrators and the procedure for arbitration shall be governed by the provisions of such rules of court as the Supreme Court shall promulgate *(Art. 2046, Civil Code).* In force and effect is Republic Act 876, now commonly known as the Arbitration Law.

TITLE XV. GUARANTY

Chapter 1

Nature and Extent of Guaranty

Art. 2047. By guaranty a person, called the guarantor, binds himself to the creditor to fulfill the obligation of the principal debtor in case the latter should fail to do so.

If a person binds himself solidarily with the principal debtor, the provisions of Section 4, Chapter 3, Title I of this Book shall be observed. In such case the contract is called a suretyship. (1822a)

Art. 2048. A guaranty is gratuitous, unless there is a stipulation to the contrary. (n)

Art. 2049. A married woman may guarantee an obligation without the husband's consent, but shall not thereby bind the conjugal partnership, except in cases provided by law. (n)

Art. 2050. If a guaranty is entered into without the knowledge or consent, or against the will of the principal debtor, the provisions of Articles 1236 and 1237 shall apply. (n)

Art. 2051. A guaranty may be conventional, legal or judicial, gratuitous, or by onerous title.

It may also be constituted, not only in favor of the principal debtor, but also in favor of the other guarantor, with the latter's consent, or without his knowledge, or even over his objection. (1823)

Art. 2052. A guaranty cannot exist without a valid obligation.

Nevertheless, a guaranty may be constituted to guarantee the performance of a voidable or an unenforceable contract. It may also guarantee a natural obligation. (1824a)

Art. 2053. A guaranty may also be given as security for future debts, the amount of which is not yet known; there can be no claim against the guarantor until the debt is liquidated. A conditional obligation may also be secured. (1825a)

Art. 2054. A guarantor may bind himself for less, but not for more than the principal debtor, both as regards the amount and the onerous nature of the conditions.

Should he have bound himself for more, his obligations shall be reduced to the limits of that of the debtor. (1826)

Art. 2055. A guaranty is not presumed; it must be express and cannot extend to more than what is stipulated therein.

If it be simple or indefinite, it shall compromise not only the principal obligation, but also all its accessories, including the judicial costs, provided with respect to the latter, that the guarantor shall only be liable for those costs incurred after he has been judicially required to pay. (1827a)

Art. 2056. One who is obliged to furnish a guarantor shall present a person who possesses integrity, capacity to bind himself, and sufficient property to answer for the obligation which he guarantees. The guarantor shall be subject to the jurisdiction of the court of the place where this obligation is to be complied with. (1828a)

Art. 2057. If the guarantor should be convicted in first instance of a crime involving dishonesty or should become insolvent, the creditor may demand another who has all the qualifications required in the preceding article. The case is expected where the creditor has required and stipulated that a specified person should be the guarantor. (1829a)

Contracts of Security

Contracts of security may be personal or real. In contracts of personal security, like a guaranty or a suretyship, the faithful performance of the obligation by the principal debtor is secured by the *personal* commitment of another (the guarantor or surety). In contracts of real security, such as a pledge, a mortgage or an antichresis, that fulfillment is secured by an *encumbrance of property* — in *pledge,* the placing of movable property in the possession of the creditor; in *chattel* mortgage, by the execution of the corresponding deed substantially in the form prescribed by law; in *real estate mortgage*, by the execution of a public instrument encumbering the real property covered thereby; and in *antichresis,* by a written instrument granting to the creditor the right to receive the fruits of an immovable property with the obligation to apply such fruits to the payment of interest, if owing, and thereafter to the principal of his credit — upon the condition that if the principal obligation becomes due and the debtor defaults, then the property encumbered can be alienated for the payment of the obligation, but that should the obligation be duly paid, then the contract is automatically extinguished proceeding from the accessory character of the agreement. Once the obligation is complied with, then the contract of security, whether personal or real, becomes, *ipso facto,* null and void.

1. Concept

By guaranty a person, called the guarantor, binds himself to the creditor to fulfill the obligation of the principal debtor in case the latter should fail to do so. If a person binds himself solidarily with the principal debtor, the contract is called a suretyship, and the provisions of the Code on solidary obligations such as may be applicable shall be observed *(Art. 2047, Civil Code;* see *Government of the Philippines vs. Tizon, 20 SCRA 1182).*

A guaranty is an *accessory* contract that cannot exist without the principal; it creates a *subsidiary* liability

that renders the guarantor obligated only when the principal obligor cannot do so; and it is unilateral "because from it only obligations are derived on the part of the guarantor in relation to the creditor, although its fulfillment or consummation gives rise to obligations of the guaranteed with respect to the guarantor, and also because it can take place without the intervention of the debtor, and even of the creditor, in whose favor it is constituted" (see *Visayan Surety and Insurance Corp. vs. Laperal, 69 Phil. 688*). A surety is distinguished from a guaranty in that a guarantor is the insurer of the *solvency* of debtor and thus binds himself to pay if the principal is *unable to pay*; a surety, however, is the insurer of the debt, and he obligates himself to pay if the principal *does not pay* (see *Machetti vs. Hospicio de San Jose, 42 Phil. 297*). A surety, while bound solidarily with the obligor, does not make him a solidary co-debtor. Neither a guarantor nor a surety is liable unless the debtor is himself liable *(Pacific Bank vs. Intermediate Appellate Court, 203 SCRA 496)*. In sum and substance, the surety merely loses the benefit of excussion. A suretyship agreement itself is valid and binding even before the principal obligation intended to be secured thereby is born. But a surety is not yet bound under any particular principal obligation until and unless that principal obligation actually arises *(South City Homes, Inc. vs. BA Finance Corp., G.R. No. 135462, 07 December 2001)*. A contract of surety is an accessory promise by which a person binds himself for another already bound. Said the Court of Appeals in *Stevenson & Co. Ltd. vs. Climaco (36 O.G. 1571,* cited in *Padilla, Civil Code Annotated, 1975 Ed., Vol. VII, p. 10)*:

> "Art. 1822 of the Civil Code in part provides: 'If the guarantor binds himself *in solidum* with the principal debtor, the provisions of section IV, Chapter III, Title I of this book shall be applicable.' But this does not import that a *fiador in solidum* loses entirely his character as *fiador*, and becomes a solidary co-debtor to all interests and purposes. Manresa, commenting on this Article, says that there is a differ-

ence between a solidary co-debtor and a *fiador in solidum* (surety), and that the latter, outside of the liability he assumes to pay the debt before the property of the principal debtor has been exhausted, retains all the other rights, actions, and benefits which pertain to him by reason of the *fianza*; while the principal debtor has no other rights than those bestowed upon him in Section IV, Chapter III, Title I, Book IV of the Code.

"As a matter of plain fact, the Spanish Supreme Court, in a decision of 6 October 1908, released two *fiadores in solidum* by reason of an extension of payment granted to the debtor without their consent.

"And in the case of *Villa vs. Garcia Bosque, 49 Phil. 126, 134*, our Supreme Court announced:

"x x x The execution of these new promissory notes undoubtedly constituted an extension of time as to the obligation included therein, such as would release a surety, even though of the solidary type, under Article 1851 of the Civil Code."

A guaranty may be *conventional* (by agreement), *legal* (by law), or *judicial* (by court order). It may also be constituted, not only in favor of the principal debtor, but also in favor of the other guarantor *(counter-guaranty),* with the latter's consent, or without his knowledge, or even over his objection *(Art. 2051, Civil Code)*. A guaranty may be *simple* or *indefinite*, in which case it shall comprise not only the principal obligation, but also all its accessories, including the judicial costs, provided with respect to the latter, that the guarantor shall only be liable for those costs incurred after he has been judicially required to pay *(Art. 2055, Civil Code)* or *limited* to that described by the guaranty.

A contract of surety cannot extend to more than what is stipulated. It is strictly construed against the creditor, every doubt being resolved against enlarging the liability of the surety *(Security Bank & Trust Co. vs. Rodolfo Cuenca, 135 SCAD 98, 341 SCRA 781).*

2. Elements

a. *Consent*

A guaranty is not presumed; it must be express and cannot extend to more than what is stipulated therein *(Art. 2055, Civil Code; National Marketing Corporation vs. Marquez, 26 SCRA 722)*. The contract is consensual as to perfection but, unless it is in writing, the guaranty is unenforceable under the Statute of Frauds *(Art. 1403, Civil Code; Macondray & Co. vs. Piñon, 2 SCRA 1109)*. Any person who has capacity to act may be a guarantor but one who is obliged to furnish a guarantor shall present a person who possesses integrity, capacity to bind himself, and sufficient property to answer for the obligation which he guarantees. The guarantor shall be subject to the jurisdiction of the court of the place where this obligation is to be complied with *(Art. 2056, Civil Code)*. If the guarantor should be convicted in the first instance of a crime involving dishonesty or should become insolvent, the creditor may demand another who has all the above qualifications, unless the creditor has required and stipulated that a specified person should be the guarantor (see *Art. 2057, Civil Code*).

A married woman may guarantee an obligation without the husband's consent, but shall not thereby bind the conjugal partnership, except in cases provided by law *(Art. 2049, Civil Code)*.

A guaranty may be entered into without the knowledge or consent, or against the will of the principal debtor; in such a case, the provisions of Articles 1236 and 1237 shall apply (see *Art. 2050, Civil Code;* see also *De Guzman vs. Santos, 68 Phil. 371*).

b. *Object*

The guaranty, being an accessory contract, cannot exist without a valid obligation. Nonetheless, a guaranty may be constituted to guarantee the performance of a

voidable or an unenforceable contract. It may also guarantee a natural obligation *(Art. 2052, Civil Code)*.

A guaranty may also be given as security for future debts, the amount of which is not yet known; there can be no claim against the guarantor until the debt is liquidated. A conditional obligation may also be secured (*Art. 2053, Civil Code;* see *Smith, Bell & Co. vs. National Bank, 42 Phil. 733;* see also *Art. 2091, Civil Code*, on contracts of real security).

A guarantor may bind himself for less, but not for more, than the principal debtor, both as regards the amount and the onerous nature of the conditions. Should he have bound himself for more, his obligations shall be reduced to the limits of that of the debtor *(Art. 2054, Civil Code; Standard Oil vs. Cho Song, 52 Phil. 612)*.

As a rule, the guarantor may not be held liable to a degree more than what the principal obligor may be accountable for prescinding from the accessory nature of the guaranty (see *Hospicio de San Jose vs. Fidelity & Surety Co., 52 Phil. 926; Bantoto vs. Bobis, 18 SCRA 690*). Accordingly, where the principal obligation is unenforceable so also must the accessory undertaking be so considered, absent the application, in appropriate cases, of other legal or equitable doctrines such as ratification, waiver or estoppel.

c. *Cause*

A guaranty may be gratuitous or by onerous title *(Art. 2051, Civil Code),* but unless there is a stipulation to the contrary, it is gratuitous *(Art. 2048, Civil Code)*. An accommodation surety (purely gratuitous) is entitled to have the contract interpreted *in strictissimi juris* in his favor as a means of guarding against a greater impoverishment, but this rule does not apply to compensated sureties where that *rationale* no longer holds (see *National Marketing Corp. vs. Marquez, 26 SCRA 722*).

Chapter 2

Effects of Guaranty

Section 1 — Effects of Guaranty Between the Guarantor and the Creditor

Art. 2058. The guarantor cannot be compelled to pay the creditor unless the latter has exhausted all the property of the debtor, and has resorted to all the legal remedies against the debtor. (1830a)

Art. 2059. This excussion shall not take place:

(1) If the guarantor has expressly renounced it;

(2) If he has bound himself solidarily with the debtor;

(3) In case of insolvency of the debtor;

(4) When he has absconded, or cannot be sued within the Philippines unless he has left a manager or representative;

(5) If it may be presumed that an execution on the property of the principal debtor would not result in the satisfaction of the obligation. (1831a)

Art. 2060. In order that the guarantor may make use of the benefit of excussion, he must set it up against the creditor upon the latter's demand for payment from him, and point out to the creditor available property of the debtor within Philippine territory, sufficient to cover the amount of the debt. (1832)

Art. 2061. The guarantor having fulfilled all the conditions required in the preceding article, the creditor who is negligent in exhausting the property pointed out shall suffer the loss, to the extent of said property, for the insolvency of the debtor resulting from such negligence. (1833a)

Art. 2062. In every action by the creditor, which must be against the principal debtor alone, except in the cases mentioned in Article 2059, the former shall ask the court to notify the guarantor of the action. The guarantor may appear so that he may, if he so desire,

set up such defenses as are granted him by law. The benefit of excussion mentioned in Article 2058 shall always be unimpaired, even if judgment should be rendered against the principal debtor and the guarantor in case of appearance by the latter. (1834a)

Art. 2063. A compromise between the creditor and the principal debtor benefits the guarantor but does not prejudice him. That which is entered into between the guarantor and the creditor benefits but does not prejudice the principal debtor. (1835a)

Art. 2064. The guarantor of a guarantor shall enjoy the benefit of excussion, both with respect to the guarantor and to the principal debtor. (1836)

Art. 2065. Should there be several guarantors of only one debtor and for the same debt, the obligation to answer for the same is divided among all. The creditor cannot claim from the guarantors except the shares which they are respectively bound to pay, unless solidarity has been expressly stipulated.

The benefit of division against the co-guarantors ceases in the same cases and for the same reasons as the benefit of excussion against the principal debtor. (1837)

Section 2 — Effects of Guaranty Between the Debtor and the Guarantor

Art. 2066. The guarantor who pays for a debtor must be indemnified by the latter.

The indemnity comprises:

(1) The total amount of the debt;

(2) The legal interests thereon from the time the payment was made known to the debtor, even though it did not earn interest for the creditor;

(3) The expenses incurred by the guarantor after having notified the debtor that payment had been demanded of him;

(4) Damages, if they are due. (1838a)

Art. 2067. The guarantor who pays is subrogated by virtue thereof to all the rights which the creditor had against the debtor.

If the guarantor has compromised with the creditor, he cannot demand of the debtor more than what he has really paid. (1839)

Art. 2068. If the guarantor should pay without notifying the debtor, the latter may enforce against him all the defenses which he could have set up against the creditor at the time the payment was made. (1840)

Art. 2069. If the debt was for a period and the guarantor paid it before it became due, he cannot demand reimbursement of the debtor until the expiration of the period unless the payment has been ratified by the debtor. (1841a)

Art. 2070. If the guarantor has paid without notifying the debtor, and the latter not being aware of the payment, repeats the payment, the former has no remedy whatever against the debtor, but only against the creditor. Nevertheless, in case of a gratuitous guaranty, if the guarantor was prevented by a fortuitous event from advising the debtor of the payment, and the creditor becomes insolvent, the debtor shall reimburse the guarantor for the amount paid. (1842a)

Art. 2071. The guarantor, even before having paid, may proceed against the principal debtor:

(1) When he is sued for the payment;

(2) In case of insolvency of the principal debtor;

(3) When the debtor has bound himself to relieve him from the guaranty within a specified period, and this period has expired;

(4) When the debt has become demandable, by reason of the expiration of the period for payment;

(5) After the lapse of ten years, when the principal obligation has no fixed period for its maturity, unless it be of such nature that it cannot be extinguished except within a period longer than ten years;

(6) If there are reasonable grounds to fear that the principal debtor intends to abscond;

(7) If the principal debtor is in imminent danger of becoming insolvent.

In all these cases, the action of the guarantor is to obtain release from the guaranty, or to demand a security that shall protect him from any proceedings by the creditor and from the danger of insolvency of the debtor. (1843a)

Art. 2072. If one, at the request of another, becomes a guarantor for the debt of a third person who is not present, the guarantor who satisfies the debt may sue either the person so requesting or the debtor for reimbursement. (n)

Section 3 — Effects of Guaranty as Between Co-Guarantors

Art. 2073. When there are two or more guarantors of the same debtor and for the same debt, the one among them who has paid may demand of each of the others the share which is proportionally owing from him.

If any of the guarantors should be insolvent, his share shall be borne by the others, including the payer, in the same proportion.

The provisions of this article shall not be applicable, unless the payment has been made in virtue of a judicial demand or unless the principal debtor is insolvent. (1844a)

Art. 2074. In the case of the preceding article, the co-guarantors may set up against the one who paid, the same defenses which would have pertained to the principal debtor against the creditor, and which are not purely personal to the debtor. (1845)

Art. 2075. A sub-guarantor, in case of the insolvency of the guarantor for whom he bound himself, is responsible to the co-guarantors in the same terms as the guarantor. (1846)

3. Effects

a. *Effects of Guaranty Between the Guarantor and the Creditor*

Benefits of Excussion

The guarantor cannot be compelled to pay the creditor unless the latter has exhausted all the property of the debtor and has resorted to all the legal remedies against the debtor *(Art. 2058, Civil Code)*. No execution may lie against the guarantor until after a writ of execution against the debtor is returned unsatisfied *(Machetti vs. Hospicio de San Jose, 53 Phil. 297)*. The creditor may hold the guarantor liable only after judgment has been obtained against the principal debtor and the latter is unable to pay, for obviously the exhaustion of the principal's property cannot even begin to take place before judgment has been obtained *(Baylon vs. Court of Appeals, 110 SCAD 877, 312 SCRA 502)*. The benefit of excussion shall not take place —

(1) If the guarantor has expressly renounced it;

(2) If he has bound himself solidarily with the debtor;

(3) In case of insolvency of the debtor;

(4) When he has absconded, or cannot be sued within the Philippines unless he has left a manager or representative;

(5) If it may be presumed that an execution on the property of the principal debtor would not result in the satisfaction of the obligation *(Art. 2059, Civil Code)*. This benefit does not extend to a surety who binds himself solidarily with the debtor (see *Luzon Steel Corp. vs. Sia, 28 SCRA 58*).

In order that the guarantor may make use of the benefit of excussion, he must set it up against the credi-

tor upon the latter's demand for payment from him and point out to the creditor available property of the debtor within Philippine territory, sufficient to cover the amount of the debt *(Art. 2060, Civil Code; Luzon Steel Corp. vs. Sia, 28 SCRA 58)*. The benefit of excussion must be interposed by the guarantor before a judgment against him is rendered *(Saavedra vs. Price, 68 Phil. 699)*. The guarantor having fulfilled all the above conditions, the creditor who is negligent in exhausting the property pointed out shall suffer the loss, to the extent of said property, for the insolvency of the debtor resulting from such negligence *(Art. 2061, Civil Code)*.

In every action by the creditor, which must be against the principal debtor alone, except in the cases where the benefit of excussion does not take place *(Art. 2059, Civil Code;* see *Banzon vs. Court of Appeals, 175 SCRA 297; Pioneer Ins. vs. Court of Appeals, 175 SCRA 668)*, the former shall ask the court to notify the guarantor of the action. The guarantor may appear so that he may, if he so desires, set up such defenses as are granted him by law. The benefit of excussion mentioned in Article 2058 shall always be unimpaired, even if judgment should be rendered against the principal debtor and the guarantor in case of appearance by the latter *(Art. 2062, Civil Code;* see *Lavides vs. Eleazar, 106 Phil. 576)*. Commenting on this provision, Justice Eduardo P. Caguioa *(Civil Law, 1970 Ed., Vol. VI, p. 323)* states:

> "It is submitted, therefore, that the notice referred to in the above Article should be a judicial notice merely and must never take the form of including the guarantor as a party defendant, much less in the form of judicial summons, because the purpose is not to acquire jurisdiction over the person of the guarantor since that is prohibited under the above Article, saving the case of the guarantor's voluntary intervention or loss of the benefit of execution, but to inform the guarantor of the filing of the

suit against the principal debtor. It would seem, however, that the giving of this judicial notice is mandatory on the creditor. On receipt of said notice, the guarantor may or may not appear but he may set up the defenses he may want only if he voluntarily intervenes as a party defendant, and then, in that case, judgment can be rendered against both of them but saving always to the guarantor the benefit of excussion."

The guarantor of a guarantor shall enjoy the benefit of excussion both with respect to the guarantor and to the principal debtor *(Art. 1064, Civil Code)*.

Compromises

A compromise between the creditor and the principal debtor benefits the guarantor but does not prejudice him; and that which is entered into between the guarantor and the creditor benefits but does not prejudice the principal debtor *(Art. 2063, Civil Code)*.

Benefit of Division

Should there be several guarantors of only one debtor and for the same debt, the obligation to answer for the same is divided among all. The creditor cannot claim from the guarantors except the share which they are respectively bound to pay, unless solidarity has been expressly stipulated. The benefit of division against the co-guarantors ceases in the same cases and for the same reasons as the benefit of excussion against the principal debtor *(Art. 2065, Civil Code)*.

b. *Effects of Guaranty Between the Debtor and the Guarantor*

The guarantor who pays for a debtor must be indemnified by the latter. The indemnity comprises: (1) the total amount of the debt; (2) the legal interests thereon from the time the payment was made known to the debtor,

even though it did not earn interest for the creditors; (3) the expenses incurred by the guarantor after having notified the debtor that payment had been demanded of him; and (4) damages, if they are due *(Art. 2066, Civil Code)*.

The guarantor who pays is subrogated by virtue thereof to all the rights which the creditor had against the debtor. If the guarantor has compromised with the creditor, he cannot demand of the debtor more than what he has really paid *(Art. 2067, Civil Code)*. If the debt was for a period and the guarantor paid it before it became due, he cannot demand reimbursement of the debtor until the expiration of the period, unless the payment has been ratified by the debtor *(Art. 2069, Civil Code)*.

If the guarantor should pay without notifying the debtor, the latter may enforce against him all the defenses which he could have set up against the creditor at the time the payment was made *(Art. 2068, Civil Code)*. If the guarantor has paid without notifying the debtor and, the latter being aware of the payment, repeats the payment, the former has no remedy whatever against the debtor, but only against the creditor. Nevertheless, in case of a gratuitous guaranty, if the guarantor was prevented by a fortuitous event from advising the debtor of the payment, and the creditor becomes insolvent, the debtor shall reimburse the guarantor for the amount paid *(Art. 2070, Civil Code)*.

The guarantor may not proceed against the debtor until he has been made to pay under his guaranty *(Banzon vs. Court of Appeals, 175 SCRA 297)*. The guarantor, even before having paid, may proceed against the principal debtor when it is stipulated *(Pioneer Insurance vs. Court of Appeals, 175 SCRA 668),* as well as in the following cases, *viz.*:

(1) When he is sued for the payment;

(2) In case of insolvency of the principal debtor;

(3) When the debtor has bound himself to relieve him from the guaranty within a specified period, and this period has expired;

(4) When the debt has become demandable, by reason of the expiration of the period for payment;

(5) After the lapse of ten years, when the principal obligation has no fixed period for its maturing, unless it be of such nature that it cannot be extinguished except within a period longer than ten years;

(6) If there are reasonable grounds to fear that the principal debtor intends to abscond;

(7) If the principal debtor is in imminent danger of becoming insolvent.

In all these cases, the action of the guarantor is to obtain release from the guaranty or to demand a security that shall protect him from any proceedings by the creditor and from the danger of insolvency of the debtor *(Art. 1071, Civil Code;* see *Manila Surety & Fidelity Co. vs. Almeda, 34 SCRA 136).*

If one, at the request of another, becomes a guarantor for the debt of a third person who is not present, the guarantor who satisfies the debt may sue either the person so requesting or the debtor for reimbursement *(Art. 2071, Civil Code;* see *Umali vs. Court of Appeals, 189 SCRA 529; Tuason vs. Machuca, 46 Phil. 561).*

c. *Effects of Guaranty Among Co-guarantors*

When there are two or more guarantors of the same debtor and for the same debt, the one among them who has paid may demand of each of the others the share which is proportionally owing from him. If any of the guarantors should be insolvent, his share shall be borne by the others, including the payer, in the same proportion. The provisions of Article 2073 shall not be applicable, unless the payment has been made in virtue of a

judicial demand or unless the principal debtor is insolvent (see *Art. 2073, Civil Code*). The co-guarantors may set up against the one who paid the same defenses which would have pertained to the principal debtor against the creditor and which are not purely personal to the debtor *(Art. 2074, Civil Code).*

A sub-guarantor, in case of the insolvency of the guarantor from whom he bound himself, is responsible to the co-guarantors in the same terms as the guarantor *(Art. 2075, Civil Code).*

Chapter 3

Extinguishment of Guaranty

Art. 2076. The obligation of the guarantor is extinguished at the same time as that of the debtor, and for the same causes as all other obligations. (1847)

Art. 2077. If the creditor voluntarily accepts immovable or other property in payment of the debt, even if he should afterwards lose the same through eviction, the guarantor is released. (1849)

Art. 2078. A release made by the creditor in favor of one of the guarantors, without the consent of the others, benefits all to the extent of the share of the guarantor to whom it has been granted. (1850)

Art. 2079. An extension granted to the debtor by the creditor without the consent of the guarantor extinguishes the guaranty. The mere failure on the part of the creditor to demand payment after the debt has become due does not of itself constitute any extension of time referred to herein. (1851a)

Art. 2080. The guarantors, even though they be solidary, are released from their obligation whenever by some act of the creditor they cannot be subrogated to the rights, mortgages, and preferences of the latter. (1852)

Art. 2081. The guarantor may set up against the creditor all the defenses which pertain to the principal

debtor and are inherent in the debt; but not those that are purely personal to the debtor. (1853)

4. Extinguishment of Guaranty

The obligation of the guarantor is extinguished at the same time as that of the debtor and for the same causes as all other obligations (*Art. 2076, Civil Code;* see *Article 1231, Civil Code;* see also discussions*, supra.,* on Extinguishment of Obligations). Thus, a novation of the principal obligation which is not merely modificatory, but extinctive in nature, would extinguish the guaranty (see *National Bank vs. Veraguth, 50 Phil. 253*).

If the creditor voluntarily accepts immovable or other property in payment of the debt *(dacion en pago),* even if he should afterwards lose the same through eviction, the guarantor is released *(Art. 2077,* in relation to *Art. 1245, Civil Code).*

A release made by the creditor in favor of one of the guarantors, without the consent of the others, benefits all to the extent of the share of the guarantor to whom it has been granted *(Art. 2078, Civil Code; Araneta vs. Commonwealth Insurance Co., 103 Phil. 522).*

An extension granted to the debtor by the creditor without the consent of the guarantor extinguishes the guaranty. This extension contemplates an agreement whereby the creditor deprives himself of the right to enforce the claim *(Ibañez de Aldecoa vs. Hongkong & Shanghai Bank, 30 Phil. 255).* The theory behind Article 2079 is that an extension of time given to the principal debtor by the creditor without the surety's consent would deprive the surety of his right to pay the creditor and to be immediately subrogated to the creditor's remedies against the principal debtor upon the maturity date. The surety is said to be entitled to protect himself against the contingency of the principal debtor or the indemnitors becoming insolvent during the extended period *(Cochingyan, Jr. vs. R&B Surety and Insurance Co., 151 SCRA 339,*

cited in *Security Bank and Trust Company, Inc. vs. Cuenca, 135 SCAD 98, 341 SCRA 781)*. The mere failure on the part of the creditor to demand payment after the debt has become due does not of itself constitute such extension of time *(Art. 2079, Civil Code; Shannon vs. Philippine Lumber, 61 Phil. 872),* as a mere delay in the commencement of a court suit (see *Bank of P.I. vs. Albaladejo y Cia, 53 Phil. 141*). The consent of the guarantor on the extension of the period may be given in advance, expressly or impliedly, such as when the guaranty covers the payment of the obligation on its due date "or its extensions" *(Philamgen vs. Mutuc, 61 SCRA 22;* see also *Garcia, Jr. vs. Court of Appeals, 191 SCRA 493)*. It has been held that if the principal obligation is not with a term or period, an extension of time granted by the creditor does not release the guarantor (see *Hospicio de San Jose vs. Fidelity & Surety Co., 52 Phil. 926*).

The guarantors, even though they be solidary, are released from their obligation whenever by some act of the creditor they cannot be subrogated to the rights, mortgages, and preferences of the latter *(Art. 2080, Civil Code;* see *Philippine National Bank vs. Manila Surety & Fidelity Co., 14 SCRA 776).*

The guarantor may set up against the creditor all the defenses which pertain to the principal debtor and are inherent in the debt; but not those that are purely personal to the debtor *(Art. 2081, Civil Code;* see *Chinese Chamber of Commerce vs. Pua Te Ching, 16 Phil. 466).*

Chapter 4

Legal and Judicial Bonds

Art. 2082. The bondsman who is to be offered in virtue of a provision of law or of a judicial order shall have the qualifications prescribed in Article 2056 and in special laws. (1854a)

Art. 2083. If the person bound to give a bond in the cases of the preceding article, should not be able

to do so, a pledge or mortgage considered sufficient to cover his obligation shall be admitted in lieu thereof. (1855)

Art. 2084. A judicial bondsman cannot demand the exhaustion of the property of the principal debtor.

A sub-surety in the same case, cannot demand the exhaustion of the property of the debtor or of the surety.

Legal and Judicial Bonds

The bondsman who is to be offered in virtue of a provision of law or of a judicial order shall have the qualifications prescribed in Article 2056 *(supra.)* and in special laws *(Art. 2082, Civil Code)*. If the person bound to give a bond in these cases should not be able to do so, a pledge or mortgage considered sufficient to cover his obligation shall be admitted in lieu thereof *(Art. 2083, Civil Code)*.

A judicial bondsman cannot demand the exhaustion of the property of the principal debtor, and a sub-surety in the same case cannot demand the exhaustion of the property of the debtor or of the surety. If the surety contests the application of a prevailing party for satisfaction against a bond, a summary hearing is set only to consider new defenses not set up by the principal *(Stronghold Ins. vs. Court of Appeals, 208 SCRA 336)*.

TITLE XVI. PLEDGE, MORTGAGE AND ANTICHRESIS

Chapter 1

Provisions Common to Pledge and Mortgage

Art. 2085. The following requisites are essential to the contracts of pledge and mortgage:

(1) That they be constituted to secure the fulfillment of a principal obligation;

(2) That the pledgor or mortgagor be the absolute owner of the thing pledged or mortgaged;

(3) That the persons constituting the pledge or mortgage have the free disposal of their property, and in the absence thereof, that they be legally authorized for the purpose.

Third persons who are not parties to the principal obligation may secure the latter by pledging or mortgaging their own property.

Art. 2086. The provisions of Article 2052 are applicable to a pledge or mortgage. (n)

Art. 2087. It is also of the essence of these contracts that when the principal obligation becomes due, the things in which the pledge or mortgage consists may be alienated for the payment to the creditor. (1858)

Art. 2088. The creditor cannot appropriate the things given by way to pledge or mortgage, or dispose of them. Any stipulation to the contrary is null and void. (1859a)

Art. 2089. A pledge or mortgage is indivisible, even though the debt may be divided among the successors in interest of the debtor or of the creditor.

Therefore, the debtor's heir who has paid a part of the debt cannot ask for the proportionate extinguishment of the pledge or mortgage as long as the debt is not completely satisfied.

Neither can the creditor's heir who received his share of the debt return the pledge or cancel the mortgage, to the prejudice of the other heirs who have not been paid.

From these provisions is expected the case in which, there being several things given in mortgage or pledge, each one of them guarantees only a determinate portion of the credit.

The debtor, in this case, shall have a right to the extinguishment of the pledge or mortgage as the portion of the debt for which each thing is specially answerable is satisfied. (1860)

Art. 2090. The indivisibility of a pledge or mortgage is not affected by the fact that the debtors are not solidarily liable. (n)

Art. 2091. The contract of pledge or mortgage may secure all kinds of obligations, be they pure or subject to a suspensive or resolutory condition. (1861)

Art. 2092. A promise to constitute a pledge or mortgage gives rise only to a personal action between the contracting parties, without prejudice to the criminal responsibility incurred by him who defrauds another, by offering in pledge or mortgage as unencumbered, things which he knew were subject to some burden, or by misrepresenting himself to be the owner of the same. (1862)

1. Concepts

Personal Guaranty vis-a-vis Real Guaranty

Contracts of security are either personal or real. In contracts of personal security, such as a guaranty or suretyship, the fulfillment of the obligation of the principal debtor is secured by the *personal* commitment of an-

other (the guarantor or surety). In contracts of real security such as a pledge, mortgage and antichresis, that fulfillment is secured by an *encumbrance of property* — in *pledge*, the placing of movable property in the possession of the creditor; in chattel mortgage, by the execution of the corresponding deed substantially in the form prescribed by law; in *real estate mortgage*, by the execution of a public instrument encumbering the real property covered thereby; and in *antichresis*, by a written instrument granting to the creditor the right to receive the fruits of an immovable property with the obligation to apply such fruits to the payment of interest, if owing, and thereafter to the principal of his credit — upon the essential condition that when the principal obligation becomes due, such things so encumbered may be alienated for the payment of the obligation *(Arts. 2085, 2087, 2093, 2125, 2126, 2132, 2139* and *2140, Civil Code).*

These contracts create a real right over the property given by way of security and the right is not lost just because the debtor is adjudged insolvent *(PCIB vs. Court of Appeals, 172 SCRA 436; Integrated Realty vs. PNB, 174 SCRA 295).* But a mere promise to constitute a pledge or mortgage gives rise only to a personal action between the contracting parties, without prejudice to the criminal responsibility incurred by him who defrauds another, by offering in pledge or mortgage as unencumbered things which he knew were subject to some burden, or by misrepresenting himself to be the owner of the same *(Art. 2092, Civil Code; Mitsui Bussan Kaisha vs. Hongkong & Shanghai Bank, 36 Phil. 27).*

Common Requisites and Essence of Pledges and Mortgages

The following requisites are essential to the contracts of pledge and mortgage:

(1) That they be constituted to secure the fulfillment of a principal obligation;

(2) That the pledgor or mortgagor be the absolute owner of the thing pledged or mortgaged;

(3) That the persons constituting the pledge or mortgage have the free disposal of their property, and in the absence thereof, that they be legally authorized for the purpose.

Third persons who are not parties to the principal obligation may secure the latter by pledging or mortgaging their own property *(Art. 2085, Civil Code; Government Service Insurance System vs. Court of Appeals, 170 SCRA 533)* or by giving it in antichresis (see *Art. 2087, Civil Code*). Although Article 2085 of the Code requires the pledgor or mortgagors to be owners, an innocent mortgagee for value of registered land is protected *(P.D. 1529; Rural Bank of Soriaya, Inc. vs. Yacon, 175 SCRA 62).*

It is also of the essence of these contracts that when the principal obligation becomes due, the things in which the pledge or mortgage consists may be alienated for the payment to the creditor *(Art. 2087, Civil Code).*

The accessory character of pledge and mortgage, *i.e.*, to secure the fulfillment of a principal obligation, is also of sum and substance *(Manila Surety & Fidelity Co. vs. Velayo, 21 SCRA 515).* The provisions, however, of Article 2052 *(supra.)* are applicable to a pledge or mortgage *(Art. 2086, Civil Code),* which is to say that these contracts of real security may be constituted to secure the performance of voidable or unenforceable contracts and natural obligations. A pledge, mortgage, or antichresis may also secure all kinds of obligations, be they pure or subject to a suspensive or resolutory condition *(Art. 2091,* in relation to *Art. 2139, Civil Code),* as well as after-incurred obligations so long as these future debts are accurately described (see *Mojica vs. Court of Appeals, 201 SCRA 517; Bonnevie vs. Court of Appeals, 125 SCRA 122; Lim Julian vs. Lutero, 49 Phil. 703*). A chattel mortgage, however, can only cover obligations existing at the time the mortgage is constituted and not those contracted subse-

quent to the execution thereof (see *Sec. 5, Act 1508; Belgian Catholic Missionaries vs. Magallanes Press, 49 Phil. 647*) but a *promise* to include such future property is a binding commitment (see *infra.* discussion on chattel mortgages).

A mortgage, being in the nature of contract of adhesion, is to be strictly construed against the party who prepared it *(Philippine Bank of Communications vs. Court of Appeals, 68 SCAD 60, 253 SCRA 241).*

Pactum Commissorium

The creditor can neither appropriate without foreclosure the things given by way of pledge or mortgage, nor dispose of them. Any stipulation to the contrary is null and void *(Art. 2088, Civil Code; Hechanova vs. Adil, 144 SCRA 450; Manila Banking Corp. vs. Teodoro, Jr., 169 SCRA 95; Reyes vs. Sierra, 93 SCRA 472; Montevirgen vs. Court of Appeals, 112 SCRA 641).* This same rule applies to antichresis (see *Art. 2137, Civil Code*). But a stipulation promising to assign the property given as security in payment of the debt if, upon its maturity, is not paid is valid and not violative of Article 2088 (see *Dalay vs. Aquiatin, 47 Phil. 951*). A *pacto commissorio* presupposes the existence of a pledge, mortgage or antichresis, without which no violation of the rule would result *(Caridad Estates, Inc. vs. Santero, 71 Phil. 114).* The application of Article 2088 does not depend on the presence of an explicit provision in an instrument to the effect that the mortgagee will appropriate the things given by mortgage without following the procedure prescribed by law for the foreclosure of the mortgage for, otherwise, it would allow a subversion of the prohibition against *pactum commissorium (A. Francisco Realty and Development Corporation vs. Court of Appeals, 100 SCAD 478, 289 SCRA 349).*

In fine, the two elements of *pactum commissorium* under Article 2088 of the Civil Code, said the Court in *Uy*

Tong vs. Court of Appeals (161 SCRA 383), are: (1) that there should be a pledge or mortgage wherein property is pledged or mortgaged by way of security for the payment of the principal obligation; and (2) that there should be stipulation for an *automatic* appropriation by the creditor of the thing pledged or mortgaged in the event of nonpayment of the principal obligation within the stipulated period. The rule does not thus apply to a sale contract where there is no indication of a pledge or mortgage to secure the unpaid price and the deed of assignment in favor of the seller of the property earlier sold was done in conformity with the judgment of the court which can no longer be impugned.

A condition in a deed of assignment providing for the appointment of an assignee as attorney-in-fact with authority, among other things, to sell or otherwise dispose of real rights, in case of default by the assignor, and to apply the proceeds to the payment of the loan does not constitute *pactum commissorium*. This provision is a standard condition in mortgage contracts and is in conformity with Article 2087 of the Civil Code which would authorize the mortgagee to foreclose the mortgage and alienate the mortgaged property for the payment of the principal obligation *(Development Bank of the Philippines vs. Court of Appeals, 90 SCAD 12, 284 SCRA 14)*.

A stipulation in a promissory note providing that, upon failure of the maker to pay interest, ownership of the property mortgaged would be automatically transferred to the mortgagee and the deed of sale in its favor would then be registered, is in substance a *pactum commissorium (A. Francisco Realty and Development Corporation vs. Court of Appeals, 100 SCAD 478, 298 SCRA 349)*. A stipulation that the ownership of the property would automatically pass on to the vendee in case no redemption is effected within a stipulated period would be void for being a *pactum commissorium* that enables the mortgagee to acquire ownership of the mortgaged property without need of foreclosure *(Olea vs. Court of Appeals,*

63 SCAD 579, 247 SCRA 274). An encashment, however, of a deposit certificate given as security for the payment of a debt would not be violative of the provisions of either Article 2088 or Article 2112 of the Code requiring foreclosure *(Yao Chu vs. Court of Appeals, 177 SCRA 793)*, since the same can qualify as a medium of exchange itself where no undue prejudice or disadvantage to the debtor can result.

Indivisibility

The rule of indivisibility presupposes several debtor or several creditors (see *Rose Packing Co., Inc. vs. Court of Appeals, 167 SCRA 309;* but see *PNB vs. De los Reyes, 179 SCRA 619*). In one case, however, the Court held that the rule of indivisibility also meant that the corresponding partial release of the property hypothecated in cases of partial payments of the secured obligation is not warranted and that what can only be asked is a foreclosure by lots *(PNB vs. De los Reyes, supra.)*. A pledge or mortgage, as well as antichresis, is indivisible, even though the debt may be divided among the successors in interest of the debtor or of the creditor, unless this indivisibility rule is stipulated against (see *Philippine National Bank vs. De los Reyes, supra*.). Therefore, the debtor's heir who has paid a part of the debt cannot ask for the proportionate extinguishment of the pledge or mortgage as long as the debt is not completely satisfied. Neither can the creditor's heir who received his share of the debt return the pledge or cancel the mortgage, to the prejudice of the other heirs who have not been paid. From these provisions is excepted the case in which, there being several things given in mortgage or pledge, each one of them guarantees only a determinate portion of the credit. The debtor in this case shall have a right to the extinguishment of the pledge or mortgage as the portion of the debt for which each thing is specially answerable is satisfied *(Art. 2089,* in relation to *Art. 2139, Civil Code)*. The indivisibility of a pledge, mortgage or antichresis is not af-

fected by the fact that the debtors are not solidarily liable *(Art. 2090,* in relation to *Art. 2134, Civil Code;* see *Philippine National Bank vs. Mallorca, 21 SCRA 694).*

In another case, a bank, which agreed to lend P80,000 to a borrower but was able to lend P17,000 only because it was prohibited by the Monetary Board from doing further business, was held to be in default on its obligation under its contract to lend P80,000 subjecting to resolution the undrawn balance of the loan, its closure not being a justification for its breach. On the other hand, the borrower who received only P17,000 as part of the loan, would likewise be in default if he were not to pay to the bank the amount when it fell due. The foreclosure by the bank of the real mortgage would be valid only up to 21.25% of the area mortgaged and unenforceable to the extent of 78.75% of the collateral mortgaged *(Central Bank vs. Court of Appeals, 139 SCRA 47;* but see *Ramos vs. Central Bank, 137 SCRA 685).*

Chapter 2

Pledge

Art. 2093. In addition to the requisites prescribed in Article 2085, it is necessary, in order to constitute the contract of pledge, that the thing pledged be placed in the possession of the creditor, or of a third person by common agreement. (1863)

Art. 2094. All movables which are within commerce may be pledged, provided they are susceptible of possession. (1864)

Art. 2095. Incorporeal rights, evidenced by negotiable instruments, bills of lading, shares of stock, bonds, warehouse receipts and similar documents may also be pledged. The instrument proving the right pledged shall be delivered to the creditor, and if negotiable, must be indorsed. (n)

Art. 2096. A pledge shall not take effect against third persons if a description of the thing pledged and

the date of the pledge do not appear in a public instrument. (1865a)

Art. 2097. With the consent of the pledgee, the thing pledged may be alienated by the pledgor or owner, subject to the pledge. The ownership of the thing pledged is transmitted to the vendee or transferee as soon as the pledgee consents to the alienation, but the latter shall continue in possession. (n)

Art. 2098. The contract of pledge gives a right to the creditor to retain the thing in his possession or in that of a third person to whom it has been delivered, until the debt is paid. (1866a)

Art. 2099. The creditor shall take care of the thing pledged with the diligence of a good father of a family; he has a right to the reimbursement of the expenses made for its preservation, and is liable for its loss or deterioration, in conformity with the provisions of this Code. (1867)

Art. 2100. The pledgee cannot deposit the thing pledged with a third person, unless there is a stipulation authorizing him to do so.

The pledgee is responsible for the acts of his agents or employees with respect to the thing pledged. (n)

Art. 2101. The pledgor has the same responsibility as a bailor in commodatum in the case under Article 1951. (n)

Art. 2102. If the pledge earns or produces fruits, income, dividends, or interests, the creditor shall compensate what he receives with those which are owing him; but if none are owing him, or insofar as the amount may exceed that which is due, he shall apply it to the principal. Unless there is a stipulation to the contrary, the pledge shall extend to the interest and earnings of the right pledged.

In case of a pledge of animals, their offspring shall pertain to the pledgor or owner of the animals pledged, but shall be subject to the pledge, if there is no stipulation to the contrary. (1868a)

Art. 2103. Unless the thing pledged is expropriated, the debtor continues to be the owner thereof.

Nevertheless, the creditor may bring the actions which pertain to the owner of the thing pledged in order to recover it from, or defend it against a third person. (1869)

Art. 2104. The creditor cannot use the thing pledged, without the authority of the owner, and if he should do so, or should misuse the thing in any other way, the owner may ask that it be judicially or extrajudicially deposited. When the preservation of the thing pledged requires its use, it must be used by the creditor but only for that purpose. (1870a)

Art. 2105. The debtor cannot ask for the return of the thing pledged against the will of the creditor, unless and until he has paid the debt and its interest, with expenses in a proper case. (1871)

Art. 2106. If through the negligence or willful act of the pledgee, the thing pledged is in danger of being lost or impaired, the pledgor may require that it be deposited with a third person. (n)

Art. 2107. If there are reasonable grounds to fear the destruction or impairment of the thing pledged, without the fault of the pledgee, the pledgor may demand the return of the thing, upon offering another thing in pledge, provided the latter is of the same kind as the former and not of inferior quality, and without prejudice to the right of the pledgee under the provisions of the following article.

The pledgee is bound to advise the pledgor, without delay, of any danger to the thing pledged. (n)

Art. 2108. If, without the fault of the pledgee, there is danger of destruction, impairment, or diminution in value of the thing pledged, he may cause the same to be sold at a public sale. The proceeds of the auction shall be a security for the principal obligation in the same manner as the thing originally pledged. (n)

Art. 2109. If the creditor is deceived on the substance or quality of the thing pledged, he may either

claim another thing in its stead, or demand immediate payment of the principal obligation. (n)

Art. 2110. If the thing pledged is returned by the pledgee to the pledgor or owner, the pledge is extinguished. Any stipulation to the contrary shall be void.

If subsequent to the perfection of the pledge, the thing is in the possession of the pledgor or owner, there is a *prima facie* presumption that the same has been returned by the pledgee. This same presumption exists if the thing pledged is in the possession of a third person who has received it from the pledgor or owner after the constitution of the pledge. (n)

Art. 2111. A statement in writing by the pledgee that he renounces or abandons the pledge is sufficient to extinguish the pledge. For this purpose, neither the acceptance by the pledgor or owner, nor the return of the thing pledged is necessary, the pledgee becoming a depositary. (n)

Art. 2112. The creditor to whom the credit has not been satisfied in due time, may proceed before a Notary Public to the sale of the thing pledged. This sale shall be made at a public auction, and with notification to the debtor and the owner of the thing pledged in a proper case, stating the amount for which the public sale is to be held. If at the first auction the thing is not sold, a second one with the same formalities shall be held; and if at the second auction there is no sale either, the creditor may appropriate the thing pledged. In this case he shall be obliged to give an acquittance for his entire claim. (1872a)

Art. 2113. At the public auction, the pledgor or owner may bind. He shall, moreover, have a better right if he should offer the same terms as the highest bidder.

The pledgee may also bid, but his offer shall not be valid if he is the only bidder. (n)

Art. 2114. All bids at the public auction shall offer to pay the purchase price at once. If any other bid is accepted, the pledgee is deemed to have received the

purchase price, as far as the pledgor or owner is concerned. (n)

Art. 2115. The sale of the thing pledged shall extinguish the principal obligation, whether or not the proceeds of the sale are equal to the amount of the principal obligation, interest and expenses in a proper case. If the price of the sale is more than said amount, the debtor shall not be entitled to the excess, unless it is otherwise agreed. If the price of the sale is less, neither shall the creditor be entitled to recover the deficiency, notwithstanding any stipulation to the contrary. (n)

Art. 2116. After the public auction, the pledgee shall promptly advise the pledgor or owner of the result thereof. (n)

Art. 2117. Any third person who has any right in or to the thing pledged may satisfy the principal obligation as soon as the latter becomes due and demandable. (n)

Art. 2118. If a credit which has been pledged becomes due before it is redeemed, the pledgee may collect and receive the amount due. He shall apply the same to the payment of his claim, and deliver the surplus, should there by any, to the pledgor. (n)

Art. 2119. If two or more things are pledged, the pledgee may choose which he will cause to be sold, unless there is a stipulation to the contrary. He may demand the sale of only as many of the things as are necessary for the payment of the debt. (n)

Art. 2120. If a third party secures an obligation by pledging his own movable property under the provisions of Article 2085 he shall have the same rights as a guarantor under Articles 2066 to 2070, and Articles 2077 to 2081. He is not prejudiced by any waiver of defense by the principal obligor. (n)

Art. 2121. Pledges created by operation of law, such as those referred to in Articles 546, 1731, and 1994, are governed by the foregoing articles on the possession, care and sale of thing as well as on the termination of the pledge. However, after payment of

the debt and expenses, the remainder of the price of the sale shall be delivered to the obligor. (n)

Art. 2122. A thing under a pledge by operation of law may be sold only after demand of the amount for which the thing is retained. The public auction shall take place within one month after such demand. If, without just grounds, the creditor does not cause the public sale to be held within such period, the debtor may require the return of the thing. (n)

Art. 2123. With regard to pawnshops and other establishments, which are engaged in making loans secured by pledges, the special laws and regulations concerning them shall be observed, and subsidiarily, the provisions of this Title. (1873a)

Chapter 3

Mortgage

Art. 2124. Only the following property may be the object of a contract of mortgage:

(1) Immovables;

(2) Alienable real rights in accordance with the laws, imposed upon immovables.

Nevertheless, movables may be the object of a chattel mortgage. (1874a)

Art. 2125. In addition to the requisites stated in Article 2085, it is indispensable, in order that a mortgage may be validly constituted, that the document in which it appears be recorded in the Registry of Property. If the instrument is not recorded, the mortgage is nevertheless binding between the parties.

The persons in whose favor the law establishes a mortgage have no other right than to demand the execution and the recording of the document in which the mortgage is formalized. (1875a)

Art. 2126. The mortgage directly and immediately subjects the property upon which it is imposed, who-

ever the possessor may be, to the fulfillment of the obligation for whose security it was constituted. (1876)

Art. 2127. The mortgage extends to the natural accessions, to the improvements, growing fruits, and the rents or income not yet received when the obligation becomes due, and to the amount of the indemnity granted or owing to the proprietor from the insurers of the property mortgaged, or in virtue of expropriation for public use, with the declarations, amplifications and limitations established by law, whether the estate remains in the possession of the mortgagor, or it passes into the hands of a third person. (1877)

Art. 2128. The mortgage credit may be alienated or assigned to a third person, in whole or in part, with the formalities required by law. (1878)

Art. 2129. The creditor may claim from a third person in possession of the mortgaged property, the payment of the part of the credit secured by the property which said third person possesses, in terms and with the formalities which the law establishes. (1879)

Art. 2130. A stipulation forbidding the owner from alienating the immovable mortgaged shall be void. (n)

Art. 2131. The form, extent and consequences of a mortgage, both as to its constitution, modification and extinguishment, and as to other matters not included in this Chapter, shall be governed by the provisions of the Mortgage Law and of the Land Registration Law. (1880a)

Chapter 4

Antichresis

Art. 2132. By the contract of antichresis the creditor acquires the right to receive the fruits of an immovable of his debtor, with the obligation to apply them to the payment of the interest, if owing, and thereafter to the principal of his credit. (1881)

Art. 2133. The actual market value of the fruits at the time of the application thereof to the interest and principal shall be the measure of such application. (n)

Art. 2134. The amount of the principal and of the interest shall be specified in writing; otherwise, the contract of antichresis shall be void. (n)

Art. 2135. The creditor, unless there is a stipulation to the contrary, is obliged to pay the taxes and charges upon the estate.

He is also bound to bear the expenses necessary for its preservation and repair.

The sums spent for the purposes stated in this article shall be deducted from the fruits. (1882)

Art. 2136. The debtor cannot reacquire the enjoyment of the immovable without first having totally paid what he owes the creditor.

But the latter, in order to exempt himself from the obligations imposed upon him by the preceding article, may always compel the debtor to enter again upon the enjoyment of the property, except when there is a stipulation to the contrary. (1883)

Art. 2137. The creditor does not acquire the ownership of the real estate for non-payment of the debt within the period agreed upon.

Every stipulation to the contrary shall be void. But the creditor may petition the court for the payment of the debt or the sale of the real property. In this case, the Rules of Court on the foreclosure of mortgages shall apply. (1884a)

Art. 2138. The contracting parties may stipulate that the interest upon the debt be compensated with the fruits of the property which is the object of the antichresis, provided that if the value of the fruits should exceed the amount of interest allowed by the laws against usury, the excess shall be applied to the principal. (1885a)

Art. 2139. The last paragraph of Article 2085, and Articles 2089 to 2091 are applicable to this contract. (1886a)

Chapter 5

Chattel Mortgage

Art. 2140. By a chattel mortgage, personal property is recorded in the Chattel Mortgage Register as a security for the performance of an obligation. If the movable, instead of being recorded, is delivered to the creditor or a third person, the contract is a pledge and not a chattel mortgage. (n)

Art. 2141. The provisions of this Code on pledge, insofar as they are not in conflict with the Chattel Mortgage Law, shall be applicable to chattel mortgages. (n)

2. Elements

a. *Consent and Delivery or Form*

The contracts of pledge, mortgage and antichresis are not merely consensual as to perfection. A pledge is a *real* contract, necessitating the delivery of the thing pledged to the creditor or a third person by common agreement; a mortgage and antichresis are *solemn* contracts, requiring the compliance with certain formalities expressed by law for their validity. Solemnities are also prescribed for greater efficacy. Thus —

In Pledges

In addition to the requisites expressed in Article 2085, it is necessary, in order to constitute the contract of pledge, that the thing pledged be placed in the possession of the creditor or of a third person by common agreement *(Art. 2093, Civil Code)*. Incorporeal rights, evidenced by negotiable instruments, bills of lading, shares of stock, bonds, warehouse receipts and similar documents, may also be pledged. The instrument proving the right pledged shall be delivered to the creditor, and if negotiable, must be indorsed *(Art. 2095, Civil Code)*. A pledge shall not take effect against third persons if a description of the thing pledged and the date of the pledge do not appear in

a public instrument *(Art. 2096, Civil Code)*. Actual, not mere symbolic, possession is essential in order to validly constitute a pledge (see *Belita vs. Ganzon, 49 Phil. 87*) and to affect third persons, it must be in a public instrument *(Ong vs. Intermediate Appellate Court, 201 SCRA 543)*.

In Real Estate Mortgages

In addition to the requisites found in Article 2085, it is indispensable, in order that a mortgage may be validly constituted, that the document in which it appears be recorded in the Registry of Property. If the instrument is not recorded, the mortgage is nevertheless binding between the parties. The persons in whose favor the law establishes a mortgage have no other right than to demand the execution and the recording of the document in which the mortgage is formalized *(Art. 2125, Civil Code)*. The form, extent and consequences of a mortgage, both as to its constitution, modification and extinguishment, and as to other matters not governed specifically by the Civil Code, the provisions of the Mortgage Law and of the Land Registration Law shall apply *(Art. 2131, Civil Code)*. The Land Registration Act (see *Sec. 127, Act 496, [Presidential Decree 1529]*), as well as the Mortgage Law, requires a real estate mortgage to be in a public instrument. Registration of the deed is not necessary for the validity of the mortgage, but its registration will have the effect of constructive notice to third persons (see *Arts. 708-709* and *2125, Civil Code; Samanilla vs. Cajucom, 107 Phil. 432*). An unregistered mortgage may still be the subject of foreclosure *(Mobil Oil Phil., Inc. vs. Diocares, 29 SCRA 656)*.

In Antichresis

In antichresis, the amount of the principal and of the interest should be specified in writing, otherwise the contract shall be void *(Art. 2134, Civil Code)*.

In Chattel Mortgages

In a chattel mortgage, personal property is recorded in the Chattel Mortgage Register as a security for the performance of an obligation. If the movable, instead of being recorded, is delivered to the creditor or a third person, the contract shall be deemed to be a pledge and not a chattel mortgage *(Art. 2140, Civil Code)*. The provisions of this Code on pledge, insofar as they are not in conflict with the Chattel Mortgage Law, shall be applicable to chattel mortgages *(Art. 2141, Civil Code)*.

A chattel mortgage must comply substantially with the form of chattel mortgages and affidavit of good faith prescribed by the law. It is enough that the language sufficiently conveys the intendment of the parties of placing certain described personal property of the mortgagor as security for the payment of specific obligations due the mortgagee, upon the condition that if the said obligation is performed, then the mortgage becomes null and void. The affidavit is a sworn statement of the parties to the effect that the mortgage is made to secure a just and valid obligation therein specified and for no other purpose, and that it is not one entered into for purposes of fraud *(Sec. 5, Act 1508)*. In order to be valid against any person other than the mortgagor, the chattel mortgage should be recorded in the office of the Register of Deeds *(Sec. 4, Act 1508)*.

A chattel mortgage, to which an affidavit of good faith is not appended, is still valid as between the parties *(Lilius vs. Manila Railroad Co., 34 O.G. 790),* but not against third persons in good faith (see *Philippine Refining Co. vs. Jarque, 61 Phil. 229*).

A chattel mortgage that is not recorded is valid between the parties but void as to innocent third persons (see *Lara vs. Bayona, L-7920, 10 May 1955 [unreported]; Cf. Chua Gua vs. Samahang Magsasaka, 62 SCRA 472*).

The parties creating contracts of real security, although they need not be the principal obligors themselves,

must, besides the usual capacities required by law (juridical capacity and capacity to act), be the absolute owners of the things encumbered and have the free disposal thereof (see *Art. 2086, Civil Code;* see also *Tomas vs. Tomas, 98 SCRA 280; Parque vs. Philippine National Bank, 96 Phil. 157; Bautista vs. Marcos, 3 SCRA 434*). In *Duran & Gaspar vs. Intermediate Appellate Court (138 SCRA 489),* however, the Supreme Court ruled:

> "But even if the signatures were a forgery, and the sale would be regarded as void, still it is our opinion that the Deed of Mortgage is VALID, with respect to the mortgagees, the defendant-appellants. While it is true that under Article 2085 of the Civil Code, it is essential that the mortgagor be the absolute owner of the property mortgaged, and while as between the daughter and the mother, it was the daughter who still owned the lots, STILL insofar as innocent third persons are concerned the owner was already the mother (Fe S. Duran) inasmuch as she had already become the registered owner *(Transfer Certificates of Title Nos. 2418 and 2419).* The mortgagee had the right to rely upon what appeared in the certificate of title, and did not have to inquire further. If the rule were otherwise, the efficacy and conclusiveness of Torrens Certificates of Title would be futile and nugatory." (see also *Mallorca vs. De Ocampo, 32 SCRA 48*).

A mortgage made by a co-owner affects only his interest in the thing but not the shares of the others *(Philippine National Bank vs. Court of Appeals, 98 SCRA 207).*

The nullity of a mortgage does not render null and void the principal obligation which it guarantees. What is lost is the right to foreclose the mortgage as a special remedy for satisfying or settling the indebtedness or the principal obligation. In case of nullity, the mortgage deed remains as evidence on proof of a personal obligation of the debtor, and the amount due to the creditor may be

enforced in an ordinary personal action *(DBP vs. Court of Appeals, 65 SCAD 82, 249 SCRA 331).*

In *Acme Shoe vs. Court of Appeals (260 SCRA 714, 22 August 1996),* the Supreme Court held:

> "While a pledge, real estate mortgage, or antichresis may exceptionally secure after-incurred obligations so long as these future debts are accurately described, a chattel mortgage, however, can only cover obligations existing at the time the mortgage is constituted. Although a *promise* expressed in a chattel mortgage 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 chattel mortgage agreement covering the newly contracted debt is executed either by concluding a fresh chattel mortgage or by amending the old contract conformably with the form prescribed by the Chattel Mortgage Law. Refusal on the part of the borrower to execute the agreement so as to cover the after-incurred obligation can constitute an act of default on the part of the borrower of the financing agreement whereon the promise is written but, of course, the remedy of foreclosure can only cover the debts extant at the time of constitution and during the life of the chattel mortgage sought to be foreclosed.
>
> "A chattel mortgage, as hereinbefore so intimated, must comply substantially with the form prescribed by the Chattel Mortgage Law itself. One of the requisites, under Section 5 thereof, is an affidavit of good faith. While it is not doubted that if such an affidavit is not appended to the agreement, the chattel mortgage would still be valid between the parties (not against third persons acting in good faith), the fact, however, that the statute has provided that the parties to the contract must execute an oath that x x x (the) mortgage is made for the purpose

of securing the obligation specified in the conditions thereof, and for no other purpose, and that the same is a just and valid obligation and one not entered into for the purpose of fraud makes it obvious that the debt referred to in the law is a current, not an obligation that is yet merely contemplated. x x x By virtue of Section 3 of the Chattel Mortgage Law, the payment of the obligation automatically renders the chattel mortgage void or terminated. In *Belgian Catholic Missionaries, Inc. vs. Magallanes Press, Inc., et al.,* the Court has said —

x x x A mortgage that contains a stipulation in regard to future advances in the credit will take effect only from the date the same are made and not from the date of the mortgage."

b. *Object*

All movables which are within commerce may be pledged, provided they are susceptible of possession *(Art. 2094, Civil Code)*. Only immovable and alienable real rights in accordance with the laws, imposed upon immovables, may be the object of a contract of real estate mortgage or of antichresis. Real estate mortgages may validly secure *future* advancements or after-incurred obligations without the necessity of further registration everytime such advances are given (see *Mojica vs. Court of Affidavit, 201 SCRA 517*). Personal property may be the object of a chattel mortgage (see *Arts. 2024, 2132* and *2140, Civil Code*). Thus, any property not included in the enumeration of real property under Article 415 of the Civil Code may be the proper object of chattel mortgage. For purposes of the Chattel Mortgage Law, growing fruits are considered as personality (*Sec. 7, Act No. 1508*, as amended).

In *Makati Leasing and Finance Corporation vs. Wearever Textile Mills, Inc. (122 SCRA 297),* the respondent discounted and assigned several receivables with the petitioner and, to secure the collection of the receivables, a chattel mortgage was constituted by the respondent over

some raw materials and a piece of machinery. Upon respondent's default, the petitioners filed a petition for the foreclosure of the chattel mortgage. The trial court caused the seizure of the machinery which was bolted to the floor. The Court of Appeals ordered its return on the ground that it could not be the object of a chattel mortgage because it was real property. On appeal, the Supreme Court reversed the decision and said:

> "A similar, if not identical, issue was raised in *Tumalad vs. Vicencio (41 SCRA 143)* where this Court, speaking through Justice J.B.L. Reyes, ruled:
>
> "Although there is no specific statement referring to the subject house as personal property, yet by ceding, selling or transferring a property by way of chattel mortgage defendants-appellants could only have meant to convey the house as chattel, or at least, intended to treat the same as such, so that they should not now be allowed to make an inconsistent stand by claiming otherwise."

Nonetheless, in the foreclosure of the mortgage, the procedure for real estate (not chattel) mortgages should be observed.

c. *Cause*

The cause that supports the principal contract or the obligation itself may adequately serve as the essential cause for an accessory contract. In cases where a person, other than the principal debtor, is the pledgor or mortgagor, the pledge or mortgage can either be onerous or gratuitous.

3. Effects

a. *Right of Retention*

In Pledges

The contract of *pledge* gives a creditor the right to retain the thing in his possession or in that of a third person to whom it has been delivered, until the debt is paid

(Art. 2098, Civil Code). The debtor cannot ask for the return of the thing pledged against the will of the creditor, unless and until he has paid the debt and its interest, with expenses in a proper case *(Art. 2105, Civil Code).* The creditor shall take care of the thing pledged with the diligence of a good father of a family; he has a right to the reimbursement of the expenses made for its preservation and is liable for its loss or deterioration, in conformity with the provisions of the Code *(Art. 2099, Civil Code;* see *Cruz vs. Lee, 54 Phil. 10).* The pledgee cannot deposit the thing pledged with a third person, unless there is a stipulation authorizing him to do so. The pledgee is responsible for the acts of his agents or employees with respect to the thing pledged *(Art. 2100, Civil Code).* The pledgor has the same responsibility as a bailor in *commodatum* under Article 1951 (see *Art. 2101, Civil Code*).

If through the negligence or willful act of the pledgee, the thing pledged is in danger of being lost or impaired, the pledgor may require that it be deposited with a third person *(Art. 2106, Civil Code).* If there are reasonable grounds to fear the destruction or impairment of the thing pledged, the pledgor may demand the return of the thing, upon offering another thing in pledge, provided the latter is of the same kind as the former and not of inferior quality and without prejudice to the right of the pledgee under the provisions of Article 2108 *(infra.).* The pledgee is bound to advise the pledgor, without delay, of any danger to the thing pledged *(Art. 2107, Civil Code).* If, without the fault of the pledgee, there is danger of destruction, impairment, or diminution in value of the thing pledged, he may cause the same to be sold at a public sale. The proceeds of the auction shall be a security for the principal obligation in the same manner as the thing originally pledged *(Art. 2108, Civil Code).*

If the creditor is deceived on the substance or quality of the thing pledged, he may either claim another thing in its stead or demand immediate payment of the principal obligation *(Art. 2109, Civil Code).*

Unless the thing pledged is expropriated, the debtor continues to be the owner thereof. The creditor may nevertheless bring the actions which pertain to the owner of the thing pledged in order to recover it from, or defend it against, a third person *(Art. 2103, Civil Code)*.

The creditor cannot use the thing pledged, without the authority of the owner, and if he should do so, or should misuse the thing in any other way, the owner may ask that it be judicially or extra-judicially deposited. When the preservation of the thing pledged requires its use, it must be used by the creditor but only for that purpose *(Art. 2104, Civil Code)*.

If the thing pledged is returned by the pledgee to the pledgor or owner, the pledge is extinguished. Any stipulation to the contrary shall be void. If subsequent to the perfection of the pledge, the thing is in the possession of the pledgor or owner, there is a *prima facie* presumption that the same has been returned by the pledgee. This same presumption exists if the thing pledged is in the possession of a third person who has received it from the pledgor or owner after the constitution of the pledge *(Art. 2110, Civil Code)*. It has been held, however, that it would be possible for the pledgee to temporarily entrust the physical possession of the thing pledged without extinguishing the debt (see *Yuliongsiut vs. Philippine National Bank, 22 SCRA 585*).

A statement in writing by the pledgee that he renounces or abandons the pledge is sufficient to extinguish the pledge. For this purpose, neither the acceptance by the pledgor or owner, nor the return of the thing pledged is necessary, the pledgee becoming thereby a depositary *(Art. 2111, Civil Code)*.

In Mortgages and Antichresis

The mortgagor in chattel and real estate mortgages continues in the possession of the property. The mortgage directly and immediately subjects the property upon which

it is imposed, whosoever the possessor may be, to the fulfillment of the obligation for whose security it was constituted *(Art. 2126, Civil Code; E.C. McCullough & Co. vs. Veloso, 46 Phil. 1)*. Even without a formal assumption of mortgage, the mortgage follows the property whoever the possessor may be. A real mortgage subsists notwithstanding changes of ownership and all subsequent purchases of the property must respect the mortgage, whether the transfer to them be with or without consent of the mortgagee *(Asuncion vs. Evangelista, 114 SCAD 384, 316 SCRA 848)*.

The creditor may claim from a third person in possession of the mortgaged property the payment of the part of the credit secured by the property which said third person possesses, upon the terms and with the formalities which the law establishes *(Art. 2129, Civil Code; E.C. McCullough & Co. vs. Veloso, supra.)*.

In antichresis, the law does not specifically require the delivery of possession to the creditor, for what is really essential is that the creditor enjoys the fruits of the property (see *Art. 2132, Civil Code;* see also *Dizon vs. Gaborro, 83 SCRA 688; Adrid vs. Morga, 108 Phil. 927)*. Possession of the property however, has been held to be a standard characteristic of that contract (see *Cosio vs. Palileo, 17 SCRA 196; Trillana vs. Manansala, 96 Phil. 865; Macapinlac vs. Gutierrez Repide, 43 Phil. 770*).

b. *Right over the Fruits / Accessions / Proceeds*

In Pledges

If the pledge earns or produces fruits, income, dividends, or interests, the creditor shall compensate what he receives with those which are owing him; but if none are owing him, or insofar as the amount may exceed that which is due, he shall apply it to the principal. Unless there is a stipulation to the contrary, the pledge shall extend to the interest and earnings of the right pledged.

In case of a pledge of animals, their offspring shall pertain to the pledgor or owner of the animals pledged, but shall be subject to the pledge, if there is no stipulation to the contrary *(Art. 2102, Civil Code)*.

If a credit which has been pledged becomes due before it is redeemed, the pledgee may collect and receive the amount due. He shall apply the same to the payment of his claim and deliver the surplus, should there be any, to the pledgor *(Art. 2118, Civil Code)*.

In Real Estate Mortgage

The mortgage extends to the natural accessions, to the improvements, *growing* fruits, and the rents or income not yet received when the obligation becomes due, and to the amount of the indemnity granted or owing to the proprietor from the insurers of the property mortgaged, or in virtue of expropriation for public use, with the declarations, amplifications and limitations established by law, whether the estate remains in the possession of the mortgagor, or it passes into the hands of a third person *(Art. 2127, Civil Code; Berkenkotter vs. Cu Unjieng, 61 Phil. 664)*.

Article 2127 of the Civil Code. The law reads:

> "Art. 2127. The mortgage extends to the natural accessions, to the improvements, growing fruits, and the rents or income not yet received when the obligation becomes due, and to the amount of the indemnity granted or owing to the proprietor from the insurers of the property mortgaged, or in virtue of expropriation for public use, with the declarations, amplifications and limitations established by law, whether the estate remains in the possession of the mortgagor, or passes into the hands of a third person."

This article extends the effects of the real estate mortgage to accessions and accessories found on the

hypothecated property when the secured obligation becomes due. The law is predicated on an assumption that the ownership of such accessions and accessories also belongs to the mortgagor as the owner of the principal. The provision has thus been seen by the Court, in a long line of cases beginning in 1909 with Bischoff vs. Pomar, to mean that all improvements subsequently introduced or owned by *the mortgagor* on the encumbered property are deemed to form part of the mortgage. That the improvements are to be considered so incorporated only if so owned by the mortgagor is a rule that can hardly be debated since a contract of security, whether real or personal, needs as an indispensable element thereof the ownership by the pledgor or mortgagor of the property pledged or mortgaged. The rationale should be clear enough — in the event of default on the secured obligation, the foreclosure sale of the property would naturally be the next step that can expectedly follow. A sale would result in the transmission of title to the buyer which is feasible only if the seller can be in a position to convey ownership of the thing sold (Article 1458, Civil Code). It is to say, in the instant case, that a foreclosure would be ineffective unless the mortgagor has title to the property to be foreclosed.

It may not be amiss to state, in passing, that in respect of the lease on the foreclosed property, the buyer at the foreclosure sale merely succeeds to the rights and obligations of the pledgor-mortgagor subject, however, to the provisions of Article 1676 of the Civil Code on its possible termination. *(Castro, Jr. vs. Court of Appeals, G.R. No. 97401, 06 December 1995).*

In Antichresis

In antichresis, the creditor acquires the right to receive the fruits of the property with the obligation to apply them to the payment of the interest, if owing, and thereafter to the principal of his credit *(Art. 2132, Civil Code)*. The actual market value of the fruits at the time of

the application thereof to the interest and principal shall be the measure of such application *(Art. 2133, Civil Code)*. The creditor, however, is obliged, unless there is a stipulation to the contrary, to pay the taxes and charges upon the estate. He is also bound to bear the expenses necessary for its preservation and repair. The sums spent for these purposes stated shall be deducted from the fruits *(Art. 2135, Civil Code; Rosales vs. Tanseco, 90 Phil. 496)*.

The debtor cannot reacquire the enjoyment of the immovable without first having totally paid what he owes the creditor. But the latter, in order to exempt himself from the obligations imposed upon him by the preceding article, may always compel the debtor to enter again upon the enjoyment of the property, except when there is a stipulation to the contrary *(Art. 2136, Civil Code)*.

In Chattel Mortgages

The mortgage is deemed to cover only the property described therein and not like or substituted property thereafter acquired by the mortgagor notwithstanding any contrary stipulation *(Sec. 7, Act 1508)*. This prohibition has been held not to cover stocks in trade which by their very nature are revolving or floating *(Torres vs. Limjap, 56 Phil. 141),* or which are perishable and naturally expected to be replaced (see *People's Bank and Trust Co. vs. Dahican Lumber Co., 20 SCRA 84*).

A stipulation in another agreement, such as in a loan contract or a credit arrangement, providing that upon the acquisition by the borrower of personal property (for which the financing accommodation is given) the same shall be hypothecated by way of, or included in, a chattel mortgage, would be valid but the chattel mortgage itself on said property shall not arise or be deemed covered until, in fact, the chattel mortgage thereon is executed after its acquisition. Refusal on the part of the borrower to execute (or include by a supplement or amendment to) a chattel mortgage so as to cover the newly

acquired property can constitute an act of default on the part of the borrower of the *financial agreement* but the property merely promised to be hypothecated cannot itself be an object of foreclosure.

Although a promise expressed in a chattel mortgage to include debts to be contracted can be a binding commitment that can be compelled upon the security itself, however, it does not come into existence or arise until after a chattel mortgage agreement covering the newly contracted debts is executed either by concluding a fresh chattel mortgage or by amending the old contract conformably with the form prescribed by the Chattel Mortgage Law *(Acme Shoe vs. Court of Appeals, 73 SCAD 410, 260 SCRA 714)*.

c. *Alienation of Property*

In *pledge*, the thing, with the consent of the pledgee, may be alienated by the pledgor or owner, subject to the pledge. The ownership of the thing pledged is transmitted to the vendee or transferee as soon as the pledgee consents to the alienation, but the latter shall continue in possession *(Art. 2097, Civil Code)*.

In a *real estate mortgage*, a stipulation forbidding the owner from alienating the immovable mortgaged shall be void *(Art. 2130, Civil Code; Rivera vs. Peña, 1 SCRA 474)*. The stipulation in the real estate mortgage which prohibits the mortgagor from selling the mortgaged property without the written consent of the mortgagee contravenes the law. The phrase "without the written consent of the mortgagee" is of no real comfort to the mortgagee and does nothing but to stress the restriction against what should otherwise be an unimpeded right of the mortgagor to alienate the property. The clear intention of the law is to outlaw a stipulation that would effectively prevent the mortgagor from freely conveying the property during the life of the mortgage. Needless to state, the injunction of the law may not be circumvented, whether directly or indirectly, by the parties. No similar provision

is found in the law on *antichresis* but the rationale on the prohibition should apply equally to it. The mortgage credit itself, however, may be freely alienated or assigned to a third person, in whole or in part, with the formalities required by law *(Art. 2128, Civil Code; see Litonjua vs. L & R Corporation, 320 SCRA 405)*.

In a chattel mortgage, it is punishable to sell, encumber or remove from the province or city of its location, the mortgaged chattel without the consent of the mortgagee (see *Art. 319, Revised Penal Code*).

In *Servicewide Specialists, Incorporated vs. Intermediate Appellate Court (174 SCRA 80),* the Court has observed that in a chattel mortgage, the mortgagor continues to be the owner of the property, and he has thus the power to alienate the same, but he is obliged under pain of penal liability to secure the written consent of the mortgagee. The instruments of mortgage is binding, while they subsist, not only upon the parties executing them but also upon those who later, by purchase or otherwise, acquire the property referred to therein. The absence of the written consent of the mortgagee to the sale of the mortgaged property in favor of a third person affects not the validity of the sale but only the penal liability of the mortgagor (see also *Dy vs. Court of Appeals, 198 SCRA 826,* but see *Art. 1409, Civil Code*).

d. *Extinguishment / Foreclosures*

Contracts of real security, being merely accessory in nature, are extinguished at the same time as that of the principal contract or obligation to which they are attached and which they secure, as well as for the same causes as all other obligations.

Such contracts are likewise extinguished upon the foreclosure of the property by the creditor upon non-payment of his credit in due time subject to such rights as subrogation and redemption in proper cases. The foreclosure may be effected judicially or extra-judicially such

as in pledges *(Art. 2112, Civil Code)* and chattel mortgages *(Art. 1508)* or when there is a special power to so extra-judicially foreclose in the case of real estate mortgages (see *Act No. 3135,* as amended; *Santiago vs. Pioneer Savings Bank, 157 SCRA 100*). Foreclosure by lots may be asked *(PNB vs. De los Reyes, 179 SCRA 619).*

The three common types of forced sales arising from a failure to pay a mortgage debt include (a) an extrajudicial foreclosure sale, governed by Act No. 3135; (b) a judicial foreclosure sale, regulated by Rule 68 of the Rules of Court; and (c) an ordinary execution sale, covered by Rule 39 of the Rules of Court. Each mode, peculiarly, has its own requirements.

In an extrajudicial foreclosure, for instance, Section 3 of Act No. 3135 is the law applicable; the provision reads:

> "Sec. 3. Notice shall be given by posting notices of the sale for not less than twenty days in at least three public places of the municipality or city where the property is situated, and if such property is worth more than four hundred pesos, such notice shall also be published once a week for at least three consecutive weeks in a newspaper of general circulation in the municipality or city."

The Act only requires (1) the posting of notices of sale in three public places, and (2) the publication of the same in a newspaper of general circulation. Personal notice to the mortgagor is not necessary. Nevertheless, the parties to the mortgage contract are not precluded from exacting additional requirements *(Spouses Antonio E.A. Concepcion & Manuela S. Concepcion vs. CA, Home Savings Bank & Trust Co., et al., G.R. No. 122079, 27 June 1997, 274 SCRA 614).*

In pledges particularly, the creditor to whom the credit has not been satisfied in due time may proceed before a Notary Public for the sale of the thing pledged. This sale shall be made at a public auction, and with

notification to the debtor and the owner of the thing pledged in a proper case, stating the amount for which the public sale is to be held. If at the first auction the thing is not sold, a second one with the same formalities shall be held; and if at the second auction there is no sale either, the creditor may appropriate the thing pledged. In this case he shall be obliged to give an acquittance for his entire claim *(Art. 2112, Civil Code)*. At the public auction, the pledgor or owner may bid. He shall, moreover, have a better right if he should offer the same terms as the highest bidder. The pledgee may also bid, but his offer shall not be valid if he is the only bidder *(Art. 2113, Civil Code)*. All bids at the public auction shall offer to pay the purchase price at once. If any other bid is accepted, the pledgee is deemed to have received the purchase price, as far as the pledgor or owner is concerned *(Art. 2114, Civil Code)*.

If two or more things are pledged, the pledgee may choose which he will cause to be sold, unless there is a stipulation to the contrary. He may demand the sale of only as many of the things as are necessary for the payment of the debt *(Art. 2119, Civil Code)*.

A thing under a pledge by operation of law may be sold only after demand of the amount for which the thing is retained. The public auction shall take place within one month after such demand. If, without just grounds, the creditor does not cause the public sale to be held within such period, the debtor may require the return of the thing *(Art. 2122, Civil Code)*.

With regard to pawnshops and other establishments, which are engaged in making loans secured by pledges, the special laws and regulations concerning them shall be observed, and suppletorily, the provisions of the Civil Code *(Art. 2123, Civil Code;* see also *Sec. 70, Insolvency Law)*.

In foreclosure and execution sales, unlike the contrary possibility in voluntary conveyances or assign-

ments, the buyer gets the rights, not liabilities, of the debtor but holds the foreclosed property subject to legitimate charges, including preferred liens and encumbrances, thereon and, in appropriate cases, to the right of redemption or right of subrogation. The buyer, in exercising his rights as such, cannot be held to have thereby also assumed unqualifiedly the liabilities of the debtor even beyond the benefit derived by the creditor consequent to the foreclosure (or execution sale). (But see *Spouses Laganda vs. Court of Appeals, G.R. No. 102526, 21 May 1998*).

In antichresis, the creditor may petition the court for the payment of the debt or the sale of the real property, in which case, the Rules of Court on the foreclosure of mortgages shall apply *(Art. 2137, Civil Code)*. Stipulations in a contract of antichresis for the extrajudicial foreclosure of the security may be allowed in the same manner as they are allowed in contracts of mortgage (see *El Hogar Filipino vs. Paredes, 45 Phil. 178*).

While the law recognizes the right of a bank to foreclose a mortgage upon the mortgagor's failure to pay his obligation, it is imperative that such right be exercised according to its clear mandate *(Metropolitan Bank and Trust Company vs. Francisco Y. Wong, G.R. No. 120859, 26 June 2001, 150 SCAD 178)*. The procedure in all other cases of foreclosure are governed by the Rules of Court and special laws. In extra-judicial foreclosure under Act No. 3135, *personal* notice to the mortgagor is not additionally required (see *GSIS vs. Court of Appeals, 170 SCRA 533)*. Section 3, Act No. 3135 requires: (1) the posting of notices of sale in three public places, and (2) the publication of the same in a newspaper of general circulation. Personal notice to the mortgagor is not necessary. Nevertheless, the parties to the mortgage contract are not precluded from exacting additional requirements *(Metropolitan Bank and Trust Company vs. Francisco Y. Wong, supra.)*.

Deficiency Judgment

In *pledges*, the sale of the thing pledged shall extinguish the principal obligation, whether or not the proceeds of the sale are equal to the amount of the principal obligation, interest and expenses in a proper case. If the price of the sale is more than said amount, the debtor shall not be entitled to the excess, unless it is otherwise agreed. If the price of the sale is less, neither shall the creditor be entitled to recover the deficiency notwithstanding any stipulation to the contrary *(Art. 2115, Civil Code; Manila Surety & Fidelity Co. vs. Velayo, 21 SCRA 515)*. After the public auction, the pledgee shall promptly advise the pledgor or owner of the result thereof *(Art. 2116, Civil Code)*. In pledges created by operation of law, however, such as those referred to in Articles 546, 1731, and 1944, which are also governed by the law on pledge on the possession, care and sale of the thing, as well as on the termination of the pledge, after payment of the debt and expenses, the remainder of the price of the sale shall be delivered to the obligor *(Art. 2121, Civil Code)*. In case of deficiency, the same may no longer be recovered by the creditor. The rules on concurrence and preferences of credits that would allow participation of lienholders over the other assets of the debtor contemplate cases where a deficiency judgment is not precluded.

If a third person secures an obligation by pledging his own movable property under the provisions of Article 2085, he shall have the same rights as a guarantor under Articles 2066 to 2070 and Articles 2077 to 2081. He is not prejudiced by any waiver of defense by the principal obligor *(Art. 2120, Civil Code)*.

In mortgages and antichresis, the deficiency or excess is for the account or credit, as the case may be, of the debtor *(Rules of Court on Foreclosures; Gorospe vs. Gochengco, 106 Phil. 425; Act No. 3135; Philippine Bank of Commerce vs. Vera, 6 SCRA 1026; Act No. 1508; Philippine National Bank vs. Manila Investment & Construc-*

tion Co., 38 SCRA 462), except in the foreclosure of chattel mortgage of property sold on installment under the provisions of Article 1484 of the Civil Code where the foreclosure disentitles the installment seller from recovering the deficiency (see *Reyes vs. Luneta Motors, 117 SCRA 726*; see also discussions, *supra*., on Article 1484 under the Title on *Sales*). The loss of the property mortgaged does not free the debtor-mortgagor from the principal obligation *(Perla Compania de Seguros, Inc. vs. Court of Appeals, 208 SCRA 487).*

Equity and Rights of Redemption

The pledgor, mortgagor, or third person who has any right in or to the property encumbered may satisfy the principal obligation as soon as it becomes due and demandable and before foreclosure, or in the case of judicial foreclosure, by exercising the equity of redemption within 90 days from the order of foreclosure. After foreclosure, there is no right of redemption, except in foreclosures of real property by banking institutions and in the extra-judicial foreclosures of *real property* by any other mortgagee by an actual tender of payment for the full amount of the repurchase price. The filing of a complaint to enforce the repurchase has the effect of preserving the right to redeem (see *Belisario vs. Intermediate Appellate Court, 165 SCRA 101; Art. 2117, Civil Code; Rules of Court on Foreclosure; Sec. 76, General Banking Act; Act No. 3135;* see *P.D. 385, Filipinas Marble Corp. vs. Intermediate Appellate Court, 142 SCRA 180; Act No. 1508;* see also *Villar vs. Javier de Paderanga, 97 Phil. 604*). During the redemption period of one year from registration of the certificate of foreclosure *(Bermudez vs. Reyes, 201 SCRA 648),* the purchaser is entitled to the possession provided that: (a) a proper motion therefor has been filed, (b) a bond is approved, and (c) no third person is involved *(Sec. 7, Act 3135; Banco Filipino vs. Intermediate Appellate Court, 142 SCRA 44)*. In one case, the Supreme Court has ruled that the "title to the land sold

under mortgage foreclosure remains (with) the mortgagor or his grantee, until the expiration of the redemption period and conveyance by the master's deed" *(Medida vs. Court of Appeals, 208 SCRA 887)*. This rule is not to be likened, however, to the rights of redemption in *pacto de retro* sales, where ownership remains with the buyer *a retro* during the period of redemption and while the right to redeem is not exercised.

If the buyer at auction commits himself to resell the property to the mortgagor beyond the period of redemption, the same would amount to a mere offer, or an option if supported by an independent consideration. In *Rural Bank of Parañaque vs. Remolado, 135 SCRA 409*, the Court has held the commitment to be *void* if it has no consideration distinct from the price.

TITLE XVII. EXTRA-CONTRACTUAL OBLIGATIONS

The Civil Code under this Title governs the two extra-contractual relations of, or arising from, *quasi-contracts* and *quasi-delicts* (see discussions, *supra*., on the Sources and Breach of Obligation under the Title on *Obligations*).

Chapter 1

Quasi-Contracts

Art. 2142. Certain lawful, voluntary and unilateral acts give rise to the juridical relation of quasi-contract to the end that no one shall be unjustly enriched or benefited at the expense of another. (n)

Art. 2143. The provisions for quasi-contracts in this Chapter do not exclude other quasi-contracts which may come within the purview of the preceding article. (n)

A quasi-contract may then be described as a juridical relation that the law creates on the basis of certain *voluntary* and *unilateral*, but *lawful*, acts of a person, in the interest of equity and justice such as the avoidance of what could otherwise be a situation of unjust enrichment. A quasi-contract will not arise if the act is not unilateral and voluntary such as when it is by virtue of an express contract *(Cruz vs. Tuason & Co., 76 SCRA 543; Tangco vs. Court of Appeals, 89 Phil. 395),* or if the act is unlawful *(Leung Ben vs. O'Brien, 38 Phil. 182);* or if no unjust enrichment exists *(Pascual vs. Court of Industrial Relations, 88 SCRA 645).*

Unlike the unjust enrichment governed by the provisions on Human Relations (see discussion under the Preliminary Title of the Civil Code, *supra*.), where the actor is enriched at the impoverishment of another, in quasi-contracts it is generally at the expense of the actor that the other is benefited. Quasi-contracts are either nominate *(negotiorum gestio* and *solutio indebiti)* or innominate (exemplified by, but not limited to, those enumerated in *Arts. 2164-2175, Civil Code*; see *Leung Ben vs. O'Brien, supra*.). The rights granted by law to a party under the provisions on quasi-contracts prescribe in six years conformably with the provisions of Article 1145 of the Code *(supra.; Procter & Gamble vs. Mun. of Jagna, Bohol, 94 SCRA 894).*

Section 1 — Negotiorum Gestio

Art. 2144. Whoever voluntarily takes charge of the agency or management of the business or property of another, without any power from the latter, is obliged to continue the same until the termination of the affair and its incidents, or to require the person concerned to substitute him, if the owner is in a position to do so. This juridical relation does not arise in either of these instances:

(1) When the property or business is not neglected or abandoned;

(2) If in fact the manager has been tacitly authorized by the owner.

In the first case, the provisions of Articles 1317, 1403, No. 1 and 1404 regarding unauthorized contracts shall govern.

In the second case, the rules on agency in Title X of this Book shall be applicable. (1888a)

Art. 2145. The officious manager shall perform his duties with all the diligence of a good father of a family, and pay the damages which through his fault or

negligence may be suffered by the owner of the property or business under management.

The courts may, however, increase or moderate the indemnity according to the circumstances of each case. (1889a)

Art. 2146. If the officious manager delegates to another person all or some of his duties, he shall be liable for the acts of the delegate, without prejudice to the direct obligation of the latter toward the owner of the business.

The responsibility of two or more officious managers shall be solidary, unless the management was assumed to save the thing or business from imminent danger. (1890a)

Art. 2147. The officious manager shall be liable for any fortuitous event:

(1) If he undertakes risky operations which the owner was not accustomed to embark upon;

(2) If he has preferred his own interest to that of the owner;

(3) If he fails to return the property or business after demand by the owner;

(4) If he assumed the management in bad faith. (1891a)

Art. 2148. Except when the management was assumed to save the property or business from imminent danger, the officious manager shall be liable for fortuitous events:

(1) If he is manifestly unfit to carry on the management;

(2) If by his intervention he prevented a more competent person from taking up the management. (n)

Art. 2149. The ratification of the management by the owner of the business produces the effects of an express agency, even if the business may not have been successful. (1892a)

Art. 2150. Although the officious management may not have been expressly ratified, the owner of the property or business who enjoys the advantages of the same shall be liable for obligations incurred in his interest, and shall reimburse the officious manager for the necessary and useful expenses and for the damages which the latter may have suffered in the performance of his duties.

The same obligation shall be incumbent upon him when the management had for its purpose the prevention of an imminent and manifest loss, although no benefit may have been derived. (1893)

Art. 2151. Even though the owner did not derive any benefit and there has been no imminent and manifest danger to the property or business, the owner is liable as under the first paragraph of the preceding article, provided:

(1) The officious manager has acted in good faith, and

(2) The property or business is intact, ready to be returned to the owner. (n)

Art. 2152. The officious manager is personally liable for contracts which he has entered into with third persons, even though he acted in the name of the owner, and there shall be no right of action between the owner and third persons. These provisions shall not apply:

(1) If the owner has expressly or tacitly ratified the management, or

(2) When the contract refers to things pertaining to the owner of the business. (n)

Art. 2153. The management is extinguished:

(1) When the owner repudiates it or puts an end thereto;

(2) When the officious manager withdraws from the management, subject to the provisions of Article 2144;

(3) By the death, civil interdiction, insanity or insolvency of the owner or the officious manager. (n)

Negotiorum gestio arises when a person, without the express or implied authority of, or opposition from, the owner of a business or property which is neglected or abandoned, takes charge of the agency or management thereof. The ratification of the management by the owner of the business produces the effects of an express agency, even if the business may not have been successful *(Art. 2149, Civil Code; Gutierrez Hermanos vs. Orense, 28 Phil. 571).*

Responsibilities of the Officious Manager

The officious manager shall —

a. Continue taking charge of the agency or management until the termination of the affairs and its incidents, but he may require the owner, if the latter is in a position to do so, to substitute the officious manager *(Art. 2144, Civil Code).*

b. Perform his duties with all the diligence of a good father of a family, and pay the damages which through his fault or negligence may be suffered by the owner of the property or business under management, but the courts may, however, increase or moderate the indemnity according to the circumstances of each case *(Art. 2145, Civil Code).*

c. Be liable for any fortuitous event:

(1) If he undertakes risky operations which the owner was not accustomed to embark upon;

(2) If he preferred his own interest to that of the owner;

(3) If he fails to return the property or business after demand by the owner;

(4) If he assumed the management in bad faith *(Art. 2147, Civil Code);*

(5) Except when the management was assumed to save the property or business from imminent danger —

(a) If he is manifestly unfit to carry on the management;

(b) If by his intervention he prevented a more competent person from taking up the management *(Art. 2148, Civil Code)*.

d. Be personally liable for contracts which he has entered into with third persons, even though he acted in the name of the owner, and there shall be no right of action between the owner and third persons, except —

(1) When the owner has expressly or tacitly ratified the management, or

(2) When the contract refers to things pertaining to the owner of the business *(Art. 2152, Civil Code)*.

If the officious manager delegates to another person all or some of his duties, he shall be liable for the acts of the delegate, without prejudice to the direct obligation of the latter toward the owner of the business.

The responsibility of two or more officious managers shall be solidary, unless the management was assumed to save the things or business from imminent danger *(Art. 2146, Civil Code)*.

A gestor who attempts to appropriate the property is governed by the rules on implied trust (see discussions on *Art. 1456, supra.; Adille vs. Court of Appeals, 157 SCRA 455*).

Responsibilities of the Owner

The owner shall —

a. Be liable for obligations incurred in his interest and shall reimburse the officious manager for the necessary and useful expenses and for the damages which the latter may have suffered in the performance of his duties —

(1) When such owner has enjoyed the advantages of the officious management although it may not have been expressly ratified by him;

(2) When the management had for its purpose the prevention of an imminent and manifest loss, although no benefit may have been derived *(Art. 2150, Civil Code);* and

(3) When, even though he did not derive any benefit and there has been no imminent and manifest danger to the property or business —

(a) The officious manager has acted in good faith; and

(b) The property or business is intact, ready to be returned to the owner *(Art. 2151, Civil Code).*

b. Be liable for contracts which the officious manager has entered into with third persons when —

(1) Such owner has expressly or tacitly ratified the management; or

(2) The contract refers to things pertaining to the owner of the business (see *Art. 2152, Civil Code*).

Extinguishment of Management

The management is extinguished:

(1) When the owner repudiates it or puts an end thereto;

(2) When the officious manager withdraws from the management, subject to the provisions of Article 2144 *(supra.);*

(3) By the death, civil interdiction, insanity or insolvency of the owner or officious manager *(Art. 2153, Civil Code).*

Section 2 — Solutio Indebiti

Art. 2154. If something is received when there is no right to demand it, and it was unduly delivered through mistake, the obligation to return it arises. (1895)

Art. 2155. Payment by reason of a mistake in the construction or application of a doubtful or difficult question of law may come within the scope of the preceding article. (n)

Art. 2156. If the payer was in doubt whether the debt was due, he may recover if he proves that it was not due. (n)

Art. 2157. The responsibility of two or more payees, when there has been payment of what is not due, is solidary. (n)

Art. 2158. When the property delivered or money paid belongs to a third person, the payee shall comply with the provisions of Article 1984. (n)

Art. 2159. Whoever in bad faith accepts an undue payment, shall pay legal interest if a sum of money is involved, or shall be liable for fruits received or which should have been received if the thing produces fruits.

He shall furthermore be answerable for any loss or impairment of the thing from any cause, and for damages to the person who delivered the thing, until it is recovered. (1986a)

Art. 2160. He who in good faith accepts an undue payment of a thing certain and determinate shall only be responsible for the impairment or loss of the same or its accessories and accessions insofar as he has thereby been benefited. If he has alienated it, he shall return the price or assign the action to collect the sum. (1897)

Art. 2161. As regards the reimbursement for improvements and expenses incurred by him who unduly received the thing, the provisions of Title V of Book II shall govern. (1898)

Art. 2162. He shall be exempt from the obligation to restore who, believing in good faith that the payment was being made of a legitimate and subsisting claim, destroyed the document, or allowed the action to prescribe, or gave up the pledges, or cancelled the guaranties for his right. He who paid unduly may proceed only against the true debtor or the guarantors with regard to whom the action is still effective. (1899)

Art. 2163. It is presumed that there was a mistake in the payment if something which had never been due or had already been paid was delivered; but he from whom the return is claimed may prove that the delivery was made out of liberality or for any other just cause. (1901)

Solutio indebiti arises when something is delivered through *mistake* to, and received by, a person who has *no right to demand it* and obligates thereby the latter to return such thing (see *Banco de Oro vs. Equitable Bank, 157 SCRA 188; Andres vs. Manufacturers Hanover & Trust Corp., 177 SCRA 618*). The quasi-contract of *solutio indebiti* is one of concrete manifestations of the ancient principle that no one shall enrich himself unjustly at the expense of another. *Solutio indebiti* applies where: (1) a payment is made when there exists no binding relation between the payor, who has no duty to pay, and the person who received the payment, and (2) the payment is made through mistake, and not through liberality or some other cause *(Power Commercial and Industrial Corp. vs. Court of Appeals, 84 SCAD 67, 274 SCRA 597).* Payment by reason of a mistake in the construction or application of a doubtful or difficult question of law may come within the scope of *solutio indebiti (Art. 2155, Civil Code;* see *Puyat & Sons vs. Manila, 7 SCRA 970).* If the payer was in doubt whether the debt was due, he may recover if he proves that it was not due *(Art. 2156, Civil Code).* It is presumed that there was a mistake in the payment if something, which had never been due or had already been paid, was delivered; but he from whom the return is

claimed may prove that the delivery was made out of liberality or for any other just cause *(Art. 2163, Civil Code)*.

Responsibilities of Payee

The payee is obligated to return what he has received *(Art. 2154, Civil Code)*.

A payee in bad faith accepting an undue payment shall pay legal interest if a sum of money is involved or shall be liable for fruits received or which should have been received if the thing produces fruits. He shall, furthermore, be answerable for any loss or impairment of the thing from any cause and for damages to the person who delivered the thing until it is *recovered (Art. 2159, Civil Code)*.

He who in good faith accepts an undue payment of a thing certain and determinate shall only be responsible for the impairment or loss of the same or its accessories and accessions insofar as he has thereby been benefited. If he has alienated it, he shall return the price or assign the action to collect the sum *(Art. 2160, Civil Code)*. He shall be exempt from the obligation to restore who, believing in good faith that the payment was being made of a legitimate and subsisting claim, destroyed the document, or allowed the action to prescribe, or gave up the pledges, or cancelled the guaranties for his right. He who paid unduly may proceed only against the true debtor or the guarantors with regard to whom the action is still effective *(Art. 2162, Civil Code)*.

The responsibility of two or more payees, when there has been payment of what is not due, is solidary *(Art. 2157, Civil Code)*.

Suppletorily, the rules on "Possession" established in Title V, Book II of the Civil Code, can apply.

Right of Third Person

When the property delivered or money paid belongs to a third person, the payee shall advise such person of

the payment. If, in spite of such information, he does not claim the property or money paid within one month, the payee shall be relieved of all responsibility by returning the thing to the payor *(Art. 2158* in relation to *Art. 1984, Civil Code)*.

In cases where the payor has, indeed, an obligation but which is owing to a third person, his payment to the wrong party will also be governed by the provisions of Articles 1240-1242 of the Code (see discussions on Payment under Extinguishment of Obligations in the Title on *Obligations*).

Section 3 — Other Quasi-Contracts

Art. 2164. When, without the knowledge of the person obliged to give support, it is given by a stranger, the latter shall have a right to claim the same from the former, unless it appears that he gave it out of piety and without intention of being repaid. (1894a)

Art. 2165. When funeral expenses are borne by a third person, without the knowledge of those relatives who were obliged to give support to the deceased, said relatives shall reimburse the third person, should the latter claim reimbursement. (1894a)

Art. 2166. When the person obliged to support an orphan, or an insane or other indigent person unjustly refuses to give support to the latter, any third person may furnish support to the needy individual, with right of reimbursement from the person obliged to give support. The provisions of this article apply when the father or mother of a child under eighteen years of age unjustly refuses to support him.

Art. 2167. When through an accident or other cause a person is injured or becomes seriously ill, and he is treated or helped while he is not in a condition to give consent to a contract, he shall be liable to pay for the services of the physician or other person aiding him,

unless the service has been rendered out of pure generosity.

Art. 2168. When during a fire, flood, storm, or other calamity, property is saved from destruction by another person without the knowledge of the owner, the latter is bound to pay the former just compensation.

Art. 2169. When the government, upon the failure of any person to comply with health or safety regulations concerning property, undertakes to do the necessary work, even over his objection, he shall be liable to pay the expenses.

Art. 2170. When by accident or other fortuitous event, movables separately pertaining to two or more persons are commingled or confused, the rules on co-ownership shall be applicable.

Art. 2171. The rights and obligations of the finder of lost personal property shall be governed by Articles 719 and 720.

Art. 2172. The right of every possessor in good faith to reimbursement for necessary and useful expenses is governed by Article 546.

Art. 2173. When a third person, without the knowledge of the debtor, pays the debt, the rights of the former are governed by Articles 1236 and 1237.

Art. 2174. When in a small community a majority of the inhabitants of age decide upon a measure for protection against lawlessness, fire, flood, storm or other calamity, any one who objects to the plan and refuses to contribute to the expenses but is benefited by the project as executed shall be liable to pay his share of said expenses.

Art. 2175. Any person who is constrained to pay the taxes of another shall be entitled to reimbursement from the latter.

The foregoing provisions are mere illustrations of other specific cases of quasi-contracts; the enumeration has no preclusive effect on possible other instances.

Chapter 2

Quasi-Delicts

Art. 2176. Whoever by act or omission causes damage to another, there being fault or negligence, is obliged to pay for the damage done. Such fault or negligence, if there is no pre-existing contractual relation between the parties, is called a quasi-delict and is governed by the provisions of this Chapter. (1902a)

Art. 2177. Responsibility for fault or negligence under the preceding article is entirely separate and distinct from the civil liability arising from negligence under the Penal Code. But the plaintiff cannot recover damages twice for the same act or omission of the defendant. (n)

Art. 2178. The provisions of Articles 1172 to 1174 are also applicable to a quasi-delict. (n)

Art. 2179. When the plaintiff's own negligence was the immediate and proximate cause of his injury, he cannot recover damages. But if his negligence was only contributory, the immediate and proximate cause of the injury being the defendant's lack of due care, the plaintiff may recover damages, but the courts shall mitigate the damages to be awarded. (n)

Art. 2180. The obligation imposed by Article 2176 is demandable not only for one's own acts or omissions, but also for those of persons for whom one is responsible.

The father and, in case of his death or incapacity, the mother, are responsible for the damages caused by the minor children who live in their company.

Guardians are liable for damages caused by the minor or incapacitated persons who are under their authority and live in their company.

The owners and managers of an establishment or enterprise are likewise responsible for damages caused by their employees in the service of the branches in which the latter are employed or on the occasion of their functions.

Employers shall be liable for the damages caused by their employees and household helpers acting within the scope of their assigned tasks, even though the former are not engaged in any business or industry.

The State is responsible in like manner when it acts through a special agent; but not when the damage has been caused by the official to whom the task done properly pertains, in which case what is provided in Article 2176 shall be applicable.

Lastly, teachers or heads of establishments of arts and trades shall be liable for damages caused by their pupils and students or apprentices, so long as they remain in their custody.

The responsibility treated of in this article shall cease when the persons herein mentioned prove that they observed all the diligence of a good father of a family to prevent damage. (1903a)

Art. 2181. Whoever pays for the damage caused by his dependents or employees may recover from the latter what he has paid or delivered in satisfaction of the claim. (1904)

Art. 2182. If the minor or insane person causing damage has no parents or guardian, the minor or insane person shall be answerable with his own property in an action against him where a guardian *ad litem* shall be appointed. (n)

Art. 2183. The possessor of an animal or whoever may make use of the same is responsible for the damage which it may cause, although it may escape or be lost. This responsibility shall cease only in case the damage should come from *force majeure* or from the fault of the person who has suffered damage. (1905)

Art. 2184. In motor vehicle mishaps, the owner is solidarily liable with his driver, if the former, who was in the vehicle, could have, by the use of due diligence, prevented the misfortune. It is disputably presumed that a driver was negligent, if he had been found guilty of reckless driving or violating traffic regulations at least twice within the next preceding two months.

If the owner was not in the motor vehicle, the provisions of Article 2180 are applicable. (n)

Art. 2185. Unless there is proof to the contrary, it is presumed that a person driving a motor vehicle has been negligent if at the time of the mishap, he was violating any traffic regulation. (n)

Art. 2186. Every owner of a motor vehicle shall file with the proper government office a bond executed by a government-controlled corporation or office, to answer for damages to third persons. The amount of the bond and other terms shall be fixed by the competent public official. (n)

Art. 2187. Manufacturers and processors of foodstuffs, drinks, toilet articles and similar goods shall be liable for death or injuries caused by any noxious or harmful substances used, although no contractual relation exists between them and the consumers. (n)

Art. 2188. There is *prima facie* presumption of negligence on the part of the defendant if the death or injury results from his possession of dangerous weapons or substances, such as firearms and poison, except when the possession or use thereof is indispensable in his occupation or business. (n)

Art. 2189. Provinces, cities and municipalities shall be liable for damages for the death of, or injuries suffered by, any person by reason of the defective condition of roads, streets, bridges, public buildings, and other public works under their control or supervision. (n)

Art. 2190. The proprietor of a building or structure is responsible for the damages resulting from its total or partial collapse, if it should be due to the lack of necessary repairs. (1907)

Art. 2191. Proprietors shall also be responsible for damages caused:

(1) By the explosion of machinery which has not been taken care of with due diligence, and the inflammation of explosive substances which have not been kept in a safe and adequate place;

(2) By excessive smoke, which may be harmful to persons or property;

(3) By the falling of trees situated at or near highways or lanes, if not caused by *force majeure*;

(4) By emanations from tubes, canals, sewers or deposits of infectious matter, constructed without precautions suitable to the place. (1908)

Art. 2192. If damage referred to in the two preceding articles should be the result of any defect in the construction mentioned in Article 1723, the third person suffering damages may proceed only against the engineer or architect or contractor in accordance with said article, within the period therein fixed. (1909a)

Art. 2193. The head of a family that lives in a building or a part thereof, is responsible for damages caused by things thrown or falling from the same. (1910)

Art. 2194. The responsibility of two or more persons who are liable for a quasi-delict is solidary. (n)

Concept

An established rule under our law is that an act or omission extra-contractual in nature, causing damage to another and there being fault or negligence, can create two separate civil liabilities on the part of the offender, *i.e.*, civil liability *ex delicto* and civil liability *ex quasi delicto*. Either one of these two possible liaiblities may be sought to be enforced against the offender subject, however, to the *caveat* under Article 2177 of the Civil Code that the offended party cannot "recover damages twice for the same act or omission" or under both causes *(Barredo vs. Garcia, 73 Phil. 607; Mendoza vs. Arrieta, 91 SCRA 113; Padilla vs. Court of Appeals, 129 SCRA 558).* Outside of this proscription, the two civil liabilities are distinct and independent of each other; thus, and conversely against the rule on double recovery, the failure of recovery in one will not necessarily preclude recovery in the other.

Based on its statutory concept, a quasi-delict would be an extra-contractual relation that the law ordains

whenever one, by act or omission, causes damage to another, there being fault or negligence. The concept covers, said the Supreme Court in *Elcano vs. Hill (77 SCRA 98),* not only acts not punishable by law but also those punishable "whether intentional and voluntary or negligent." Where negligence is punishable under the Penal Code, the responsibility for quasi-delict is separate and distinct from the civil liability arising from the felony but the plaintiff cannot recover damages twice for the same act or omission of the defendant although the incident may give rise to two or more causes of action (*Art. 2177, Civil Code; Joseph vs. Bautista, 170 SCRA 540; Bermudez, Sr. vs. Hon. Herrera, 158 SCRA 168*; see also discussions, *supra.,* on *Independent Civil Actions* under the Preliminary Title on *Human Relations* and on *Common Carriers* under the Title of *Lease*). Even the existence of a contract does not necessarily militate, it has been held, against the application of quasi-delict which can indeed be the very act or omission that breaches the contract (see *Singson vs. Bank of P.I., 23 SCRA 1117; Air France vs. Carrascoso, 18 SCRA 155*). The test would appear to be that where, without a pre-existing contract between two parties, an act or omission would have constituted an actionable tort, the mere existence of a contract will not bar the appropriate application of tort, even as regards such parties.

The broad concept of quasi-delict has apparently been purposely structured in order to render actionable any wrongful act or omission, causing damage to another, that would not otherwise be actionable under any of the other stated possible sources of obligation — law, contracts, quasi-contracts and delicts — and so ensure that appropriate relief can be sought. It has not been intended, however, that quasi-delict should predominate over such other sources of obligations where, in fact, the application of such other sources is clearly warranted; otherwise, the specific distinctions in law — substantive and procedural — in the governance of these various kinds of

obligations could very well be reduced to great insignificance. The Report of the Code Commission elucidates, thus:

> "A question of nomenclature confronted the Commission. After a careful deliberation it was agreed to use the terms 'quasi-delict' for those obligations which do not arise from law, contracts, quasi-contracts, or criminal offenses. They are known in Spanish legal treatises as *'culpa aquiliana,' 'culpa-extra-contractual'* or *'cuasi-delitos.'* The phrase 'culpa-extra-contractual' or its translation 'extra-contractual fault' was eliminated because it did not exclude quasi-contractual or penal obligations. 'Aquiliana fault' might have been selected, but it was though inadvisable to refer to so ancient a law as the *'lex aquiliana.'* So 'quasi-delicts' was chosen, which more nearly corresponds to the Roman Law classification of obligations and is in harmony with the nature of this kind of liability.
>
> The Commission, also, thought of the possibility of adopting the word 'tort' from Anglo-American law. But 'tort' under that system is much broader than the Spanish-Philippine concept of obligations arising from non-contractual negligence. 'Tort' in Anglo-American jurisdiction includes not only negligence, but also intentional criminal acts such as assault and battery, false imprisonment and deceit. In the general plan of the Philippine legal system, intentional and malicious acts are governed by the Penal Code, although certain exceptions are made in the Project x x x."

Prescinding from the rule that "(o)bligations arising from contracts have the force of law between the contracting parties x x x" (Article 1159, Civil Code), the existence of a contract will ordinarily bar an intrusion of specific provisions of law to the extent that the latter would be opposed to the specific areas validly and adequately covered by contractual stipulations. The provi-

sions on quasi-delict might then be inapplicable to a breach of contract. In matters, however, not provided for by the parties themselves, the deficiency can be governed by the general provisions of the Civil Code. Upon the other hand, that there is a contractual relation between parties will not necessarily be a bar to the application of the rules on quasi-delict which, at times, can be the source of contractual breach. In such exceptional instances, the principles laid down for quasi-delicts can also govern (see *Singson vs. Bank of P.I.,* 23 SCRA 1117; *Air France vs. Carrasco,* 18 SCRA 115; *Philippine Air Lines vs. Court of Appeals,* 106 SCRA 143).

In common carriers, for instance, a premise for the employer's liability is negligence or fault on the part of the employee. Once such fault is established, the employer can then be made liable on the basis of the presumption *juris tantum* that the employer failed to exercise *diligentissimi patris families* in the selection and supervision of its employees. The liability is primary and can only be negated by showing due diligence in the selection and supervision of the employee. Absent such a showing, one might ask further, how then must the liability of the common carrier, on the one hand, and an independent actor, on the other hand, be described? It would be solidary. A contractual obligation can be breached by tort and when the same act or omission causes the injury, one resulting in *culpa contractual* and the other in *culpa aquiliana,* Article 2194 of the Civil Code can well apply. In fine, a liability for tort may arise even under a contract, where tort is that which breaches the contract. Stated differently, when an act which constitutes a breach of contract would have itself constituted the source of a *quasi-delictual* liability had no contract existed between the parties, the contract can be said to have been breached by tort, thereby allowing the rules on tort to apply *(Light Rail Transit Authority & Rodolfo Roman vs. Marjorie Navidad, Heirs of the Late Nicanor Navidad & Prudent Security Agency, G.R. No. 145804, 06 February 2003, 397 SCRA 75).*

Essential Elements of Quasi-Delict

1. Culpable Act or Negligence —

The "act" referred to in the law must be "culpable" or an act that is "blameworthy when judged by accepted legal standards" which is thus "broad enough to include any rational conception of liability for the tortious acts likely to be developed in any society" *(Daywalt vs. Corporacion de PP Agustinos Recoletos, 39 Phil. 587).* Negligence, generally, is the failure to observe that diligence which is expected of a good father of a family. The test, according to the Supreme Court in *Picart vs. Smith (37 Phil. 809),* is — "Would a prudent man, in the position of the person to whom negligence is attributed, foresee harm to the person injured as a reasonable consequence of the course about to be pursued. If so, the law imposes precaution against its mischievous results, and the failure to do so constitutes negligence. Reasonable foresight of harm, followed by the ignoring of the admonition born of this provision, is the constructive fact in negligence."

Article 2178 on quasi-delicts expressly adopts the provisions of Articles 1172 to 1174 of the Code governing obligations, in general, *viz.*:

> Art. 1172. Responsibility arising from negligence in the performance of every kind of obligation is also demandable, but such liability may be regulated by the courts, according to the circumstances. (1103)
>
> Art. 1173. The fault or negligence of the obligor consists in the omission of that diligence which is required by the nature of the obligation and corresponds with the circumstances of the persons, of the time and of the place. When negligence shows bad faith, the provisions of Articles 1171 and 2201, paragraph 2, shall apply.
>
> If the law or contract does not state the diligence which is to be observed in the performance,

that which is expected of a good father of a family shall be required. (1104a)

Art. 1174. Except in cases expressly specified by the law, or when it is otherwise declared by stipulation, or when the nature of the obligation requires the assumption of risk, no person shall be responsible for those events which, could not be foreseen, or which, though foreseen, were inevitable. (1105a)

2. Damage to Another —

Damage is any loss or injury sustained by a person, as well as any indemnity, recoverable under the provisions of the Code or applicable special laws (see discussions, *infra*., under the Title on *Damages*).

3. Causal Relation between the Culpable Act or Negligence and the Damage to Another

Doctrine of Proximate Cause

It is not enough that there be just some kind of connection between fault or negligence and the loss or injury, but that the former must be the *proximate cause* of the latter. The proximate cause is that "which in natural and continuous sequence, unbroken by any efficient intervening cause, produces the injury and without which the result would not have occurred" (*38 Am. Jur. 695; Fernando vs. Court of Appeals, 208 SCRA 714*). In *Taclan vs. Medina, 54 O.G. 1805, 102 Phil. 181*, citing with approval *38 Am. Jur. 695-696*, see also *Urbano vs. Intermediate Appellate Court, 157 SCRA 1),* the Court held:

"The proximate legal cause is that acting first and producing the injury, either immediately or by setting other events in motion, all constituting a natural and continuous chain of events, each having a close causal connection with its immediate predecessor, the final event in the chain immediately affecting the injury as a natural and probable result of

the cause which first acted, under such circumstances that the person responsible for the first event should, as an ordinarily prudent and intelligent person, have reasonable ground to expect at the moment of his act or default that an injury to some person might probably result therefrom."

Doctrine of Contributory Negligence

When the plaintiff's own negligence was the immediate and proximate cause of his injury, he cannot recover damages. But if his negligence was only contributory, the immediate and proximate cause of the injury being the defendant's lack of due care, the plaintiff may recover damages, but the courts shall mitigate the damages to be awarded *(Art. 2179, Civil Code; Philippine National Railways vs. Court of Appeals, 139 SCRA 87).* Where the plaintiff contributes to the principal occurrence, as one of its determining factors (proximate cause), he cannot recover, but if, in conjunction therewith, he merely contributes to his own injury (results), he may still recover less a sum deemed a suitable equivalent for his own imprudence *(Taylor vs. Manila Electric Railroad & Light Co., 16 Phil. 8).*

Where both parties are negligent, but the negligent act of one is appreciably later in time than the other or when it is impossible to determine whose fault or negligence shall be attributed to the incident, the one who had the last clear opportunity to avoid the impending harm and failed to do so is chargeable with the consequences thereof (Doctrine of "Last Clear Chance," of "Supervening Negligence," or of "Discovered Peril;" see *Picart vs. Smith, 37 Phil. 809; LBC Air Cargo, Inc., et al. vs. Court of Appeals, et al., 241 SCRA 619, 23 February 1995*).

Stated in another way, the doctrine of last clear chance means that an antecedent negligence of a person does not preclude recovery of damages for the supervening negligence of, or bar a defense against liability sought

by, another if the latter, who had the last fair chance, could have avoided the impending harm by exercising due diligence *(Pantranco North Express, Inc. vs. Baesa, 179 SCRA 5; Glan People's Lumber and Hardware vs. Intermediate Appellate Court, 173 SCRA 462)*. Thus, it was ruled that the antecedent negligence of a telephone company in not earlier providing warning signs on its excavations would not make it liable if the claimant had a clear chance to avoid the accident *(Philippine Long Distance Tel. Co. vs. Court of Appeals, 178 SCRA 94)*.

The doctrine does not apply if only one of the two parties is negligent and the other is not. The *"volonti non fit injuria"* rule does not apply if a person, although knowing a possible danger, takes some risks because he has to in order to preserve life or property (see *Ilocos Norte Electric Co. vs. Court of Appeals, 179 SCRA 5;* also *Philippine Long Distance Tel. Co. vs. Court of Appeals, 178 SCRA 94*).

The doctrine of last clear chance would also be inapplicable to ward off a claim of an innocent third person against the parties guilty of the antecedent negligence and the supervening negligence who, as joint tort-feasors, are both made solidarily liable to said third person (see *Art. 2194, Civil Code*).

Doctrine of Imputed Negligence

The fault or negligence of an associate may determine either the right to, or responsibility for, damages (see *Art. 2184, Civil Code, infra.; Caedo vs.Yu Khe Thai, 26 SCRA 381*).

Burden of Proof

The burden of proof lies with the plaintiff in establishing fault or negligence on the part of the defendant *(Ong vs. Metropolitan Water District, 104 Phil. 397)*, unlike in *culpa contractual* where negligence is presumed after the breach of the contract is established (see discus-

sions, *supra*., on negligence under the title on *Obligations*). At times, negligence is presumed even in quasi-delicts, such as, but not limited to, those cases mentioned in Articles 2180, 2184, 2186 and 2188 of the Code.

In motor vehicle mishaps, when the owner is made solidarily liable under the first paragraph of Article 2184, he may recover half of that liability from the driver, both being considered equally guilty, but where the owner's liability has been predicated under Article 2180, he may recover the full amount from the driver *(Art. 2181, Civil Code)*. Liability under Article 2180 does not apply where the driver is neither the driver nor the employee of the owner *(Duavit vs. Court of Appeals, 173 SCRA 490)*.

Under the *Res Ipsa Loquitur* rule, a peculiar doctrine in the law on negligence, where the instrumentality causing the injury was at the time under the control of the defendant and such injury could not have been caused except by negligence, circumstances may justify the inference that defendant's negligence had been the proximate cause *(F.F. Cruz & Co. vs. Court of Appeals, 164 SCRA 731; U.S. vs. Crame, 30 Phil. 2)*. The doctrine of *res ipsa loquitur* holds a defendant liable where the thing which caused the injury complained of is shown to be under the latter's management and the accident is such that, in the ordinary course of things, cannot be expected to happen if those who have its management or control use proper care. It affords reasonable evidence, in the absence of explanation by the defendant, that the accident arose from want of care. It is not a rule of substantive law and, as such, it does not create an independent ground of liability. Instead, it is regarded as a mode of proof, or a mere procedural convenience since it furnishes a substitute for, and relieves the plaintiff of, the burden of producing specific proof of negligence. The maxim simply places on the defendant the burden of going forward with the proof. Resort to the doctrine, however, may be allowed only when: (a) the event is of a kind which does not ordinarily occur in the absence of negligence; (b) other

responsible causes, including the conduct of the plaintiff and third persons, are sufficiently eliminated by the evidence; and (c) the indicated negligence is within the scope of the defendant's duty to the plaintiff. Thus, it is not applicable when an unexplained accident may be attributable to one of several causes, for some of which the defendant could not be responsible *(FGU Insurance Corporation vs. G.P. Sarmiento Trucking Corporation, G.R. No. 141910, 6 August 2002).*

Res ipsa loquitur generally finds relevance whether or not a contractual relationship exists between the plaintiff and the defendant, for the inference of negligence arises from the circumstances and nature of the occurrence and not from the nature of the relation of the parties. Nevertheless, the requirement that responsible causes other than those due to defendant's conduct must first be eliminated, for the doctrine to apply, should be understood as being confined only to cases of pure (noncontractual) tort since obviously the presumption of negligence in *culpa contractual*, as previously so pointed out, immediately attaches by a failure of the covenant or its tenor *(ibid.).*

In *Layugan vs. Intermediate Appellate Court (167 SCRA 363),* the Supreme Court has held that the doctrine recognizes that *prima facie* negligence may be established without direct proof thereof, but that it can only be invoked when such direct evidence is absent or not readily available. When liability is anchored under Article 2180 (paragraph 5) of the Civil Code, proof of negligence of a servant or employee instantly raises a presumption of negligence on the part of the master or employer in the selection and supervision of such servant or employee.

Exceptionally, liability is created even where there may have been no fault or negligence; such instances are sometimes referred to as *strict liability in torts or strict liability torts* for short, exemplified by Articles 2183, 2187

and 2193 of the Code. Parenthetically, the liability under Article 2183, said the Supreme Court, is on the possessor, regardless of ownership of the animal which has caused the damage *(Vestil vs. Intermediate Appellate Court, 179 SCRA 47).*

The rules vary in certain cases. The proprietor of a building or structure is responsible for the damages resulting from its total or partial collapse if it should be due to the lack of necessary repairs (*Art. 2190, Civil Code;* see *Deroy vs. Court of Appeals, 157 SCRA 757,* where the "doctrine of last clear chance" was held to be inapplicable). Proprietors shall also be responsible for damages caused:

(1) By the explosion of machinery which has not been taken care of with due diligence, and the inflammation of explosive substances which have not been kept in a safe and adequate place;

(2) By excessive smoke, which may be harmful to persons or property;

(3) By the falling of trees situated at or near highways or lanes, if not caused by *force majeure*;

(4) By emanations from tubes, canals, sewers or deposits of infectious matter, constructed without precautions suitable to the place *(Art. 2191, Civil Code*).

If the damage should be the result of any defect in the construction mentioned in Article 1723 *(supra)*, the third person suffering damages may proceed only against the engineer or architect or contractor in accordance with said article, within the period therein fixed *(Art. 2192, Civil Code).*

Provinces, cities and municipalities shall be liable for damages for the death of, or injuries suffered by, any person by reason of the defective condition of roads, streets, bridges, public buildings, and other public works under their control or supervision *(Art. 2189, Civil Code;*

Jimenez vs. City of Manila, 150 SCRA 510; see *Local Government Code [R.A. 7160]);* ownership by them is not essential (see *City of Manila vs. Teotico, 22 SCRA 267)* nor that the crew under their supervision are employees of the National Government *(Guilatco vs. City of Dagupan, 171 SCRA 382).*

Criminal Negligence

Where negligence is punishable under the Penal Code, the responsibility for quasi-delict is separate and distinct from the civil liability arising from the felony but the plaintiff cannot recover damages twice for the same act or omission of the defendant (*Art. 2177, Civil Code; Gula vs. Dianala, 132 SCRA 245*; see also discussions, *supra.,* on *Independent Civil Actions* under the Preliminary Title on *Human Relations* and on *Common Carriers* under the Title on *Lease*).

An early established rule under our law is that an act or omission, extra-contractual in nature, causing damage to another and there being fault or negligence, can create two separate civil liabilities on the part of the offender, *i.e.*, civil liability *ex delicto* and civil liability *ex quasi delicto*. Either one of these two possible liabilities may be sought to be enforced against the offender subject, however, to the *caveat* under Article 2177 of the Civil Code that the offended party cannot "recover damages twice for the same act or omission" or under both causes. Outside of this proscription, the two civil liabilities are distinct and independent of each other; thus, and conversely against the rule on double recovery, the failure of recovery in one will not necessarily preclude recovery in the other.

In the recently decided case of *San Ildefonso Lines, Inc. vs. Court of Appeals (94 SCAD 20, 289 SCRA 568),* the Supreme Court has ruled that, notwithstanding the independent nature of civil actions falling under Articles 32, 33, 34 and 2176 of the Civil Code, the right to insti-

tute the action must still have to be reserved. In the stern words of the Court: The "past pronouncements that view the reservation requirement as an unauthorized amendment to substantive law, *i.e.*, the Civil Code, should no longer be controlling." *San Ildefonso*, essentially, might be understood as merely fortifying a procedural rule that unless a reservation is made, the court trying the criminal case would not, for instance, be precluded from taking cognizance of the civil aspect of the litigation and that, upon the other hand, the other court in the civil case might, *motu proprio* or at the instance of a party, hold in abeyance the consideration thereof pending the outcome of the criminal case. In *Maniago vs. Court of Appeals (68 SCAD 419, 253 SCRA 674; Emerencia vs. Gonzales, 104 Phil. 1059)*, the Court has said that the requirement of reservation is not incompatible with the distinct and separate character of independent civil actions. Indeed, there is no incongruence between allowing the trial of civil actions to proceed independently of the criminal prosecution and mandating that, before so proceeding, a reservation to do so should first be made.

There has not been a clear consistency of court decisions on the question of the effects of defendant's acquittal in the criminal case as regards the plaintiff's ability to institute the civil action. One extreme holds the independent civil action as completely distinct and separate from the criminal case. In fine, Article 29 of the Civil Code would be confined to what might be termed as "dependent civil actions." This view had reached its peak in *Elcano vs. Hill (77 SCRA 98)* when the court declared that an independent civil action could in no way be affected by the results of the criminal case. In later decisions, however, the Supreme Court appears to have relented somewhat. In *Ismael Gula vs. Dianala (132 SCRA 245),* the wife of the complaint Gula was run over and killed by a cargo truck driven by Dianala. The City Fiscal filed a case for homicide through reckless imprudence against Dianala. Gula and other members of the family

participated in the criminal case through their private prosecutors. No reservation to file a civil action was made. After trial, the court acquitted Dianala on reasonable doubt. Later, the plaintiffs Gula and members of his family sued for damages based on quasi-delict. On motion of defendant Dianala and Rejon (owner of the truck driven by Dianala), the Court of First Instance dismissed the case. On appeal, the Supreme Court reversed the dismissal and held: "Since the cause of action of the plaintiffs appellants is based on *culpa aquiliana*, and not *culpa criminal*, thus precluding the application of the exception in Sec. (3) of Rule 111, and the fact that it can be inferred from the criminal case that defendant accused, Pedro Dianala, was acquitted on reasonable doubt because of dearth of evidence and lack of veracity of the two principal witnesses, the doctrine in *Mendoza vs. Arrieta, 91 SCRA 113*, will not find application x x x. There is no reason why the suit for damages may not prosper."

In *Bermudez vs. Hon. Herrera (158 SCRA 168),* the Supreme Court has held:

> "In cases of negligence, the injured party or his heirs has the choice between an action to enforce the civil liability arising from crime under Article 100 of the Revised Penal Code and an action for quasi-delict under Articles 2176-2194 of the Civil Code. If a party chooses the latter, he may hold the employer solidarily liable for the negligent act of his employee, subject to the employer's defense of exercise of the diligence of a good father of the family.
>
> "In the case at bar, the action filed by appellant was an action for damages based on quasi-delict. The fact that appellants reserved their right in the criminal case to file an independent civil action did not preclude them from choosing to file a civil action for quasi-delict.
>
> "The appellant precisely made a reservation to file an independent civil action in accordance with

the provisions of Section 2 of Rule 111, Rules of Court. In fact, even without such reservation, we have allowed the injured party in the criminal case which resulted in the acquittal of the accused to recover damages based on quasi-delict. In *People vs. Ligon*, *G.R. No. 74041*, we held:

> 'However, it does not follow that a person who is not criminally liable is also free from civil liability. While the guilt of the accused in a criminal prosecution must be established beyond reasonable doubt, only a preponderance of evidence is required in a civil action for damages *(Art. 29, Civil Code).* The judgment of acquittal extinguishes the civil liability of the accused only when it includes a declaration that the facts from which the civil liability might arise did not exist *(Padilla vs. Court of Appeals, 129 SCRA 559).*'

It would seem that the rule that has prevailed is to consider primordial a distinction between an instance where there is intervention and active participation by the complainant in the criminal case and another when there is none. In the affirmative, Article 29 of the Civil Code would apply which means that the ability of the complainant in the criminal case to file the independent civil action mainly lies on the grounds expressed by the court in the acquittal of the accused. If the accused is acquitted on *quantum* of proof, then the civil action may still prosper, but if the facts on which the civil action can be based are held not to exist, such as when the court premises its acquittal on the fact that the crime did not exist or that the accused is not the guilty party, then the civil action is likewise foreclosed and can no longer be instituted. Where the complainants, however, do not intervene and actively participate in the criminal case, Article 31, instead of Article 29, would apply but the civil liability must be based not on *ex-delicto* itself (for which the defendant has been "not guilty") but on a different cause of action such as,

possibly, *culpa contractual* or *culpa aquiliana* (see *Marcia vs. Court of Appeals, 120 SCRA 193; Madeja vs. Caro, 126 SCRA 293*). On the question of whether or not the court in the criminal case may award civil liability where an acquittal is decreed by it based on *quantum* of proof, the Supreme Court, in *People vs. Jalandoni (131 SCRA 454)*, reiterating *Padilla vs. Court of Appeals (129 SCRA 558),* has ruled that, in such situations, the criminal court may make an award on the accused's civil liability, abrogating the old doctrine that the criminal court would not have jurisdiction to do so.

It should be interesting to watch jurisprudential development in this area with the recent amendatory provisions contained in Rule 111 of the Revised Rules of Criminal Procedure (made effective on December 1, 2000) on the prosecution of the civil action along with the criminal case.

The Revised Rules of Criminal Procedure, while reiterating that a civil action under the Civil Code may be brought separately from the criminal action, provides, nevertheless, that **the right to bring it must be reserved**. Rule 111 reads:

> "Section 1. Institution of criminal and civil actions. — When a criminal action is instituted, the civil action for the recovery of civil liability is impliedly instituted with the criminal action, unless the offended party waives the civil action, reserves his right to institute it separately, or institutes the civil action prior to the criminal action.
>
> "Such civil action includes recovery of indemnity under the Revised Penal Code, and damages under Articles 32, 33, 34 and 2176 of the Civil Code of the Philippines arising from the same act or omission of the accused.
>
> "A waiver of any of the civil actions extinguishes the others. The institution of, or the reservation of

the right to file, any of said civil actions separately waives the others.

"The reservation of the right to institute the separate civil actions shall be made before the prosecution starts to present its evidence and under circumstances affording the offended party a reasonable opportunity to make such reservation.

"In no case may the offended party recover damages twice for the same act or omission of the accused.

"When the offended party seeks to enforce civil liability against the accused by way of moral, nominal, temperate or exemplary damages, the filing fees for such civil action as provided in these Rules shall constitute a first lien on the judgment except in an award for actual damages.

"In cases wherein the amount of damages, other than actual, is alleged in the complaint or information, the corresponding filing fees shall be paid by the offended party upon the filing thereof in court for trial.

"Sec. 2. Institution of separate civil action. — Except in the cases provided for in Section 3 hereof, after the criminal action has been commenced, the civil action which has been reserved cannot be instituted until final judgment has been rendered in the criminal action.

"(a) Whenever the offended party shall have instituted the civil action as provided for in the first paragraph of Section 1 hereof before the filing of the criminal action and the criminal action is subsequently commenced, the pending civil action shall be suspended, in whatever stage before final judgment it may be found, until final judgment in the criminal action has been rendered. However, if no final judgment has been rendered by the trial court

in the civil action, the same may be consolidated with the criminal action upon application with the court trying the criminal action. If the application is granted, the evidence presented and admitted in the civil action shall be deemed automatically reproduced in the criminal action, without prejudice to the admission of additional evidence that any party may wish to present. In case of consolidation, both the criminal and the civil actions shall be tried and decided jointly.

"(b) Extinction of the penal action does not carry with it extinction of the civil, unless the extinction proceeds from a declaration in a final judgment that the fact from which the civil might arise did not exist.

"Sec. 3. When civil action may proceed independently. — In the cases provided for in articles 32, 33, 34, and 2176 of the Civil Code of the Philippines, the independent civil action which has been reserved may be brought by the offended party, shall proceed independently of the criminal action, and shall require only a preponderance of evidence."

Accordingly, it would appear that —

First — The civil action is deemed instituted together with the criminal case except when the civil action is reserved. The reservation should be made at the institution of the criminal case. In independent civil actions, not being dependent on the criminal case, such reservation would be required not for preserving the cause of action but in order to allow the civil action to proceed separately from the criminal case in interest of good order and procedure. Indeed, independent civil actions already filed and pending may still be sought to be consolidated in the criminal case before final judgment is rendered in the latter case. When no criminal proceedings are instituted, a separate civil action may be brought to demand the civil liability, and a preponderance of evidence is sufficient to warrant a favorable judgment

therefor. The same rule applies if the information were to be dismissed upon motion of the fiscal.

Second — The *pendency of the criminal case suspends the civil action, except* —

(1) When properly reserved, in *independent civil actions,* such as those cases (a) not arising from the act or omission complained of as a felony (*e.g., culpa contractual* under Article 31, intentional torts under Articles 32 and 34, and *culpa acquiliana* under Article 2176 of the Civil Code); or (b) where the injured party is granted a right to file an action independent and separate from the criminal action; and

(2) In the case of *pre-judicial questions* which must be decided before any criminal prosecution may be instituted or may proceed.

In the above instances, the civil case may proceed independently and regardless of the outcome of the criminal case.

Third — An *acquittal in the criminal case may bar any further separate civil action, except* —

(1) In *independent civil actions,* unless the complainant, not having reserved a separate action, has actively participated and intervened in the criminal case. Such active participation and intervention can only be deemed to be an unequivocal election by the complainant to sue under *ex delictu* rather than on another cause of action (arising from the same act or omission complained of as being *ex-delictu*). If, however, the acquittal is predicated on the ground that guilt has not been proven beyond reasonable doubt, and not upon a finding that the "fact from which the civil (action) might arise did not exist," an action for damages can still be instituted.

(2) In *dependent civil actions* where the acquittal is premised on a failure of proof beyond reasonable doubt, which the court shall so declared as its basis, a civil

action for damages for the same act or omission may be instituted. Such action requires only a preponderance of evidence. Where acquittal is thus based on the fact that the crime did not exist or that the offender did not commit the crime, and not on mere *quantum of proof,* a civil action based on such *ex delictu* of which the accused is already acquittal would be improper.

Responsibility for Acts of Others

A person may be held accountable not only for his own culpable act or negligence but also for those of others based on the former's responsibility under a relationship of *patria potestas*. The liability of a person for the fault or negligence of another under Article 2180, which establishes the rule of *in loco parentis (Philippine School of Business Administration vs. Court of Appeals, 205 SCRA 729),* is premised on his own presumed failure to exercise due diligence in discharging his responsibility of control and supervision. His vicarious liability is thus *primary* and *direct*, defeasible only if he can show that there was, in fact, no fault or negligence on his part. This defense from liability distinguishes the Civil Code rule from the principle of *respondeat superior,* a minority view in Common Law, which would hold the master liable in every case and unconditionally for the damage caused by his subordinate while in his service and acting within the scope of his assigned task (see *Filamer vs. Court of Appeals, 190 SCRA 485; St. Francis High School vs. Court of Appeals, 194 SCRA 341; Cangco vs. Manila Railroad Co., 38 Phil. 768; Cf. Malipol vs.Tan, 55 SCRA 202; Poblete vs. Fabros, 93 SCRA 200*).

In *Elcano vs. Hill (77 SCRA 98),* the Supreme Court held liable a father for a quasi-delict committed by his *emancipated* (by marriage) minor son since the latter was still living with and getting subsistence from the father, but the child being already emancipated, that liability was ruled to be merely *subsidiary* (but see *Libi vs. Intermediate Appellate Court, 214 SCRA 16*).

The Family Code now limits the liability of parents and other persons exercising parental authority for injuries and damages to acts or omissions of *unemancipated* children living in their company, thus —

> "Art. 221. Parents and other persons exercising parental authority shall be civilly liable for injuries and damages caused by the acts or omissions of their unemancipated children living in their company and under their parental authority subject to the appropriate defenses provided by law." (see *"Family Code Annotated," Addendum to Book I, supra*.)

The liability of an employer in a business enterprise arises where the negligent act of the employee was committed while in the performance of his master's employment; where the employer is not engaged in business, his liability would arise if the negligent act was committed while the employee was acting within the scope of his assigned task (see *Yamada vs. Manila Railroad Co., 33 Phil. 8*). In any event, an employer-employee relationship must exist *(Martin vs. Court of Appeals, 205 SCRA 591; Filamer vs. Court of Appeals, 190 SCRA 485).* In the case of an employer, that vicarious liability attaches only when the tortious conduct of the employee relates to, or is in the course of, his employment. The question to ask should be whether, at the time of the damage or injury, the employee is engaged in the affairs or concerns of the employer or, independently, in that of his own. While an employer incurs no liability when an employee's conduct, act or omission is beyond the range of employment, a minor deviation from the assigned task of an employee, however, does not affect the employer's liability.

The State is liable only when it acts through a special agent, specifically commissioned to carry out the act complained of outside of such agent's regular duties *(Republic vs. Palacio, 23 SCRA 899,* citing *Merrit vs. Insular Government, 34 Phil. 311; Fontanilla vs. Maliaman, 179 SCRA 685).*

The liability of teachers or heads of establishments of arts and trades, said the Court in *Palisoc vs. Brillantes (41 SCRA 548),* covers damages caused by their pupils and students or apprentices so long as they remain in their protective and supervisory custody, including recess time, and they need not be living and boarding in the school. On the question as to whether the law contemplated to include academic educational institutions, the Supreme Court has answered in the negative in *Exconde vs. Kapuno (101 Phil. 843)*, although the decision of the majority (four against three justices) in the *Palisoc* case (involving a school of arts and trades) has carried a footnote expressing agreement with Justice J.B.L. Reyes in his dissenting opinion in the *Exconde* decision.

The case of *Pasco vs. Court of First Instance of Bulacan (160 SCRA 784)* has added a new dimension to the raging controversy on the question of the liability of educational institutions under Article 2180, paragraph 5, of the Civil Code. Whereas, there had been a conflict of views among the members of the Court on whether educational institutions which are not schools of arts and trades are, like the latter, covered by the law, the *Pasco* decision penned by Justice Paras, concurred in by Justices Yap and Padilla, has ruled, however, that only the teachers and heads of the establishment, not the school or the university itself, may be made liable. Justices Melencio-Herrera and Sarmiento dissented and would hold liable the institution itself under the *patria potestas* rule unless it is able to prove that it itself had exercised the diligence of a good father of a family.

In *Amadora vs. Court of Appeals (160 SCRA 315),* decided by the Supreme Court *en banc*, the following summation was made:

> "Applying the foregoing considerations, the Court has arrived at the following conclusions:
>
> "1. At the time Alfredo Amadora was fatally shot, he was still in the custody of the authorities of

Colegio de San Jose-Recoletos notwithstanding that the fourth year classes had formally ended. It was immaterial if he was in the school auditorium to finish his physics report for what is important is that he was there for a legitimate purpose. As previously observed, even the mere savoring of the company of his friends in the premises of the school is a legitimate purpose that would have also brought him in the custody of the school authorities.

2. The rector, the high school principal and the dean of boys cannot be held liable because none of them was the teacher-in-charge as previously defined. Each of them was exercising only a general authority over the student body and not the direct control and influence exerted by the teacher placed in charge of particular classes or sections and thus immediately involved in its discipline. The evidence of the parties does not disclose who the teacher-in-charge of the offending student was. The mere fact that Alfredo Amadora had gone to school that day in connection with his physics report did not necessarily make the physics teacher, respondent Celestino Dicon, the teacher-in-charge of Alfredo's killer.

3. At any rate, assuming that he was the teacher-in-charge, there is no showing that Dicon was negligent in enforcing discipline upon Daffon or that he had waived observance of the rules and regulations of the school or condoned their non-observance. His absence when the tragedy happened cannot be considered against him because he was not supposed or required to report to school on that day. And while it is true that the offending student was still in the custody of the teacher-in-charge even if the latter was physically absent when the tort was committed, it has not been established that it was caused by his laxness in enforcing discipline upon the student. On the contrary, the private respondents have proved that they had exercised due dili-

gence, through the enforcement of the school regulations in maintaining that discipline.

4. In the absence of a teacher-in-charge, it is probably the dean of boys who should be held liable, especially in view of the unrefuted evidence that he has earlier confiscated an unlicensed gun from one of the students and returned the same later to him without taking disciplinary action or reporting the matter to higher authorities. While this was clearly negligence on his part, for which he deserves sanctions from the school, it does not necessarily link him to the shooting of Amador as it has not been shown that the confiscated and returned pistol was the gun that killed the petitioner's son.

5. Finally, as previously observed, the Colegio de San Jose-Recoletos cannot be held directly liable under the Article because only the teacher or the head of the school of arts and trades is made responsible for the damage caused by the student or apprentice. Neither can it be held to answer for the tort committed by any of the other private respondents for none of them has been found to have been charged with the custody of the offending student or has been remiss in the discharge of his duties in connection with such custody.

In sum, the Court finds under the facts as disclosed by the record and in the light of the principles herein announced that none of the respondents is liable for the injury inflicted by Pablito Daffon on Alfredo Amadora that resulted in the latter's death at the auditorium of the Colegio de San Jose Recoletos on April 13, 1972. While we deeply sympathize with the petitioners over the loss of their son under the tragic circumstances here related, we nevertheless are unable to extend them the material relief they seek, as balm to their grief, under the law they have invoked."

Under Articles 218 and 219 of the Family Code, educational institutions, as well as those engaged in child care, are now expressly made principally and solidarily liable with administrators and teachers for damages caused by the child while he is under their supervision, instruction or custody, but the provisions allow the defense of due diligence on the part of said persons exercising special parental authority. The parents and persons exercising substitute parental authority over the unemancipated child are subsidiarily liable but likewise entitled to their own defense of due diligence.

Where the liability is predicated on Article 2180, the payor may recover, in full, the amount paid from the dependent or employee (see *Art. 2181; Gelisan vs. Alday, 154 SCRA 388;* but see *Philippine Rabbit vs. Intermediate Appellate Court, 189 SCRA 158*).

In *Sarkies Tours Phil., Inc. vs. Intermediate Appellate Court (124 SCRA 588),* where a tour operator was made liable in a suit filed against it and the owner of the boat to which the former booked its client, the operator was allowed to seek reimbursement from the owner upon the thesis that although Article 2181 would not technically be invocable, its principle should nonetheless be applicable to the case.

Subsidiary Liability

The vicarious liability of an employer for the fault or negligence of an employee is founded on at least two specific provisions of law. The *first* is expressed in Article 2176, in relation to Article 2180, of the Civil Code which would allow an action predicated on quasi-delict to be instituted by the injured party against the employer for an act or omission of the employee and would necessitate only a preponderance of evidence in order to prevail. Here, the liability of the employer for the negligent conduct of the subordinate is direct and primary subject to the defense of due diligence in the selection and supervision of the employee. The enforcement of the judgment against

the employer for an action based on Article 2176 does not require the employee to be insolvent since the nature of the liability of the employer with that of the employee, the two being statutorily considered joint tortfeasors, is solidary *(Art. 2194, Civil Code).* The *second*, predicated on Article 103 of the Revised Penal Code, provides that an employer may be held subsidiarily liable for a felony committed by his employee in the discharge of his duty. This liability attaches when the employee is convicted of a crime done in the performance of his work and is found to be insolvent that renders him unable to properly respond to the civil liability adjudged *(Franco vs. Intermediate Appellate Court, 178 SCRA 333).*

In *Yonaha vs. Court of Appeals (255 SCRA 397, 29 March 1996, the Supreme Court* ruled:

> "The statutory basis for an employer's subsidiary liability is found in Article 103 of the Revised Penal Code. This Court has since sanctioned the enforcement of this subsidiary liability in the same criminal proceedings in which the employee is adjudged guilty, on the thesis that it really is a part of, and merely an incident in, the execution process of the judgment. But, execution against the employer must *not* issue as just a matter of course, and it behooves the court, as a measure of due process to the employer, to determine and resolve *a priori,* in a hearing set for the purpose, the legal applicability and propriety of the employer's liability. The requirement is mandatory even when it appears *prima facie* that execution against the convicted employee cannot be satisfied. The court must convince itself that the convicted employee is in truth in the employ of the employer; that the latter is engaged in an industry of some kind; that the employee has committed the crime to which civil liability attaches while in the performance of his duties as such, and that execution against the employee is unsuccessful by reason of insolvency."

The subsidiary liability of an employee under Article 103 of the Revised Penal Code requires: (a) the existence of an employer-employee relationship; (b) that the employer is engaged in any kind of industry; (c) that the employee is adjudged guilty of the wrongful act *(Franco vs. Intermediate Appellate Court, 178 SCRA 331)* and found to have committed the offense in the discharge of his duties (not necessarily any offense he commits "while" in the discharge of such duties); and (d) that said employee is insolvent *(Bermudez vs. Hon. Herrera, 158 SCRA 168; Diaz-Leus vs. Melvida, 158 SCRA 21)*. The judgment of conviction of the employee concludes the employer *(Alvarez vs. Court of Appeals, 158 SCRA 57)* and the subsidiary liability may be enforced in the same criminal case, but to afford the employer due process, the court should hear and decide said liability on the basis of the concurrence of the foregoing requisites (see *Vda. De Paman vs. Señeris, 115 SCRA 709*). The issuance of a subsidiary writ of execution against the employer of an accused has once again been upheld in the case of *Pepe Catacutan vs. Heirs of Norman Kadusale (343 SCRA 592),* notwithstanding the non-participation of such employer in the criminal case against the accused. A separate hearing to determine the employer's subsidiary liability, said the Court, would only entail a waste of time and resources of the trial court, considering that the requisites for the attachment of the employer's subsidiary liability have already been established. Once a driver is proven negligent in causing damage, the law presumes the employer equally negligent and the burden of proof to get freed from liability shifts to the latter *(Carticiano vs. Nuval, 134 SCAD 517, 341 SCRA 265).*

In highly meritorious cases, the extent of the liability of the employer himself, including the amount of damages, although final and conclusive on the accused, may be shown by the employer to be clearly unwarranted or unconscionable to be a valid measure of his own subsidiary liability. In such an instance, there is little excuse for

not allowing the employer due process and to be given a chance to be heard thereon. The right of the employer to his own day in court, in no way, would amend or nullify the final judgment rendered by the court which stands unaffected insofar as the accused himself is concerned. It bears stressing that the employer takes no active role in the criminal proceedings, nor entitled to take such role, up until he suddenly finds himself open to a possible subsidiary liability following the judgment of conviction. (See *Rafael Reyes Trucking Corporation vs. People and Rosario Dy, 329 SCRA 600; but see Philippine Rabbit Bus Lines, Inc. vs. People, G.R. No. 147703, 14 April 2004*).

Solidary Liability of Joint Tortfeasors

The responsibility of two or more persons who are liable for a quasi-delict is solidary *(Art. 2194, Civil Code)*. Thus, for his own negligence, a driver of a freight truck which figures in a road mishap is primarily liable to a person who suffers thereby *(Art. 2176, Civil Code);* and for the failure of the owner or operator of the truck to rebut the legal presumption of negligence in the selection and supervision of his employee, he, too, is primarily liable *(Art. 2180, Civil Code)*. The liabilities of the two tortfeasors are solidary *(Art. 2194, Civil Code; Lanuzo vs. Ping, 100 SCRA 205),* but the employer may demand full reimbursement from the employee *(Art. 2181, Civil Code; Gelisan vs. Alday, 154 SCRA 388;* but see *Philippine Rabbit vs. Intermediate Appellate Court, 189 SCRA 158)*.

TITLE XVIII. DAMAGES

Chapter 1

General Provisions

Art. 2195. The provisions of this Title shall be respectively applicable to all obligations mentioned in Article 1157.

Art. 2196. The rules under this Title are without prejudice to special provisions on damages formulated elsewhere in this Code. Compensation for workmen and other employees in case of death, injury or illness is regulated by special laws. Rules governing damages laid down in other laws shall be observed insofar as they are not in conflict with this Code.

Art. 2197. Damages may be:

(1) Actual or compensatory;

(2) Moral;

(3) Nominal;

(4) Temperate or moderate;

(5) Liquidated; or

(6) Exemplary or corrective.

Art. 2198. The principles of the general law on damages are hereby adopted insofar as they are not inconsistent with this Code.

In General

The provisions of the Civil Code on "Damages" embody, except for Articles 2200, 2201, 2209 and 2212, some principles of the American Law on the subject matter enriched and developed extensively by common-law courts

(see *Report of the Code Commission*). Article 2185 expressly makes applicable the said provisions to all the sources of obligations under Article 1157: law, contracts, quasi-contracts, delicts and quasi-delicts, respectively. The rules under this title on damages are without prejudice to special provisions on damages formulated elsewhere in the Code. Compensation for workmen and other employees in case of death, injury or illness is regulated by special laws. Rules governing damages laid down in other laws shall be observed insofar as they are not in conflict with the Code *(Art. 2196, Civil Code)*. The principles of the general law on damages have been adopted insofar as they are not inconsistent with the Civil Code *(Art. 2198, Civil Code)*.

The term "damages" refers to the sum of money which the law awards or imposes by way of pecuniary compensation, recompense, or satisfaction for an injury done or a wrong sustained as a consequence of either a breach of a contractual obligation or a tortuous or illegal act, while the term "damage" pertains to the actionable loss, hurt or harm which results from the unlawful act, omission or negligence of another. In fine, damages are the amounts recoverable or that which can be awarded for the damage done or sustained *(People vs. Dianos, 297 SCRA 191)*. In common law, injury is the illegal invasion of a legal right; damage is the loss, hurt, or harm which results from the injury. Damages are the recompense or compensation awarded for the damage suffered. Thus, there can be damage without injury in those instances in which the loss or harm was not the result of a violation of a legal duty. These situations are often called *damnum absque injuria*. Not always is this distinction followed, however, for the words damage and injury are not infrequently used interchangeably *(22 Am Jur. 2d. 13)*. In *Spouses Lim vs. UNI-TAN Marketing Corporation (G.R. No. 147328, 20 February 2002)*, the Court has said that those who exercise their rights properly do no legal injury. If damages result from the exercise of their legal rights, it

is but *damnum absque injuria*, which is a loss without injury, for which the law gives no remedy.

Damages may be: (a) actual or compensatory; (b) moral; (c) nominal; (d) temperate or moderate; (e) liquidated; or (f) exemplary or corrective *(Art. 2197, Civil Code).*

Except for actual or compensatory damages which must be duly proved *(De los Santos vs. De la Cruz, 37 SCRA 555),* no proof of *pecuniary* loss is necessary in order that moral, nominal, temperate, liquidated or exemplary damages may be adjudicated. The assessment of such damages, except liquidated ones, by and large, is left to the discretion of the court, according to the circumstances of each case (see *Art. 2216, infra., Civil Code; People vs. Baylon, 129 SCRA 62*).

Chapter 2

Actual or Compensatory Damages

Art. 2199. Except as provided by law or by stipulation, one is entitled to an adequate compensation only for such pecuniary loss suffered by him as he has duly proved. Such compensation is referred to as actual or compensatory damages.

Art. 2200. Indemnification for damages shall comprehend not only the value of the loss suffered, but also that of the profits which the obligee failed to obtain. (1106)

Art. 2201. In contracts and quasi-contracts, the damages for which the obligor who acted in good faith is liable shall be those that are the natural and probable consequences of the breach of the obligation, and which the parties have foreseen or could have reasonably foreseen at the time the obligation was constituted.

In case of fraud, bad faith, malice or wanton attitude, the obligor shall be responsible for all damages which may be reasonably attributed to the non-performance of the obligation. (1107a)

Art. 2202. In crimes and quasi-delicts, the defendants shall be liable for all damages which are the natural and probable consequences of the act or omission complained of. It is not necessary that such damages have been foreseen or could have reasonably been foreseen by the defendant.

Art. 2203. The party suffering loss or injury must exercise the diligence of a good father of a family to minimize the damages resulting from the act or omission in question.

Art. 2204. In crimes, the damages to be adjudicated may be respectively increased or lessened according to the aggravating or mitigating circumstances.

Art. 2205. Damages may be recovered:

(1) For loss or impairment of earning capacity in cases of temporary or permanent personal injury;

(2) For injury to the plaintiff's business standing or commercial credit.

Art. 2206. The amount of damages for death caused by a crime or quasi-delict shall be at least Three thousand pesos, even though there may have been mitigating circumstances. In addition:

(1) The defendant shall be liable for the loss of the earning capacity of the deceased, and the indemnity shall be paid to the heirs of the latter; such indemnity shall in every case be assessed and awarded by the court, unless the deceased on account of permanent physical disability not caused by the defendant, had no earning capacity at the time of his death;

(2) If the deceased was obliged to give support according to the provisions of Article 291, the recipient who is not an heir called to the decedent's inheritance by the law of testate or intestate succession, may demand support from the person causing the death, for a period not exceeding five years, the exact duration to be fixed by the court;

(3) The spouse, legitimate and illegitimate descendants and ascendants of the deceased may de-

mand moral damages for mental anguish by reason of the death of the deceased.

Art. 2207. If the plaintiff's property has been insured, and he has received indemnity from the insurance company for the injury or loss arising out of the wrong or breach of contract complained of, the insurance company shall be subrogated to the rights of the insured against the wrongdoer or the person who has violated the contract. If the amount paid by the insurance company does not fully cover the injury or loss, the aggrieved party shall be entitled to recover the deficiency from the person causing the loss or injury.

Art. 2208. In the absence of stipulation, attorney's fees and expenses of litigation, other than judicial costs, cannot be recovered, except:

(1) When exemplary damages are awarded;

(2) When the defendant's act or omission has compelled the plaintiff to litigate with third persons or to incur expenses to protect his interest;

(3) In criminal cases of malicious prosecution against the plaintiff;

(4) In case of a clearly unfounded civil action or proceeding against the plaintiff;

(5) Where the defendant acted in gross and evident bad faith in refusing to satisfy the plaintiff's plainly valid, just and demandable claim;

(6) In actions for legal support;

(7) In actions for the recovery of wages of household helpers, laborers and skilled workers;

(8) In actions for indemnity under workmen's compensation and employer's liability laws;

(9) In a separate civil action to recover civil liability arising from a crime;

(10) When at least double judicial costs are awarded;

(11) In any other case where the court deems it

just and equitable that attorney's fees and expenses of litigation should be recovered.

In all cases, the attorney's fees and expenses of litigation must be reasonable.

Art. 2209. If the obligation consists in the payment of a sum of money, and the debtor incurs in delay, the indemnity for damages, there being no stipulation to the contrary, shall be the payment of the interest agreed upon, and in the absence of stipulation, the legal interest, which is six per cent per annum. (1108)

Art. 2210. Interest may, in the discretion of the court, be allowed upon damages awarded for breach of contract.

Art. 2211. In crimes and quasi-delicts, interest as a part of the damages may, in a proper case, be adjudicated in the discretion of the court.

Art. 2212. Interest due shall earn legal interest from the time it is judicially demanded, although the obligation may be silent upon this point. (1109a)

Art. 2213. Interest cannot be recovered upon unliquidated claims or damages, except when the demand can be established with reasonable certainty.

Art. 2214. In quasi-delicts, the contributory negligence of the plaintiff shall reduce the damages that he may recover.

Art. 2215. In contracts, quasi-contracts, and quasi-delicts, the court may equitably mitigate the damages under circumstances other than the case referred to in the preceding article, as in the following instances:

(1) That the plaintiff himself has contravened the terms of the contract;

(2) That the plaintiff himself has derived some benefit as a result of the contract;

(3) In cases where exemplary damages are to be awarded, that the defendant acted upon the advice of counsel;

(4) That the loss would have resulted in any event;

(5) That since the filing of the action, the defendant has done his best to lessen the plaintiff's loss or injury.

Except as provided by law or by stipulation, one is entitled to an adequate compensation only for such pecuniary loss suffered by him as he has duly proved (see *Capco vs. Macasaet, 189 SCRA 561*). Such indemnification for damages shall comprehend not only the value of the loss suffered, which is referred to as *actual or daño emergente* or *damnum emergens*, but also that of the profits which the obligee failed to obtain or what is known as compensatory or *lucro cessante* or *lucrum cessans* (see *Arts. 2199* and *2200, Civil Code; Magat, Jr. vs. Court of Appeals, 131 SCAD 303, 337 SCRA 298; M.D. Transit, Inc. vs. Court of Appeals, 90 SCRA 542*), which the court may separately award *(Radio Communications of the Phils., Inc. vs. Court of Appeals, 103 SCRA 359)* once duly proved).

Credence can only be given to the claims for actual or compensatory damages which are adequately supported with receipts *(People vs. Avillana, 126 SCAD 370, 332 SCRA 19; People vs. Guillermo, 102 SCAD 841, 302 SCRA 257)*. Where, however, the defense did not contest the claim of actual damages, the same should be granted *(People vs. Arellano, 128 SCAD 847, 334 SCRA 775)*. Medical expenses, said the Court in *People vs. Enguito (121 SCAD 835, 326 SCRA 508),* partake of the nature of actual damages and the award thereof cannot be made on the basis of the doctor's prescriptions alone.

Damages may be recovered for loss or impairment of earning capacity in cases of temporary or permanent personal injury and for injury to the plaintiff's business standing or commercial credit *(Art. 2205, Civil Code)*. The recoverable amount for the loss of "earning capacity" is the loss of net earnings which is the gross earning less necessary expenses in the creation of such earnings and less

living and other incidental expenses during the victim's average life span *(Marchan vs. Mendoza, 24 SCRA 888; Davila vs. PAL, 49 SCRA 497)*. As a rule, documentary evidence should be presented to substantiate the claim for damages for loss of earning capacity. The claim may, however, be allowed despite the non-availability of documentary evidence, provided there be oral testimony to the effect that: (a) the victim has been self-employed, and judicial notice is taken of the fact that in his line of work, no documentary evidence is available; and (b) the victim has been employed as a daily wage worker earning less than the minimum wage under current labor laws (But see *People vs. Daroy, 130 SCAD 21, 336 SCRA 24*). The provision of Article 2199 denies the grant of speculative damages, or such damage not actually proved to have existed and to have been caused to the party claiming the same *(Gregorio De Vera, Jr. vs. Court of Appeals, G.R. No. 132869, 18 October 2001)*.

The award of future income is based mainly on two factors, namely: (1) the number of years of which the damages shall be computed; and (2) the rate at which the losses sustained by the heirs should be fixed *(People vs. Arellano, 128 SCAD 847, 334 SCRA 775)*. It is computed in accordance with the formula, *viz.*: net earning capacity = 2/3 x (80 – age at the time of death) x reasonable portion of the annual net income which would have been received as support by the heirs *(People vs. Aspiras, 125 SCAD 222, 330 SCRA 479)*. As the award for loss of earning capacity refers to the net income of the deceased, that is, total income less average expenses, there must be a reliable estimate of the victim's average expenses *(People vs. Ereno, 121 SCAD 510, 326 SCRA 157)*. Net income equivalent to 50% of the gross annual income could be a fair estimate of the living expenses of the deceased (see *People vs. Aspiras, 125 SCAD 222, 330 SCRA 479; People vs. Verde, 302 SCRA 690*).

To be recompensed for loss of earning capacity, it is not necessary that the victim, at the time of injury or

death, be gainfully employed. Compensation of this nature is awarded not for loss of earning but for loss of capacity to earn money *(People vs. Mayor Antonio Sanchez, G.R. Nos. 121039-45, 18 October 2001; People vs. Teehankee, Jr., 64 SCAD 808, 249 SCRA 54).*

Extent of Recoverable Damages

In General

In *contracts* and *quasi-contracts*, the damages for which the obligor who acted in *good faith* is liable shall be those that are the natural and probable consequences of the breach of the obligation, and which the parties have *foreseen* or could have reasonably foreseen at the time the obligation was constituted (see *Batong Buhay vs. Court of Appeals, 147 SCRA 4*). In case of fraud, *bad faith*, malice or wanton attitude, the obligor shall be responsible for all damages which may be *reasonably attributed* to the non-performance of the obligation *(Art. 2201, Civil Code;* see *Samhwa vs. Intermediate Appellate Court, 205 SCRA 632; Cerrano vs. Tan Chuco, 38 Phil. 392; General Enterprises, Inc. vs. Lianga Bay Logging Co., 11 SCRA 733; 12 SCRA 464).*

In *crimes* and *quasi-delicts*, the defendant shall be liable for *all* damages which are the *natural* and *probable* consequences of the act or omission complained of. It is not necessary that such damages have been foreseen or could have reasonably been foreseen by the defendant *(Art. 2202, Civil Code; Banzon vs. Court of Appeals, 175 SCRA 297; Malonzo vs. Galang, 109 Phil. 16).* In crimes, the damages to be adjudicated may be respectively increased or lessened according to the aggravating or mitigating circumstances *(Art. 2204, Civil Code; Heirs of Castro vs. Bustos, 27 SCRA 327).* In case of death caused by a crime or quasi-delict, the Civil Code specifically provides:

> "Art. 2206. The amount of damages for death caused by a crime or quasi-delict shall be at least

three thousand pesos, even though there may have been mitigating circumstances. In addition:

(1) The defendant shall be liable for the loss of the earning capacity of the deceased, and the indemnity shall be paid to the heirs of the latter; such indemnity shall in every case be assessed and awarded by the court, unless the deceased on account of permanent physical disability not caused by the defendant, had no earning capacity at the time of his death;

(2) If the deceased was obliged to give support according to the provisions of Art. 291, the recipient who is not an heir called to the decedent's inheritance by the law of testate or intestate succession, may demand support from the person causing the death, for a period not exceeding five years, the exact duration to be fixed by the court;

(3) The spouse, legitimate and illegitimate descendants and ascendants of the deceased may demand moral damages for mental anguish by reason of the death of the deceased."

The amount of P3,000 is a statutory minimum that has been increased in various instances to P6,000 (see *M. Ruiz Highway Transit vs. Court of Appeals, 11 SCRA 98*), then to P12,000 *(People vs. Pantoja, 25 SCRA 468)* and still perhaps to such amounts as the peso value might actually command at given times and circumstances. Thus, starting with the case of *People vs. De la Fuente (126 SCRA 518),* the Supreme Court has increased the death indemnity for intentional felonies to P30,000 (see also *De Luna vs. LTB Co., 160 SCRA 70*). It is presently fixed at P50,000 *(Fortune Express Inc. vs. Court of Appeals, 305 SCRA 14).* In the case of death of a victim of *crime* or *quasi-delict*, the surviving spouse, as well as the descendants and ascendants, whether legitimate or illegitimate and irrespective of successional rights, but not the collateral relatives, apparently may all recover moral damages (see *Receiver for North Negros Sugar Co. vs.*

Ybañez, 24 SCRA 979; Heirs of Gonzales vs. Alegarbes, 99 Phil. 213).

Attorney's Fees and Litigation Expenses

In the absence of stipulation, attorney's fee and expenses of litigation other than judicial costs, cannot be recovered except:

(1) When exemplary damages are awarded;

(2) When the defendant's act or omission has compelled the plaintiff to litigate with third persons or to incur expenses to protect his interests;

(3) In criminal cases of malicious prosecution against the plaintiff;

(4) In case of a clearly unfounded civil action or proceeding against the plaintiff;

(5) Where the defendant acted in gross and evident bad faith in refusing to satisfy the plaintiff's plainly valid, just and demandable claim;

(6) In actions for legal support;

(7) In actions for the recovery of wages of household helpers, laborers and skilled workers;

(8) In actions for indemnity under workmen's compensation and employer's liability laws;

(9) In a separate civil action to recover civil liability arising from a crime;

(10) When at least double judicial costs are awarded;

(11) In any other case where the court deems it just and equitable that attorney's fees and expenses of litigation should be recovered.

Generally, attorney's fees cannot be recovered as part of damages because of the policy that no premium should be placed on the right to litigate. The grant of attorney's

fees as part of damages is the exception rather than the rule as counsel's fees are not awarded every time a party prevails in a suit *(Philtranco Service Enterprises, Inc. vs. Court of Appeals, 83 SCAD 482, 273 SCRA 562)*. It is necessary for the courts to make findings of facts and law that would bring the case within the exception *(Country Bankers Insurance vs. Lianga Bay, G.R. No. 136914, 25 January 2002)*. An award of attorney's fees under Article 2208 demands factual, legal and equitable justification, and it must, in all cases, be reasonable. Courts are empowered to reduce the amount of attorney's fees if the same are iniquitous or unconscionable. Even when a claimant is compelled to litigate with a third person or to incur expenses to protect his rights, still attorney's fees may not be awarded where no sufficient showing of bad faith could be reflected in the party's persistence in a case other than an erroneous conviction of the righteousness of his cause *(ABS-CBN Broadcasting Corp. vs. Court of Appeals, 102 SCAD 459, 301 SCRA 572)*. The attorney's fees so provided in penal clauses, being in the nature of liquidated damages, are awarded in favor of the litigant, not his counsel, and it is the litigant, not counsel, who is the judgment creditor entitled to enforce the judgment by execution *(Barons Marketing Corp. vs. Court of Appeals, 91 SCAD 509, 286 SCRA 96)*.

Interest

If the obligation consists in the payment of a sum of money and the debtor incurs in delay, the indemnity for damages, there being no stipulation to the contrary, shall be the payment of the interest agreed upon, and in the absence of stipulation, the legal interest, which is six per cent *per annum (Art. 2209, Civil Code)*.

In *Reformina vs. Hon. Tomol (139 SCRA 260),* an action for damages for injury to persons and loss of property, the then Court of First Instance of Cebu rendered judgment for the petitioners and against the private respondents with *legal interest* from the filing of the com-

plaint. The Court of Appeals affirmed the judgment with some modifications. When the judgment became final and executory, a controversy developed over the meaning of "legal interest." The petitioners said legal interest should be 12 percent *per annum* and invoked Central Bank Circular 416. Private respondents insisted that the legal interest should be six percent *per annum* pursuant to Article 2209 of the New Civil Code in relation to Articles 2210 and 2211. CB Circular 416 provides: "By virtue of the authority granted to it under Section 1 of Act 2655, as amended, otherwise known as the"'Usury Law,' the Monetary Board in its Resolution No. 1622, dated 29 July 1974, has prescribed that the rate of interest for the loan, or forbearance of any money, goods, or credits and the rate allowed in judgments, in the absence of express contract as to such rate of interest, shall be twelve percent (12%) *per annum*. This Circular shall take effect immediately." The petitioners elevated the issue to the Supreme Court which ruled:

> "The judgments spoken of and referred to are judgments in litigations involving loans or forbearance of any money, goods or credits. Any other kind of monetary judgment which has nothing to do with, nor involving loans or forbearance of any money, goods or credits does not fall within the coverage of the said law for it is not within the ambit of the authority granted to the Central Bank. x x x.
>
> "Coming to the case at bar, the decision herein sought to be executed is one rendered in an Action for Damages for injury to persons and loss of property and does not involve any loan, much less forbearances of any money, goods or credits. As correctly argued by the private respondents, the law applicable to the said case is Article 2209 of the New Civil Code x x x."

The ruling was reiterated in *Philippine Rabbit Bus Lines, Inc. vs. Cruz (143 SCRA 158)* and in *Florendo vs. Ruiz (170 SCRA 461).* In *Nakpil & Sons vs. Court of*

Appeals (160 SCRA 339), however, the Court ruled that a rate of interest of 12% *per annum* on the total sum is due although there is neither a loan nor forbearance of money since such interest is not being imposed until after the finality of the judgment when there is *delay* in the payment of the amount due under such final judgment. The *Reformina vs. Tomol* and other cases applying Article 2209 (6% legal interest), said the Court, refer to the interest due in the concept of damages imposed on the total sum claimed from the filing of the complaint until paid (see also *National Power Corporation vs. Angas, 208 SCRA 542*). But in *American Express International vs. Intermediate Appellate Court (G.R. No. 70766, 9 November 1989),* a 6% interest was again imposed by the court computed from the finality of the decision until fully paid.

While the Usury Law ceiling on interest rates has been lifted by Central Bank Circular No. 905, nothing in the said circular, however, grants lenders *carte blanche* authority to raise interest rates to levels which would either enslave their borrowers or lead to a hemorrhaging of their assets *(Almeda vs. Court of Appeals, 70 SCAD 248, 256 SCRA 292)*. In *Medel vs. Court of Appeals (200 SCRA 481)*, the Court has ruled that the stipulated interest rate at 5.5% per month on a loan amounting to P500,000.00, while not usurious, must be equitably reduced nonetheless for being iniquitous, unconscionable, and exorbitant. In *Spouses Solangon vs. Salazar (G.R. No. 125944, 29 June 2001, 150 SCAD 706),* the stipulated interest rate of 6% per month or 72% *per annum* has been held to be definitely outrageous and inordinate.

In *Consolidated Bank and Trust Corp. vs. Court of Appeals (G.R. No. 114286, 19 April 2000)*, the Court has counseled that while it may be acceptable, for practical reasons given the fluctuating economic conditions, for banks to stipulate that interest rates on a loan not be fixed and instead be made dependent upon prevailing market conditions, there should always be a reference rate upon which to peg such variable interest rates. A

stipulation ostensibly signifying an agreement to "any increase or decrease in the interest rate," without more, cannot be accepted as valid because it leaves solely to the creditor the determination of what interest rate to charge against an outstanding loan.

Interest may, in the discretion of the court, be allowed upon damages awarded for breach of contract *(Art. 2210, Civil Code)*. In crimes and quasi-delicts, interest as a part of the damages may, in a proper case, be adjudicated in the discretion of the court *(Art. 2211, Civil Code)*. Interest due shall earn legal interest from the time it is judicially demanded, although the obligation may be silent upon this point *(Art. 2212, Civil Code)*. Interest cannot be recovered upon unliquidated claims or damages except when the demand can be established with reasonable certainty *(Art. 2213, Civil Code;* see *Malayan Insurance Co. vs. Manila Port Service, 28 SCRA 65)*.

The pronouncement in *Eastern Shipping Lines, Inc. vs. Court of Appeals (53 SCAD 207, 234 SCRA 78)* has summed up the rules on the payment of interest thusly: (1) (a) When the obligation consisting in the payment of sum of money, *i.e.*, a loan or forbearance of money, is breached, the interest due should be that which may have been stipulated in writing *(Art. 1956)*. Furthermore, the interest due shall earn legal interest from the time it is judicially demanded *(Art. 2212)*. In the absence of stipulation, the rate of interest shall be 12% *per annum* to be computed from default, *i.e.*, from the judicial or extrajudicial demand under and subject to the provisions of Article 1169 of the Civil Code; (b) When the obligation breached, however, is one which does not constitute a loan or forbearance of money, an interest on the amount of damages awarded may be imposed at the discretion of the court at the rate of 6% *per annum (Art. 2209)*. No interest shall be adjudged on unliquidated claims or damages except when or until the demand is established with reasonable certainty *(Art. 2213)*. Once it is established with reasonable certainty, the interest shall begin to run

from the time the claim is made judicially or extrajudicially. When the certainty cannot be reasonably established at the time the demand is made, the interest shall begin to run only from the date the judgment of the court is made. The actual base for the computation of legal interest shall, in any case, be on the amount finally adjudged. (2) In either case (a) or case (b), when the judgment of the court awarding a sum of money becomes final and executory, the rate of legal interest shall be 12% *per annum* from such finality until its satisfaction, the interim period being deemed to be by then an equivalent to a forbearance of credit.

More particularly

The factual circumstances may call for different applications, guided by the rule that the courts are vested with discretion, depending on the equities of each case, on the award of interest. Nonetheless, the following rules of thumb suggestions have been made by the Court for guidance.

I. When an obligation, regardless of its source, i.e., law contracts, quasi-contracts, delicts or quasi-delicts is breached, the contravenor can be held liable for damages. The provisions under Title XVIII on "Damages" of the Civil Code govern in determining the measure of recoverable damages.

II. With regard specifically to an award of interest in the concept of actual and compensatory damages, the rate of interest, as well as the accrual thereof, is imposed, as follows:

> 1. When the obligation is breached, and it consists in the payment of a sum of money, i.e., a loan or forbearance of money, the interest due should be that which may have been stipulated in writing. Furthermore, the interest due shall itself earn legal interest from the time it is judicially demanded. In the absence of stipulation, the rate of interest shall

be 12% per annum to be computed from default, i.e., from judicial or extrajudicial demand under and subject to the provisions of Article 1169 of the Civil Code.

2. When an obligation, not constituting a loan or forbearance of money, is breached, an interest on the amount of damages awarded may be imposed at the *discretion of the court* at the rate of 6% per annum. No interest, however, shall be adjudged on unliquidated claims or damages except when or until the demand can be established with reasonable certainty. Accordingly, where the demand is established with reasonable certainty, the interest shall begin to run from the time the claim is made judicially or extrajudicially (Art. 1169, Civil Code) but when such certainty cannot be so reasonably established at the time the demand is made, the interest shall begin to run only from the date the judgment of the court is made (at which time the quantification of damages may be deemed to have been reasonably ascertained). The actual base for the computation of legal interest shall, in any case, be on the amount finally adjudged.

3. When the judgment of the court awarding a sum of money becomes final and executory, the rate of legal interest, whether the case falls under paragraph 1 or paragraph 2, above, shall be 12% per annum from such finality until its satisfaction, this interim period being deemed to be by then an equivalent to a forbearance of credit *(Eastern Shipping Lines, Inc. vs. Court of Appeals and Mercantile Insurance Company, Inc., G.R. No. 97412, 12 July 1994, 234 SCRA 78).*

While the nullity of the stipulation on the usurious interest does not affect the lender's right to receive back the principal amount of the loan, the debtor may recover the amount paid as interest under a usurious interest because the payment is deemed to have been made under restrain, rather then voluntarily *(First Metro Investment*

Corporation vs. Este del Sol Mountain Reserve, Inc., G.R. No. 141811, 15 November 2001).

Mitigation and Assessment of Damages

The party suffering loss or injury must exercise the diligence of a good father of a family to minimize the damages resulting from the act or omission in question *(Art. 2203, Civil Code; University of the Philippines vs. De los Angeles, 35 SCRA 102).*

In quasi-delicts, the contributory negligence of the plaintiff shall reduce the damages that he may recover *(Art. 2214, Civil Code;* see *Grand Union Supermarket vs. Espino, 90 SCRA 542)*. In contracts, quasi-contracts, and quasi-delicts, the court may equitably mitigate the damages under circumstances other than the case referred to in the preceding article, such as in the following instances:

(1) That the plaintiff himself has contravened the terms of the contract;

(2) That the plaintiff has derived some benefit as a result of the contract;

(3) In case where exemplary damages are to be awarded, that the defendant acted upon the advice of counsel;

(4) That the loss would have resulted in any event;

(5) That since the filing of the action, the defendant has done his best to lessen the plaintiff's loss or injury *(Art. 2215, Civil Code).*

Chapter 3

Other Kinds of Damages

Art. 2216. No proof of pecuniary loss is necessary in order that moral, nominal, temperate, liquidated or exemplary damages, may be adjudicated. The assessment of such damages, except liquidated ones, is left to the discretion of the court, according to the circumstances of each case.

In Other Kinds of Damages

Proof of pecuniary loss is not necessary in order that moral, nominal, temperate, liquidated or exemplary damages may be adjudicated. The assessment of such damages, except liquidated ones, is left to the sound discretion of the court, according to the circumstances of each case *(Art. 2216, Civil Code)*.

The Supreme Court, in *Rama vs. Court of Appeals (148 SCRA 496)*, sanctioned an award for damages under Article 2216 of the Court to improperly dismissed employees. Said the court:

> "Justice demands that they be recompensated for the predicament they were placed in, apart from the back salaries which they are entitled to as a matter of right. We are inclined to agree that the amount of P1,000 damages granted to each of them by the Court of Appeals was fixed by that court judiciously and is a reasonable sum" *(Art. 2216, Civil Code)*.
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> "Petitioner Rama's protestations that when he eventually became the governor of Cebu, he reinstated most of the dismissed employees through provincial board Resolution No. 392 (L-4484 Rollo, p. 16) cannot erase the fact that he had a hand in the adoption of Resolution No. 990. His subsequent benevolent act cannot sufficiently make up for the damage suffered by the dismissed employees during their period of unemployment."

Subrogatory Rights of Insurer

If the plaintiff's *property* has been insured and he has received indemnity from the insurance company for the injury or loss arising out of the wrong or breach of contract complained of, the insurance company shall be subrogated to the rights of the insured against the wrongdoer or the person who has violated the contract. If the amount paid by the insurance company does not fully

cover the injury or loss, the aggrieved party shall be entitled to recover the deficiency from the person causing the loss or injury *(Art. 2207, Civil Code; F.F. Cruz vs. Court of Appeals, 164 SCRA 731; Pioneer Ins. vs. Court of Appeals, 175 SCRA 668; Rizal Surety & Insurance Co. vs. MRR, 23 SCRA 205)*. This provision does not apply to death or injury to natural persons *(Catuiza vs. People, 13 SCRA 538)* since that loss of life or limb can never really be fully recompensed.

Section 1 — Moral Damages

Art. 2217. Moral damages include physical suffering, mental anguish, fright, serious anxiety, besmirched reputation, wounded feelings, moral shock, social humiliation, and similar injury. Though incapable of pecuniary computation, moral damages may be recovered if they are the proximate result of the defendant's wrongful act for omission.

Art. 2218. In the adjudication of moral damages, the sentimental value of property, real or personal, may be considered.

Art. 2219. Moral damages may be recovered in the following and analogous cases:

(1) A criminal offense resulting in physical injuries;

(2) Quasi-delicts causing physical injuries;

(3) Seduction, abduction, rape, or other lascivious acts;

(4) Adultery or concubinage;

(5) Illegal or arbitrary detention or arrest;

(6) Illegal search;

(7) Libel, slander or any other form of defamation;

(8) Malicious prosecution;

(9) Acts mentioned in Article 309;

(10) Acts and actions referred to in Articles 21, 26, 27, 28, 29, 30, 32, 34 and 35.

The parents of the female seduced, abducted, raped, or abused, referred to in No. 3 of this article, may also recover moral damages.

The spouse, descendants, ascendants, and brothers and sisters may bring the action mentioned in No. 9 of this article, in the order named.

Art. 2220. Willful injury to property may be a legal ground for awarding moral damages if the court should find that, under the circumstances, such damages are justly due. The same rule applies to breaches of contract where the defendant acted fraudulently or in bad faith.

Moral damages, occasionally termed contemporary damages, are awarded to compensate a person for such injuries as physical sufferings, fright, serious anxiety, mental anguish, besmirched reputation, wounded feelings, moral shock, social humiliation or similar injury caused to him by the wrongful act or omission of another *(Art. 2217, Civil Code).* An award of moral damages requires in addition to the injury sustained — (a) that there is a factual basis for the damages *(San Miguel Brewery vs. Magno, 128 Phil. 328; Algarra vs. Sandejas, 27 Phil. 284; Malonzo vs. Galang, 109 Phil. 16; Darang vs. Belizar, 125 Phil. 631)*; (b) that the proximate cause of the injury is the claimee's wrongful act or omission *(Guilatco vs. City of Dagupan, 171 SCRA 382; Tiburcio Guita vs. Court of Appeals, 139 SCRA 576; Enervida vs. Dela Torre, 55 SCRA 339; Ruagas vs. Traya, 22 SCRA 839; San Miguel Brewery vs. Magno, 128 Phil. 328; Algarra vs. Sandejas, 27 Phil. 284; Malonzo vs. Galang, 109 Phil. 16; Darang vs. Belizar, 125 Phil. 631);* and (c) that the case is predicated on any of the instances enumerated in, and must come to terms with, the provisions of Article 2217 to Article 2220 *(Guilatco vs. City of Dagupan, 171 SCRA 382; Strebel vs. Figueras, 96 Phil. 321; Sparrevohn vs. Fisher, 2 Phil. 266; Castueras vs. Bayona, 106 Phil. 340; Felista*

vs. Villanueva, 139 SCRA 431), as well as other special provisions (such as some provisions on "Human Relations;" *Malonzo vs. Galang, 100 Phil. 16; Ventanilla vs. Centeno, 110 Phil. 811; Mercado vs. Court of Appeals, 108 Phil. 414*), of the Civil Code.

Actual and moral damages cannot be dealt with in the aggregate; neither being kindred terms nor governed by a coincident set of rules, each must be separately identified and independently justified. A requirement common to both, of course, is that an injury must have been sustained by the claimant. The nature of that injury, nonetheless, differs for while it is pecuniary in actual or compensatory damages, it is, upon the other hand, non-pecuniary in the case of moral damages *(Mariano L. Del Mundo vs. Court of Appeals, Jose U. Francisco and Genoveva V. Rosales, G.R. No. 104576, 20 January 1995, 240 SCRA 348).*

Articles 2219 and 2220 of the Civil Code specify the instances when moral damages are recoverable. The term "analogous cases" preceding the enumeration in Article 2219 appears to indicate that the instances referred to therein are not exclusive in nature. In the case of *Concepcion vs. Court of Appeals (119 SCAD 761, 324 SCRA 85),* the Court said that the violations mentioned in articles 26 and 2219 of the Civil Code do not preclude other similar acts, such as profane, insulting, humiliating, scandalous, or abusive language, but, following the *ejusdem generis* rule, they must be analogous to those expressly enumerated by the law. Thus, although the institution of a clearly unfounded civil suit can at times be a legal justification for an award of attorney's fees, such filing, however, has almost invariably been held not to be a ground for an award of moral damages. The *rationale* for the rule is that the law could not have meant to impose a penalty on the right to litigate. The anguish suffered by a person for having been made a defendant in a civil suit would be no different from the usual worry and anxiety suffered by anyone who is haled to court, a situation that

cannot by itself be a cogent reason for the award of moral damages. If the rule were otherwise, then moral damages must every time be awarded in favor of the prevailing defendant against an unsuccessful plaintiff *(Expertravel & Tours, Inc. vs. The Honorable Court of Appeals and Ricardo Lo, G.R. No. 130030, 25 June 1999, 309 SCRA 141)*.

Moral damages are not punitive in nature but are designed to compensate the claimant for real injury suffered and not to impose a penalty on the wrongdoer *(Expertravel & Tours, Inc. vs. Court of Appeals, 309 SCRA 141, 25 June 1999)*. Although hardly susceptible of being quantified by exact standards, moral damages, nevertheless, should be neither minimal nor excessive but reasonable and kept proportionate to the harm sustained. Judicial discretion in fixing the award must be exercised with a balanced restraint and measured objectivity (see *R&B Surety & Ins. Co. vs. Uson, 129 SCRA 736; Siguenza vs. Quimbo, 137 SCRA 570; Inhelder Corp. vs. Panganiban, 122 SCRA 576; Prudenciado vs. Alliance Transport System, 148 SCRA 440*), not whims and caprice, bias or prejudice, but guided by what is fair and just under the given situation. Among the factors that can be considered in assessing moral damages is the standing of the offended party in the community, on the one hand, and the financial capability of the claimee, upon the other hand, without either being preclusive of other circumstances even perhaps more primordial at times, like the gravity of the injury and wrong causing it, that may be attendant to each case (see *Zulueta vs. Pan American World Airways, Inc., 43 SCRA 396* and *49 SCRA 1*). In *Metropolitan Bank and Trust Co. vs. Francisco Wong (G.R. No. 120859, 26 June 2001, 150 SCAD 178),* the Court has emphasized that while the amount of moral damages is a matter left largely to the sound discretion of the trial court, the same, when found excessive, should be reduced to more reasonable amounts considering the attendant facts and circumstances. Moral damages are not intended to enrich a

complainant at the expense of the defendant; they are awarded only to enable the injured party to obtain means, diversion or amusements that will serve to alleviate the moral sufferings he has undergone by reason of the defendant's culpable action.

The person claiming moral damages must prove the existence of bad faith by clear and convincing evidence, for the law presumes good faith. It is not enough that one merely suffered sleepless nights, mental anguish, serious anxiety as the result of the actuation of the other party. Such action must be shown to have been willfully done in bad faith or with ill motive *(Ace Haulers Corp. vs. Court of Appeals, 132 SCAD 398, 338 SCRA 572)*. Thus, in a breach of contract of carriage, an injured passenger cannot recover moral damages, unless the common carrier acted fraudulently or in bad faith *(Roque vs. Buan, 21 SCRA 642;* see also *RCPI vs. Court of Appeals, 103 SCRA 359)*.

The law itself allows the recovery of moral damages in the law on common carriers in case of death of a passenger caused by the breach of contract (see *Art. 1764, Civil Code; Martinez vs. Gonzales, 6 SCRA 331*). In other instances, following the *ejusdem generis* rule, the case must be similar to those expressly enumerated by the law (see *Bagumbayan Corp. vs. Intermediate Appellate Court, 132 SCRA 441*).

Moral damages are explicitly authorized in breaches of contract where the defendant acted fraudulently or in bad faith *(Spouses Mirasol vs. Court of Appeals, 142 SCAD 654, 351 SCRA 44)*, or in wanton disregard of a contractual obligation *(Makabili vs. Court of Appeals, 17 SCRA 253)*. In *Spouses Herbosa vs. PVE (G.R. No. 119086, 25 January 2002)*, moral damages were awarded in favor of petitioner spouses due to malicious breach of contract by the respondent corporation because of its failure to record on video the former's wedding ceremony and reception. The respondent's wanton and reckless neglect to timely

detect the mechanical defect in the video tape recorder constitutes, said the Court, gross negligence in the discharge of its contractual obligation.

In *Far East Bank and Trust Company vs. Court of Appeals (G.R. No. 108164, 23 February 1995),* the Supreme Court said that bad faith implies a conscious and intentional design to do a wrongful act for a dishonest purpose or moral obliquity; it is different from the negative idea of negligence in that malice or bad faith contemplates a state of mind affirmately operating with furtive design or ill will. It added:

> "We are not unaware of the previous rulings of this Court, such as in American Express International, Inc. *vs.* Intermediate Appellate Court (167 SCRA 209) and Bank of Philippine Islands *vs.* Intermediate Appellate Court (206 SCRA 408), sanctioning the application of Article 21, in relation to Article 2217 and Article 2219 of the Civil Code to a contractual breach similar to the case at bench. Article 21 states:
>
> "Art. 21. Any person who willfully causes loss or injury to another in a manner that is contrary to morals, good customs or public policy shall compensate the latter for the damage."

Article 21 of the Code, it should be observed, contemplates a conscious act to cause harm. Thus, even if we are to assume that the provision could properly relate to a breach of contract, its application can be warranted only when the defendant's disregard of his contractual obligation is so deliberate as to approximate a degree of misconduct certainly no less worse than fraud or bad faith. Most importantly, Article 21 is a mere declaration of a general principle in human relations that clearly must, in any case, give way to the specific provision of Article 2220 of the Civil Code authorizing the grant of moral damages in *culpa contractual* solely when the breach is due to fraud or bad faith.

Mr. Justice Jose B.L. Reyes, in his *ponencia* in *Fores vs. Miranda* explained with great clarity the predominance that we should give to Article 2220 in contractual relations; we quote:

> "(A) breach of contract can not be considered included in the descriptive term 'analogous cases' used in Art. 2219 not only because Art. 2220 specifically provides for the damages that are caused by contractual breach, but (also) because the definition of *quasi-delict* in Art. 2176 of the Code expressly *excluses* the cases where there is a 'preexisting contractual relation between the parties.'
>
> "'Art. 2176. Whoever by act or omission causes damage to another, there being fault or negligence, is obliged to pay for the damage done. Such fault or negligence, if there is no pre-existing contractual relation between the parties, is called a quasi-delict and is governed by the provisions of this Chapter.'
>
> "The exception to the basic rule of damages now under consideration is a mishap resulting in the death of a passenger, in which case Article 1764 makes the common carrier expressly subject to the rule of Art. 2206, that entitles the spouse, descendants and ascendants of the deceased passenger to 'demand moral damages for mental anguish by reason of the death of the deceased' (Necesito *vs*. Paras, 104 Phil. 84, Resolution on motion to reconsider, September 11, 1958). But the exceptional rule of Art. 1764 makes it all the more evident that where the injured passenger does not die, moral damages are not recoverable unless it is proved that the carrier was guilty of malice or bad faith. We think it is clear that the mere carelessness of the carrier's driver does not *per se* constitute or justify an inference of malice or bad faith on the part of the carrier; and in the case at bar there is no other evidence of such malice to support the award of moral damages by

the Court of Appeals. To award moral damages for breach of contract, therefore, without proof of bad faith or malice on the part of the defendant, as required by Art. 2220, would be to violate the clear provisions of the law, and constitute unwarranted judicial legislation.

x x x x x x x x x

"The distinction between fraud, bad faith or malice in the sense of deliberate or wanton wrong doing and negligence (as mere carelessness) is too fundamental in our law to be ignored (Arts. 1170-1172); their consequences being clearly differentiated by the Code.

" 'ART. 2201. In contracts and quasi-contracts, the damages for which the obligor who acted in good faith is liable shall be those that are the natural and probable consequences of the breach of the obligation, and which the parties have foreseen or could have reasonably foreseen at the time the obligation was constituted.

'In case of fraud, bad faith, malice or wanton attitude, the obligor shall be responsible for all damages which may be reasonably attributed to the non-performance of the obligation."

"It is to be presumed, in the absence of statutory provision to the contrary, that this difference was in the mind of the lawmakers when in Art. 2220 they limited recovery of moral damages to breaches of contract in bad faith. It is true that negligence may be occasionally so gross as to amount to malice; but that fact must be shown in evidence, and a carrier's bad faith is not to be lightly inferred from a mere finding that the contract was breached through negligence of the carrier's employees."

The Court has not in the process overlooked another rule that a quasi-delict can be the cause for breaching a

contract that might thereby permit the application of applicable principles on tort even where there is a pre-existing contract between the plaintiff and the defendant (Phil. Airlines *vs*. Court of Appeals, 106 SCRA 143; Singson *vs*. Bank of Phil. Islands, 23 SCRA 1117; and Air France *vs*. Carrascoso, 18 SCRA 155). This doctrine, unfortunately, cannot improve private respondents' case for it can aptly govern only where the act or omission complained of would constitute an actionable tort independently of the contract. The test (whether a quasi-delict can be deemed to underlie the breach of a contract) can be stated thusly: Where, without a pre-existing contract between two parties, an act or omission can nonetheless amount to an actionable tort by itself, the fact that the parties are contractually bound is no bar to the application of quasi-delict provisions to the case. Here, private respondents' damage claim is predicated solely on their contractual relationship; without such agreement, the act or omission complained of cannot by itself be held to stand as a separate cause of action or as an independent actionable tort.

Moral damages may also be recoverable where the contract is breached by tort resulting in physical injuries *(Philippine AirLines vs. Court of Appeals, 106 SCRA 143)* or generally where the defendant is guilty of intentional tort. In *Manila Electric Co. vs. Court of Appeals (157 SCRA 243),* the Court held that the petitioner's act of disconnecting the respondent's gas service without prior notice, contrary to the electric supply contract involved, constituted breach of contract amounting to an independent tort. Willful injury to property may be a legal ground for awarding moral damages if the court should find that, under the circumstances, such damages are justly due.

In fine, moral damages may be awarded —

1) In *culpa contractual*, when in a breach of contract the defendant acted in bad faith or was guilty of gross negligence amounting to bad faith or in wanton disregard of his contractual obli-

gation and exceptionally when the act of breach itself is constitutive of tort resulting in physical injuries. In a breach of contract of carriage, moral damages may also be recovered in case of death of a passenger pursuant to the special rule in Article 1764, in relation to Article 2206 of the Civil Code.

2) In *culpa aquiliana*, (a) when the act or omission causes physical injuries, or (b) when the defendant is guilty of intentional tort (in this latter case, moral damages may be recovered even in loss of or damage to property). These rules may likewise apply, as aforesaid, to contracts when breached by tort.

3) In *culpa criminal*, when the accused is guilty of physical injuries, lascivious acts, adultery or concubinage, illegal or arbitrary detention, illegal arrest, illegal search, defamation and malicious prosecution *(Expertravel & Tours, Inc. vs. Court of Appeals, 309 SCRA 141, 25 June 1999)*.

Proof of mental and physical sufferings provided under Article 2217 of the Code can be dispensed with in rape cases because it is recognized that the victim's injury is concomitant with and necessarily results from the odious crime of rape to warrant *per se* the award of moral damages *(People vs. Mangila, 121 SCAD 110, 325 SCRA 586)*. In *People vs. Dela Cruz (132 SCAD 407, 338 SCRA 582),* the Court has dispensed with the conventional requirement of *allegata et probata* in a rape case where the civil aspect is included in the prosecution, since the mental, physical and psychological trauma suffered by the victim is too obvious to require the recital thereof at the trial by the victim.

The filing of a clearly unfounded civil suit is not a ground for recovery of moral damages, not being analogous to those enumerated in the law *(Enevida vs. Tan, 55 SCRA 339; Ramos vs. Ramos, 61 SCRA 284; Boysaw vs.*

Interphil Promotions, Inc., 148 SCRA 635; Manila Gas Corp. vs. Court of Appeals, 100 SCRA 601; but see *PNB vs. Court of Appeals, 159 SCRA 433)*, but it is a legal justification for an award of attorney's fees *(Art. 2208, Civil Code)* so long as the cause of action is untenable as to amount to gross and evident bad faith *(Mirasol vs. De la Cruz, 84 SCRA 337).*

Malicious prosecution may serve as a basis for the recovery of such moral damages provided its three elements concur and are proven, *viz.:* (1) the fact of the prosecution where the defendant was himself the prosecutor, or instigated its commencement, and which finally terminated with the plaintiff's acquittal; (2) the defendant, in bringing the case, had acted without probable cause; and (3) the defendant was prompted by legal malice, *i.e.*, by improper or sinister motives *(Tan vs. Court of Appeals, 131 SCRA 397;* see also *Equitable Banking Corp. vs. Intermediate Appellate Court, 133 SCRA 135; Cruz vs. Intermediate Appellate Court, 129 SCRA 490; Tan Kapoe vs. Masa, 134 SCRA 231; Ponce vs. Legaspi, 208 SCRA 377; Cometa vs. Court of Appeals, 117 SCAD 1006, 321 SCRA 574).*

Moral damages have been awarded in favor of a Filipino passenger who was downgraded from first to economy class with evident lack of concern of a foreign airline *(Trans World Airlines vs. Court of Appeals, 165 SCRA 143).* The president of a state college, who unjustifiably refused to enforce the decision of the Director of Public Schools allowing school honors to deserving students, was ordered to pay damages in favor of the aggrieved student *(Ledesma vs. Court of Appeals, 160 SCRA 449).* Moral damages were likewise awarded to a person who was slapped on the face by another *(Patricio vs. Judge Leviste, 172 SCRA 774).* In *Agapito Magbanua vs. Intermediate Appellate Court (137 SCRA 328),* it appears that the petitioners were denied irrigation water for their farm lots in order to make them vacate their landholdings. Since the defendants violated the petitioner's rights and

caused prejudice to the latter by the unjustified diversion of the water, the latter were entitled to a measure of moral damages. Article 2219 of the Civil Code permits the award of moral damages for acts mentioned in Article 21 thereof.

In one case, the Supreme Court ruled that a wife is not entitled to damages simply because her husband has filed a baseless complaint for annulment of their marriage which eventually caused her mental anguish, anxiety, besmirched reputation, social humiliation, and alienation from her parents. A contrary rule could lead to an absurd situation where the husband pays the wife damages from conjugal or common funds. In any case, the Court added, the law does not comprehend an action for damages between husband and wife merely because of breach of marital obligation *(Ofelia Ty vs. Court of Appeals, 138 SCAD 554, 346 SCRA 86).*

In *ABS-CBN Broadcasting Corp. vs. Court of Appeals (102 SCAD 459, 301 SCRA 572)*, the Court said that the award of moral damages could not be granted in favor of a corporation because, being an artificial person and having existence only in legal contemplation, it has no feelings, no emotions, no senses. It could not, therefore, experience physical suffering and mental anguish, which could only be felt by one having a nervous system. But moral damages may be awarded to a corporation whose reputation has been besmirched *(Jardine Davies, Inc. vs. Court of Appeals, 128 SCAD 20, 333 SCRA 684).*

Section 2 — Nominal Damages

Art. 2221. Nominal damages are adjudicated in order that a right of the plaintiff, which has been violated or invaded by the defendant, may be vindicated or recognized, and not for the purpose of indemnifying the plaintiff for any loss suffered by him.

Art. 2222. The court may award nominal damages in every obligation arising from any source enumer-

ated in article 1157, or in every case where any property right has been invaded.

Art. 2223. The adjudication of nominal damages shall preclude further contest upon the right involved and all accessory questions, as between the parties to the suit, or their respective heirs and assigns.

Nominal damages are adjusted in order that a right of the plaintiff, which has been violated or invaded by the defendant, may be vindicated or recognized, and not for the purpose of indemnifying the plaintiff for any loss suffered by him *(Art. 2221, Civil Code; Far East Bank vs. Court of Appeals, G.R. No. 108164, 23 February 1995; Manila Banking Corp. vs. Intermediate Appellate Court, 131 SCRA 271)*. The court may award nominal damages in every obligation arising from any source enumerated in Article 1157, or in every case where any property right has been invaded *(Art. 2222, Civil Code)* regardless of bad or improper conduct (see *Alitalia vs. Court of Appeals, 192 SCRA 9*). Failure to receive money within the expected time through the facilities of money orders may warrant award of nominal damages in favor of the aggrieved party. The adjudication of nominal damages shall preclude further contest upon the right involved and all accessory questions, as between the parties to the suit, or their respective heirs and assigns *(Art. 2223, Civil Code)*.

To exemplify, due process in the context of a termination of employment, particularly, would be two-fold, i.e., **substantive due process** which is complied with when the action of the employer is predicated on a just cause or an authorized cause, and **procedural due process** which is satisfied when the employee has the opportunity to contest the existence of the ground invoked by the employer in terminating the contract of employment and to be heard thereon. It is difficult to ascribe either a want of wisdom or a lack of legal basis to the early pronouncements of that sanction the termination of employment when a just or an authorized cause to warrant the termination is clearly

extant. Regrettably, the Supreme Court in some of those pronouncements has used, less than guardedly, the term "due process" when referring to the notices prescribed in the Labor Code and its implementing rules that could, thereby, *albeit* unintendedly and without meaning to, confuse the latter with the notice requirement in adjudicatory proceedings. It is not seldom when the law puts up various conditions in the juridical relations of parties; it would not be accurate to consider, an infraction thereof to *ipso-facto* raise a problem of due process. The mere failure of notice of the dismissal or lay-off does not foreclose the right of an employee from disputing the validity, in general, of the termination of his employment, or the veracity, in particular, of the cause that has been invoked in order to justify that termination. In assailing the dismissal or lay-off, an employee is entitled to be heard and to be given the corresponding due notice of the proceedings. It would be when this right is withheld without cogent reasons that, indeed, it can rightly be claimed that the fundamental demands of procedural due process have been unduly discarded.

The prescribed notices can have consequential benefits to an employee who is dismissed or laid off, as the case may be; its non-observance by an employer, therefore, can verily entitled the employee to an award of damages but, to repeat, not to the extent of rendering outrightly illegal that dismissal or lay-off predicated on valid grounds. The indemnification to the employee could be considered not a penalty or a fine against the employer, the levy of either of which would require an appropriate legislative enactment; rather, the grant of indemnity as justifiable as an award of nominal damages in accordance with the provisions of Articles 2221-2223 of the Civil Code x x x.

There is no fixed formula for determining the precise amount of nominal damages. In fixing the amount of nominal damages to be awarded, the circumstances of each case should thus be taken into account, such as, to exemplify, the —

(a) length of service **or employment of the dismissed employee;**

(b) his salary or compensation **at the time of the termination of employment** *vis-a-vis* the capability of the employer to pay;

(c) question of whether the employer has deliberately **violated the requirements for termination of employment or has** attempted to comply, **at least substantially, therewith; and/or**

(d) reasons **for the termination of employment.**

The award of nominal damages is not for the purpose of indemnification for a loss but for the recognition and vindication of a right. The degree of recovery therefor can depend, on the one hand, on the constitution of the right, and, upon the other hand, on the extent and manner by which that right is ignored to the prejudice of the holder of that right.

In fine —

A. A just cause or an authorized cause and a written notice of dismissal or lay-off, as the case may be, are required **concurrently but not really equipollent in their consequence**, in terminating an employer-employee relationship.

B. **Where there is neither just cause nor authorized cause, the** reinstatement of the employee **and the** payment of back salaries **would be proper and should be decreed. If the dismissal or lay-off is attended by bad faith or if the employer acted in wanton or oppressive manner**, moral **and** exemplary **damages might also be awarded**. x x x

C. Where there is just cause or an authorized cause for the dismissal or lay-off but the required written notices therefore have not been properly ob-

served by an employer, it would **neither** be right and justifiable **nor** likely intended by law to order either the **reinstatement** of the dismissal or laid-off employee or the **payment of back salaries** to him simply for the lack of such notices if, and so long as, the employee is not deprived of an opportunity to contest that dismissal or lay-off and to accordingly be heard thereon. In the termination of employment for an **authorized** cause (this cause being attributable to an employer), the laid-off employee is statutorily entitled to **separation pay**, unlike a dismissal for a just cause (a cause attributable to an employee) where no separation pay is due. In either case, if an employer fails to comply with the requirements of notice in terminating the services of the employee, the employer must be made to pay, as so hereinabove expressed, corresponding damages to the employee (see *Agabon and Agabon vs. Riviera Home Improvements, etc., et al., G.R. No. 158693, 17 November 2004, overturning Ruben Serrano vs. National Labor Relations Commission and Isetann Department Store, Inc., G.R. No. 117040, 27 January 2000, 323 SCRA 445).*

Section 3 — Temperate or Moderate Damages

Art. 2224. Temperate or moderate damages, which are more than nominal but less than compensatory damages, may be recovered when the court finds that some pecuniary loss has been suffered but its amount can not, from the nature of the case be proved with certainty.

Art. 2225. Temperate damages must be reasonable under the circumstances.

Temperate or moderate damages, which are more than nominal but less than compensatory damages, may be recovered when the court finds that some pecuniary loss has been suffered but its amount cannot, from the

nature of the case, be proved with certainty *(Art. 2224, Civil Code)*. Thus, failure to establish such pecuniary loss precludes the application of the rule on temperate or moderate damages. Temperate damages must be reasonable under the circumstances *(Art. 2225, Civil Code;* see *Manila Banking Corp. vs. Intermediate Appellate Court, 131 SCRA 271)*. Temperate and nominal damages are incompatible and cannot be granted concurrently *(Citytrust Banking Corporation vs. Intermediate Appellate Court, 51 SCAD 411, 232 SCRA 559)*.

Section 4 — Liquidated Damages

Art. 2226. Liquidated damages are those agreed upon by the parties to a contract, to be paid in case of breach thereof.

Art. 2227. Liquidated damages, whether intended as an indemnity or a penalty, shall be equitably reduced if they are iniquitous or unconscionable.

Art. 2228. When the breach of the contract committed by the defendant is not the one contemplated by the parties in agreeing upon the liquidated damages, the law shall determine the measure of damages, and not the stipulation.

Liquidated damages or damages agreed to by the parties beforehand in order to obviate the further necessity of proof thereof, whether intended as an indemnity or a penalty, shall be equitably reduced if they are iniquitous or unconscionable *(Art. 2227, Civil Code; Joe's Radio vs. Alto Electronics, 104 Phil. 333)*. In case of fraud, additional damages may be awarded over such liquidated damages (see *Gatmaitan vs. Court of Appeals, 94 SCRA 556*).

When the breach of the contract committed by the defendant is not the one contemplated by the parties in agreeing upon the liquidated damages, the law shall determine the measure of damages, and not the stipulation *(Art. 2228, Civil Code)*.

Section 5 — Exemplary or Corrective Damages

Art. 2229. Exemplary or corrective damages are imposed, by way of example or correction for the public good, in addition to the moral, temperate, liquidated or compensatory damages.

Art. 2230. In criminal offenses, exemplary damages as a part of the civil liability may be imposed when the crime was committed with one or more aggravating circumstances. Such damages are separate and distinct from fines and shall be paid to the offended party.

Art. 2231. In quasi-delicts, exemplary damages may be granted if the defendant acted with gross negligence.

Art. 2232. In contracts and quasi-contracts, the court may award exemplary damages if the defendant acted in a wanton, fraudulent, reckless, oppressive, or malevolent manner.

Art. 2233. Exemplary damages cannot be recovered as a matter of right; the court will decide whether or not they should be adjudicated.

Art. 2234. While the amount of the exemplary damages need not be proved, the plaintiff must show that he is entitled to moral, temperate or compensatory damages before the court may consider the question of whether or not exemplary damages should be awarded. In case liquidated damages have been agreed upon, although no proof of loss is necessary in order that such liquidated damages may be recovered, nevertheless, before the court may consider the question of granting exemplary in addition to the liquidated damages, the plaintiff must show that he would be entitled to moral, temperate or compensatory damages were it not for the stipulation for liquidated damages.

Art. 2235. A stipulation whereby exemplary damages are renounced in advance shall be null and void.

Exemplary or corrective damages are imposed, by way of example or correction for the public good, in *addition* to the moral, temperate, liquidated or compensatory

damages *(Art. 2229, Civil Code; Prudenciado vs. Alliance Transport System, 148 SCRA 440; Lopez vs. Pan American World Airways, 16 SCRA 431).* Exemplary damages, likewise known as punitive or vindictive damages, are intended to serve as a deterrent to serious wrongdoings and as a vindication of undue sufferings and wanton invasion of the rights of an injured or as a punishment for those guilty of outrageous conduct. These terms are generally, but not always, used interchangeably. In common law, there is preference in the use of exemplary damages when the award is to account for injury to feelings and for the sense of indignity and humiliation suffered by a person as a result of an injury that has been maliciously and wantonly inflicted, the theory being that there should be compensation for the hurt caused by the highly reprehensible conduct of the defendant — associated with such circumstances as willfulness, wantonness, malice, gross negligence or recklessness, oppression, insult or fraud or gross fraud — that intensifies the injury. The terms punitive or vindictive damages are often used to refer to those species of damages that may be awarded against a person to punish him for his outrageous conduct. In either case, these damages are intended in good measure to deter the wrongdoer and others like him from similar conduct in the future. *(People vs. Catubig, G.R. No. 137842, 23 August 2001, 153 SCAD 604).*

In *criminal offenses*, exemplary damages as a part of the civil liability may be imposed when the crime was committed with one or more aggravating circumstances. Such damages are separate and distinct from fines and shall be paid to the offended party *(Art. 2230, Civil Code).* In *quasi-delicts*, exemplary damages may be granted if the defendant acted with gross negligence *(Art. 2231, Civil Code; CLLC E.G. Gochangco Workers Union vs. NLRC, 161 SCRA 655; Santiago Syjuco, Inc. vs. Court of Appeals, 175 SCRA 171; Globe Mackay Cable & Radio Corp. vs. Court of Appeals, 176 SCRA 778).* In *contracts* and *quasi-contracts*, the court may award exemplary damages if the

defendant acted in a wanton, fraudulent, reckless, oppressive, or malevolent manner *(Art. 2232, Civil Code; PNB vs. Gen. Acceptance and Finance Corp., 161 SCRA 449).*

The attendance of aggravating circumstances in the perpetration of the crime serves to increase the penalty (the criminal liability aspect) as well as justify an award of exemplary or corrective damages (the civil liability aspect), moored on the greater perversity of the offender manifested in the commission of the felony such as may be shown by: (1) the motivating power itself, (2) the place of commission, (3) the means and ways employed, (4) the time, (5) the personal circumstances of the offender or the offended party or both. The term "aggravating circumstances" used by the Civil Code, the law not having specified otherwise, is to be understood in its broad or generic sense. The commission of an offense has a two-pronged effect, one upon the public as it breaches the social order and the other upon the private victim as it causes personal suffering, each of which is addressed by, respectively, the prescription of heavier punishment for the accused and the award of additional damages to the victim. The increase of the penalty or a shift to a graver felony underscores the exacerbation of the offense by the attendance of aggravating circumstances, whether ordinary or qualifying, in its commission. Unlike the criminal liability which is basically a State concern, the award of damages, however, is likewise, if not primarily, intended for the offended party who suffers thereby. It would make little sense for an award of exemplary damages to be due the private offended party when the aggravating circumstance is ordinary but to be withheld when it is qualifying. Withal, the ordinary or qualifying nature of an aggravating circumstance is a distinction that should only be of consequence to the criminal, rather than to the civil liability of the offender. In fine, relative to the civil aspect of the case, an aggravating circumstance, whether ordinary or qualifying, should entitle the offended party to an award of exemplary damages within the unbridled meaning of Article 2230 of the Civil Code *(People vs. Catubig, supra.).*

Relevantly, the Revised Rules on Criminal Procedure, made effective on 01 December 2000, requires aggravating circumstance, whether ordinary or qualifying, to be stated in the complaint or information (see *Secs. 8-9, Rule 110, Rules of Court*). A court would thus be precluded from considering in its judgment the attendance of "qualifying or aggravating circumstances" if the complaint or information is bereft of any allegation on the presence of such circumstances *(ibid.)*.

Exemplary damages cannot be recovered as a matter of right; the court will decide whether or not they should be adjudicated *(Art. 2233, Civil Code; LTB Co. vs. Diasanta, 11 SCRA 474)*. Exemplary damages may not be granted if they are devoid of any legal justification *(Bagumbayan Corp. vs. Intermediate Appellate Court, 132 SCRA 441)*. While the amount of the exemplary damages need not be proved, the plaintiff must show that he is entitled to moral, temperate or compensatory damages before the court may consider the question of whether or not exemplary damages should be awarded. In case liquidated damages have been agreed upon, although no proof of loss is necessary in order that such liquidated damages may be recovered, nevertheless, before the court may consider the question of granting exemplary, in addition to the liquidated damages, the plaintiff must show that he would be entitled to moral, temperate or compensatory damages were it not for the stipulation for liquidated damages *(Art. 2234, Civil Code;* see *Dee Hua Liong Electrical Equipment Corp. vs. Reyes, 145 SCRA 713)*.

In *De Leon vs. Court of Appeals (165 SCRA 166),* the Court enumerated the conditions for the award of exemplary damages to wit:

> 1. They may be imposed by way of example or correction only in addition, among others, to compensatory damages and cannot be recovered as a matter of right, their determination depending upon the amount of compensatory damages that may be awarded to the claimant;

2. The claimant must first establish his right to moral, temperate, liquidated or compensatory damages; and

3. The wrongful act must be accompanied by bad faith, and the award would be allowed only if the guilty party acted in a wanton, fraudulent, reckless, oppressive or malevolent manner *(Octot vs. Ybanez, 111 SCRA 79; Sweet Lines, Inc. vs. Court of Appeals, 121 SCRA 769; Dee Hua Liong Electrical Equipment Corporation vs. Reyes, 145 SCRA 713; Tan Kapoc vs. Masa, 134 SCRA 231])*. It may be awarded for breach of contract or quasi-contract as when a telegram company personnel transmitted the wrong telegram *(Radio Communication of the Philippines, Inc. vs. Court of Appeals, 103 SCRA 359)* but it is not recoverable in the absence of gross negligence *(Bagumbayan Corporation vs. Intermediate Appellate Court, 132 SCRA 441)*.

Exemplary damages were also held due to a teacher who was arbitrarily denied any teaching assignment *(Chiang Kai Shek School vs. Court of Appeals, 172 SCRA 389;* see also *Suario vs. Bank of P.I., 176 SCRA 688)*.

In *Philippine National Railways vs. Court of Appeals and Rosario Tupang (139 SCRA 87),* a passenger fell off the running train in Lucena, Quezon in 1972 and died. The widow filed a suit for damages for breach of the contract of carriage against the PNR. After trial, the Court of First Instance ordered PNR to pay the respondent a sum of money for the death of her husband, plus another sum for loss of his earning capacity, and a further sum as moral damages. The Court of Appeals ordered the PNR to pay an additional sum as exemplary damages. The case was elevated to the Supreme Court, which ruled:

"But while petitioner failed to exercise extraordinary diligence as required by law, it appears that the deceased was chargeable with contributory negligence. Since he opted to sit on the open plat-

> form between the coaches of the train, he should have held tightly and tenaciously to the upright metal bar found at the side of said platform to avoid falling off from the speeding train. Such contributory negligence, while not exempting the PNR from liability, nevertheless justified the deletion of the amount adjudicated as moral damages. By the same token, the award of exemplary damages must be set aside. Exemplary damages may be allowed only in cases where the defendant acted in a wanton, fraudulent, reckless, oppressive or malevolent manner."

A stipulation whereby exemplary damages are renounced in advance shall be null and void *(Art. 2235, Civil Code)*.

TITLE XIX. CONCURRENCE AND PREFERENCE OF CREDITS

Chapter 1

General Provisions

Art. 2236. The debtor is liable with all his property, present and future, for the fulfillment of his obligations, subject to the exemptions provided by law. (1911a)

Art. 2237. Insolvency shall be governed by special laws insofar as they are not inconsistent with this Code. (n)

Art. 2238. So long as the conjugal partnership or absolute community subsists, its property shall not be among the assets to be taken possession of by the assignee for the payment of the insolvent debtor's obligations, except insofar as the latter have redounded to the benefit of the family. If it is the husband who is insolvent, the administration of the conjugal partnership or absolute community may, by order of the court, be transferred to the wife or to a third person other than the assignee. (n)

Art. 2239. If there is property, other than that mentioned in the preceding article, owned by two or more persons, one of whom is the insolvent debtor, his undivided share or interest therein shall be among the assets to be taken possession of by the assignee for the payment of the insolvent debtor's obligations. (n)

Art. 2240. Property held by the insolvent debtor as a trustee of an express or implied trust, shall be excluded from the insolvency proceedings. (n)

Chapter 2 — Classification of Credits

Art. 2241. With reference to specific movable property of the debtor, the following claims or liens shall be preferred:

(1) Duties, taxes and fees due thereon to the State or any subdivision thereof;

(2) Claims arising from misappropriation, breach of trust, or malfeasance by public officials committed in the performance of their duties, on the movables, money or securities obtained by them;

(3) Claims for the unpaid price of movables sold, on said movables, so long as they are in the possession of the debtor, up to the value of the same; and if the movable has been resold by the debtor and the price is still unpaid, the lien may be enforced on the price; this right is not lost by the immobilization of the thing by destination, provided it has not lost its form, substance and identity; neither is the right lost by the sale of the thing together with other property for a lump sum, when the price thereof can be determined proportionally;

(4) Credits guaranteed with a pledge so long as the things pledged are in the hands of the creditor, or those guaranteed by a chattel mortgage, upon the things pledged or mortgaged, up to the value thereof;

(5) Credits for the making, repair, safekeeping or preservation of personal property, on the movable thus made, repaired, kept or possessed;

(6) Claims for laborers' wages, on the goods manufactured or the work done;

(7) For expenses of salvage, upon the goods salvaged;

(8) Credits between the landlord and the tenant, arising from the contract of tenancy on shares, on the share of each in the fruits or harvest;

(9) Credits for transportation, upon the goods carried, for the price of the contract and incidental ex-

penses, until their delivery and for thirty days thereafter;

(10) Credits for lodging and supplies usually furnished to travellers by hotel keepers, on the movables belonging to the guest as long as such movables are in the hotel, but not for money loaned to the guests;

(11) Credits for seeds and expenses for cultivation and harvest advanced to the debtor, upon the fruits harvested;

(12) Credits for rent for one year, upon the personal property of the lessee existing on the immovable leased and on the fruits of the same, but not on money or instruments of credit;

(13) Claims in favor of the depositor if the depositary has wrongfully sold the thing deposited, upon the price of the sale.

In the foregoing cases, if the movables to which the lien or preference attaches have been wrongfully taken, the creditor may demand them from any possessor, within thirty days from the unlawful seizure. (1922a)

Art. 2242. With reference to specific immovable property and real rights of the debtor, the following claims, mortgages and liens shall be preferred, and shall constitute an encumbrance on the immovable or real right:

(1) Taxes due upon the land or building;

(2) For the unpaid price of real property sold, upon the immovable sold;

(3) Claims of laborers, masons, mechanics and other workmen, as well as of architects, engineers and contractors, engaged in the construction, reconstruction or repair of buildings, canals or other works, upon said buildings, canals or other works;

(4) Claims of furnishers of materials used in the construction, reconstruction, or repair of buildings,

canals or other works, upon said buildings, canals or other works;

(5) Mortgage credits recorded in the Registry of Property, upon the real estate mortgaged;

(6) Expenses for the preservation or improvement of real property when the law authorizes reimbursement, upon the immovable preserved or improved;

(7) Credits annotated in the Registry of Property, in virtue of a judicial order, by attachments or executions, upon the property affected, and only as to later credits;

(8) Claims of co-heirs for warranty in the partition of an immovable among them, upon the real property thus divided;

(9) Claims of donors of real property for pecuniary charges or other conditions imposed upon the donee, upon the immovable donated;

(10) Credits of insurers, upon the property insured, for the insurance premium for two years. (1923a)

Art. 2243. The claims or credits enumerated in the two preceding articles shall be considered as mortgages or pledges of real or personal property, or liens within the purview of legal provisions governing insolvency. Taxes mentioned in No. 1, Article 2241, and No. 1, Article 2242, shall first be satisfied. (n)

Art. 2244. With reference to other property, real and personal of the debtor, the following claims or credits shall be preferred in the order named:

(1) Proper funeral expenses for the debtor, or children under his or her parental authority who have no property of their own, when approved by the court;

(2) Credits for services rendered the insolvent by employees, laborers, or household helpers for one year preceding the commencement of the proceedings in insolvency;

(3) Expenses during the last illness of the debtor or of his or her spouse and children under his or her

parental authority, if they have no property of their own;

(4) Compensation due the laborers or their dependents under laws providing for indemnity for damages in cases of labor accident, or illness resulting from the nature of the employment;

(5) Credits and advancements made to the debtor for support of himself or herself, and family, during the last year preceding the insolvency;

(6) Support during the insolvency proceedings, and for three months thereafter;

(7) Fines and civil indemnification arising from a criminal offense;

(8) Legal expenses, and expenses incurred in the administration of the insolvent's estate for the common interest of the creditors, when properly authorized and approved by the court;

(9) Taxes and assessments due the national government, other than those mentioned in Articles 2241, No. 1 and 2242, No. 1;

(10) Taxes and assessments due any province, other than those referred to in Articles 2241, No. 1, and 2242, No. 1;

(11) Taxes and assessments due any city or municipality, other than those indicated in Articles 2241, No. 1, and 2242, No. 1;

(12) Damages for death or personal injuries caused by a quasi-delict;

(13) Gifts due to public and private institutions of charity or beneficence;

(14) Credits which, without special privilege, appear in (a) a public instrument; or (b) in a final judgment, if they have been the subject of litigation. These credits shall have preference among themselves in the order of priority of the dates of the instruments and of the judgments, respectively. (1924a)

Art. 2245. Credits of any other kind or class, or by any other right or title not comprised in the four preceding articles, shall enjoy no preference. (1925)

Chapter 3

Order of Preference of Credits

Art. 2246. Those credits which enjoy preference with respect to specific movables, exclude all others to the extent of the value of the personal property to which the preference refers.

Art. 2247. If there are two or more credits with respect to the same specific movable property, they shall be satisfied *pro rata*, after the payment of duties, taxes and fees due the State or any subdivision thereof. (1926a)

Art. 2248. Those credits which enjoy preference in relation to specific real property or real rights, exclude all others to the extent of the value of the immovable or real right to which the preference refers.

Art. 2249. If there are two or more credits with respect to the same specific real property or real rights, they shall be satisfied *pro rata*, after the payment of the taxes and assessments upon the immovable property or real right. (1927a)

Art. 2250. The excess, if any, after the payment of the credits which enjoy preference with respect to specific property, real or personal, shall be added to the free property which the debtor may have, for the payment of the other credits. (1928a)

Art. 2251. Those credits which do not enjoy any preference with respect to specific property, and those which enjoy preference, as to the amount not paid, shall be satisfied according to the following rules:

(1) In the order establishes in Article 2244;

(2) Common credits referred to in Article 2245 shall be paid *pro rata* regardless of dates. (1929a)

The provisions of the Civil Code on concurrence and preference of credits are designed to bring about an equitable distribution of an insolvent's assets to his various creditors. Where, thus, the debtor has sufficient assets to pay in full all his debts, the matter of preference and concurrence of credits hardly comes into play (see *Pacific Farms, Inc. vs. Esguerra, 30 SCRA 684;* but see *Barretto vs. Villanueva, 110 Phil. 896*). The full application of the said provisions of law, said the Supreme Court in *Philippine Savings Bank vs. Lantin (124 SCRA 476*, citing *Barretto vs. Villanueva, 110 Phil. 896),* requires that there must be a judicial proceeding *in rem* where the claims of the preferred creditors may be bindingly adjudicated, such as insolvency, the settlement of a decedent's estate, or other liquidation proceedings of similar import. The ruling was reiterated in *Republic vs. Peralta (150 SCRA 37)* and *Development Bank of the Philippines vs. Santos, 171 SCRA 138*; but see *Philippine National Bank vs. Cruz (180 SCRA 206)*. Accordingly, where a writ of execution is returned unsatisfied and where the debtor has no other property with which to respond to satisfy the judgment, the judgment creditor may not demand a *pro rata* share of the proceeds earlier derived by a foreclosing creditor, although Article 2242 of the Civil Code considers the two claims as being concurrent, since the said provision can only become operative in liquidation proceedings. (In this case, Arts. 2242 and 2249 were particularly invoked.)

In *Philippine National Bank vs. Cruz (180 SCRA 206),* the Court upheld the preference accorded to employees for unpaid wages and other monetary claims over the order set forth in Articles 2241 to 2245 of the Civil Code. In the *Development Bank* cases *(supra.),* the Court considered such unpaid claims of laborers as merely providing a preference of credit, unlike that of a lien which creates in favor of a creditor a charge or interest upon specific property. Without such lien, the debtor can sell or encumber his property free from any preference that would only vest or accrue upon the filing of judicial proceedings

in rem to adjudicate all claims of creditors against the debtor's assets without which the provisions of the Civil Code on concurrence and preferences of credits are inoperative. In the Philippine National Bank (PNB) case, PNB was barred from claiming that the workers' lien, if at all, applied only to the products of their labor and not to other property of the employer which are encumbered by mortgaged contracts or otherwise. The Court held that PNB was deemed to have acquiesced to the decision of the labor arbiter concerning the payment of unpaid wages for failure to question the same on appeal.

The right of first preference as regards unpaid wages recognized by Article 110 of the Labor Code does not constitute a lien on the property of the insolvent debtor in favor of workers. It is but a preference of credit in their favor, a preference in application. It is a method adopted to determine and specify the order in which credits should be paid in the final distribution of the proceeds of the insolvent's assets *(Development Bank of the Philippines vs. National Labor Relations Commission, 55 SCAD 26, 236 SCRA 117)*. Preference of credit should be distinguished from a lien. The former applies only to claims which do not attach to specific property whereas the latter creates a charge on a particular property *(ibid.)*.

Insolvency shall be governed by special laws insofar as they are not inconsistent with the Civil Code (see *Art. 2237, Civil Code*).

1. Assets Subject to Claims of Creditors

> "Art. 2236. The debtor is liable with all his property, present and future, for the fulfillment of his obligations, subject to the exemptions provided by law."
>
> "Art. 2238. So long as the original partnership or absolute community subsists, its property shall not be among the assets to be taken possession of by

the assignee for the payment of the insolvent debtor's obligations, except insofar as the latter have redounded to the benefit of the family. If it is the husband who is insolvent, the administration of the conjugal partnership or absolute community may, by order of the court, be transferred to the wife or to a third person other than the assignee."

"Art. 2239. If there is property, other than that mentioned in the preceding Article owned by two or more persons, one of whom is the insolvent debtor, his undivided share or interest therein shall be among the assets to be taken possession of by the assignee for the payment of the insolvent debtor's obligations."

"Art. 2240. Property held by the insolvent debtor as a trustee of an express or implied trust, shall be excluded from the insolvency proceedings."

Provisions allowing exemptions of certain property are also found in the Civil Code (see *Arts. 223, 232, 243* modified by the Family Code, see *Annex to Book I*, and 1708), the Revised Rules of Court, the Insolvency Law and other special laws (see *P.D. 49, Sec. 3; R.A. 1611, Sec. 17*).

2. Classification of Credits and Payment of Claims

In the distribution of the debtor's assets to satisfy the claim of creditors, the following rules on preference and concurrence of credits shall be observed.

First. — Priority shall first be given to claims or liens on *specific* property, personal or real, *viz.*:

a. On Specific Movable Property

Art. 2241. With reference to specific movable property of the debtor, the following claims or liens shall be preferred:

(1) Duties, taxes and fees *due thereon to the State of any subdivision thereof;*

(2) Claims arising from misappropriation, breach of trust, or malfeasance by public officials *committed in the performance of their duties*, on the movables, money or securities obtained by them;

(3) Claims for the unpaid price of movables sold, on said movables, *so long as they are in the possession of the debtor*, up to the value of the same; and if the movable has been resold by the debtor and the *price is still unpaid, the lien may be enforced on the price*; this right *is not lost by the immobilization* of the thing by destination, *provided it has not lost its form, substance and identity; neither is the right lost by the sale of the thing together with other property for a lump sum, when the price thereof can be determined proportionally*;

(4) Credits guaranteed with a pledge *so long as the things pledged are in the hands of the creditor*, or those guaranteed by a chattel mortgage, upon the things pledged or mortgaged, up to the value thereof;

(5) Credits for the making, repair, safekeeping or preservation of personal property, *on the movable thus made, repaired, kept or possessed*;

(6) Claims for laborers' wages, *on the goods manufactured or the work done*;

(7) For expenses of salvage, *upon the goods salvaged*;

(8) Credits between the landlord and the tenant, arising from the contract of tenancy on shares, on the share of each *in the fruits or harvest*;

(9) Credits for transportation, upon the goods carried, for the price of the contract and incidental expenses, *until their delivery and for thirty days thereafter*;

(10) Credits for lodging and supplies usually furnished to travellers by hotel keepers, on the mova-

bles belonging to the guest as long as such movables are in the hotel, *but not for money loaned to the guests*;

(11) Credits for seeds and expenses for cultivation and harvest advanced to the debtor, upon the fruits harvested;

(12) Credits for rent for one year, upon the personal property of the lessee existing on the immovable leased and on the fruits of the same, but not on money or instruments of credit;

(13) Claims in favor of the depositor if the depositary has *wrongfully* sold the thing deposited, upon the price of the sale.

In the foregoing cases, if the movables to which the lien or preference attaches have been wrongfully taken, the creditor may demand them from any possessor, within *thirty days* from the unlawful seizure.

Those credits enjoying preference with respect to specific movables exclude all others to the extent of the value of the personal property to which the preference refers *(Art. 2246, Civil Code)*. If there are two or more credits with respect to the same specific movable property, they shall be satisfied *pro rata* after the payment of duties, taxes and fees due the State or any subdivision thereof *(Art. 2247, Civil Code)*.

The claims or credits enumerated in Article 2241 shall be considered as mortgages or pledges of personal property, or liens within the purview of legal provisions governing insolvency. Taxes mentioned in No. 1, Article 2241, shall first be satisfied *(Art. 2243, Civil Code;* see *Philippine Savings Bank vs. Lantin, 124 SCRA 476)*.

b. On Specific Immovable Property and Real Rights

Art. 2242. With reference to specific immovable property and real rights of the debtor, the following

claims, mortgages and liens shall be preferred, and shall constitute as encumbrance on the immovable or real right:

(1) Taxes due *upon the land or building*;

(2) For the unpaid price of real property sold, upon the *immovable sold*;

(3) Claims of laborers, masons, mechanics and other workmen, as well as of architects, engineers and contractors, engaged in the construction, reconstruction or repair of buildings, canals or other works, *upon said buildings, canals or other works*;

(4) Claims of furnishers of materials used in the construction, reconstruction, or repair of buildings, canals or other works, *upon said buildings, canals or other works*;

(5) Mortgage credits *recorded* in the Registry of Property, upon the real estate mortgaged;

(6) Expenses for the *preservation or improvement* of real property when *the law authorizes reimbursement*, upon the immovable preserved or improved;

(7) Credits *annotated* in the Registry of Property, in virtue of a judicial order, by attachments or executions, upon the property affected, and *only as to later credits*;

(8) Claims of co-heirs for *warranty* in the partition of an immovable among them, upon the real property thus divided;

(9) Claims of donors of real property for *pecuniary charges or other conditions* imposed upon the donee, upon the immovable donated;

(10) Credits of insurers, upon the property insured, for the insurance premium for *two years*."

Those credits which enjoy preference in relation to specific real property or real rights exclude all others to

the extent of the value of the immovable or real right to which the preference refers *(Art. 2248, Civil Code)*. If there are two or more credits with respect to the same specific real property or real rights, they shall be satisfied *pro rata* after the payment of the taxes and assessments upon the immovable property or real right *(Art. 2249, Civil Code;* see *Manabat vs. Laguna Federation of Facomas, 19 SCRA 621)*.

The claims or credits enumerated in Article 2242 shall be considered as mortgages or pledges of real property, or liens within the purview of legal provisions governing insolvency. Taxes mentioned in No. 1, Article 2242, shall first be satisfied (see *Art. 2243, Civil Code;* see *Philippine Savings Bank vs. Lantin, 124 SCRA 476; Barretto vs. Villanueva, 110 Phil. 896)*.

Second. — The excess, if any, after the payment of the credits which enjoy preference with respect to specific property, real or personal, shall be added to the free property which the debtor may have, for the payment of the other credits *(Art. 2250, Civil Code)*.

Those credits which do not enjoy any preference with respect to specific property and those which enjoy preference, as to the amount not paid, shall be satisfied according to the following rules:

a. In the order established in Article 2244, Civil Code, *viz*.:

> "Art. 2244. With reference to other property, real and personal of the debtor, the following claims or credits shall be preferred in the order named:
>
> (1) Proper funeral expenses for the debtor, or children under his or her parental authority who have no property of their own, *when approved by the court*;
>
> (2) Credits for services rendered the insolvent by employees, laborers, or household helpers for *one*

year preceding the commencement of the proceedings in insolvency;

(3) Expenses during the last illness of the debtor or of his or her spouse and children *under his or her parental authority*, if they have no property of their own;

(4) Compensation due the laborers or their dependents under laws providing for indemnity for damages in cases of labor accident, or illness resulting *from the nature of the employment*;

(5) Credits and advancements made to the debtor for support of himself or herself, and family, during the *last year preceding the insolvency*;

(6) Support during the insolvency proceedings, and for *three months thereafter*;

(7) Fines and civil indemnification *arising from a criminal offense*;

(8) Legal expenses, and expenses incurred in the administration of the insolvent's estate for the common interest of the creditors, *when properly authorized and approved by the court*;

(9) Taxes and assessments due the *national government*, other than those mentioned in Articles 2241, No. 1, and 2242, No. 1;

(10) Taxes and assessments due any *province*, other than those referred to in Articles 2241, No. 1, and 2242, No. 1;

(11) Taxes and assessments due any *city or municipality*, other than those referred to in Articles 2241, No. 1, and 2242, No. 1;

(12) Damages for *death or personal injuries caused by a quasi-delict*;

(13) Gifts due to public and private institutions of *charity or beneficence*;

(14) Credits which, without special privilege, appears in (a) a *public instrument*; or (b) in a *final judgment*, if they have been the subject of litigation. These credits shall have preference among themselves *in the order of priority of the dates of the instruments and of the judgments*, respectively."

b. Credits of any other kind or class (or by any other right or title not comprised in Arts. 2241, 2242 and 2244) shall enjoy no preference *(Art. 2245, Civil Code)* and shall be paid *pro rata* regardless of dates *(Art. 2251, Civil Code)*.

The Supreme Court, in *Republic vs. Hon. Peralta (150 SCRA 37),* outlined the scheme constituted by the provisions of the Civil Code thus —

Those provisions (of the Civil Code concerning the classification, concurrence and preference of credits) may be seen to classify credits against a particular insolvent into three general categories, namely:

(a) special preferred credits listed in Article 2241 and Article 2242;

(b) ordinary preferred credits listed in Article 2244; and

(c) common credits under Article 2245.

Turning first to special preferred credits under articles 2241 and 2242, it should be noted at once that these credits constitute liens or encumbrances on the specific movable or immovable property to which they relate. Article 2243 makes clear that these credits "shall be considered as mortgages or pledges of real or personal property, or liens within the purview of legal provisions governing insolvency." It should be emphasized in this connection that "duties, taxes and fees due [on specific movable property of the insolvent] to the State or any subdivision thereof" *(Article 2241[1])* and "taxes due upon the insolvent's land or building *(Art. 2242[1])*" stand first in pref-

erence in respect of the particular movable or immovable property to which the tax liens have attached. Article 2243 is quite explicit: "[T]axes mentioned in number 1, Article 2241 and number 1, Article 2242 shall first be satisfied." The claims listed in numbers 2 to 13 in Article 2241 and in numbers 2 to 10 in Article 2242, all come after taxes in order of precedence; such claims enjoy their privileged character as liens and may be paid only to the extent that taxes have been paid from the proceeds of the specific property involved (or from any other sources) and only in respect of the remaining balance of such proceeds. What is more, these other (non-tax) credits, although constituting liens attaching to particular property, are not preferred one over another *inter se*. *Provided*, tax liens shall have been satisfied, non-tax liens or special preferred credits which subsist in respect of specific movable or immovable property are to be satisfied concurrently and proportionately. Put succinctly, Articles 2241 and 2242, jointly with Articles 2246 to 2249, establish a two-tier order of preference. The first tier includes only taxes, duties and fees due on specific movable or immovable property. All other special preferred credits stand on the same second tier to be satisfied, *pari passu* and *pro rata*, out of any residual value of the specific property to which such other credits relate.

Credits which are specially preferred because they constitute liens (tax or non-tax), in turn, take precedence over ordinary preferred credits so far as concerns the property to which the liens have attached. The specially preferred credits must be discharged first out of the proceeds of the property to which they relate, before ordinary preferred creditors may lay claim to any part of such proceeds.

If the value of the specific property involved is greater than the sum total of the tax liens and other specially preferred credits, the residual value will form part of the "free property" of the insolvent — *i.e.,* property not impressed with the liens by operation of Article 2241 and

Article 2242. If, on the other hand, the value of the specific movable or immovable is less than the aggregate of the tax liens and other specially preferred credits, the unsatisfied balance of the tax liens and other such credits are to be treated as ordinary credits under Article 2244 and to be paid in the order of preference there set up.

In contrast with Articles 2241 and 2242, Article 2244 created no liens on determinate property which follow such property. What Article 2244 creates are simply rights in favor of certain creditors to have the cash and other assets of the insolvent applied in a certain sequence or order of priority.

Only in respect of the insolvent's "free property" is an order of priority established by Article 2244. In this sequence, certain taxes and assessments also figure but these do not have the same kind of overriding preference that Article 2241, No. 1 and Article 2242, No. 1 create for taxes which constitute liens on the taxpayer's property. Under Article 2244 —

(a) taxes and assessments due to the national government, excluding those which result in tax liens under Articles 2241, No. 1 and 2242, No. 1 but including the balance thereof not satisfied out of the movable or immovable property to which such liens attached, are ninth in priority;

(b) taxes and assessments due any province, excluding those impressed as tax liens under Articles 2241, No. 1 and 2242, No. 1, but including the balance thereof not satisfied out of the movable or immovable property to which such liens attached, are tenth in priority; and

(c) taxes and assessments due any city or municipality, excluding those impressed as tax liens under Articles 2241, No. 1 and 2242, No. 2 but including the balance thereof not satisfied out of the movable or immovable property to which such liens attached, are eleventh in priority.

3. Preferences under Special Laws

Certain special laws provide for preferences of credits. Thus, the Philippines Deposit Insurance Corporation is a preferred creditor over all assets of an insolvent bank *(P.D. 1935, 27 June 1984)*. Where a vessel is sold either extra-judicially or judicially, the following claims shall have preference in the order stated;

a. Judicial expenses (if judicially sold) and taxes;

b. Crew's wages;

c. General average;

d. Salvage;

e. Damages arising out of tort; and

f. Preferred mortgage registered prior in time.

All credits not paid shall, subject, whenever pertinent, to the rules on abandonment, subsist as ordinary credits enforceable by personal action against the debtor (see *Sec. 17, P.D. 1521*, otherwise known as "The Ship Mortgage Decree of 1978").

The Labor Code provides:

> Art. 110. *Workers preference in case of bankruptcy.* — In the event of bankruptcy or liquidation of an employer's business, his workers shall enjoy first preference as regards their wages due them for services rendered during the period prior to the bankruptcy or liquidation, any provisions of law to the contrary notwithstanding. Unpaid wages shall be paid in full before other creditors may establish any claim to a share in the assets of the employer."
>
> Art. 97.(f) *Wage* paid to any employee shall mean the remuneration of earnings, however, designated, capable of being expressed in terms of money, whether fixed or ascertained on a time, task, piece, or commission basis, or other method of calculating the same, which is payable by an employer to an em-

ployee under a written or unwritten contract of employment for work done or to be done, or for services rendered or to be rendered, and includes the fair and reasonable value as determined by the Secretary of Labor, of board, lodging, or other facilities customarily furnished by the employer to the employee. *Fair and reasonable value* shall not include any profit to the employer or to any person affiliated with the employer."

The pronouncement of the Court in *DBP vs. NLRC (55 SCAD 26, 236 SCRA 117)* leaves no further room for doubt on the authoritativeness of the prior ruling in *DBP vs. NLRC (183 SCRA 328)* where the Court has said: "Article 110 of the Labor Code, in determining the reach of its terms, cannot be viewed in isolation. Rather, Article 110 must be read in relation to the provisions of the Civil Code concerning the classification, concurrence and preference of credits, which provisions find particular application in insolvency proceedings where the claims of all the creditors, preferred or non-preferred, may be adjudicated in a binding manner x x x. (T)he law, in giving preference to the workers' claims, never meant to create a lien in its favor over the properties of the insolvent. What it has established is merely the worker's right to a first preference in the discharge of funds of the judgment debtor. x x x. Claims for unpaid wages do not therefore fall at all within the category of specially preferred claims established under Articles 2241 and 2242 of the Civil Code, except to the extent that such claims for unpaid wages are already covered by Article 2241, number 6: 'claims for laborers' wages, on the goods manufactured or the work done; or by Article 2242, number 3: 'claims of laborers and other workers engaged in the construction, reconstruction or repair of buildings, canals and other works, upon said buildings, canals and other works.'" Where then would claims for workers' wages fall *vis-a-vis* a recorded mortgage credit? The question was answered in *Republic vs. Peralta (supra.)* in this manner: "A re-

corded mortgage credit, being a lien on an identified immovable property, creates a real right enforceable against the whole world. It is a special preferred credit under Article 2242(5) of the Civil Code. The preference given by Article 110, when not falling within Article 2241(6) and Article 2242(3) of the Civil Code and not attached to any specific property, is an ordinary preferred credit although its impact is to move it from second priority to first priority in the order of preference established by Article 2244 of the Civil Code."

In *Republic vs. Peralta (supra.*, reiterated in the case of *DBP vs. Santos, 171 SCRA 138),* the Supreme Court, speaking through Justice F. Feliciano, ruled:

> "We come to the question of what impact Article 110 of the Labor Code has had upon the complete scheme of classification, concurrence and preference of credits in insolvency set out in the Civil Code. We believe and so hold that Article 110 of the Labor Code did not sweep away the overriding preference accorded under the scheme of the Civil Code to tax claims of the government or any subdivision thereof which constitute a lien upon properties of the Insolvent. It is frequently said that taxes are the very lifeblood of government. The effective collection of taxes is a task of highest importance for the sovereign. It is critical indeed for its own survival. It follows that language of a much higher degree or specificity than that exhibited in Article 110 of the Labor Code is necessary to set aside the intent and purpose of the legislator that shines through the precisely crafted provisions of the Civil Code. It cannot be assumed simpliciter that the legislative authority, by using in Article 220 the words "first preference" and "any provision of law to the contrary notwithstanding" intended to disrupt the elaborate and symmetrical structure set up in the Civil Code. Neither can it be assumed casually that Article 110 intended to subsume the sovereign itself within the

term "other creditors" in stating that "unpaid wages shall be paid in full before other creditors may establish any claim to a share in the assets of employer." Insistent considerations of public policy prevent us from giving to "other creditors" a linguistically unlimited scope that would embrace the universe of creditors save only unpaid employees.

"We, however, do not believe that Article 110 has had no impact at all upon the provisions of the Civil Code. Bearing in mind the overriding precedence given to taxes, duties and fees by the Civil Code and the fact that the Labor Code does not impress any lien on the property of an employer, the use of the phrase "first preference" in Article 110 indicates that what Article 110 intended to modify is the order of preference found in Article 2244, which order relates, as we have seen, to property of the Insolvent that is not burdened with the liens or encumbrances created or recognized by Articles 2241 and 2242. We have noted that Article 2244, number 2, establishes second priority for claims for wages for services rendered by employees or laborers of the Insolvent "for one year preceding the commencement of the proceedings in insolvency." Article 110 of the Labor Code establishes "first preference" for services rendered "during the period prior to the bankruptcy or liquidation. Thus, very substantial effect may be given to the provisions of Article 110 without grievously distorting the framework established in the Civil Code by holding, as we so hold, that Article 110 of the Labor Code has modified Article 2244 of the Civil Code in two respects:

(a) firstly, by removing the one year limitation found in Article 2244, number 2; and (b) secondly, by moving up claims for unpaid wages of laborers or workers of the Insolvent from second priority to first priority in the order of preference established by Article 2244."

In *Philippine National Bank vs. Cruz (180 SCRA 206),* the Supreme Court ruled that Article 110, as amended, is superior to the preferred claims under Articles 2241 to 2245 of the Civil Code. The subsequent cases of *Development Bank of the Philippines vs. NLRC (186 SCRA 841)* and *National Development Co. vs. Phil. Veterans Bank (192 SCRA 257),* however, reiterated the *Peralta rule.*

TRANSITIONAL PROVISIONS

Art. 2252. Changes made and new provisions and rules laid down by this Code which may prejudice or impair vested or acquired rights in accordance with the old legislation shall have no retroactive effect.

For the determination of the applicable law in cases which are not specified elsewhere in this Code, the following articles shall be observed. (Pars. 1 and 2, Transitional Provisions).

Art. 2253. The Civil Code of 1889 and other previous laws shall govern rights originating, under said laws, from acts done or events which took place under their regime, even though this Code may regulate them in a different manner, or may not recognize them. But if a right should be declared for the first time in this Code, it shall be effective at once, even though the act or event which gives rise thereto may have been done or may have occurred under the prior legislation, provided said new right does not prejudice or impair any vested or acquired right, of the same origin. (Rule 1)

Art. 2254. No vested or acquired right can arise from acts or omissions which are against the law or which infringe upon the rights of others. (n)

Art. 2255. The former laws shall regulate acts and contracts with a condition or period, which were executed or entered into before the effectivity of this Code, even though the condition or period may still be pending at the time this body of laws goes into effect. (n)

Art. 2256. Acts and contracts under the regime of the old laws, if they are valid in accordance therewith,

shall continue to be fully operative as provided in the same, with the limitations established in these rules. But the revocation or modification of these acts and contracts after the beginning of the effectivity of this Code, shall be subject to the provisions of this new body of laws. (Rule 2a)

Art. 2257. Provisions of this Code which attach a civil sanction or penalty or a deprivation of rights to acts or omissions which were not penalized by the former laws, are not applicable to those who, when said laws were in force, may have executed the act or incurred in the omission forbidden or condemned by this Code.

If the fault is also punished by the previous legislation, the less severe sanction shall be applied.

If a continuous or repeated act or omission was commenced before the beginning of the effectivity of this Code, and the same subsists or is maintained or repeated after this body of laws has become operative, the sanction or penalty prescribed in this Code shall be applied, even though the previous laws may not have provided any sanction or penalty therefor. (Rule 3a)

Art. 2258. Actions and rights which came into being but were not exercised before the effectivity of this Code, shall remain in full force in conformity with the old legislation; but their exercise, duration and the procedure to enforce them shall be regulated by this Code and by the Rules of Court. If the exercise of the right or of the action was commenced under the old laws, but is pending on the date this Code takes effect, and the procedure was different from that established in this new body of laws, the parties concerned may choose which method or course to pursue. (Rule 4)

Art. 2259. The capacity of a married woman to execute acts and contracts is governed by this Code, even if her marriage was celebrated under the former laws. (n)

Art. 2260. The voluntary recognition of a natural child shall take place according to this Code, even if the child was born before the effectivity of this body of laws. (n)

Art. 2261. The exemption prescribed in Article 302 shall also be applicable to any support, pension or gratuity already existing or granted before this Code becomes effective. (n)

Art. 2262. Guardians of the property of minors, appointed by the courts before this Code goes into effect, shall continue to act as such, notwithstanding the provisions of Article 320. (n)

Art. 2263. Rights to the inheritance of a person who died, with or without a will, before the effectivity of this Code, shall be governed by the Civil Code of 1889, by other previous laws, and by the Rules of Court. The inheritance of those who, with or without a will, die after the beginning of the effectivity of this Code, shall be adjudicated and distributed in accordance with this new body of laws and by the Rules of Court; but the testamentary provisions shall be carried out insofar as they may be permitted by this Code. Therefore, legitimes, betterments, legacies and bequests shall be respected; however, their amount shall be reduced if in no other manner can every compulsory heir be given his full share according to this Code. (Rule 12a)

Art. 2264. The status and rights of natural children by legal fiction referred to in Article 89 and illegitimate children mentioned in Article 287, shall also be acquired by children born before the effectivity of this Code. (n)

Art. 2265. The right of retention of real or personal property arising after this Code becomes effective, includes those things which came into the creditor's possession before said date. (n)

Art. 2266. The following shall have not only prospective but also retroactive effect:

(1) Article 315, whereby a descendant cannot be compelled, in a criminal case, to testify against his parents and ascendants;

(2) Articles 101 and 88, providing against collusion in cases of legal separation and annulment of marriage;

(3) Articles 283, 284, and 289, concerning the proof of illegitimate filiation;

(4) Article 838, authorizing the probate of a will on petition of the testator himself;

(5) Articles 1359 to 1369, relative to the reformation of instruments;

(6) Articles 476 to 481, regulating actions to quiet title;

(7) Articles 2029 to 2031, which are designed to promote compromises. (n)

Art. 2267. The following provisions shall apply not only to future cases but also to those pending on the date this Code becomes effective:

(1) Article 29, Relative to criminal prosecutions wherein the accused is acquitted on the ground that his guilt has not been proved beyond reasonable doubt;

(2) Article 33, concerning cases of defamation, fraud, and physical injuries. (n)

Art. 2268. Suits between members of the same family which are pending at the time this Code goes into effect shall be suspended, under such terms as the court may determine, in order that a compromise may be earnestly sought, or, in case of legal separation proceedings, for the purpose of effecting, if possible, a reconciliation. (n)

Art. 2269. The principles upon which the preceding transitional provisions are based shall, by analogy, be applied to cases not specifically regulated by them. (Rule 13a)

On Vested Rights

The Civil Code of 1889 and other previous laws shall govern rights originating, under said laws, from acts done or events which took place under their regime, even though the new Civil Code may regulate them in a different manner, or may not recognize them. But if a right should be declared for the first time in the new Code, it shall be

effective at once, even though the act or event which gives rise thereto may have been done or may have occurred under the prior legislation, provided said new right does not prejudice or impair any vested or acquired right, of the same origin *(Art. 2253, Civil Code)*. The changes made and new provisions and rules laid down by the Code which may prejudice or impair vested or acquired rights shall have no retroactive effect *(Art. 2252, Civil Code)*. However, no vested or acquired right can arise from acts or omissions which are against the law or which infringe upon the rights of others *(Art. 2254, Civil Code)*.

A vested right is one that is already established or fixed and free from further contingency, uncertainty, or controversy (see *Luque vs. Villegas, 30 SCRA 417*) foreign to the will of the holder *(Republic vs. Court of Appeals, 205 SCRA 356)*. Rights that have vested lawfully (see *Art. 2254, Civil Code*) when the new Civil Code took effect on August 30, 1950 *(Laria vs. Del Rosario, 94 Phil. 778)* are not prejudiced by the changes it has introduced — a consequence of the constitutional guaranty of due process — but where no impairment results, the new provisions are given retroactive effect *(Velayo vs. Shell Co., 54 O.G. 62)*.

The concept of "vested right" is part of the constitutional guaranty of due process that expresses a **present fixed interest** which in right reason and natural justice is protected against arbitrary state action; it includes not only legal or equitable title to the enforcement of a demand but also exemptions from new obligations created after the right has become vested. Rights are considered vested when the right to enjoyment is a present interest absolute, unconditional, and perfect or fixed and irrefutable *(Isabelita Lahom vs. Jose Melvin Sibulo, G.R. No. 143989, 14 July 2003)*.

On Acts and Contracts

The former laws shall regulate acts and contracts with a condition or period, which were executed or en-

tered into before the effectivity of the new Code, even though the condition or period may still be pending at the time this body of laws goes into effect *(Art. 2255, Civil Code)*. Acts and contracts under the regime of the old laws, if they are valid in accordance therewith, shall continue to be fully operative as provided in the same, with the limitations established in these rules. But the revocation or modification of these acts and contracts after the beginning of the effectivity of the new Code shall be subject to the provisions of this new body of laws *(Art. 2256, Civil Code)*.

Accordingly, a contract of sale with a right of repurchase executed prior to the effectivity of the new Civil Code and where the period of redemption expired after such effectivity is still governed by the old code. The provisions, therefore, of Article 1607 of the new Code imposing additional conditions on the vendee-*a-retro* for the consolidation of his ownership have been held inapplicable to the contract (see *Flores vs. So, G.R. L-28527, 16 June 1988; Villalobos vs. Catalan, 5 SCRA 422; Manalansan vs. Manalang, 108 Phil. 1041*).

On Civil Sanctions or Penalties

The provisions of the new Code which attach a civil sanction or penalty or a deprivation of rights to acts or omissions not penalized by the former laws are not applicable to those who, when said laws were in force, may have executed the act or incurred the omission forbidden or condemned by the new Code. If the fault is also punished by the previous legislation, the less severe sanction shall be applied. If a continuous or repeated act or omission was commenced before the beginning of the effectivity of the new Code, and the same subsists or is maintained or repeated after this body of laws has become operative, the sanction or penalty prescribed in the new Code shall be applied, even though the previous laws may not have provided any sanction or penalty therefor *(Art. 2257, Civil Code)*.

The provisions of the new Civil Code on damages allowing for the first time the award of certain damages, as well as those who may be entitled thereto, such as moral and exemplary damages, would be inapplicable to wrongful acts or omissions that have occurred prior to the effectivity of the new Code unless the same have subsisted, or have been maintained or repeated after the new Code had become operative (see *Receiver for North Negros Sugar Co. vs. Ybañez, 24 SCRA 979; Heirs of Zari vs. Santos, 27 SCRA 651*).

On Adjective Provisions

Actions and rights which came into being but were not exercised before the effectivity of the new Code shall remain in full force in conformity with the old legislation; but their exercise, duration and the procedure to enforce them shall be regulated by the new Code and by the Rules of Court. If the exercise of the right or of the action was commenced under the old laws, but is pending on the date the new Code takes effect, and the procedure was different from that established in this new body of laws, the parties concerned may choose which method or course to pursue *(Art. 2258, Civil Code)*.

The new Civil Code follows the general rule on the retroactive effects of adjective law, and Article 2258 provides for such retroactivity on the Code's provisions relating to the exercise, duration and procedure to enforce actions and rights which had arisen but had not been enforced before its effectivity *(Report of the Code Commission, p. 169;* see *Cabuatan vs. CFI of Isabela, 51 SCRA 171)*.

On Successional Rights

Rights to the inheritance of a person who died, with or without a will, before the effectivity of the new Code, shall be governed by the Civil Code of 1889, by other previous laws, and by the Rules of Court. *The inheritance of those who, with or without a will, die after the begin-*

ning of the effectivity of the new Code, shall be adjudicated and distributed in accordance with this new body of laws and by the Rules of Court; but the testamentary provisions shall be carried out insofar as they may be permitted by the new Code. Therefore, legitimes, betterments, legacies and bequests shall be respected; however, their amount shall be reduced if in no other manner can every compulsory heir be given his full share according to the new Code *(Art. 2263, Civil Code).*

The law that applies to the matter of successional rights to the estate of a deceased person is that which governs at the time of his death. Being a particular provision, Article 2263 prevails over the general transitional provisions of the Code *(Montilla vs. Montilla, 2 SCRA 695)*. Ownership by heirs rests upon death of the decedent and new rights that are legislated after such death cannot be asserted without impairing vested rights *(Balais vs. Balais, 159 SCRA 47; Uson vs. Rosario, 92 Phil. 530).*

Other Particular Provisions

The *capacity* of a married woman to execute acts and contracts is governed by the new Code, *even if her marriage was celebrated under the former laws (Art. 2259, Civil Code).*

The *voluntary recognition* of a natural child shall take place according to the new Code, *even if the child was born before the effectivity of this body of laws (Art. 2260, Civil Code).*

The *exemption* prescribed in Article 302 shall also be applicable to any support, pension or gratuity *already existing or granted before the new Code becomes effective (Art. 2261, Civil Code).*

Guardians of the property of minors, appointed by the courts *before* the new Code goes into effect, shall *continue* to act as such, notwithstanding the provisions of Article 320 *(Art. 2262, Civil Code).*

The status and rights of natural children by legal fiction referred to in Article 89 and illegitimate children mentioned in Article 287, shall also be acquired by children born before the effectivity of the new Code *(Art. 2264, Civil Code)*.

The *right of retention* of real or personal property arising after the new Code becomes effective, *includes those things which came into the creditor's possession before said date (Art. 2265, Civil Code)*.

The following shall have not only prospective but also retroactive effect:

(1) *Art. 315*, whereby a descendant cannot be compelled, in a criminal case, to testify against his parents and ascendants;

(2) *Articles 101* and *88*, providing against collusion in cases of legal separation and annulment of marriage;

(3) *Articles 283, 284,* and *289*, *concerning the proof* of illegitimate filiation;

(4) *Art. 838,* authorizing the probate of a will on petition of the testator himself*;*

(5) *Art. 1359* to *1369*, relative to the reformation of instruments;

(6) *Articles 476* to *481*, regulating actions to quiet title;

(7) *Articles 2029* to *2031*, which are designed to promote compromises *(Art. 2266, Civil Code)*.

The following provisions shall apply not only to future cases but also to those pending on the date this Code becomes effective:

(1) *Art. 29*, relative to criminal prosecutions wherein the accused is acquitted on the ground that his guilt has not been proved beyond reasonable doubt;

(2) *Art. 33*, concerning cases of defamation, fraud, and physical injuries *(Art. 2267, Civil Code)*.

Suits between members of the same family which are pending at the time the new Code goes into effect shall be suspended, under such terms as the court may determine, in order that a compromise may be earnestly sought, or, in case of legal separation proceedings, for the purpose of effecting, if possible, a reconciliation *(Art. 2268, Civil Code)*.

The *principles* upon which the preceding transitional provisions are based *shall, by analogy, be applied* to cases not specifically regulated by them *(Art. 2269, Civil Code)*. Thus, Article 278, providing for voluntary recognition of illegitimate children has been given retroactive effect *(Sy-Quia vs. Court of Appeals, G.R. No. 62283, 25 November 1983)*.

REPEALING CLAUSE

Art. 2270. The following laws and regulations are hereby repealed:

(1) Those parts and provisions of the Civil Code of 1889 which are in force on the date when this new Civil Code becomes effective;

(2) The provisions of the Code of Commerce governing sales, partnership, agency, loan, deposit and guaranty;

(3) The provisions of the Code of Civil Procedure on prescription as far as inconsistent with this Code; and

(4) All laws, Acts, parts of Acts, rules of court, executive orders, and administrative regulations which are inconsistent with this Code."

The new Civil Code was approved on June 18, 1949 but, conformably with its Article 2 to the effect that it would take effect one year after its publication in the *Official Gazette*, the new Code became effective on August 30, 1950 *(Lara vs. Del Rosario, 94 Phil. 778)* on which date the repealing clause should be deemed to have also become operative.

The repeals of laws by implication are not favored, and that courts must generally assume their congruent application. The two laws must be absolutely incompatible, and a clear finding thereof must surface, before the inference of implied repeal may be drawn. The rule is expressed in the maxim, *interpretare et concordare leqibus est optimus interpretendi, i.e.,* every statute must be so interpreted and brought into accord with other laws as to form a uniform system of jurisprudence. The fundament is that the legislature should be presumed to have known the existing laws on the subject and not to have enacted conflicting statutes. Hence, all doubts must be resolved against any implied repeal, and all efforts should be exerted in order to harmonize and give effect to all laws on the subject *(Hon. Juan M. Hagad, in his capacity as Deputy Ombudsman for the Visayas vs. Hon. Mercedes Gozo-Dadole, Presiding Judge, Branch XXVIII, Regional Trial Court, Mandaue City, Mandaue City Mayor Alfredo M. Ouano, Mandaue City Vice-Mayor Paterno Cañete and Mandaue City Sangguniang Panlungsod Member Rafael Mayol, G.R. No. 108072, 12 December 1995, 251 SCRA 242).*