PART I

TITLE IX

PARTNERSHIP

(Arts. 1767-1867)

INTRODUCTION

Brief historical background.

(1) *Development of partnership.* — The earliest form of conducting business was the single entrepreneur ownership plan whereby one individual owned the business, had sole control of the same, reaped all the profits, and suffered all the losses. Under this system, the growth of an individual business was limited, owing especially to the limitation of capital and sometimes also to the limitation of skill or knowledge. To permit combinations of capital, or capital and experience, and to secure economy by eliminating some of the overhead costs of individual enterprises, the partnership plan of business association was developed. The partnership may be traced back to ancient history. (T.S. Kerr, Business Law: Principles and Cases, 2nd ed., p. 705.)

(2) *Ancient origin of partnership as a business organization.* — Development, as distinguished from origin, of the partnership as a form of business organization, is often credited to the Romans. They found in this form of business organization a means whereby the capital, goods, talents, and credit of two or more individuals might best be combined to carry on a trade or business. Such trade or business might well have been, and frequently, was too large an undertaking for a single individual.

(a) Historically, the partnership as a business organization was used long before the Romans. As early as 2300 B.C., Hammurabi, the famous king of Babylon, in his compilation of the system of laws of that time, provided for the regulation of the relation called partnership. Commercial partnerships of that time were generally for single transactions or undertakings.

(b) Following the Babylonian period, we find clear-cut references to partnerships in Jewish law. In this connection, however, it must be remembered that the ancient Jews were a pastoral people, and, therefore, the partnership as a business organization under Jewish law was concerned with the holding of title to land by two or more persons. The Jewish word "shutolin" was used to designate this joint ownership of land. Subsequently, this same word was used to denote the partnership relation.

(3) *The relative newness of the law of partnership.*[1] — The partnership as a form of business organization has had a very long history of use. This would suggest that there would be a correspondingly long line of precedents and decisions dealing with this subject. Such is not the case. The explanation for this situation is both clear and understandable. For at least a century after the partnership as a business organization had been well and generally established in British commerce, the English courts of justice had scarcely dealt with this subject. The fact is that disputes between merchants were considered and disposed of by special courts.

[1]Blackstone's commentaries on the law which first appeared in 1765, do not contain any discussion on business partnerships. The fact is that partnerships did not have an early start in England. They began in the trading nations of Holland and Italy. The English law of partnerships is an ill-assimilated mixture of Roman Law, of the Law of Merchants, and of the Common Law of England. (Charles W. Gerstenberg, "Organization and Control" [1919], 3 Modern Business, p. 36.) One should not be surprised to learn, therefore, that the development of the law of partnership in England and the United States, was accompanied with so much confusion and uncertainty that demands for statutory uniformity arose. The result in England was Act of 1800, and in the United States, the Uniform Partnership Act and the Uniform Limited Partnership Act. (Wyatt & Wyatt, Business Law Principles and Cases [1963], p. 597.)

These special courts were commonly known as Courts Staple, Admiralty Courts, and Courts of Piepoudre.

(a) *The law of merchants.* — This subheading might well be taken to indicate that merchants had a special and peculiar kind of law that was applicable to them and their legal affairs. In fact, such was the case during the Middle Ages. During this time, there were numerous periods of rather intense commercial activity. In England, this activity was centered on so-called fairs or staples at which were gathered merchants from many countries seeking to sell their goods. Partnerships flourished during these periods of activity.

During this same period, the common law courts of England were thought to be celebrated for their slowness and their methodical exactness of form. The merchants moved more rapidly than the law and they required that justice be more speedy and that it be in general accord with their customs. This background and need gave rise to the special courts mentioned above.

(b) *English law of partnership.* — In time, the use of these special courts was discontinued and their functions were taken over by the law courts. During his term as Chief Justice, Lord Mansfield sought to establish a common law for commercial matters. His efforts were directed toward establishing and defining the customs of merchants and supplementing this body of law with the applicable principles of the civil law. It was not until the latter years of the 18th century that the law of partnership as we know it today began to assume both form and substance.

In 1778, Lord Mansfield decided the case of *Fox vs. Hanbury* (2 Cowp. 445, 98 Eng. Rep. 1179 [1776].) which dealt with the relative rights of partners as well as the rights of partnership and separate creditors so far as partnership property was concerned. In 1794, William Watson wrote a text on the subject of partnership. (William Watson, Partnership, London [1794].)

(c) *Beginning of law of partnership.* — These two sources, speaking most generally, may be said to mark the beginning

of printed precedents and the publication of the principles of law applicable to partnerships. The increased use of the partnership as a business organization, together with the increase in the complexity of business, generally has brought forth a rapid succession of decisions involving the law of partnerships.

(4) *American Uniform Acts.* — As in the case of sales and negotiable instruments, an attempt has been made to secure uniformity in the United States of state laws dealing with partnership.

The Uniform Partnership Act and the Uniform Limited Partnership Act have been of the utmost importance in helping to achieve uniformity of decisions in this particular field of law. The National Conference of Commissioners on Uniform State Laws first commenced its work in the field of partnership in 1902. It was not until the fall of 1914 that the Conference finally agreed upon a draft of a Uniform Partnership Act that was recommended to the legislative bodies of the several states for adoption.

The Commissioners' Prefatory note is quoted in part:

> "It is, however, proper here to emphasize the fact that there are other reasons in addition to the advantages which will result from uniformity x x x. There is probably no other subject connected with our business law in which greater instances can be found where, in matters of daily occurrence, the law is uncertain. This uncertainty is due not only to conflict between the decisions of different states but more to the general lack of consistency in legal theory, x x x making the actual administration of the law difficult and often inequitable.
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> Another difficulty of the present partnership law is the scarcity of authority of matters of considerable importance in the daily conduct and in the winding up of partnership affairs. In any one state, it is often impossible to find an authority on a matter of comparatively frequent occurrence, while not infrequently, an exhaustive research of the reports of the decisions of all the states and the federal courts fails to reveal a single authority throwing light on the question."

The Uniform Partnership Act that was approved for adoption by the several states in October of 1914 has many points of similarity with the Partnership Act (English) of 1890. For this reason, the practical operation of the Uniform Partnership Act has a background of application in the workings of the English Act. (see Barrett & Seago, Partners and Partnership Law and Taxation, Vol. 1, pp. 1-17.) To be sure, English settlers brought the partnership concept to their new country as part of the common law.

In fine, modern partnership law may be said to contain a combination of principles and concepts developed from three sources: the Roman law, the law merchant and equity, and the common law courts.

Governing law in our jurisdiction.

Before the new Civil Code (R.A. No. 386.) took effect on August 30, 1950 (Lara vs. del Rosario, 94 Phil. 778; Aznar vs. Garcia, 102 Phil. 1055.), commercial or mercantile partnerships were governed by the Code of Commerce (Arts. 116-238.) and non-commercial or civil partnerships by the old Spanish Civil Code. (Arts. 1665-1708.)

The new Civil Code superseded the old Civil Code. It expressly repealed *in toto* the provisions of the Code of Commerce relating to partnerships. (Art.* 2270[2].) Consequently, the provisions of Title IX, from Article 1767 to Article 1867, are intended to provide all the rules regarding partnerships, supplemented by other provisions of the Civil Code, insofar as they are applicable, particularly those on contracts and agency. There is no more distinction between commercial and civil partnerships.

The partnerships contemplated are those formed for private interest or purpose. (Art. 45, last par.)

Sources of our law on partnership.

The Civil Code provisions on partnership were mostly taken, with or without modifications, from the old Civil Code and from

*Unless otherwise indicated, refers to article in the Civil Code.

two American statutes, namely: the Uniform Partnership Act and the Uniform Limited Partnership Act.

In regard to the adoption of provisions of the Uniform Partnership Act and the Uniform Limited Partnership Act, the Code Commission which drafted the new Civil Code, has this to say:

> "Rules from these two Uniform Acts have been incorporated into the proposed Civil Code because there are numerous gaps in our present law on these two subjects. Moreover, these American statutes are more in keeping with modern business practices. (Report of the Code Commission, p. 67.)
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> New rules were adopted from the Uniform Partnership Act (*i.e.*, Arts. 1769, 1774, 1785, 1787, 1805 to 1807, 1809, 1810 to 1814, 1819 to 1826) and from the opinions of civilians (*i.e.*, Arts. 1789, 1791). Some provisions were taken from the Code of Commerce. (Arts. 1789, 1808.) New Rules were also formulated by the Commission (*i.e.*, Arts. 1768, 1770, par. 2, 1772, 1790, 1815.)
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> Many provisions were amended for clarification or improvement." (*Ibid.*, p. 149.)

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Chapter 1

GENERAL PROVISIONS

ARTICLE 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)

Concept of partnership.

The above article gives the legal definition of partnership (often called "co-partnership") from the viewpoint of a contract.

There are, however, other definitions. Thus:

(1) "A partnership is a *contract* of two or more competent persons to place their money, effects, labor and skill, or some or all of them, in lawful commerce or business and to divide the profits and bear the losses in certain proportions." (40 Am. Jur. 126, 474; 68 C.J.S. 398.)

(2) "A partnership is an *association* of two or more persons to carry on as co-owners of a business for profit." (Uniform Partnership Act, Sec. 6.)

(3) "A partnership is a *legal relation* based upon the express or implied agreement of two or more competent persons whereby they unite their property, labor or skill in carrying on some lawful business as principals for their joint profit." (Mechem, Elements of the Law of Partnership [1923], p. 1.)

(4) "A partnership is the *status* arising out of a contract entered into by two or more persons whereby they agree to share as common owners the profits of a business carried on by all or

any of them on behalf of all of them." (31 Words and Phrases [1957 ed.], p. 291.)

(5) "A partnership is an *organization* for production of income to which each partner contributes one or both of the ingredients of income, which are capital or service." (*Ibid.*, p. 292.)

(6) "A partnership is an *entity*, distinct and apart from the members composing it, and, for the purpose of which it was created, it is a person having its own assets and liabilities and any benefit or liability attaching to a member of the partnership, results from the partnership relation." (*Ibid.*, p. 293.)

(7) "A partnership is a *joint undertaking* to share in the profit and loss." (Eastman vs. Clark, 53 N.H. 276, 16 Am. Rep. 192.)

Partnership is a legal concept, but the determination of the existence of a partnership may involve inferences drawn from an analysis of all the circumstances attending its creation and operation. (68 C.J.S. 399; see Art. 1769.) As a form of business organization, it falls between two extremes of organizational form — the single proprietorship and the corporation.

Civil law concept and American concept of partnership distinguished.

(1) *Basis of concept.* — While the Civil Code speaks of a partnership as a contract, the American concept of a partnership is that of a relation. The difference, however, is more apparent than real, because Article 1767 considers the term as the agreement itself out of which a partnership is created, while the Anglo-American idea of partnership is based on the result of the contract or agreement of the parties creating the partnership, that is, the juridical relation growing out from the express or implied agreement of the parties to create a partnership. (Phil. Law of Partnerships, by A. Espiritu and E. Sibal [1937], p. 2.)

(2) *Possession of separate personality.* — It is a basic tenet of the Spanish and Philippine law that a partnership has a juridical personality of its own, distinct and separate from that of each of the partners. (Art. 1768.) The American and English law does not recognize such separate juridical personality (Commissioner of Internal Revenue vs. Suter and Court of Tax Appeals, 27 SCRA

152 [1969].), a partnership being considered merely an extension of its members, although some states of the Union classify the partnership as a legal entity.

The Uniform Partnership Act has in this respect codified the "aggregate theory" of partnership more than it has the "entity theory" or Roman Law theory of partnership.[1] Unlike a corporation, a partnership is generally regarded as a conglomerate of individuals, "an association of two or more persons"[2] and as such does not pay federal or state income taxes (although for purposes of information it is required to file a partnership tax return). The individual members of the partnership severally pay their income taxes, the partnership business being regarded merely as a source of income. (L. Teller, Law of Partnerships, 1949 ed., p. 6.)

In our jurisdiction, partnerships, except general professional partnerships, are treated for income tax purposes as corporations and subject to tax as such. (Secs. 20[b], 24[a], Pres. Decree No. 1158 [National Internal Revenue Code], as amended.)

General professional partnership.

Paragraph 2 relates to the exercise of a profession. A *profession* has been defined as "a group of men pursuing a learned art as a common calling in the spirit of public service — no less a public service because it may incidentally be a means of livelihood." (In the Matter of the Petition for Authority to Continue Use of Firm Name "Sycip, Salazar, etc.''/"Ozaeta, Romulo, etc.," 92 SCRA 1 [1979], citing Dean Pound.)

Strictly speaking, the practice of a profession is not a business or an enterprise for profit. However, the law allows the joint pursuit thereof by two or more persons as partners.[3] (see Art.

[1]At common law, a partner could maintain no action against his partnership at law. Since a partnership is conceived as an aggregate of individuals, rather than an entity existing apart from its individual members, a partner by suing a partnership of which he is a member, would be suing himself, and a judgment could not possibly be obtained both in behalf of and against a person at the same time. (L. Teller, *op. cit*., p. 81.)

[2]The contracting parties are called "partners" and the association is called "firm."

[3]For tax purposes, the National Internal Revenue Code (Sec. 20[b], Pres. Decree No. 1158, as amended.) defines general professional partnerships as those "formed by persons for the sole purpose of exercising their common profession, no part of the income of which is derived from engaging in any trade or business."

1783.) In such case, it is the individual partners, and not the partnership, who engage in the practice of the profession and are responsible for their own acts as such.

The law does not allow individuals to practice a profession as a corporate entity. Personal qualifications for such practice cannot be possessed by a corporation.

Partnership for the practice of law.

(1) *A mere association for non-business purpose.* — The right to practice law is not a natural or constitutional right but is in the nature of a privilege or franchise. A partnership for the practice of law cannot be likened to partnerships formed by other professionals or for business.[4]

It is not a partnership formed for the purpose of carrying on

[4](33) *Partnership Names.* — Partnerships among lawyers for the practice of their profession are very common and are not to be condemned. In the formation of partnerships and the use of partnership names, care should be taken not to violate any law, custom, or rule of court locally applicable. Where partnerships are formed between lawyers who are not all admitted to practice in the courts of the state, care should be taken to avoid any misleading name or representation which would create a false impression as to the professional position or privileges of the member not locally admitted.

In the formation of partnerships for the practice of law, no person should be admitted or held out as a practitioner or member who is not a member of the legal profession duly authorized to practice, and amenable to professional discipline. In the selection and use of a firm name, no false, misleading, assumed, or trade names should be used. The continued use of the name of a deceased or former partner, when permissible by local custom, is not unethical but care should be taken that no imposition or deception is practiced through this use. When a member of the firm, on becoming a judge, is precluded from practicing law, his name should not be continued in the firm name.

Partnerships between lawyers and members of other profession or non-professional persons should not be formed or permitted where any part of the partnership's employment consists of the practice of law. (Canons of Professional Ethics.)

Note: The Code of Ethics which was adopted by the American Bar Association in 1908, was also adopted by the Philippine Bar Association in 1917 (Canons 1 to 32) and in 1946 (Canons 33 to 47). In the cited case of "SyCip, Salazar, etc.," the Supreme Court ruled that "in the Philippines, no local custom permits or allows the continued use of a deceased or former partner's name in the firm names of law partnership." Even if such custom is proven, it cannot prevail against "its Resolution directing lawyers to desist from including the names of deceased partners in their firm designation. This is not to speak of our civil law (Art. 1830.) which clearly ordains that a partnership is dissolved by the death of any partner."

Rule 3.02 of the Code of Professional Responsibility approved and promulgated by the Supreme Court on June 21, 1988 in effect abandoned the ruling in the *SyCip* case. (see Art. 1815.)

trade or business or of holding property. Thus, the use of a *nom de plume*, assumed, or trade name in law practice is improper.

(2) *Distinguished from business.* — The practice of law is intimately and peculiarly related to the administration of justice and should not be considered like an ordinary "money-making trade."

The primary characteristics which distinguish the legal profession from business are the following:

(a) A duty of public service, of which the emolument is a by-product, and in which one may attain the highest eminence without making much money;

(b) A relation as an "officer of court" to the administration of justice involving thorough sincerity, integrity, and reliability;

(c) A relation to clients in the highest fiduciary degree; and

(d) A relation to colleagues at the bar characterized by candor, fairness, and unwillingness to resort to current business methods of advertising and encroachment on their practice, or dealing directly with their clients. (In the Matter of the Petition for Authority to Continue Use of Firm Name "SyCip, Salazar, etc."/"Ozaeta, Romulo, etc.," 92 SCRA 1 [1979], citing H.S. Drinker, Legal Ethics [1953], pp. 4-5.)

Characteristic elements of partnership.

The contract of partnership is:

(1) *Consensual,* because it is perfected by mere consent, that is, upon the express or implied agreement of two or more persons;

(2) *Nominate,* because it has a special name or designation in our law;

(3) *Bilateral,* because it is entered into by two or more persons and the rights and obligations arising therefrom are always reciprocal;

(4) *Onerous,* because each of the parties aspires to procure for himself a benefit through the giving of something;

(5) *Commutative,* because the undertaking of each of the partners is considered as the equivalent of that of the others;

(6) *Principal,* because it does not depend for its existence or validity upon some other contracts; and

(7) *Preparatory,* because it is entered into as a means to an end, *i.e.,* to engage in business or specific venture for the realization of profits with the view of dividing them among the contracting parties.

A partnership contract, in its essence, is a contract of agency. (see Art. 1818.)

Essential features of partnership.

The following are the essential features of a partnership contract:

(1) There must be a valid contract;

(2) The parties (two or more persons) must have legal capacity to enter into the contract;

(3) There must be a mutual contribution of money, property, or industry to a common fund;

(4) The object must be lawful; and

(5) The primary purpose must be to obtain profits and to divide the same among the parties.

It is also required that the articles of partnership must not be kept secret among the members; otherwise, the association shall have no legal personality and shall be governed by the provisions of the Civil Code relating to co-ownership. (Art. 1775.)

Existence of a valid contract.

(1) *Partnership relation fundamentally contractual.* — Partnership is a voluntary relation created by agreement of the parties. It excludes from its concept all other associations which do not have their origin in a contract, express or implied. There is no such thing as a partnership created by law or by operation or implication of law alone. Religious societies, conjugal partnerships,

and others of a similar nature are not, therefore, included as they are not created by the express or implied contract of the parties.

Actually, the partnership relation is not the contract itself, but the result of the contract.

(a) *Form*. — The relation is evidenced by the terms of the contract which may be oral or written, express or implied from the acts and declarations of the parties, subject to the provisions of Articles 1771 to 1773 and to the Statute of Frauds. *(infra.)* Thus, an election to become a member of a partnership was held sufficient to render a member a "partner," there being no necessity that the member should sign any articles of partnership. (Montgomery vs. Busyrus Machine Works, 92 U.S. 257; 31 Words and Phrases, 272.)

(b) *Articles of Partnership.* — While the partnership relation may be informally created and its existence proved by manifestations of the parties, it is customary to embody the terms of the association in a written document known as "Articles of Partnership"[5] stating the name, nature or purpose and location of the firm, and defining, among others, the powers, rights, duties, and liabilities of the partners among themselves, their contributions, the manner by which the profits and losses are to be shared, and the procedure for dissolving the partnership.

(c) *Requisites.* — Since partnership is fundamentally contractual, all the essentials of a valid contract must be present. Under the law, the following requisites must concur: 1) Consent and capacity of the contracting parties; 2) Object which is the subject matter of the contract; and 3) Cause which is established.[6] (Art. 1318.)

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[5]J.A. Crane, Handbook on the Law of Partnerships and Other Unincorporated Associations, 2nd ed. (1952), p. 99.

[6]The object of a contract may be a thing, right, or service. (Arts. 1347, 1348.) In a partnership contract, which is an onerous contract (see Art. 1350.), the cause is the prestation or promise of the other partner or partners to contribute money, property, or industry to a common fund, while the subject matter includes the contributions of the partners and the business or specific undertaking which the parties have agreed to pursue for purposes of profit.

Obviously, a person cannot enter into a contract of partnership solely with himself; there must be at least two competent parties.

As in other cases of contracts, in order to make an agreement for a partnership valid, there must be a valid consideration existing as between the partners. Each partner surrenders to the partnership an interest in his property, labor, skill, or energy, in accordance with the express or implied stipulations of their mutual agreement. (40 Am. Jur. 141.)

EXAMPLE:

A bought a secondhand car. He told B that he would give B half the profit of its sale if B would repair the car. B did not repair the car. A hired C to do the work and later sold the car at a profit. Obviously, B is not entitled to any of the profit. There was no partnership between A and B because of the absence of consideration for A's promise.

ILLUSTRATIVE CASE:

Action seeks to compel the execution of a partnership contract.

Facts: A and B entered into an agreement to form a partnership. Because of A's refusal to comply with the agreement, B brought an action to compel the execution of a partnership contract.

Issue: May A be compelled against his will to carry out the agreement or execute the partnership papers?

Held: No. Under Article 1167,[7] A has an obligation to do, not to give. The law recognizes the individual's freedom or liberty to do an act as he has promised to do, or not to do it, as he pleases. It falls within what Spanish commentators call a very personal act *(acto personalismo)*, of which courts may not compel compliance, as it is considered an act of violence to do so. *(Woodhouse vs. Halili, 83 Phil. 526 [1953].)*

[7]Art. 1167. If a person obliged to do something fails to do it, the same shall be executed at his cost.

This same rule shall be observed if he does it in contravention of the tenor of the obligation. Furthermore, it may be decreed that what has been poorly done be undone. (1098)

(2) *Partnership relation fiduciary in nature.* — Partnership is a form of voluntary association entered into by the associates. It is a personal relation in which the element of *delectus personae*[8] exists, involving as it does trust and confidence between the partners.

(a) *Right to choose co-partners.* — Unless otherwise provided in the partnership agreement, no one can become a member of the partnership association without the consent of all the other associates. The fiduciary nature of the partnership relation and the liability of each partner for the acts of the others within the scope of the partnership business (Art. 1818.) require that each person be granted the right to choose with whom he will be associated in the firm.

(2) *Power to dissolve partnership.* — 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. (see Art. 1830[2].) 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. 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. (Ortega vs. Court of Appeals, 245 SCRA 529 [1995]; Tocao vs. Court of Appeals, 342 SCRA 20 [2000].)

(3) *Application of principles of estoppel.* — A partnership liability may be imposed upon a person under principles of

[8]This Latin phrase, sometimes written *delectus personarum* which is the plural of the phrase, may be literally translated — choice of the person or choice of the persons. (Barret & Seago, *op. cit.*, p. 25.) It is because of this *delectus personae* that the law gives such wide authority to one partner, to bind another by contract or otherwise. (Teller, *op. cit.,* p. 10.) It is so unnatural that one party should give another wide authority to make contracts, incur obligations, possibly commit binding torts, pledge personal credit, without first ascertaining the character of that individual. Where such choice of person is lacking, the law presumes a lack of partnership. (*Ibid.,* p. 16.)

This element of *delectus personae,* however, is true only in the case of a general partner, but not as regards a limited partner. (see Art. 1866.)

estoppel where he holds himself out, or permits himself to be held out, as a partner in an enterprise. (see Art. 1825.) In such cases, there is no actual or legal partnership relation but merely a partnership liability imposed by law in favor of third persons. (40 Am. Jur. 137; see Art. 1825.)

A partnership may be created without any definite intention to create it. It is the substance and not the name of the arrangement, which determines the legal relationship, although the designation adopted by the parties should be considered as indicative of their intention. (68 C.J.S. 415-417.) In case there is no written agreement between the parties, the existence or non-existence of a partnership must be determined from the conduct of the parties, any documentary evidence bearing thereon, and the testimony of the parties. (Greenstone vs. Clar. [Misc.], 69 N.Y.S. [2d] 548 [1947], cited in Barrett & Seago, p. 461.)

Legal capacity of the parties to enter into the contract.

(1) *Individuals.* — Before there can be a valid contract of partnership, it is essential that the contracting parties have the necessary legal capacity to enter into the contract. As a general rule, any person may be a partner who is capable of entering into contractual relations. Consequently, any person who cannot give consent to a contract cannot be a partner. Hence, the following cannot give their consent to a contract of partnership:

(a) Unemancipated minors;[9]

(b) Insane or demented persons;

(c) Deaf-mutes who do not know how to write;

(d) Persons who are suffering from civil interdiction; and

[9]Art. 234. Emancipation takes place by the attainment of majority. Unless otherwise provided, majority commences at the age of 18 years.

Emancipation takes place:

(1) By the marriage of the minor; or

(2) By recording in the Civil Register of an agreement in a public instrument executed by the parents exercising parental authority and the minor at least eighteen years of age. Such emancipation shall be irrevocable. (Family Code)

(e) Incompetents who are under guardianship. (see Arts. 1327, 1329; Art. 34, Revised Penal Code; Rules 93-94, Rules of Court.)

Under Article 1782, persons who are prohibited from giving each other any donation or advantage cannot enter into a universal partnership.[10]

A married woman may enter into a contract of partnership even without her husband's consent, but the latter may object under certain conditions.[11]

(2) *Partnerships*. — There is no prohibition against a partnership being a partner in another partnership. When two or more partnerships combine with each other (or with a natural person or persons) creating a distinct partnership, say, partnership X, all the members of the constituent partnerships will be individually liable to the creditors of partnership X.

(3) *Corporations*. — The doctrine adopted by our Supreme Court is that, unless authorized by statute or by its charter, a corporation is without capacity or power to enter into a contract of partnership.[12] (Mendiola vs. Court of Appeals, 497 SCRA 346 [2006]; J.M. Tuason vs. Bolanos, 95 Phil. 106 [1954]; 68 C.J.S. 408.) This limitation, it is said, is based on public policy,

[10]Art. 87. Every donation or grant of gratuitous advantage, direct or indirect, between the spouses during the marriage shall be void, except moderate gifts which the spouses may give each other on the occasion of any family rejoicing. The prohibition shall also apply to persons living together as husband and wife without a valid marriage. *(Ibid.)*

[11]Art. 73. Either spouse may exercise any legitimate profession, occupation, business or activity without the consent of the other. The latter may object only on valid, serious or moral grounds.

In case of disagreement, the court shall decide whether or not:

(a) The objection is proper, and

(b) Benefit has accrued to the family prior to the objection or thereafter. If the benefit accrued prior to the objection, the resulting obligation shall be enforced against the separate property of the spouse who has not obtained consent.

The foregoing provision shall not prejudice the rights of creditors who acted in good faith. *(Ibid.)*

[12]The Uniform Partnership Act *(supra.)* expressly allows corporations to become partners. (Sec. 2 thereof.) There seems to be no fundamental reason why a corporation should not be allowed to enter into a contract of partnership where adequate safeguards and conditions are imposed for the protection of the rights of stockholders and corporate creditors.

since in a partnership the corporation would be bound by the acts of persons who are not its duly appointed and authorized agents and officers, which would be entirely inconsistent with the policy of the law that the corporation shall manage its own affairs separately and exclusively. (13 Am. Jur. par. 823; see Sec. 23, B.P. Blg. 68.)

(a) A corporation, however, may enter into joint venture[13] partnership with another where the nature of the venture is in line with the business authorized by its charter. (J.M. Tuazon & Co., Inc. vs. Bolanos, *supra*.; Aurbach vs. Sanitary Wares Manufacturing Corporation, 180 SCRA 130 [1989].)

(b) Where the partnership agreement provides that the two partners will manage the partnership so that the management of corporate interest is not surrendered, the partnership may be allowed. (SEC Opinion, Dec. 22, 1966.)

(c) Where the entry of the foreign corporation as a limited partner in a limited partnership (Chap. 4.) is merely for investment purposes and it shall not take part in the management and control of the business operation of the partnership, it shall not be deemed "doing business" in the Philippines, and hence, it is not required to obtain a license to do business in the Philippines as required by Sections 123-126 of the Corporation Code. (B.P. Blg. 68.) Such investment is allowed by and complies with R.A. No. 7042, the Foreign Investment Act. (SEC Opinion, Aug. 6, 1998.)

Contribution of money, property, or industry to a common fund.

(1) *Existence of proprietary interest.* — The partners must have a proprietary interest in the business or undertaking, that is, they must contribute capital which may be money or property, or their services, or both, to the common business. The very definition of partnership in Article 1767 provides for this element. Without

[13]A commercial undertaking by two or more persons, differing from a partnership in that it relates to the disposition of a single lot of goods or the completion of a single project. Its duration is limited to the period in which the goods are sold or the project is carried on. (E.L. Kohler, A Dictionary for Accountants, 1975 ed., p. 279; see Art. 1783.)

the element of mutual contribution to a common fund there can be no partnership (see Art. 1784.), although its presence is not necessarily a conclusive evidence of the existence of partnership.

(a) *Money.* — The term is to be understood as referring to currency which is legal tender in the Philippines. It must be pointed out that checks, drafts, promissory notes payable to order, and other mercantile documents are not money but only representatives of money. Consequently, there is no contribution of money until they have been cashed. (Art. 1249.)

(b) *Property.* — The property contributed may be real or personal, corporeal or incorporeal. Hence, credit such as promissory note or other evidence of obligation or even a mere goodwill may be contributed, as they are considered property. (see City of Manila vs. Cumbe, 13 Phil. 677 [1909].) It has been held that a license to construct and operate a cockpit may be given as a contribution to a partnership. (Balon vs. Pajarillo, [C.A.] No. 146-R, Nov. 29, 1956.)

(c) *Industry.* — In the absence of money or property, or in concurrence with these two, the law permits the contribution of industry. The word "industry" has been interpreted to mean the active cooperation, the work of the party associated, which may be either personal manual efforts or intellectual, and for which he receives a share in the profits (not merely salary) of the business. (11 Manresa 273-274.)

The contribution of a partner may be in the three forms of money, property and industry, or any two or one of them. A partnership may, therefore, exist even if it is shown that the partners have not contributed any capital of their own to a "common fund" for the contribution may be in the form of credit or industry not necessarily cash or fixed assets. (Lim Tong Lim vs. Philippine Fishing Gear Industries, Inc., 317 SCRA 728 [1999].) Note that the law does not specify the kind of industry that a partner may contribute. (see Evangelista & Co. vs. Abad Santos, 51 SCRA 416 [1973].) A limited partner in a limited partnership, however, cannot contribute mere industry or services. (Art. 1845.)

The partner contributing his industry or services must, however, be distinguished from a lessor of services in the sense that the former is independent of the other partners, that is, he is not subject to the supervision of the other partners, while the lessor is under the supervision of the lessee or employer. (see Espiritu & Sibal, *op. cit.*, p. 4.)

(2) *Proof of contribution.* — In partnership, proof is necessary that there be contribution of money, property, or industry to a common fund with the intention of dividing the income or profits obtained therefrom. (Tablason vs. Ballozos, [C.A.] 51 O.G. 1966; see Estanislao, Jr. vs. Court of Appeals, 160 SCRA 830 [1988].) If the partnership agreement provides simply that one of the parties is to give and the other is to receive a half interest in the profits of an enterprise started by the former, without anything being promised by the latter toward the accomplishment of its object, no enforceable contract exists, but if the latter takes part in carrying on the enterprise, and thus subjects himself to partnership liability to outsiders, he furnishes sufficient consideration for the former's promise and acquires all the rights of a co-partner. (68 C.J.S. 414.)

ILLUSTRATIVE CASE:

Three persons decided to form a corporation which was not legally formed, and one of them did not directly act on behalf of the corporation but reaped the benefits of the contract entered into by the other two.

Facts: On behalf of F Corporation, Chua and Yao entered into a contract for the purchase of fishing nets and floats from G Corporation, claiming that they were engaged in a business venture (fishing business) with petitioner Lim who, however, was not a signatory to the agreement. A suit was filed by G Corporation against the three in their capacities as general partners, on the allegation that F Corporation was a non-existent corporation as shown by a certification from the Securities and Exchange Commission.

Issue: Was Lim a partner of Chua and Yao in the fishing business and may thus be held liable as such for the fishing nets and floats purchased by them for the use of the partnership?

Held: Yes: (1) *Partnership formed by Chua, Yao, and Lim.* — "From the factual findings of both lower courts [Regional Trial Court and Court of Appeals], it is clear that Chua, Yao, and Lim had decided to engage in a fishing business, which they started by buying boats worth P3.35 million, financed by a loan secured from Jesus Lim who was petitioner's brother. In their Compromise Agreement, they subsequently revealed their intention to pay the loan with the proceeds of the sale of the boats, and to divide equally among them the excess or loss. These boats, the purchase and the repair of which were financed with borrowed money, fell under the term "common fund" under Article 1767. The contribution to such fund need not be cash or fixed assets; it could be an intangible like credit or industry. That the parties agreed that any loss or profit from the sale and operation of the boats would be divided equally among them also shows that they had indeed formed a partnership.

Moreover, it is clear that the partnership extended not only to the purchase of the boat, but also to that of the nets and the floats. The fishing nets and the floats, both essential to fishing, were obviously acquired in furtherance of their business. It would have been inconceivable for Lim to involve himself so much in buying the boat but not in the acquisition of the aforesaid equipment, without which the business could not have proceeded.

Given the preceding facts, it is clear that there was, among petitioner, Chua and Yao, a partnership engaged in the fishing business. They purchased the boats, which constituted the main assets of the partnership, and they agreed that the proceeds from the sales and operations thereof would be divided among them."

(2) *Lim was a partner, not a lessor.* — "We are not convinced by petitioner's argument that he was merely the lessor of the boats to Chua and Yao, not a partner in the fishing venture. His argument allegedly finds support in the Contract of Lease and the registration papers showing that he was the owner of the boats, including *F/B Lourdes* where the nets were found.

His allegation defies logic. In effect, he would like this Court to believe that he consented to the sale of *his own* boats to pay a debt of *Chua and Yao*, with the excess of the proceeds to be divided among *the three of them*. No lessor would do what

petitioner did. Indeed, his consent to the sale proved that there was a pre-existing partnership among all three.

Verily, as found by the lower courts, petitioner entered into an agreement with Chua and Yao, in which debts were undertaken in order to finance the acquisition and the upgrading of the vessels which would be used in their fishing business. The sale of the boats, as well as the division among the three of the balance remaining after the payment of their loans, proves beyond cavil that *F/B Lourdes*, though registered in his name, was not his own property but an asset of the partnership. It is not uncommon to register the properties acquired from a loan in the name of the person the lender trusts, who in this case is the petitioner himself. After all, he is the brother of the creditor, Jesus Lim. We stress that it is unreasonable — indeed, it is absurd — for petitioner to sell his property to pay a debt he did not incur, if the relationship among the three of them was merely that of lessor-lessee, instead of partners."

(3) *Lim benefited from the transaction.* — "There is no dispute that the respondent, G Corporation, is entitled to be paid for the nets it sold. The only question here is whether petitioner should be held jointly liable with Chua and Yao. Petitioner contests such liability, insisting that only those who dealt in the name of the ostensible corporation should be held liable. Since his name does not appear on any of the contracts and since he never directly transacted with the respondent corporation, ergo, he cannot be held liable.

Unquestionably, petitioner benefited from the use of the nets found inside *F/B Lourdes*, the boat which has earlier been proven to be an asset of the partnership. He in fact questions the attachment of the nets, because the Writ has effectively stopped his use of the fishing vessel.

It is difficult to disagree with the RTC and the CA that Lim, Chua and Yao decided to form a corporation. Although it was never legally formed for unknown reasons, this fact alone does not preclude the liabilities of the three as contracting parties in representation of it. Clearly, under the law on estoppel, on behalf of a corporation and those benefited by it, knowing it to be those acting on behalf of a corporation and those benefited by it, knowing it to be without valid existence, are held liable as general partners.

Technically, it is true that petitioner did not directly act on behalf of the corporation. However, having reaped the

benefits of the contract entered into by persons with whom he previously had an existing relationship, he is deemed to be part of said association and is covered by the scope of the doctrine of corporation by estoppel."[14] *(Lim Tong Lim vs. Philippine Fishing Gear Industries, Inc., 317 SCRA 728 [1999].)*

Legality of the object.

The object is unlawful when it is contrary to law, morals, good customs, public order, or public policy. (Art. 1306.) As in other kinds of contract, the purpose of a partnership must be lawful (Art. 1770.) otherwise, no partnership can arise as the contract is inexistent and void *ab initio.* (Art. 1409[1].)

Subject to this general limitation on contracts, a partnership may be organized for any purpose except that it may not engage in an enterprise for which the law requires a specific form of business organization, such as banking which, under the General Banking Law of 2000 (R.A. No. 8791, Sec. 8.), only stock corporations may undertake.

Instances of unlawful object are: to create illegal monopolies or combinations in restraint of trade (Art. 185, Revised Penal Code.); to carry on gambling (Arbes vs. Polistico, 53 Phil. 489 [1929].); to engage in smuggling; to lease furnished apartments to prostitutes; to prevent competition in bidding for government contracts; to control the price of a commodity in the interest of its members, etc. (59 Am. Jur. 2d 947.)

Purpose to obtain profits.

(1) *The very reason for existence of partnership.* — A partnership is formed to carry on a business. The idea of obtaining pecuniary

[14]Section 21 of the Corporation Code of the Philippines provides:

"Sec. 21. *Corporation by Estoppel.* — All persons who assume to act as a corporation knowing it to be without authority to do so shall be liable as general partners for all debts, liabilities and damages incurred or arising as a result thereof: *Provided, however,* That when any such ostensible corporation is sued on any transaction entered by it as a corporation or on any tort committed by it as such, it shall not be allowed to use as a defense its lack of corporate personality.

On who assumes an obligation to an ostensible corporation as such, cannot resist performance thereof on the ground that there was in fact no corporation."

profit or gain directly through or as a result of the business to be carried on is the very reason for the existence of a partnership. As a matter of fact, this element is what distinguishes the contract of partnership from voluntary religious or social organizations. (Fernandez vs. De la Rosa, 6 Phil. 671 [1906]; Council of Red Men vs. Veterans Army, 7 Phil. 685 [1907].) One without any right to participate in the profits, cannot be deemed as partner since the essence of partnership is that the partners share in the profits and losses. (Tacao vs. Court of Appeals, 365 SCRA 463 [2001].) All that is needed is a profit motive. Hence, even an unprofitable business can be a partnership provided the goal of the business is to generate profits.

(2) *Need only be the principal, not exclusive aim.* — The realization of pecuniary profit, however, by engaging in some business activity through their joint contributions and efforts need not be the exclusive aim of a partnership. It is sufficient that it is the principal purpose even if there are, incidentally, moral, social, or spiritual ends. (see 11 Manresa 264.) In a partnership, the parties intend to share the profits in certain proportions.

Sharing of profits.

A partnership is essentially a business enterprise established for profit.

(1) *Not necessarily in equal shares.* — Since the partnership is engaged for the common benefit or interest of the partners (Art. 1770.), it is necessary that there be an intention to divide the profits among the members, although not necessarily in equal shares. In the words of the Supreme Court, "there must be a joint interest in the profits." (Fernandez vs. De la Rosa, *supra*.) Without this sharing of profits, it cannot be said that an agreement of partnership has been entered into, and exists. (see Art. 1799.)

If all the other elements create a partnership, a stipulation which excludes one or more partners from any participation in the profits (or losses) is void. (Art. 1799.)

(2) *Not conclusive evidence of partnership.* — The sharing in profits is merely presumptive and not conclusive, even if cogent, evidence of partnership. There are numerous instances of parties

who have a common interest in the profits and losses of an enterprise but who are not partners. (Art. 1769.) Thus, if the division of profits is merely used as a guide to determine the compensation due to one of the parties, such one is not a partner. (see Art. 1769[4].)

Sharing of losses.

(1) *Necessary corollary of sharing in profits.* — The definition of partnership under Article 1767 refers to "profits" only and is silent as to "losses." The reason is that the object of a partnership is primarily the sharing of profits, while the distribution of losses is but a "consequence of the same." (Espiritu & Sibal, *op. cit.*, p. 2, citing 11 Manresa 263.) Be that as it may, the right to share in the profits carries with it the duty to contribute to the losses, if any. (see Art. 1797.)

In other words, a community in losses is a necessary corollary of a participation in profits, where it is determined that a partnership exists. (Lyon vs. MacQuarrie, 46 Cal. App. [2d], 119.)

(2) *Agreement not necessary.* — It is not necessary for the parties to agree upon a system of sharing losses, for the obligation is implied from the partnership relation but 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. (Art. 1797, par. 1.)

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

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)

Partnership, a juridical person.

A partnership is sometimes referred to as a "firm" or a "company," terms that connote an entity separate from its aggregate individual partners.

Like the corporation, a partnership duly formed under the law is a juridical person to which the law grants a juridical personality separate and distinct from that of each of the partners. (Art. 44, par. 3.) As an independent juridical person, a partnership may enter into contracts, acquire and possess property of all kinds in its name, as well as incur obligations and bring civil or criminal actions in conformity with the laws and regulations of its organizations. (Art. 46.)

Thus, in the partnership X & Co., in which A and B are the partners, there are three distinct persons, namely, the partnership X & Co., A, and B. As a consequence of the distinct legal personality possessed by X & Co., it may be declared insolvent even if A and B are not. (Campos Rueda & Co. vs. Pacific Commercial & Co., 44 Phil. 916 [1923].) It may enter into contracts and may sue and be sued, it being sufficient that service of summons or other process be served on any partner (Vargas & Co. vs. Chan, 29 Phil. 446 [1915].); and the death of either A or B is not a ground for the dismissal of a pending suit against X & Co. (Ngo Tian Tek vs. Phil. Education Co., 78 Phil. 275 [1947].)

Neither A nor B may sue on a cause of action belonging to X & Co., in his own name and for his own benefit. X & Co. may sue and be sued in its firm name or by its duly authorized representative. (Tai Tong Chuache & Co. vs. Insurance Commission, 158 SCRA 336 [1988]; see Arts. 1800-1803, 1818.) In view of the separate juridical personality possessed by a partnership, the partners cannot be held liable for the obligations of the partnership unless it is shown that the legal fiction of a different juridical personality is being used for a fraudulent, unfair, or illegal purpose (Aguila, Jr. vs. Court of Appeals, 316 SCRA 246 [1999].) and except as provided in Article 1816.

Effect of failure to comply with statutory requirements.

(1) *Under Article 1772.* — This article makes it clear that even in case of failure to comply with the requirements of Article 1772, with reference to the execution of a public instrument and registration of the same with the Securities and Exchange Commission in cases when the partnership capital exceeds

P3,000.00, such partnership acquires juridical personality. (see Art. 1784.) The law recognizes that in the Philippines, most partnerships are created with very small capital to engage in small business and it would be impractical to require that they appear in a public instrument and be registered as provided in Article 1772.

(2) *Under Articles 1773 and 1775.* — However, in the case contemplated in Article 1773, the partnership shall not acquire any juridical personality because the contract itself is void. This is also true regarding secret associations or societies which do not acquire juridical personality under Article 1775.

To organize a partnership not an absolute right.

To organize a corporation or a partnership that could claim a juridical personality of its own and transact business as such, is not a matter of absolute right but a privilege which may be enjoyed only under such terms as the State may deem necessary to impose.

Thus, it has been held that the State through Congress, and in the manner provided by law, had the right to enact Republic Act No. 1180 (Retail Trade Nationalization Law)[15] and to provide therein that only Filipinos may engage in the retail business, cannot be seriously doubted. The law provides, among other things, that after its enactment, a partnership not wholly formed by Filipinos could continue to engage in the retail business only until the expiration of its term. This provision is clearly intended to apply to partnerships already existing at the time of the enactment of the law. Hence, the agreement in the articles of partnership to extend the terms of its life must be deemed subject to Republic Act No. 1180 if it was already in force when the parties came to agree regarding the extension of the original term of their partnership. (Ang Pue & Co. vs. Sec. of Commerce and Industry, 5 SCRA 645 [1962].)

[15]R.A. No. 8762 (Retail Trade Liberalization Act of 2000) liberalizes the retail trade business, repealing for this purpose R.A. No. 1180.

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)

Rules to determine existence of partnership.

Article 1769 lays down the rules for determining whether or not an association is one of partnership. In general, to establish the existence of a partnership, *all* of its essential features or characteristics must be shown as being present.

(1) *Where terms of contract not clear.* — In the typical contract of partnership, the parties expressly agree to unite their property

and services as co-proprietors to carry on a business for profit, and to share the profits in stated proportions. Such a contract creates no difficulty in regard to the determination of the existence of a partnership relation. Sometimes, however, the contract between the persons engaged in a business enterprise which is supposed to create a partnership is uncertain in terms, or they have never executed a formal expression of their relations. (59 Am. Jur. 2d 359.) In case of doubt, Article 1769 shall apply. It must be observed that this article seeks to exclude from the category of partnership certain features enumerated therein which, by themselves, are not indicative of the existence of a partnership.

(2) *Where existence disputed.* — The existence of a partnership may be disputed by an interested party. The issue as to whether a partnership exists is a factual matter to be decided on the basis of all circumstances. No single factor usually is controlling. Where circumstances taken singly may be inadequate to prove the intent to form a partnership, nevertheless the collective effect of these circumstances may be such as to support a finding of the existence of the parties' intent. (Heirs of Tan Eng Kee vs. Court of Appeals, 341 SCRA 740 [2000].)

Persons not partners as to each other.

Persons who are partners as between themselves are partners as to third persons. Generally, the converse is true, to wit: if they are not partners as between themselves, they cannot be partners as to third persons.

(1) *Intention to create partnership.* — Partnership is a matter of intention, each party giving his consent to become a partner. Whether or not the parties call their relationship or believe their relationship a partnership is immaterial. However, whether a partnership exists between the parties is a factual matter. Where the parties expressly declare they are not partners, this, as a rule, settles the question as between themselves.[16]

[16]It is, however, the substance, and not the name of the arrangement between them which determines their legal relation toward each other. Thus, the intention to form a partnership is not always required.

(2) *Partnership by estoppel.* — A partnership can never exist as to third persons if no contract of partnership, express or implied, has been entered into between the parties themselves. (see Art. 1834, last par.) The exception refers to partnership by estoppel. Thus, where persons by their acts, consent, or representations have misled third persons or parties into believing that the former are partners in a non-existing partnership, such persons become subject to liabilities of partners to all who, in good faith, deal with them in their apparent relations. This liability is predicated on the doctrine of estoppel provided for in Article 1825.

EXAMPLE:

If A and B are not partners as to each other, neither will they be partners with respect to C, a third person. But if A, with the consent of B, represents to C that they are partners, then A and B will be considered partners as to C even if they are not really partners.

Co-ownership or co-possession.

There is *co-ownership* (or co-possession) whenever the ownership (or co-possession) of an undivided thing or right belongs to different persons. (Art. 484.)

(1) *Clear intent to derive profits from operation of business.* — Co-ownership of property does not of itself establish the existence of a partnership, although "co-ownership" is an essential element of partnership. (see Art. 1811.)

(a) Two or more persons may become co-owners without a contract (*e.g.*, by inheritance or by law) but they cannot be partners in the absence of contract. This is true even though the co-owners share in the profits derived incident to the joint ownership. The profits must be derived from the operation of the business or undertaking by the members of the association and not merely from property ownership. A partner may transfer to the partnership, as his contribution, merely the use or enjoyment of a specific thing, retaining the ownership thereof. (Art. 1830[4].) In such case, the partners become co-owners, not of the property, but of the right to use such property.

(b) The law does not imply a partnership between co-owners or co-possessors because of the fact that they develop or operate a common property, since they may rightfully do this by virtue of their respective titles. (Crondale vs. Van Boynburgk, 195 Pa. 377, cited in Teller, p. 14.) Thus, in a case, it was held that two isolated transactions whereby two persons purchased two (2) parcels of land and then another three (3) parcels of land and sold the same a few years thereafter, did not thereby make them partners. There must be a clear intent to form a partnership. (Pascual vs. Commission of Internal Revenue, 166 SCRA 560 [1988].)

(2) *Existence of fiduciary relationship.* — If the parties are partners in the business undertaking, there is a well-defined fiduciary relationship between them as partners. On the other hand, if the parties are merely co-owners, there is no fiduciary relationship between them. If the parties are partners, the remedy for a dispute or difference between them would be an action for dissolution, termination, and accounting. Where the relationship is that of co-owner, the remedy would be an action, as for instance, for non-performance of a contract. (Barrett & Seago, *op. cit.*, p. 21.)

EXAMPLES:

(1) A and B inherited from their father an apartment which is leased to third persons. Are they partners? No, they are merely co-owners of the property, whether or not they share in the profits made by the lease of the property, and not of the lease business itself.

(2) A, B, and C, joint owners of merchandise, consigned it for sale abroad to the same consignee. Each gave separate instructions for his own share. In this case, the interests are "several" and they are not to be treated as "partners" in the adventure. (Berthold vs. Goldsmith, 65 U.S. 536; 31 Words and Phrases 272.)

ILLUSTRATIVE CASES:

1. *Heirs agreed, after partition, to use common properties and income therefrom as a common fund with the intention of making profit for them in proportion to their shares in the inheritance.*

Facts: A and B are co-owners of inherited properties. They agreed to use the said common properties and the income derived therefrom as a common fund with the intention to produce profits for them in proportion to their respective shares in the inheritance as determined in a project of partition.

Issue: What is the effect of such agreement on the existing co-ownership?

Held: The co-ownership is automatically converted into a partnership. From the moment of partition, A and B, as heirs, are entitled already to their respective definite shares of the estate and the income thereof, for each of them to manage and dispose of as exclusively his own without the intervention of the other heirs, and, accordingly, he becomes liable individually for all taxes in connection therewith.

If, after such partition, an heir allows his shares to be held in common with his co-heirs under a single management to be used with the intent of making profit thereby in proportion to his share, there can be no doubt that, even if no document or instrument were executed for the purpose, for tax purposes, at least, an unregistered[17] partnership is formed. *(Ona vs. Commissioner of Internal Revenue, 45 SCRA 74 [1972].)*

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2. *Two persons contributed money to buy a sweepstakes ticket with the intention to divide the prize which they may win.*

Facts: A, B, etc. put up money to buy a sweepstakes ticket for the sole purpose of dividing equally the prize which they may win as they did in fact the amount of P50,000.00. If a partnership had been formed by A, B, etc. then it was liable for income tax pursuant to law then in force; if merely a community of property, then such co-ownership was not liable, not having a legal personality of its own.

Issue: Did A, B, etc. form a partnership or merely a community of property?

Held: A, B, etc. formed a partnership. The partnership was not only formed, but upon the organization thereof and the

[17] A partnership, whether registered or not, other than a general professional partnership, is now considered for tax purposes a corporation and the partners are considered stockholders. (see Sec. 26, The National Internal Revenue Code.) Before the amendment of Section 26, only unregistered partnerships were taxable as corporations.

winning of the prize, it appeared that B personally appeared in the office of the Philippine Charity Sweepstakes, in his capacity as co-partner, and as such collected the prize. All these circumstances repel the idea that A, B, etc. organized and formed a community of property only. *(Gatchalian vs. Collector of Internal Revenue, 67 Phil. 666 [1939].)*

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3. *Children sold lots given by their father and divided the proceeds.*

Facts: O, after completing payment to S on two lots, transferred his rights to his four children, C, etc. to enable them to build their residences. S sold the two lots for P178,708.12 to C, etc. who resold them more than a year later to T for P313,050, treating the profit of P134,341.88 as capital gains and paying an income tax on one-half of their respective shares (or P33,584) of the profit.

Issue: Did C, etc. form a partnership under Article 1767?

Held: No. (1) *Division of profits was merely incidental.* — They were co-owners pure and simple. To consider them as partners would obliterate the distinction between a co-ownership and a partnership. C, etc. were not engaged in any joint venture by reason of that isolated transaction.[18]

The original purpose was to divide the lots for residential purposes. If later on they found it not feasible to do so because of the high cost of construction, then they had no choice but to resell the same to dissolve the co-ownership. The division of the profits was merely incidental to the dissolution of the co-ownership which was, in the nature of things, a temporary state. It has to be terminated sooner or later.

(3) *There must be an unmistakable intention to form a partnership.* — Article 1769(3) provides that "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

[18]The Commissioner of Internal Revenue acted on the theory that C, etc., had formed an unregistered partnership or joint venture within the meaning of Sections 24(a) and 76(b) of the National Internal Revenue Code. He required C, etc. to pay corporate income tax on the total profit in addition to individual income tax on their shares thereof, considering the share of the profits of each (P33,584) as a distributive dividend taxable in full (not a mere capital gain of which 1/2 is taxable).

interest in any property from which the returns are derived." There must be an unmistakable intention to form a partnership or joint venture.

Such intent was present in the *Gatchalian* case *(supra.)* where 15 persons contributed small amounts to purchase a two-peso sweepstakes ticket with the agreement that they would divide the prize. The ticket won the third prize of P50,000. The 15 persons were held liable for income tax as an unregistered partnership.

The instant case is distinguishable from the case where the parties engaged in joint ventures of profit. Thus, in the *Ona* case *(supra.)*, where after an extrajudicial settlement the co-heirs used the inheritance or the incomes derived therefrom as a common fund to produce profits for themselves, it was held that they were taxable as an unregistered partnership.

It is likewise different from *Reyes vs. Commissioner of Internal Revenue* (24 SCRA 198 [1968]) where father and son purchased a lot and building, entrusted the administration of the building to an administrator, and divided equally the net income, and from *Evangelista vs. Collector of Internal Revenue* (102 Phil. 140 [1957]) where three sisters bought four pieces of real property which they leased to various tenants and derived rentals therefrom. Clearly, the petitioners in these two cases had formed an unregistered partnership. *(Obillos, Jr. vs. Commissioner of Internal Revenue, 139 SCRA 436 [1985].)*

(3) *Persons living together without benefit of marriage.* — Before the new Civil Code went into operation on August 30, 1950, the Supreme Court had recognized marital partnerships between persons living together without the bond of marriage and made such union as basis of an informal civil partnership which accords to each partner an equal interest in the properties acquired by their joint efforts, but this is only so where there is no impediment for a legal marriage between them. (Aznar vs. Garcia, 102 Phil. 1055 [1958].)

This doctrine is no longer applicable under the Family Code in view of the following provisions:

"Art. 147. When a man and a woman who are capacitated to marry each other, live exclusively with each other as husband and wife without the benefit of marriage or under

a void marriage, their wages and salaries shall be owned by them in equal shares and the property acquired by both of them through their work or industry shall be governed by the rules on co-ownership x x x."

Under Article 147, the property acquired by a man and a woman who live together as husband and wife shall be governed by the rules on co-ownership.[19]

Sharing of gross returns.

(1) *Not even presumptive evidence of partnership.* — The mere sharing of gross returns alone does not indicate a partnership, since in a partnership, the partners share net profits after satisfying all of the partnership's liabilities. (Arts. 1812, 1839; see Evangelista vs. Collector of Internal Revenue, 102 Phil. 140 [1957].) As distinguished from the general rule recognizing sharing of profits as presumptive evidence of partnership *(infra.)*, the sharing of gross returns has been held not to constitute even *prima facie* evidence of the relation. (68 C.J.S. 441.)

(2) *Reason for rule.* — The reason behind the rule is a sound and practical one, for when a business is carried on in behalf of a given person as partner, he is conceived as being interested in its failures as well as its successes; it is the chance of gain or loss which characterizes a business, whether in the form of a partnership or otherwise. As a matter of experience, therefore, it is found generally that where the contract requires a given portion of "gross returns" to be paid over, the portion is paid over as commission, wages, rent, interest on a loan, etc. (Schleicker vs. Krier, 218 Wis. 376.)

(3) *Where there is evidence of mutual management.* — Where, however, there is further evidence of mutual management and control, a partnership may result, even though the agreement

[19]Article 147 (par. 1.) of the Family Code is taken from Article 144 of the new Civil Code which has a similar provision. It reads:

"When a man and a woman live together as husband and wife, but they are not married, or their marriage is void from the beginning, the property acquired by either or both of them through their work or industry or their wages and salaries shall be governed by the rules on co-ownership. (n)"

calls for a portion of "gross returns." Of course, opinions will differ with respect to the precise extent of management and control necessary to create an inference of partnership, when gross returns are involved. (Teller, *op. cit.,* pp. 12-13.)

EXAMPLE:

A, owner of a passenger jeepney, agrees with B, a driver, that B shall have full control and use of the jeepney to carry passengers, pay for gasoline and oil, and shoulder the cost of repairs, and that the gross receipts are to be divided between them.

In this case, no partnership is established between A and B as no sharing of profits is contemplated.

Receipt of share in the profits.

(1) *Strong presumptive evidence of partnership.* — An agreement to share both profits and losses tends strongly to establish the existence of a partnership, and conversely, the lack of such an agreement tends strongly to negate the existence of a partnership. But the mere fact of a right under the contract to participate in both profits and losses of a business does not of itself have the effect of establishing a partnership between those engaged therein.

The sharing of profits and losses is *prima facie* evidence of an intention to form a partnership but not a conclusive evidence. The presumption of partnership arising from such profit-sharing agreement may be rebutted and outweighed by other circumstances. (see 59 Am. Jur. 2d 968-969.)

(2) *When no such inference will be drawn.* — While a right to share of the profits, as such, is essential to constitute a person a partner, this test may be controlled by other considerations. Thus, under paragraph 4 of Article 1769, sharing of profits by a person is not a *prima facie* evidence that he is a partner in the business in the cases enumerated under sub-paragraphs (a), (b), (c), (d), and (e). In all of the said cases, the profits in the business are not shared as profits of a partner as a partner but in some other respects or for some other purpose, *i.e.,* to pay a debt to

creditor, wage to an employee, or rent to a landlord, annuity to a widow or legal representative of a deceased partner, or interest on a loan, or consideration for the sale of property, though the amount of payment varies with the net profits of the business. Where the "compensation" given to the manager of a project who had put substantial sum in the venture is pegged to profits, said compensation actually constitutes his share in the net profits of the partnership as partner and not as employee. (Philex Mining Corp. vs. Comm. of Internal Revenue, 551 SCRA 428 [2008].)

The basic test of partnership, whether *inter se* or as to third persons, is whether the business is carried on in behalf of the person sought to be held liable. And persons who are partners in fact may not avoid the consequences of the relation by mere word of denial.

(3) *Sharing of profits as owner.* — It is not merely the sharing of profits, but the sharing of them as co-owner of the business or undertaking, that makes one a partner. If the contract states that the parties are partners or co-owners of the business, then they are co-owners of the business. The courts must look beyond the agreement if it is ambiguous or unclear.

A test given is this: "Does the recipient of a share of the profits have an equal voice as proprietor in the conduct and control of the business? Does he own a share of the profits as proprietor of the business producing them?" Thus, if one takes a share of the profits as payment of a debt, he is not a partner. (Babb & Martin, Business Law [1957], p. 237.)

In other words, to be a partner, one must have an interest with another in the profits of a business as profits.

EXAMPLES:

In the following cases, Y is not a partner in partnership X:

(1) Y, creditor of partnership X, is entrusted by the partners to manage the business, and Y shall receive, in addition to his compensation, a share in the net profits of the business in settlement of his credit;

(2) Y, an employee of partnership X, shall receive instead a fixed salary, or being the owner of a building rented by the

partnership, Y shall receive as rent a certain percentage of the monthly net profits of the business;

(3) Y, the widow of a deceased partner in partnership X, in consideration of the continuation of the business without liquidation and satisfaction of the deceased's interest, shall receive an annuity for a period of five (5) years based on a certain percentage of the net profits;

(4) Y, creditor of partnership X, agreed that the payment of interest shall be taken from the net profits to be realized by the partnership; and

(5) Y sold property to partnership X, and he agreed that the purchase price shall be paid out of the net profits of the business.

In any of the above cases, Y shall not be entitled to receive payment where there are no profits; nor shall he be liable to share any losses incurred by the partnership.

ILLUSTRATIVE CASES:

1. *The compensation of an employee was to be determined under the contract with reference to the profits made by the partnership.*

Facts: A brought action to recover the balance due him as salary from B and C alleging that he was entitled to 5% of the net profits of the business of B and C as co-partner of the latter.

Issue: Whether the contract made was one of partnership or one of mere employment.

Held: The contract was a mere contract of employment. A had no voice nor vote in the management of the affairs of the company. The fact that the compensation received by him was to be determined with reference to the profits made by B and C in the business did not in any sense make him a partner therein.

The articles of partnership between B and C provided that the profits should be divided among the partners in a certain proportion. The contract between A and the then manager of the partnership did not in any way vary or modify this provision of the articles of partnership.

The profits of the business could not be determined until all the expenses had been paid, part of which was the salary of A. It was undoubtedly necessary in order to determine

what the salary of A was, to determine what the profits of the business were, after paying all of the expenses except his, but that determination was not the final determination of the net profits of the business which were to be divided between B and C. It was made for the purpose of fixing the basis upon which A's compensation should be determined. (*Fortis vs. Gutierrez Hermanos, 6 Phil. 100 [1906];* see Sardane vs. Court of Appeals, 167 SCRA 524 [1988].)

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2. *The compensation of a supervisor was fixed in the contract as 35% of the net profits of the business.*

Facts: A entered into a contract with B Company whereby A was to receive 35% of net profits of the fertilizer business of B as compensation for his services of supervising the mixing of fertilizers.

Issue: Whether the relationship established between A and B was that of partners or merely that of employee and employer.

Held: Neither the provisions of the contract nor the conduct of the parties prior or subsequent to its execution justify the conclusion that it was a contract of co-partnership.

In the case at bar, there was no common fund, that is, a fund belonging to the parties as joint owners or partners. The fact that the phrase *"en sociedad con"* was used in providing that B shall not engage in the business of prepared fertilizers except in association with A, does not show that the parties were establishing a partnership or intended to become partners. The phrase, as used in the contract, merely means *"en sociedad con"* or in association with, and does not carry the meaning of *in partnership with. (Bastida vs. Menzi and Co., 58 Phil. [1933].)*

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3. *Funds used in the purchase of a property by the partnership were secured from third persons who were to share in the profits and losses of the business.*

Facts: Desiring to enlarge its business of operating the steam launch *Luisa*, the partnership N & G composed of N and G, purchased six (6) additional launches. It secured the sum of P28,000.00 from X and four (4) others to finance said purchase. A contract was executed for the purpose. Barely seven (7)

months after its execution, the contract was terminated and the launches were sold by mutual consent.

X brought action alleging that the contract was one of partnership, and that the consent of his agent to the termination of said contract and the sale of the launches was obtained by fraud and the dissolution of the partnership was null and void.

Issue: Was the transaction a loan or a contract of partnership?

Held: (1) *Features of loan contained in contract.* — It was a loan in view of the following features contained in the contract as found by the Supreme Court:

(a) It is twice stated positively that N and G are the only partners and the only persons interested in the partnership of N and G, to which statements X assented to when he signed the document;

(b) It is stated, also distinctly and positively, that the money has been furnished as a loan;

(c) N and G bind themselves in the contract to repay the amount something that they would not be bound to do were the contract one of partnership;

(d) In the contract, N and G create in favor of X and his associates a right of pledge over the launches, a thing inconsistent with the idea of partnership;

(e) N and G are to be considered as consignees only as long as they do not pay the debt. This indicates that they had a right to pay it;

(f) They bind themselves not to alienate the launches until they had paid the debt indicating clearly that by paying the debt they could do so, a thing inconsistent with the idea of a partnership; and

(g) It is also stated that the launch *Luisa* is not included in the contract.

(2) *Loans with right to receive profits in lieu of interests not uncommon.* — The fact that X was to share in the profits and losses of the business and that N and G should answer for the payment of the debt only with the launches and not with their property, indicate that X was a partner. But these provisions are not conclusive. The rights of third persons are not concerned. The parties could, in making the contract, if they choose, take some provisions from the law of partnership and others from

the law of loans. Loans with a right to receive a part of the profits in lieu of interests are not uncommon. As between the parties, such a contract is not one of a partnership. *(Pastor vs. Gaspar, 2 Phil. 592 [1903].)*

_____ _____ _____

4. *The parties entered into an agreement to make a joint bid of certain articles which the owner would only sell in one lot, with the understanding that the property was to be owned in severalty, not jointly, and that there was to be no sharing of profits or losses.*

Facts: G & Co. was winding its business and had for sale certain large trucks, and also small trucks or delivery wagons, and certain electrical appliances to be used in connection with the trucks. Plaintiff CL was desirous of purchasing only the small trucks and the electrical appliances. Upon inquiry, CL was told by G & Co. that all the articles would only be sold in one lot, and he was advised to get in touch with HH who was only interested in purchasing the large trucks.

Subsequently, CL and HH entered into an agreement to make a joint bid.

The complaint alleges, among others:

"(4) That the defendant (HH) represented to the plaintiff (CL) that he, said defendant, could purchase said trucks and other property for the sum of $10,000, and plaintiff thereupon agreed to advance toward such purchase price the sum of $6,000, for which he was to receive six half-ton trucks and six one-ton trucks, including full stock of extra parts therefor, and also two charging boards, with appurtenances. That the defendant should receive the remainder of said trucks and property, excepting a certain hydraulic lift, in return for the moneys advanced by said defendant toward such purchase price. That the hydraulic lift was to be disposed of between the parties by lot.

(5) That on or about April 11, 1918, the defendant represented to the plaintiff that he could not purchase the said trucks and other property for $10,000 but would be obliged to pay $12,000 therefor, with the understanding that, if G & Co. were unable to make delivery of the charging boards and appurtenances, they would return $1,000 of the purchase price.

(6) That relying upon such representations, the plaintiff thereupon agreed to advance the sum of $7,000 towards said purchase price, with the understanding that, if G & Co. were unable to deliver the charging boards and appurtenances, the $1,000 to be rebated by said G & Co. for such failure was to be divided *pro rata* between the plaintiff and the defendant.

(7) That in pursuance of said agreement, the plaintiff did on April 12, 1918, advance to the said defendant for the purpose aforesaid the sum of $7,000.

(8) That thereafter, the said defendant did purchase from said G & Co. the said trucks and other property, excepting the charging boards and appurtenances thereto, and did cause to be delivered to the plaintiff six half-ton trucks and six one-ton trucks, with the extra parts, as agreed, as aforesaid.

(9) That plaintiff is informed and believed to be true that the defendant did not pay the sum of $12,000 to said G & Co. for the said trucks and other property, including said charging boards and appurtenances thereto, but in fact the said defendant only paid the said G & Co. the sum of $10,500 for said property, including the said charging boards and appurtenances thereto.

(10) That defendant falsely represented to the plaintiff that the purchase price of said property was $12,000, when the purchase price in fact was only $10,500.

(11) That the said G & Co. was unable to make delivery of said charging boards and appurtenances thereto, and that in accordance with the agreement between the defendant and the said G & Co., the said G & Co. did return to the said defendant the sum of $1,000."

Issue: Does the agreement alleged in the complaint constitute a partnership in a common-law action?

Held: (1) *Essential elements of partnership lacking.* — "According to the complaint, the property purchased was to be owned in severalty, not jointly. There was to be no sharing of profits or losses. If the trucks received by defendant were thereafter sold by him for a greater price than the sum he contributed therefor, the plaintiff had no interest in such profits and would have no cause of action against defendant. If plaintiff sold his share of

the property purchased at a loss, he could not call on defendant to contribute to such loss. Thus, the essential elements of partnership are lacking.''

(2) *Parties without interest in profits and losses.* — "To constitute a partnership, as between the parties thereto, there must be a joint ownership of the partnership funds, and an agreement, either express or implied, to participate in the profits or losses of the business. The complaint in this action distinctly negated the idea of a joint interest in the profits or losses, as each of the parties was to own the specifically described articles which each needed and for which a specified sum was to be paid. The hydraulic lift, which neither party appeared to want, was not to be sold and the proceeds to be divided, but was "to be disposed of between the parties by lot.'' *(Columbian Laundry vs. Hencken, 196 N.V.S. 523 [1922].)*

Burden of proof and presumption.

In accordance with the general rule of evidence, the burden of proving the existence of a partnership rests on the party having the affirmative of that issue.

(1) The existence of a partnership must be proved and will not be presumed.

(2) The law presumes that persons who are acting as partners have entered into a contract of partnership. Where the law presumes the existence of a partnership *(supra.),* the burden of proof is on the party denying its existence.

(3) When a partnership is shown to exist, the presumption is that it continues in the absence of evidence to the contrary, and the burden of proof is on the person asserting its termination. (68 C.J.S. 466.)

(4) One who alleges a partnership cannot prove it merely by evidence of an agreement wherein the parties call themselves partners, since use of the term "partner" in popular sense, or as a matter of business convenience, will not necessarily import an intention that a legal partnership should result. (31 Words and Phrases 274.) But while use of "partnership" or "partners" in an alleged oral agreement claimed to have constituted partnership is not conclusive that partnership did not exist, non-use of such terms is entitled to weight. (*Ibid.,* 281.)

(5) Among other meanings, "associate" means "partner," but a mere employee may also be an "associate." "We" and "us," when used in an editorial sense, are not conclusive of either partnership or employment. (*Ibid.*, 274.)

(6) The question of whether or not a partnership exists is not always dependent upon the personal arrangement or understanding of the parties. Parties intending to do a thing which in law constitutes partnership are partners, whether their purpose was to create or avoid the relation (*Ibid.*, 278.), or even expressly stipulated in their agreement that they were not to become partners.

We, therefore, arrive at the rule that *legal intention* is the crux of partnership. Parties may call themselves partners in no uncertain terms, yet their contract may be adjudged something quite different. Conversely, parties may expressly stipulate that their contract is not a partnership yet the law may determine otherwise on the basis of legal intent. It is true, however, that courts will be influenced to some extent by what the parties call their contract. (Teller, *op. cit.*, p. 9.)

Tests and incidents of partnership.

In determining whether a partnership exists, it is important to distinguish between tests or indicia and incidents of partnership.

(1) Only those terms of a contract upon which the parties have reached an actual understanding, either expressly or impliedly, may afford a test by which to ascertain the legal nature of the contract. Once the legal nature of a contract as one of partnership has been established, whether or not the parties intended that relationship to be called partnership or believed it to be a partnership, certain consequences or incidents follow as a matter of law, irrespective of any actual understanding between the parties. (see 40 Am. Jur. 146-147.)

(2) Some of the typical incidents of a partnership are:

(a) The partners share in profits and losses. (Arts. 1767, 1797, 1798.) This community of interest in profits is not incidental to the ordinary agency;

(b) They have equal rights in the management and conduct of the partnership business (Art. 1803.);

(c) Every partner is an agent of the partnership, and entitled to bind the other partners by his acts, for the purpose of its business. (Art. 1818.) He may also be liable for the entire partnership obligations;

(d) All partners are personally liable for the debts of the partnership with their separate property (Arts. 1816, 1822-1824.) except that limited partners are not bound beyond the amount of their investment (Art. 1843.);

(e) A fiduciary relation exists between the partners (Art. 1807.); and

(f) On dissolution, the partnership is not terminated, but continues until the winding up of partnership is completed. (Art. 1828.)

Such incidents may be modified by stipulation of the partners subject to the rights of third persons dealing with the partnership.

Partnership distinguished from a labor union.

A *labor union* is any association of employees which exists in whole or in part for the purpose of collective bargaining or of dealing with employers concerning terms and conditions of employment. (Art. 210, Labor Code.)

Partnerships and labor unions have some characteristics in common, but the purpose of partnership is essentially to enable its members, as principals, to conduct a lawful business, trade, or profession for pecuniary gain of partners, and no one may become a partner without consent of all partners. (People vs. Herbert, 295 N.Y.S. 251, 162 Misc. 817; 68 C.J.S. 403.)

Partnership distinguished from a business trust.

A *trust* is the legal relationship between one person (beneficiary) having the equitable ownership in property and another (trustee) owning the legal title to such property, the equitable

ownership of the former entitling him to the performance of certain duties and the exercise of certain powers by the latter. (76 Am. Jur. 2d, 247-248; see Art. 1440.)

An outstanding distinction between the partnership and trust relations is that in the partnership, all of the members are principals and are agents for each other (see Art. 1818.), while the trustee is only a principal and is not an agent. (68 C.J.S. 403.) Only the trustee and not the beneficiaries is empowered to make contracts to carry on the business affairs and the only one who has legal title to the property.[20] (Teller, *op. cit.*, p. 25.)

In a partnership, a partner is a "co-owner" with his partners of specific partnership property. (Art. 1811.)

Partnership distinguished from co-ownership.

There is a *co-ownership* whenever the ownership of an undivided thing or right belongs to different persons. (Art. 484.) It is the right of common dominion which two or more persons have in a spiritual part of a thing which is not physically divided. (4 Sanchez Roman 162.)

The following are the distinctions between a partnership and a co-ownership:

(1) *Creation.* — Co-ownership is generally created by law. It may exist even without a contract, but partnership is always created by a contract (Art. 1767.), either express or implied;

(2) *Juridical personality.* — A partnership has a juridical personality separate and distinct from that of each partner (Art. 1768.), while a co-ownership has none;

(3) *Purpose.* — The purpose of a partnership is the realization of profits (Art. 1767.), while in co-ownership, it is the common

[20]A *business trust,* also called a "Massachusetts trust," has been defined by the U.S. Supreme Court as a form of business organization "consisting essentially of an arrangement whereby property is conveyed to trustees, in accordance with the terms of an instrument of trust, to be held and managed for the benefit of such persons as may from time to time be the holders of transferable certificates issued by the trustees showing the shares into which the beneficial interest in the trust property is divided." (Hecht vs. Malley, 265 U.S. 144.)

enjoyment of a thing or right (see Art. 486.) which does not necessarily involve the sharing of profits;

(4) *Duration.* — Under the law, there is no limitation upon the duration of a partnership (see Arts. 1767, 1785.) while in co-ownership, an agreement to keep the thing undivided for more than ten years is not allowed (see Art. 494.);

(5) *Disposal of interests.* — A partner may not dispose of his individual interest in the partnership (Art. 1812.) so as to make the assignee a partner unless agreed upon by all of the partners (see comments under Art. 1814.), while a co-owner may freely do so (see Art. 495.);

(6) *Power to act with third persons.* — In the absence of any stipulation to the contrary (Art. 1803.), a partner may bind the partnership, while a co-owner cannot represent the co-ownership (see Arts. 491, 492.); hence, a judgment secured against only one of the co-owners will not bind the other co-owners (Smith vs. Lopez, 5 Phil. 78 [1905].); and

(7) *Effect of death.* — The death of a partner results in the dissolution of the partnership (Art. 1830[5].), but the death of a co-owner does not necessarily dissolve the co-ownership. (Rodriguez vs. Ravalan, 17 Phil. 63 [1910].)

ILLUSTRATIVE CASES:

1. *Land purchased with funds contributed by the parties would be divided equally between them.*

Facts: Under a verbal contract, A and B contributed P22.00 each for the purpose of purchasing a parcel of land. It was agreed that upon its acquisition, the property would be divided equally between them. A kept the land for himself and refused to divide. B brought an action for partition.

Issue: Did the parties enter into a contract of partnership?

Held: No. The transaction entered into between A and B was the acquisition jointly by mutual agreement of the land in question, not for the purpose of undertaking any business, nor for its cultivation in partnership, but solely to divide it equally between them. Since the land was undivided, A and B were co-owners of the said land, and the partition or division of such

property must, therefore, be allowed in accordance with their agreement. *(Gallemet vs. Tabilaran, 20 Phil. 241 [1911].)*

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2. *Cascoes were acquired for a transportation business with the intention to share in the profits but the parties were unable to draw up the written articles of partnership because of disagreement as to its terms.*

Facts: A and B entered into a verbal contract for the purchase of cascoes and the subsequent establishment of a transportation business, each to furnish for the purpose such money as he could, the profits to be divided proportionately between them. A was to buy the cascoes. He bought two out of the money contributed by both of them.

The parties were unable to draw up the articles of partnership because of disagreement as to its terms.

Issue: Did the parties enter into a contract of partnership?

Held: Yes. The minds of the parties met upon two essential points, to wit: (a) mutual contribution to a common fund and (b) a joint interest in the profits. The first was established by the fact that money was furnished by B and received by A for the purchase of the cascoes. The intention to share in the profits, the second element, could not but be deduced from the purchase of the cascoes in common in the absence of any other explanation of the object of the parties in making the purchase in that form.

"If, for instance, it were shown that the object of the parties in purchasing it in company had been to make a more favorable bargain for the two cascoes, then they could have done by purchasing them separately, and that they had no ulterior object except to effect a division of the common property when once they had acquired it, the *affectio societatis* would be lacking, and the parties would become joint tenants only; but, as nothing of this sort appears in the case, we must assume that the object of the purchase was active use and profit and not mere passive ownership in common." *(Fernandez vs. De la Rosa, 1 Phil. 671 [1902].)*

Partnership distinguished from conjugal partnership of gains.

Conjugal partnership of gains is a partnership formed by the marriage of husband and wife by virtue of which they place in a

common fund the fruits and income of their separate properties and those acquired through their efforts or by chance, and unless otherwise agreed upon in the marriage settlements, divide equally, upon the dissolution of the marriage or the partnership, the net gains or benefits obtained by either or both of them during the marriage. (Art. 106, Family Code.)

The ordinary or business partnership may be distinguished from a conjugal partnership as follows:

(1) *Parties.* — A business partnership is created by the voluntary agreement of two or more partners (Art. 1767.) belonging to either sex, while a conjugal partnership arises in case the future spouses — a man and a woman — agree that it shall govern their property relations during the marriage (Art. 105, Family Code.);

(2) *Laws which govern.* — The ordinary partnerships are, as a rule, governed by the stipulation of the parties (see Arts. 1159, 1308.), whereas a conjugal partnership is governed by law (Arts. 105-133, *Ibid.*);

(3) *Juridical personality.* — A partnership has a juridical personality (Art. 1768.), while a conjugal partnership of gains has none;

(4) *Commencement.* — A partnership begins from the moment of the execution of the contract, unless it is otherwise stipulated (Art. 1784.), while a conjugal partnership of gains commences precisely on the date of the celebration of the marriage and any stipulation to the contrary is void (Arts. 88, 107, *Ibid.*);

(5) *Purpose.* — The primary purpose of the ordinary partnership is to obtain profits (Art. 1767.), while that of a conjugal partnership is to regulate the property relations of husband and wife during the marriage (Art. 74, *Ibid.*);

(6) *Distribution of profits.* — In the ordinary partnership, the profits are divided according to the agreement of the partners or in proportion to their respective capital contributions (Art. 1797.), while in a conjugal partnership, the shares of the spouses in the profits are divided equally (Art. 106, *Ibid.*);

(7) *Management.* — In the ordinary partnership, the management is shared equally by all the partners unless one or more

of them are appointed managers in the articles of partnership (Arts. 1801-1803.), while in a conjugal partnership, although the administration belongs to both spouses jointly, the husband's decision shall prevail in case of disagreement (Art. 124, *Ibid.*); and

(8) *Disposition of shares.* — In the ordinary partnership, the whole interest of a partner may be disposed of without the consent of the other partners (see comments under Art. 1813.), while in a conjugal partnership, the share of each spouse cannot be disposed of during the marriage even with the consent of the other. (see Arts. 89, 107, 121, 127, *Ibid.*)

Partnership distinguished from a voluntary association.

A partnership is distinguished from voluntary associations organized for social purposes (such as social clubs, committees, lodges, fraternal societies, etc.) as follows:

(1) *Juridical personality.* — A partnership has a juridical personality, while a voluntary association has none;

(2) *Purpose.* — A partnership is always organized for pecuniary profit, while in a voluntary association, this objective is lacking;

(3) *Contributions of members.* — In a partnership, there is a contribution of capital, either in the form of money, property, or services, while in a voluntary association for social purposes, although fees are usually collected from the members to maintain the organization, there is no contribution of capital; and

(4) *Liability of members.* — The partnership, as a rule, is the one liable in the first place for the debts of the firm, while in a voluntary association, the members are individually liable for the debts of the association, authorized by them either expressly or impliedly, or subsequently ratified by them. (Mechem, *op. cit.*, p. 115.)

The members of such associations, societies, or clubs are not strictly partners, though the organization may possess business features and be conducted partly for pecuniary gain. The property rights and the legal liabilities of the members depend,

as between themselves, on the constitution and rules of the association or club. (40 Am. Jur. 130.) If in a particular case such members are held personally liable for the acts or obligations of the association, their liability is based on the law of agency, and such agency must be clearly shown.

ILLUSTRATIVE CASE:

Pursuant to "reinsurance treaties," a number of local insurance firms formed themselves into a "pool" in order to facilitate the handling of business contracted with a non-resident foreign insurance company.

Facts: The petitioners are 41 non-life insurance corporations, organized and existing under the laws of the Philippines. Upon issuance by them of Erection, Machinery Breakdown, Boiler Explosion and Contractors' All Risk insurance policies, the petitioners on August 1, 1965 entered into a Quota Share Reinsurance Treaty and a Surplus Reinsurance Treaty with the MUNICH, a non-resident foreign insurance corporation. The reinsurance treaties required petitioners to form a [p]ool. Accordingly, a pool composed of the petitioners was formed on the same day.

On April 14, 1976, the pool of machinery insurers submitted a financial statement and filed an "Information Return of Organization Exempt from Income Tax" for the year ending in 1975, on the basis of which it was assessed by the Commissioner of Internal Revenue deficiency corporate taxes in the amount of P1,843,273.60, and withholding taxes in the amount of P1,768,799.39 and P89,438.68 on dividends paid to Munich and to the petitioners, respectively.

On January 27, 1986, the Commissioner of Internal Revenue denied the protest and ordered the petitioners, assessed as "Pool of Machinery Insurers," to pay deficiency income tax, interest, and withholding tax.

The Court of Appeals ruled in the main that the pool of machinery insurers was a partnership taxable as a corporation, and that the latter's collection of premiums on behalf of its members, the ceding companies, was taxable income.

Petitioners belie the existence of a partnership in this case, because: (1) they, the insurers, did not share the same risk or solidary liability; (2) there was no common fund; (3)

the executive board of the pool did not exercise control and management of its funds, unlike the board of directors of a corporation; and (4) the pool or clearing house "was not and could not possibly have engaged in the business of reinsurance from which it could have derived income for itself."

Issue: One of the three (3) issues raised by the petitioners is whether or not the Clearing House, acting as a mere agent and performing strictly administrative functions, and which did not insure or assume any risk in its own name, was a partnership or association subject to tax as a corporation.

Held: (1) *Business partnerships taxable as corporation.* — "Under Sections 20 and 24 (now Secs. 22 and 27) of the National Internal Revenue Code (NIRC), (business) partnerships are included in the term "corporation" and taxable as such.

Thus, in *Evangelista vs. Collector of Internal Revenue* (102 Phil. 140 [1957]), it was held that Section 24 covered these unregistered partnerships and even associations or joint accounts, which had no legal personalities apart from their individual members."

(2) *Formation of a partnership.* — Article 1767 of the Civil Code recognizes the creation of a contract of partnership when '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.' Its requisites are: '(1) mutual contribution to a common stock, and (2) a joint interest in the profits.' In other words, a partnership is formed when persons contract 'to devote to a common purpose either money, property, or labor with the intention of dividing the profits between themselves.' Meanwhile, an association implies associates who enter into a 'joint enterprise x x x for the transaction of business.' "

(3) *Pool of machinery insurers formed a partnership.* — "In the case before us, the ceding companies entered into a Pool Agreement or an association that would handle all the insurance business covered under their quota-share reinsurance treaty and surplus reinsurance treaty with Munich. The following unmistakably indicates a partnership or an association covered by Section 24 of the NIRC.

> (a) The pool has a common fund, consisting of money and other valuables that are deposited in the name

and credit of the pool. This common fund pays for the administration and operation expenses of the pool.

(b) The pool functions through an executive board, which resembles the board of directors of a corporation, composed of one representative for each of the ceding companies.

(c) True, the pool itself is not a reinsurer and does not issue any insurance policy; however, its work is indispensable, beneficial and economically useful to the business of the ceding companies and Munich, because without it they would not have received their premiums. The ceding companies share 'in the business ceded to the pool' and in the 'expenses' according to a 'Rules of Distribution' annexed to the Pool Agreement. Profit motive or business is, therefore, the primordial reason for the pool's formation."

(d) *Insurers become partners not mere co-owners.* — "The petitioner's reliance on *Pascual vs. Commissioner* (166 SCRA 560 [1988].) is misplaced, because the facts obtaining therein are not on all fours with the present case. In Pascual, there was no unregistered partnership, but merely a co-ownership which took up only two isolated transactions. The Court of Appeals did not err in applying Evangelista, which involved a partnership that engaged in a series of transactions spanning more than ten years, as in the case at bar." *(AFISCO Insurance Corporation vs. Court of Appeals, 302 SCRA 1 [1999].)*

Partnership distinguished from a corporation.

The following are the distinctions:

(1) *Manner of creation.* — A partnership is created by mere agreement of the parties (Art. 1787.), while a corporation is created by law or by operation of law (Sec. 2, B.P. Blg. 68.);

(2) *Number of incorporators.* — A partnership may be organized by only two persons (Art. 1767.), while a corporation (except a corporation sole) requires at least five incorporators (Sec. 10, *Ibid*.);

(3) *Commencement of juridical personality.* — A partnership commences to acquire juridical personality from the moment of

the execution of the contract of partnership (Art. 1784.), while a corporation begins to have juridical personality only from the date of issuance of the certificate of incorporation by the Securities and Exchange Commission (Sec. 19, *Ibid*.);

(4) *Powers.* — A partnership may exercise any power authorized by the partners provided it is not contrary to law, morals, good customs, public order, or public policy (Art. 1306.), while a corporation can exercise only the powers expressly granted by law or implied from those granted or incident to its existence (Secs. 2, 36, *Ibid*.);

(5) *Management.* — In a partnership, when the management is not agreed upon, every partner is an agent of the partnership (Art. 1803.), while in a corporation, the power to do business and manage its affairs is vested in the board of directors or trustees (Sec. 23, *Ibid*.);

(6) *Effect of mismanagement.* — In a partnership, a partner as such can sue a co-partner who mismanages (see Arts. 1794, 1806, 1809.), while in a corporation, the suit against a member of the board of directors or trustees who mismanages must be in the name of the corporation (see Sec. 23, *Ibid*.);

(7) *Right of succession.* — A partnership has no right of succession (see Arts. 1828-1831, 1860.), while a corporation has such right (Sec. 2, *Ibid*.);

(8) *Extent of liability to third persons.* — In a partnership, the partners (except limited partners) are liable personally and subsidiarily (sometimes solidarily) for partnership debts to third persons (see Arts. 1816, 1822-1824.), while in a corporation, the stockholders are liable only to the extent of the shares subscribed by them (see Secs. 64, 37, *Ibid*.);

(9) *Transferability of interest.* — In a partnership, a partner cannot transfer his interest in the partnership so as to make the transferee a partner without the consent of all the other existing partners because the partnership is based on the principle of *delectus personarum* (see Arts. 1767, 1804.), while in a corporation, a stockholder has generally the right to transfer his shares without

the prior consent of the other stockholders because a corporation is not based on this principle (Sec. 63, *Ibid*.);

(10) *Term of existence.* — A partnership may be established for any period of time stipulated by the partners (see Arts. 1767, 1785.), while a corporation may not be formed for a term in excess of 50 years extendible to not more than 50 years in any one instance (Sec. 11, *Ibid*.);

(11) *Firm name.* — A limited partnership is required by the law to add the word "Ltd." to its name (Art. 1844[1, a].), while a corporation may adopt any firm name provided it is not the same as or similar to any registered firm name (see Sec. 18, *Ibid*.);

(12) *Dissolution.* — A partnership may be dissolved at any time by the will of any or all of the partners (Art. 1830[1, 2].), while a corporation can only be dissolved with the consent of the State (Secs. 117-122, *Ibid*.); and

(13) *Governing law.* — A partnership is governed by the Civil Code, while a corporation is governed by the Corporation Code.

Similarities between a partnership and a corporation.

They are as follows:

(1) Like a corporation, a partnership has a juridical personality separate and distinct from that of the individuals composing it;

(2) Like a corporation, a partnership can act only through agents;

(3) Like a corporation, a partnership (except a corporation sole) is an organization composed of an aggregate of individuals;

(4) Like a (stock) corporation, a partnership distributes its profits to those who contribute capital to the business (although an industrial partner also shares in partnership profits);

(5) Like a corporation, a partnership can be organized only where there is a law authorizing its organization; and

(6) A partnership, no matter how created or organized (except

a general professional partnership)[21] is taxable as a corporation, subject to income tax. (Secs. 20[b], 24[a], NIRC.)

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)

Object or purpose of partnership.

The provision of the first paragraph of the above article reiterates two essential elements of a contract of partnership: legality of the object and community of benefit or interest of the partners. (see Art. 1767.)

The parties possess absolute freedom to choose the transaction or transactions they must engage in. The only limitation is that the object must be lawful and for the common benefit of the members. This limitation arises not only from the express provisions of the law, but from the general principles of morality and justice. (Espiritu and Sibal, *op. cit.*, p. 5; see Art. 1306.)

The illegality of the object will not be presumed; it must appear to be of the essence of the relationship. (Barrett & Seago, *op. cit.*, p. 291.) Pursuant to applicable laws, certain businesses (*e.g.*, banking) may be engaged in only by corporations.

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[21]General professional partnerships are partnerships formed by persons for the sole purpose of exercising their common profession no part of the income of which is derived from engaging in any trade or business. (Sec. 20[b], NIRC.) Under the Civil Code, they are classified as particular partnerships. (see Art. 1783.) Under the Tax Code, partnerships are either taxable or exempt. Exempt partnerships (such as general professional partnerships and joint ventures for undertaking construction projects or engaging in petroleum operations (see Sec. 20[b], NIRC.), are not similarly identified as corporations nor even considered as independent taxable entities for income tax purposes. Hence, the partners themselves, not the partnership (although it is still obligated to file an income tax return mainly for administration and data), are liable for the payment of income tax in their individual capacity computed on their respective distributive shares of profits. (Tan vs. Del Rosario, Jr., 237 SCRA 324 [1994].)

Effects of an unlawful partnership.

The following are the consequences of a partnership formed for an unlawful purpose:

(1) The contract is void *ab initio* and the partnership never existed in the eyes of the law (Art. 1409[1].);

(2) The profits shall be confiscated in favor of the government;

(3) The instruments or tools and proceeds of the crime shall also be forfeited in favor of the government;[22] and

(4) The contributions of the partners shall not be confiscated unless they fall under No. 3.[23]

A partnership is dissolved by operation of law upon the happening of an 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. (Art. 1830[3].)

A judicial decree is not necessary to dissolve an unlawful partnership. However, it may sometimes be advisable that a judicial decree of dissolution be secured for the convenience

[22]Art. 45. *Confiscation and forfeiture of the proceeds or instruments of the crime.* — Every penalty imposed for the commission of a felony shall carry with it the forfeiture of the proceeds of the crime and the instruments or tools with which it was committed.

Such proceeds and instruments or tools shall be confiscated and forfeited in favor of the Government, unless they be the property of a third person not liable for the offense, but those articles which are not subject of lawful commerce shall be destroyed. (Revised Penal Code)

[23]Art. 1411. When the nullity proceeds from the illegality of the cause or object of the contract, and the act constitutes a criminal offense, both parties being in *pari delicto,* they shall have no action against each other, and both shall be prosecuted. Moreover, the provisions of the Penal Code relative to the disposal of effects or instruments of a crime shall be applicable to the things or the price of the contract.

This rule shall be applicable when only one of the parties is guilty; but the innocent one may claim what he has given, and shall not be bound to comply with his promise. (1305)

Art. 1412. If the act in which the unlawful or forbidden cause consists does not constitute a criminal offense, the following rules shall be observed:

(1) When the fault is on the part of both contracting parties, neither may recover what he has given by virtue of the contract, or demand the performance of the other's undertaking;

(2) When only one of the contracting parties is at fault, he cannot recover what he has given by reason of the contract, or ask for the fulfillment of what has been promised him. The other, who is not at fault, may demand the return of what he has given without any obligation to comply with his promise. (1306)

and peace of mind of the parties. Third persons who deal with the partnership without being aware of its illegal purpose or character are protected unless such knowledge can be presumed as where the transaction is plainly unlawful.

ILLUSTRATIVE CASE:

A party to a contract of partnership providing for the division of a fishpond between the parties which stipulation is illegal, seeks the transfer of 1/2 of the fishpond.

Facts: A filed a fishpond application for a big tract of swampy land. B also filed his own application for the area covered by A's application. A introduced improvements on portions of the area applied for him in the form of dikes, fishpond gates, clearings, etc. Subsequently, A and C (B's wife) entered into a contract of partnership, with A as industrial partner and C, as capitalist partner, which contract may be divided into two parts, namely, a contract to exploit the fishpond pending its award to either A or B, and a contract to divide the fishpond between A and C after such award.

The Secretary of [Agriculture and] Natural Resources awarded to A the possession of the area in question. Thereafter, A forbade C from further administering the fishpond.

B and C brought action for specific performance and damages resulting from breach of contract. Under the law (Sec. 63, Act No. 4003 [Fisheries Act] and Fisheries Administrative Order 14, Sec. 7.), the transfer or subletting of fishponds covered by permits or lease agreements without prior approval of the DENR Secretary is prohibited.

Issue: Is the contract of partnership valid?

Held: (1) *The first part is valid.* — Although the fishpond was then in possession of A, neither he nor B was the holder of a fishpond permit over the area. Be that as it may, they were not, however, precluded from exploiting the fishpond pending approval of A's application over the same area. No law, rule, or regulation prohibited them from doing so. Thus, rather than let the fishpond remain idle, they cultivated it.

(2) *The second part is illegal.* — Under the law, only a holder of a permit or lease and no one else may enjoy the benefits allowed by the law. Since the partnership had for its object

the division into two equal parts of the fishpond between A and C after it shall have been awarded to the former, and therefore, it envisaged the unauthorized transfer of one-half thereof to C other than A, it was dissolved by the approval of the application and the award of the fishpond. The approval was an event which made it unlawful for the business of the partnership to be carried on or for the members to carry it on in partnership and, therefore, caused its *ipso facto* dissolution. (see Art. 1830[3].) *(Deluao vs. Casteel, 26 SCRA 475 [1968].)*

And since the contract is null and void, A cannot be made to execute a formal transfer of one-half of the fishpond and to secure official approval of the same as agreed upon. *(Ibid., 29 SCRA 350 [1969].)*

Right to return of contribution where partnership is unlawful.

(1) Article 1770 does not state whether upon the dissolution of the unlawful partnership, the amounts contributed are to be returned to the partners, because it only deals with the disposition of profits. The fact, however, that said contributions are not included in the disposal prescribed for said profits, shows that in consequence of said exclusion, the general rules of law must be followed, and hence, the partners must be reimbursed the amount of their respective contributions.

(2) The partner who limits himself to demanding only the amount contributed by him need not resort to the partnership contract on which to base his claim or action. Since the purpose for which the contribution was made has not come into existence, the manager or administrator of the partnership holding said contribution retains what belongs to others, without any consideration, for which reason he is bound to return it, and he who has paid in his share is entitled to recover it.

(3) Any other solution would be immoral, and the law will not consent to the contribution remaining in the possession of the manager or administrator who has refused to return them by denying to the partners the action to demand them. (Arbes vs. Polistico, 53 Phil. 489 [1929].)

Right to receive profits where partnership is unlawful.

(1) Article 1770 permits no action for the purpose of obtaining the earnings made by an unlawful partnership, during its existence as a result of the business in which it was engaged, because for that purpose, the partner will have to base his action upon the partnership contract, which is null and without legal existence by reason of its unlawful object; and it is self-evident that what does not exist cannot be a cause of action.

(2) The profits earned in the course of the partnership do not constitute or represent the partner's contribution but are the result of the industry, business, or speculation which is the object of the partnership; and again, in order to demand the proportional part of said profits, the partner would have to base his action on the contract, which is null and void since the partition or distribution of profits is one of the juridical effects thereof.

(3) Furthermore, it would be immoral and unjust for the law to permit a profit from an industry prohibited by it. *(Ibid.)*

(4) Under the general rule that the courts will not aid either party to an illegal agreement (see Art. 1411.), where a partnership is formed for the prosecution of an illegal business or for the conduct of a lawful business in an illegal manner, the courts will refuse to recognize its existence, and will not lend their aid to assist either of the parties thereto in an action against each other. Therefore, there can be no accounting demanded of a partner for the profits which may be in his hands, nor can a recovery be had. (68 C.J.S. 411.)

Effect of partial illegality of partnership business.

(1) Where a part of the business of a partnership is legal and a part illegal, an account of that which is legal may be had.

(2) Where, without the knowledge or participation of the partners, the firm's profits in a lawful business have been increased by wrongful acts, the innocent partners are not precluded as against the guilty partners from recovering their share of the profits. *(Ibid.)*

Effect of subsequent illegality of partnership business.

Under Article 1830, one of the causes for the dissolution of a partnership is "any event which makes it unlawful for the business of the partnership to be carried on or for the members to carry it on in partnership."(Art. 1830[3].)

The happening of an event subsequent to the making of a valid partnership contract which would render illegal the business of the partnership as planned, will not nullify the contract. Where the business for which the partnership is formed is legal when the partnership is entered into, but afterward becomes illegal, an accounting may be had as to the business transacted prior to such time. (68 C.J.S. 412.)

Community of interest between the partners for business purposes.

The salient features of an ordinary partnership are a community of interest in profits and losses, a community of interest in the capital employed, and a community of power in administration.[24] (Crane, *op. cit.*, p. 61.)

(1) This community of interest — the partners must be co-owners of the business — is the basis of the partnership relation. However, although every partnership appears to be founded on a community of interest, every community of interest does

[24]These features are comprehended in one of the essential requisites of partnership which is simply known in American law as "community of interest." Our Civil Code adheres to this notion of community of interest when it speaks of the contribution of the partners "to a common fund, with the intention of dividing the profits among themselves" (Art. 1767.) and requires that a partnership must be "established for the common benefit and interest of the partners." The term "common fund" connotes co-ownership by the partners of the property and business of the partnership and which in turn implies joint powers of management and control of the partnership and sharing of the profits and losses.

The partners may, however, by agreement, entrust the management of the business to one or some of them. (see Arts. 1801-1803.) Such an arrangement is itself an exercise of the right to participate in the management or control of the partnership. (Art. 1810[3].) In a limited partnership, the limited partners do not participate in the control or management of the business. (see Art. 1848.)

not necessarily constitute a partnership. For example, tenants in common of land are not partners. (59 Am. Jur. 2d 964.)

(2) Property used in the business may belong to one or more partners, so that there is no joint property, other than joint earnings. To state that partners are co-owners of a business is to state that they have the power of ultimate control. But partners may agree upon concentration of management, leaving some of their members entirely inactive or dormant.

(3) Only one of these features, profit-sharing, seems to be absolutely essential. No doubt, in every partnership, profits are to be divided among the partners. (see Crane, *op. cit.*, pp. 61-63.) But the mere sharing of profits of itself does not of necessity constitute a partnership or the members partners *inter se.* (68 C.J.S. 427; see Art. 1769[4].)

Pursuant to Article 1767, the court must consider all the essential elements of a partnership in the light of the facts of the particular case before deciding whether or not a partnership exists.

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)

Form of partnership contract.

(1) *General rule.* — As a general rule, no special form is required for the validity or existence of the contract of partnership. (see Art. 1356.) The contract may be made orally or in writing regardless of the value of the contributions.

(2) *Where immovable property or real rights are contributed.* — In such case, according to Article 1771, "a public instrument shall be necessary," without stating, unlike Article 1773, that without the public instrument, the contract is void. (see Arts. 1356-1358.) Read together, they require the execution of a public instrument for the validity of a contract of partnership whenever immovable property is contributed thereto. To affect third persons, the transfer of real property to the partnership must be

duly registered in the Registry of Property of the province or city where the property contributed is located.

(3) *When partnership agreement covered by Statute of Frauds.* — An agreement to enter in a partnership at a future time, which "by its terms is not to be performed within a year from the making thereof" is covered by the Statute of Frauds. Such agreement is unenforceable unless the same be in writing or at least evidenced by some note or memorandum thereof subscribed by the parties. (see Art. 1403[2, a].)

Partnership implied from conduct.

(1) *Binding effect.* — A partnership may exist and often exists in the absence of express agreement, written or verbal, between the parties. Its existence may be implied from the acts or conduct of the parties, as well as from other declarations, and such implied contract would be as binding as a written and express contract. Thus, where A and B, house painters, oblige themselves to paint the house of C for a certain sum, undertaking to furnish both labor and material, and they divide the sum received after payment of expenses, a partnership is created notwithstanding that they did not expressly agree to establish a partnership.

(2) *Ascertainment of intention of parties.* — In determining whether or not a particular transaction constitutes a partnership, as between the parties, the intention as disclosed by the entire transaction, and as gathered from the facts and from the language employed by the parties as well as their conduct, should be ascertained. A partnership may even be created without any definite intention; the intention of the parties being inferred from their conduct and dealings with each other. (see Kiel vs. Estate of Sabert, 46 Phil. 198 [1924]; Negado vs. Makabento, [CA] No. 10342-R, Feb. 28, 1948.)

(3) *Conflict between intention and terms of contract.* — Also, if the parties intend a general partnership, they are general partners although their purpose is to avoid the creation of such a relation. Thus, in a case, the Supreme Court declared an association as a general partnership it appearing that the inclusion of "Ltd."

(limited) in the firm name was only a subterfuge resorted to by the partners in order to evade liability for possible losses, while assuming their enjoyment of the advantages to be derived from the relation. (Jo Chung Cang vs. Pacific Commercial Co., 45 Phil. 142 [1923].)

> **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)**

Registration of partnership.

(1) *Partnership with capital of P3,000.00 or more.* — There are two requirements where the capital of the partnership is P3,000.00 or more,[25] in money or property, namely:

(a) The contract must appear in a public instrument; and

(b) It must be recorded or registered with the Securities and Exchange Commission.

However, failure to comply with the above requirements does not prevent the formation of the partnership (Art. 1768.) or affect its liability and that of the partners to third persons. But any of the partners is granted the right by the law (see Arts. 1357, 1358.) to compel each other to execute the contract in a public instrument. Of course, this right cannot be availed of if the partnership is void under Article 1773.

[25]From the strictly legal point of view, therefore, a partnership with a capital of less than P3,000.00 need not register its articles of partnership. However, for purposes of convenience in dealing with government offices and financial institutions, registration of partnership having a capital of less than P3,000.00 is recommended. (SEC Opinion, June 1, 1960.)

(2) *Purpose of registration.* — The requirement of public instrument is imposed as a prerequisite to registration, and registration is necessary as "a condition for the issuance of licenses to engage in business or trade. In this way, the tax liabilities of big partnerships cannot be evaded and the public can also determine more accurately their membership and capital before dealing with them." (IV Capistrano, Civil Code of the Phils., p. 260.)

(3) *When partnership considered registered.* — The Securities and Exchange Commission performs the works of a mercantile registrar insofar as the recording of articles of partnership is concerned. Since the recording of articles of partnership is not for the purpose of giving the partnership juridical personality (see Art. 1784.), the only objective of the law is to make the recorded instrument open to all and to give notice thereof to interested parties.

This objective is achieved from the date the partnership papers are presented to and left for record in the Commission. For this reason, when the certificate of recording of the instrument is issued on a date subsequent to the date of presentation thereof, its effectivity retroacts as of the latter date. In other words, the date the partnership papers are presented to and left for record in the Commission is considered the effective date of registration of the articles of partnership. (SEC Opinion, Feb. 8, 1962 and Feb. 5, 1963.) This conforms with the ordinary rule of jurisprudence that: "Ordinarily, an instrument is deemed to be recorded when it is deposited with the proper office for the purpose of being recorded." *(Ibid.)*

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)

Partnership with contribution of immovable property.

(1) *Requirements.* — Where immovable property, regardless of its value, is contributed, the failure to comply with the following

requirements will render the partnership contract void in so far as the contracting parties are concerned:

(a) The contract must be in a public instrument (Art. 1771.); and

(b) An inventory of the property contributed must be made, signed by the parties, and attached to the public instrument.

(2) *As to contracting parties.* — The absence of either formality renders the contract void. Although Article 1771 does not expressly state that without the public instrument the contract is void, Article 1773 is very clear that the contract is void if the formalities specifically provided therein are not observed, implying that compliance therewith is absolute and indispensable for validity.

(3) *As to third persons.* — Article 1773 is intended primarily to protect third persons. With regard to them, a *de facto* partnership or partnership by estoppel may exist. (see Art. 1825.) There is nothing to prevent the court from considering the partnership agreement an ordinary contract from which the parties' rights and obligations to each other may be inferred and enforced. (Torres vs. Court of Appeals, 320 SCRA 428 [1999].)

When inventory is not required.

An inventory is required only "whenever immovable property is contributed." Hence, Article 1773 does not apply in the case of immovable property which may be possessed or even owned by the partnership but not contributed by any of the partners. Thus, it has been held that a partnership contract which states that the partnership is established "to *operate* a fishpond" (not "to *engage* in a fishpond business") is not rendered void because no inventory of the fishpond was made where it did not clearly and positively appear in the articles of partnership that the real property had been contributed by anyone of the partners. (Agad vs. Mabolo and Agad & Co., 23 SCRA 1223 [1968].)

If personal property, aside from real property, is contributed, the inventory need not include the former.

Importance of making inventory of real property in a partnership.

Article 1773 complements Article 1771.

(1) An inventory is very important in a partnership to show how much is due from each partner to complete his share in the common fund and how much is due to each of them in case of liquidation. (Tablason vs. Bollozas, [C.A.] 51 O.G. 1966.)

(2) The execution of a public instrument of partnership would be useless if there is no inventory of immovable property contributed because without its description and designation, the instrument cannot be subject to inscription in the Registry of Property, and the contribution cannot prejudice third persons. This will result in fraud to those who contract with the partnership in the belief of the efficacy of the guaranty in which the immovables may consist. Thus, the contract is declared void by law when no such inventory is made. (11 Manresa 278-279; Republic Engineering Works and Manufacturing Co. vs. Alcantara, et al., 13 C.A. Rep. 221; Torres vs. Court of Appeals, 320 SCRA 428 [1999].)

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)

Acquisition or conveyance of property by partnership.

Since a partnership has juridical personality separate from and independent of that of the persons or members composing it (Art. 1768.), it is but logical and natural that immovable property may be acquired in the partnership name. Title so acquired can, therefore, be conveyed only in the partnership name. (see Art. 46.) The legal effects of conveyance of property standing in the name of the partnership executed by a partner in the partnership name or in his own name are governed by Article 1819, paragraphs one and two.

The right of a partnership to deal in real as well as personal property is subject to limitations and restrictions prescribed by the Constitution (see Art. XIV, Secs. 3, 5, 8, 9, 11 thereof.) and special laws. A partnership is an "association" within the meaning of the word as used in the Constitution.

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)

Secret partnerships without juridical personality.

The partnership relation is created only by the voluntary agreement of the partners. (Art. 1767.) It is essential that the partners are fully informed not only of the agreement but of all matters affecting the partnership. (Art. 1806.) Likewise, a partner is considered the agent of his co-partners and of the partnership in respect of all partnership transactions. (Art. 1803.) Every partnership must have a firm name under which it shall conduct its business (Art. 1815.) and to distinguish it from the partners and other partnerships. (Art. 1768.) The partners have equal rights and interests in the partnership (Art. 1810.) which must be established for the common benefit or interest of the partners. (Art. 1770, par. 1.)

In view of the above, associations[26] whose articles or agreements are kept secret among the members (*i.e.*, known to some members only but withheld from the rest) and wherein anyone of them may contract in his own name with third persons are, by this article, deprived of juridical personality for evidently such

[26]Sec. 15. *Entity without juridical personality as defendant.* — When two or more persons not organized as an entity with juridical personality enter into a transaction, they may be sued under the name by which they are generally or commonly known.

In the answer of such defendant, the names and addresses of the persons composing said entity must all be revealed. (Rule 3, Rules of Court.)

associations are not partnerships. As among themselves, they shall be governed by the provisions relating to co-ownership.

Importance of giving publicity to articles of partnership.

It is essential that the articles of partnership be given publicity for the protection not only of the members themselves but also third persons from fraud and deceit to which otherwise they would be easy victims. A member who transacts business for the secret partnership in his own name becomes personally bound to third persons unaware of the existence of such association, in the same way and for the same reason that an agent who acts in his own name when dealing with third persons is directly bound in favor of such persons who may only sue or be sued by the agent and not his principal. (see Art. 1883.)

But a person may be held liable as a partner or partnership liability may result in favor of third persons by reason of estoppel. (see Art. 1825.)

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)

Classifications of partnership.

(1) *As to the extent of its subject matter.* — A partnership may be:

(a) *Universal partnership* or one which refers to all the present property or to all profits. (Art. 1777.)

There are thus two kinds of universal partnership, to wit:

(1) Universal partnership of all present property. This is defined in Article 1778; and

(2) Universal partnership of profits. This is defined in Article 1780;

or

(b) *Particular partnership.* — This is defined in Article 1783.

(2) *As to liability of the partners.* — It may be:

(a) *General partnership* or one consisting of general partners who are liable *pro rata* and subsidiarily (Art. 1816.) and sometimes solidarily (Arts. 1822-1824.) with their separate property for partnership debts; or

(b) *Limited partnership* or one formed by two or more persons having as members one or more general partners and one or more limited partners, the latter not being personally liable for the obligations of the partnership. (Art. 1843.)

(3) *As to its duration.* — It is either:

(a) *Partnership at will* or one in which no time is specified and is not formed for a particular undertaking or venture and which may be terminated at anytime by mutual agreement of the partners, or by the will of any one partner alone; or one for a fixed term or particular undertaking which is continued by the partners after the termination of such term or particular undertaking without express agreement (see Art. 1785.); or

(b) *Partnership with a fixed term* or one in which the term for which the partnership is to exist is fixed or agreed upon or one formed for a particular undertaking, and upon the expiration of the term or completion of the particular enterprise, the partnership is dissolved, unless continued by the partners. *(Ibid.)*

(4) *As to the legality of its existence.* — It may be:

(a) *De jure partnership* or one which has complied with all the legal requirements for its establishment (see Arts. 1772, par. 2; 1773.); or

(b) *De facto partnership* or one which has failed to comply with all the legal requirements for its establishment. *(Ibid.)*

(5) *As to representation to others.* — It may be:

(a) *Ordinary* or *real partnership* or one which actually exists among the partners and also as to third persons; or

(b) *Ostensible partnership* or *partnership by estoppel* or one which in reality is not a partnership, but is considered a partnership only in relation to those who, by their conduct or admission, are precluded to deny or disprove its existence. (Art. 1825.)

EXAMPLE:

Suppose A, B, and C are not really partners, but A told X that he (A), B, and C are partners. X, believing the representation made by A and consented to by B, extended credit to A.

As against A and B, A, B, and C constitute a partnership by estoppel. But as against C, there is no partnership and X cannot hold him liable as a partner. When the debt matures, X is entitled to collect only from A and B who are liable as partners although not actually partners.

(6) *As to publicity.* — It may be:

(a) *Secret partnership* or one wherein the existence of certain persons as partners is not avowed or made known to the public by any of the partners; or

(b) *Open* or *notorious partnership* or one whose existence is avowed or made known to the public by the members of the firm. (68 C.J.S. 400.)

(7) *As to purpose.* — It may be:

(a) *Commercial* or *trading partnership* or one formed for the transaction of business[27] (Art. 1767.); or

[27]A trading partnership, generally, is one which buys and sells; but buying and selling need not be its sole purpose, nor even its characteristic feature. A partnership for the operation of a manufacturing or mechanical business is nonetheless a trading partnership since buying and selling in the market is one of its incidents. (Marsh, Merwin & Lemmon vs. Wheeler, 77 Conn. 449.) Trading partners naturally conceive the employment of capital, credit, and the usual instrumentalities of trade. Non-trading partnerships do not. So one partner in a law firm cannot bind the firm by a note given to pay a firm debt. But usages of trade may supply the power in one partner of a non-trading firm to bind the others by the issuance of negotiable instruments. (Teller, *op. cit.,* p. 63, citing Smith vs. Sloan, 37 Wis. 285; Dowling vs. Exchange Bank of Boston, 145 U.S. 512.)

Under American law, a partner in a trading partner has generally more powers of representation than a partner in a non-trading partnership.

(b) *Professional* or *non-trading partnership* or one formed for the exercise of a profession. *(Ibid.)*

Kinds of partners.

Partners are classified according to their interests in the partnership business, or their obligations to the partnership, or their liabilities to third persons.

(1) *Under the Civil Code.* — Partners[28] are classified into:

(a) *Capitalist partner* or one who contributes money or property to the common fund (see Art. 1767.);

(b) *Industrial partner* or one who contributes only his industry or personal service (Arts. 1789, 1767.);

(c) *General partner* or one whose liability to third persons extends to his separate property; he may be either a capitalist or industrial partner. (see Arts. 1843, 1816.) He is also known as *real partner*;

(d) *Limited partner* or one whose liability to third persons is limited to his capital contribution. (see Art. 1843.) He is also known as *special partner.* The terms "general partner" and "limited partner" have relevance only in a limited partnership;

(e) *Managing partner* or one who manages the affairs or business of the partnership; he may be appointed either in the articles of partnership or after the constitution of the partnership. (see Art. 1800.) He is also known as *general* or *real* partner;

(f) *Liquidating partner* or one who takes charge of the winding up of partnership affairs upon dissolution (see Art. 1836.);

(g) *Partner by estoppel* or one who is not really a partner, not being a party to a partnership agreement, but is liable as a partner for the protection of innocent third persons. (see Art. 1825.) He is one who is represented as being in fact a partner,

[28]The term is also used to designate various relationships such as companions, fellow workers, or close friends. (31 Words and Phrases 271.)

but who is not so as between the partners themselves. He is also known as *partner by implication* or *nominal partner*.

The term "quasi-partner" is sometimes used (68 C.J.S. 405.);

(h) *Continuing partner* or one who continues the business of a partnership after it has been dissolved by reason of the admission of a new partner, or the retirement, death, or expulsion of one or more partners (see Art. 1840.);

(i) *Surviving partner* or one who remains after a partnership has been dissolved by the death of any partner (see Art. 1842.); and

(j) *Subpartner* or one who, not being a member of the partnership, contracts with a partner with reference to the latter's share in the partnership. (see Art. 1804.)

(2) *Other classifications.* — They have also been classified into:

(a) *Ostensible partner* or one who takes active part and known to the public as a partner in the business (see Art. 1834, par. 2.), whether or not he has an actual interest in the firm. Thus, he may be an actual partner or a nominal partner. If he is not actually a partner, he is subject to liability by the doctrine of estoppel (Art. 1825.);

(b) *Secret partner* or one who takes active part in the business but is not known to be a partner by outside parties nor held out as a partner by the other partners *(Ibid.)*, although he participates in the profits and losses of the partnership. He is an actual partner. He is also an active partner in the sense that he participates in the management of the partnership affairs;

(c) *Silent partner* or one who does not take any active part in the business although he may be known to be a partner. *(Ibid.)* Thus, he need not be a secret partner. If he withdraws from the partnership, he must give notice to those persons who do business with the firm to escape liability in the future;

(d) *Dormant partner* or one who does not take active part in the business and is not known or held out as partner. (see Art. 1834, par. 2.) He would be both a silent and a secret

partner. He would be both a secret and a silent partner. He may retire from the partnership without giving notice and cannot be held liable for obligations of the firm subsequent to his withdrawal. His only interest in joining the partnership would be the sharing of the profits earned.

The term is used as synonymous with "sleeping partner" (68 C.J.S. 404.);

(e) *Original partner* or one who is a member of the partnership from the time of its organization;

(f) *Incoming partner* or a person lately, or about to be, taken into an existing partnership as a member (68 C.J.S. 404; see Arts. 1826, 1828.); and

(g) *Retiring partner* or one withdrawn from the partnership; a withdrawing partner. (68 C.J.S. 404-405; see Arts. 1840, 1841.)

All partners in any of these six classes are subject to liability for all partnership obligations. (see Arts. 1816, 1822-1824, 1826, 1835, 1844, 1841.)

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 they may acquire therewith. (1673)

ART. 1779. In a universal partnership of all present property, the property which belongs 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. (1674a)

Universal partnership of all present property explained.

A *universal partnership of profits* is one which comprises all that the partners may acquire by their industry or work during the existence of the partnership and the usufruct[29] of movable or immovable property which each of the partners may possess at the time of the celebration of the contract.

In this kind of partnership, the following become the common property of all the partners:

(1) Property which belonged to each of them at the time of the constitution of the partnership; and

(2) Profits which they may acquire from the property contributed.

EXAMPLE:

A and B are partners in a partnership known as X & Co. They agreed that they would contribute all their properties to a common fund for the purpose of dividing the same between themselves, as well as the profits to be derived therefrom. A contributed all his properties consisting of two big parcels of agricultural land and a tractor. B contributed also his properties consisting of P100,000.00 cash and farm implements.

The partnership formed by the contract of A and B is a universal partnership of all present property.

Contribution of future property.

As a general rule, future properties cannot be contributed. The very essence of the contract of partnership that the properties contributed be included in the partnership requires the contribution of things determinate. The position of a partner is like that of a donor, and donations cannot comprehend future prop-

[29]Art. 562. Usufruct gives a right to enjoy the property of another with the obligation of preserving its form and substance, unless the title constituting it or the law otherwise provides. (467)

erty. (Art. 751.) Thus, property subsequently acquired by (1) inheritance, (2) legacy, or (3) donation cannot be included by stipulation except the fruits thereof. Hence, any stipulation including property so acquired is void.

Profits from other sources (not from the properties contributed) will become common property only if there is a stipulation.

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)

Universal partnership of profits explained.

A *universal partnership of profits* is one which comprises all that the partners may acquire by their industry or work during the existence of the partnership and the usufruct of movable or immovable property which each of the partners may possess at the time of the celebration of the contract.

(1) *Ownership of present and future property.* — It is to be noted that in this class of partnership, the partners retain their ownership over their present and future property. What passes to the partnership are the profits or income and the use or usufruct of the same. Consequently, upon the dissolution of the partnership, such property is returned to the partners who own it. (11 Manresa 303.)

EXAMPLE:

In the preceding example, if the agreement of A and B is that they would retain the ownership over their respective properties, only their usufruct being transferred to partnership X & Co., and that they would divide equally the net profits realized during the existence of the partnership, then the partnership formed is a universal partnership of profits.

Upon the dissolution of the partnership, the properties shall be returned to the respective owners. The amount of P100,000 contributed by B shall be paid to him as a loan to the partnership.

(2) *Profits acquired through chance.* — Since the law speaks only of profits which the partners may acquire by their industry or work, it follows that profits acquired by the partners through chance, such as lottery or by lucrative title without employment of any physical or intellectual efforts, are not included.

(3) *Fruits of property subsequently acquired.* — In view of paragraph 2, fruits of property subsequently acquired by the partners do not belong to the partnership. Such profits may, however, be included by express stipulation. But profits which the partners may acquire by their industry or work during the existence of the partnership as well as the usufruct of their present properties belong to the partnership as a matter of right. An express stipulation is necessary to exclude any of them. (11 Manresa 308-310.)

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

Presumption in favor of universal partnership of profits.

Where the articles of partnership do not specify the nature of the partnership, whether it is one of "present property" or of "profits" only, it will be presumed that the parties intended merely a partnership of profits. The reason for this presumption is that a universal partnership of profits imposes less obligations on the partners,[30] since they preserve the ownership of their separate property.

[30]Art. 1378. When it is absolutely impossible to settle doubts by the rules established in the preceding articles, and the doubts refer to incidental circumstances of a gratuitous contract, the least transmission of rights and interests shall prevail. If the contract is onerous, the doubt shall be settled in favor of the greatest reciprocity of interests. x x x.

It is to be noted that this article applies only when a universal partnership has been organized.

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

Limitations upon the right to form a partnership.

Persons who are prohibited by law to give donations cannot enter into a universal partnership for the reason that each of the partners virtually makes a donation. To allow persons who are prohibited to give each other any donation or advantage to form a universal partnership will be like permitting them to do indirectly what the law expressly prohibits.

A partnership formed in violation of this article is null and void. (Art. 1409[7].) Consequently, no legal personality is acquired.

A husband and his wife, however, may enter into a particular partnership or be members thereof. (see Commissioner of Internal Revenue vs. Suter, 27 SCRA 152 [1969].)

ILLUSTRATIVE CASE:

In a particular partnership composed of three members, two of the partners got married and the third partner subsequently sold, for a nominal amount, his share to them.

Facts: A, B, and C formed a limited partnership to engage, among other activities, in the importation, marketing and operation of automatic phonographs, radios, television sets and amusement machines, their parts and accessories, with B and C as limited partners. Subsequently, A and B got married and, thereafter, C sold his share to A and B. For a taxable year, A and B filed a separate income return for the limited partnership and a consolidated return for them as spouses.

The Commissioner of Internal Revenue consolidated the income of the firm and the individual income of the partners

resulting in the determination of a deficiency income tax. A and B protested the assessment. The issues are:

Issues: (1) Whether or not the separate personality of the partnership should be disregarded for income tax purposes considering that A and B actually formed a single taxable unit; and

(2) Whether or not the partnership was dissolved after the marriage of A and B and the subsequent sale to them by C of the latter's participation for the amount of P1.00.

Held: (1) *Partners retained their separate interests.* — The view that by the marriage of A and B the company became a single proprietorship is erroneous. Their capital contributions were separately owned and contributed by them before their marriage; and after they were joined in wedlock, such contributions remained their respective separate property. (see Art. 148[1], Civil Code.[31]) Thus, the individual interest of A and B did not become common property of both after their marriage. The change in the membership of the firm is no ground for withdrawing the partnership from the coverage of Section 24 of the National Internal Revenue Code requiring it to pay income tax. A and B did not enter into matrimony and thereafter buy the interests of C with the premeditated scheme or design to use the partnership as a business conduit to dodge the tax laws.

(2) *Partnership, a particular one.* — The firm was not a universal partnership, but a particular one. It follows that the partnership was not one that A and B were forbidden to enter under Article 1677. (now Art. 1782.) Nor could the subsequent marriage of the partners operate to dissolve it, such marriage not being one of the causes provided for that purpose by law. *(Commissioner of Internal Revenue vs. Suter, supra.)*

In connection with Article 1782, the following provisions must be noted:

"Art. 87. Every donation or grant of gratuitous advantage, direct or indirect, between the spouses during the marriage shall be void, except moderate gifts, which the spouses may

[31]Now, Art. 109, Family Code.

give to each other on the occasion of any family rejoicing. The prohibition shall also apply to persons living together as husband and wife without a valid marriage." (Family Code.)

"Art. 739. The following donations shall be void:

(1) Those made between persons who were guilty of adultery or concubinage at the time of the donation;

(2) Those made between persons found guilty of the same criminal offense, in consideration thereof;

(3) Those made to a public officer or his wife, descendants and ascendants, by reason of his office.[32]

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 the donee may be proved by preponderance of evidence in the same action." (Civil Code.)

In order that Article 739 may apply, it is not required that there be a previous conviction for adultery or concubinage. This can be inferred from the clause that "the guilt of the donor and the donee may be proved by preponderance of evidence." (The Insular Life Assurance Co., Ltd. vs. Ebrado, 80 SCRA 181 [1977].)

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)

Particular partnership explained.

The above article defines a particular partnership. In other words, it is a partnership which is neither a universal partnership of present property nor a universal partnership of profits.

The fundamental difference between a universal partnership and a particular partnership lies in the scope of their subject matter or object. In the former, the object is vague and indefinite, contemplating a general business with some degree of continuity,

[32]There seems to be no reason why the prohibition should not also apply to the husband of a public officer.

while in the latter, it is limited and well-defined, being confined to an undertaking of a single, temporary, or *ad hoc* nature.

Examples of particular partnerships are those formed for the acquisition of an immovable property for the purpose of reselling it at a profit or for the common enjoyment of its use and the benefits derived therefrom, or those established for the purpose of carrying out a specific enterprise such as the construction of a building, or those formed for the practice of a profession or vocation. (11 Manresa, 318-319.) Hence, two or more persons as accountants associating themselves in the practice of accountancy or two or more lawyers in the practice of law form a particular partnership. "A firm engaged, among other activities, in the importation, marketing, distribution and operation of automatic phonographs, radios, television sets and amusement machines, their parts and accessories" is a particular partnership. (Commissioner of Internal Revenue vs. Suter, *supra.*)

Business of partnership need not be continuing in nature.

It may be inferred from Articles 1767 and 1783 that the carrying on of a business of a continuing nature is not essential to constitute a partnership. An agreement to undertake a particular piece of work or a single transaction or a limited number of transactions and immediately divide the resulting profits would seem to fall within the meaning of the term "partnership" as used in the law.

(1) *Rule under American law.* — The above is not true under the Uniform Partnership Act which defines a partnership as "an association of two or more persons to carry on as co-owners a business for profit" (Sec. 6 thereof.) and states that "business includes every trade, occupation, or profession." (Sec. 2 thereof.)

The word "business," as used in the Act, clearly means business in the commercial sense only, not merely "a joint venture" which exists for carrying on a single act or isolated transaction or a limited number of transactions. Thus, a distinction exists between a joint venture, a legal concept of common law origin, on which the members are interested only in a single transaction,

and is thus of a temporary nature although the business of conducting it may continue for a number of years, and a partnership in which the members (partners) are interested in carrying on together of a general and continuing business of a particular kind.

(2) *Joint venture.* — Sometimes called "joint adventure" or "joint enterprise" in American law, it is essentially a partnership created for a limited purpose. While a joint venture is not a formal partnership in the legal or technical sense, both are governed, subject to certain qualifications, practically by the same rules or principles of partnership.[33] This is logical since in a joint venture, like in a partnership, there is a community of interest in the business and a mutual right of control and an agreement to share jointly in profits and losses resulting from the enterprise.

The usual rules as regards the construction and operation of contracts generally apply to a contract of a joint venture. (Aurbach vs. Sanitary Wares Manufacturing Corp., 180 SCRA 130 [1989]; Litonjua, Jr. vs. Litonjua, Sr., 477 SCRA 576 [2005]; see Philex Mining Corp. vs. Comm. of Internal Revenue, 551 SCRA 428 [2008].)

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[33]A particular partnership has been distinguished from a joint adventure, to wit:

(a) A joint adventure (an American concept similar to our *joint accounts*) is a sort of informal partnership, with no firm name and no legal personality. In a joint account, the participating merchants can transact business under their own name, and can be *individually liable* therefor.

(b) Usually, but not necessarily, a joint adventure is limited to a SINGLE TRANSACTION, although the business of pursuing to a successful termination may continue for a number of years; a partnership *generally* relates to a continuing business of various transactions of a certain kind.

A joint venture "presupposes generally a parity of standing between the joint coventures or partners, in which each party has an equal proprietary interest in the capital or property contributed, and where each party exercises equal rights in the conduct of the business. (Heirs of Tan Eng Kee vs. Court of Appeals, 341 SCRA 740 [2000].) Nonetheless, in *Aurbach (supra.),* the Supreme Court expressed the view that a joint venture may be likened to a particular partnership. (see Primelink Properties & Development Corp. vs. Lazatin-Magat, 493 SCRA 444 [2006].)

Kilosbayan vs. Guingona (232 SCRA 110 [1994].) defines a *joint venture* as "an association of persons or companies jointly undertaking some commercial enterprise; generally, all contribute assets and share risks. It requires a community of interest in the performance of the subject matter, a right to direct and govern the policy in connection therewith, and [a] duty which may be altered by agreement to share both in profits and losses." (see Information Technology Foundation vs. Commission on Elections, 419 SCRA 141 [2004].)

(3) *Corporation as a partner.* — While under the Philippine Civil Code, a joint venture is a form of partnership with a legal personality separate and distinct from the parties composing it, and should thus be governed by the law of partnership, the Supreme Court has, however, recognized a distinction between these two business forms, and has held that although a corporation cannot enter into a partnership contract, it may, however, engage in a joint venture with others (Tuazon vs. Bolanos, 95 Phil. 906 [1954].) through a contract or agreement if the nature of the venture is authorized by its charter. (SEC Opinion, April 29, 1985.)

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Chapter 2

OBLIGATIONS OF THE PARTNERS

SECTION 1. — *Obligations of the Partners Among Themselves.*

Relations created by a contract of partnership.

A contract of partnership gives rise to at least four distinct juridical relations, namely:

(1) Relations among the partners themselves;

(2) Relations of the partners with the partnership;

(3) Relations of the partnership with third persons with whom it contracts; and

(4) Relations of the partners with such third persons.

EXAMPLE:

If A and B formed a partnership called X & Co., and it transacts business with Y, a third person, the relations created will be as follows: relations between A and B; relations between A and B on the one hand and X & Co. on the other hand; relations between X & Co. and Y, and relations between A and B on the one hand and Y on the other hand.

Rights and obligations, in general, of partners inter se.

(1) *Partnership relationship essentially one of mutual trust and confidence.* — The partnership relationship is essentially one of

mutual trust and confidence, and the law imposes upon the partners highest standards of integrity and good faith in their dealings with each other for the benefit of the partnership.

(a) Each partner is, in one sense, a trustee and at the same time, a *cestui que trust*. He is a trustee to the extent that his duties bind him with respect to his co-partners and the partnership, and a *cestui que trust* as far as the duties that rest on his co-partners. (Allen vs. Steinberg, 223 A.d. 240.) This relationship is as much the same as the one existing between the principal and agent because, technically, the partnership is the principal and each partner is an agent of the partnership and every other partners with respect to partnership affairs.

(b) The many particular rights and duties to each other are, in reality, but aspects of the broad fiduciary relation. These particular duties are expressly defined by law subject to any modifying agreement between the partners themselves (40 Am. Jur. 137, 208.), though its provisions will not in many cases be effective as to third persons dealing with the partnership.

(2) *Fiduciary relationship remains until partnership terminated.* — The relation of trust applies also to matters concerned with the formation of the partnership (Art. 1807.), and when a partnership is dissolved, the assets of the partnership must still be managed in accordance with this fiduciary principle. The obligation of partners to act with the utmost candor and good faith in their dealings between themselves is not lessened by the existence of strained relations between them or the existence of any condition which might in and of itself justify the firm's dissolution. The fiduciary obligation of a partner remains until the relationship is terminated (Fouchek vs. Janicek, 225 P. 2d 783; Johnson vs. Peckham, 120 S.W. 2d 786.) and the equities between the partners adjusted and satisfied.

(3) *Relationship in a limited partnership.* — The rights and obligations of the partners as to each other are provided on the theory that a partner is both a principal and an agent in relation to his co-partners. (see Art. 1818.) But the relationship between a limited partner and the other partners in a limited partnership

does not involve the element of trust and confidence, as in the case of a general partnership. (see Art. 1866.)

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

Commencement and term of partnership.

(1) A partnership is a consensual contract; hence, it exists from the moment of the celebration of the contract by the partners.[1] (see Art. 1315.) Since under Article 1784, a partnership commences from the time of execution of the contract if there is no contrary stipulation as to the date of effectivity of the same, its registration in the Securities and Exchange Commission is not essential to give it juridical personality.

(2) The birth and life of a partnership is predicated on the mutual desire and consent of the parties. (see Ortega vs. Court of Appeals, 245 SCRA 529 [1995].) Unlike a corporation, no time limit is prescribed by law for the life of partnership. Hence, the partners may fix in their contract any term and they shall be bound to remain under such a relation for the duration of the term barring the occurrence of any of the events causing dissolution of the partnership before its expiration. (Arts. 1830-1831.)

Rules governing partnership relation.

What is necessary for the existence of a partnership is that the essential requisites of a contract of partnership are present even when the partners have not yet actually begun the carrying on of its business or given their contributions, or even though its conditions or details, such as the participation of the partners in the profits and losses and the nature of the partnership, have not yet been fixed, as they pertain to the accidental and not to the essential parts of the contract.

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[1]A general partnership, as distinguished from a limited partnership (see Art. 1843.), may result from an oral contract except those partnerships by the terms of the agreement are to be formed by the parties for more than one (1) year from the making thereof, in which case the partnership agreement must be in writing as required by the Statute of Frauds. (Art. 1403[2, a].)

Where a partnership relation results, the law itself fixes the incidents and consequences of this relation *(supra.)* if the parties fail to do so. (Fernandez vs. De la Rosa, 1 Phil. 671 [1902].) This is true although the parties thereto actually call their relation something other than a partnership or even go as far as to state expressly that they are not partners.

Executory agreement of partnership.

The above rule on the commencement of a partnership is not absolute.

(1) *Future partnership.* — The partners may stipulate some other date for the commencement of the partnership. Persons who have entered into a contract to become partners at some future time or on the happening of some future contingency do not become partners until or unless the agreed time has arrived or the contingency has happened. As long as the agreement for a partnership remains inchoate or unperformed, the partnership is not consummated. (68 C.J.S. 418; Urra vs. Ponce, [C.A.] 59 O.G. 244.)

Hence, there can be a future partnership which at the moment has no juridical existence yet. In the absence of express stipulation, evidence is admissible to show the commencement date as determined by the words, acts or conduct of the parties. Incidentally, the Statute of Frauds provides that an agreement that by its terms is not to be performed within a year from the making thereof, must be in writing and signed by the party charged in order to be enforceable. (Art. 1403[2, a].)

(2) *Agreement to create partnership.* — There is a marked distinction between a partnership actually consummated and an agreement to enter into a contract of partnership at a future time. A partnership in fact cannot be predicated on an agreement to enter into a co-partnership at a future day unless it is shown that such an agreement was actually consummated. So long as the agreement remains executory the partnership is inchoate, not having called into being by the concerted action necessary under the partnership agreement. (40 Am. Jur. 142.)

The death of either party to an executory agreement of partnership prevents the formation of a firm, since such agreement is based on the continuance of the life of each. (68 C.J.S. 419.)

(3) *Failure to agree on material terms.* — A failure of the parties to agree on material terms may not merely be evidence of the intent of the parties to be bound only in the future, but may prevent any rights or obligations from arising on either side for lack of complete contract. (7 C.J.S. 391; Limuco vs. Calinao, [C.A.] No. 10099-R, Sept. 30, 1953.)

Article 1784 must be read in relation to Articles 1771 and 1773.

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)

Continuation of partnership beyond fixed term.

A *partnership with a fixed term* is one in which the term of its existence has been agreed upon expressly (as when there is a definite period) or impliedly (as when a particular enterprise or transaction is undertaken). The expiration of the term thus fixed or the accomplishment of the particular undertaking specified (or the demonstration of the impossibility of its accomplishment) will cause the automatic dissolution of the partnership. (Art. 1830[1, a].)

(1) *Rights and duties of partners.* — The partnership, however, may be extended or renewed by the partners by express

agreement, written or oral, or impliedly, by the mere continuation of the business after the termination of such term or particular undertaking without any settlement or liquidation. In such case, the rights and duties of the partners remain the same as they were at such termination but only insofar as is consistent with a partnership at will. (See Art. 1776.)

In other words, with such continuation, the partnership for a fixed term or particular undertaking is dissolved and a new one, a partnership at will, is created by implied agreement the continued existence of which will depend upon the mutual desire and consent of the partners. Thus, for example, the manner of management and profit-sharing ratio originally agreed upon shall still govern but the partnership having become a partnership at will may be lawfully terminated at any time by the express will of all the partners or any of them. (see Art. 1830[1, b, c].)

(2) *Dissolution of partnership.* — Verily, any one of the partners may, at his sole pleasure, dictate a dissolution of a partnership at will. He must, however, act in good faith not that the attendance of bad faith can prevent the dissolution of the partnership (see Art. 1830[1, b].) but that can result in a liability for damages to the other partners. (Art. 1830[2]; see Art. 1837, par. 2; Ortega vs. Court of Appeals, 245 SCRA 529 [1995].) Implicit in good faith is the requirement that the dissolution must not be made at an improper or unreasonable time.

Even a partnership for a fixed term may likewise be terminated by the express will of any partner before the time mentioned. (Art. 1830[2].) There is no such thing as an indissoluble partnership.

Continuation of partnership for an indefinite term.

(1) *Partnership for a term impliedly fixed.* — Although the term of a partnership is not expressly fixed, an agreement of the parties may evidence an understanding that the relation should continue until the accomplishment of a particular undertaking or certain things have been done or have taken place.

(a) When a partner advances a sum of money to a partnership with the understanding that the amount contributed

is to be loaned to the partnership and is to be repaid as soon as feasible from the prospective profits of the business, the partnership is for the term reasonably required to repay the loan. The partners may impliedly agree to continue in business until a certain sum of money is earned, or one or more partners recoup their investment, or until certain debts are paid, or until certain property could be disposed of on favorable terms.

In each of these cases, however, the implied agreement must be proved.

(b) In each of the following cases the court properly held that the partners' implied promise was to continue the partnership for a term reasonably required to allow the partnership to earn sufficient money to accomplish the understood objective:

1) where the partners borrowed substantial amounts of money to launch an enterprise and there was an understanding that the loans would be repaid from partnership profits (Owen vs. Owen, 119 P. 2d 713.);

2) where one partner loaned his co-partner money to invest in the partnership with the understanding that the money would be repaid from partnership profits (Vangel vs. Vangel, 254 P. 2d 919.);

3) where one partner contributed all the capital, the other contributed his services, and it was understood that upon the repayment of the contributed capital from partnership profits the partner who contributed his services would receive a one-third interest in the partnership assets (Mervyn Investment Co. vs. Beber, 194 P 1037.); and

4) where the parties entered into a joint venture to build and operate a motel until it could be sold upon favorable and mutually satisfactory terms. (Shannon vs. Hudson, 325 P. 2d 1022.)

(2) *Partnership with mere expectation that business will be profitable.* — Where the understanding to which defendant (the

partner who contended that the partnership created was for a term) testified was no more than a common hope that the partnership earnings would pay for all the necessary expenses, such a hope does not establish even by implication a "fixed term or particular undertaking" as required by Article 1785. The mere expectation that the business would be successful and that the partners would be able to recoup their investment is not sufficient to create a partnership for a term. All partnerships are ordinarily entered into with the hope or expectation that they will be profitable, but that alone does not make them all partnerships for a term and obligate the partners to continue in the partnership until all the losses over a period of many years may have been recovered. (Cohen vs. Cohen, 119 P. 2d 713.)

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)

Obligations with respect to contribution of property.

The above article deals with the obligations of the partners among themselves and to the partnership with respect to contribution of property. They are as follows:

(1) To contribute at the beginning of the partnership or at the stipulated time the money, property, or industry which he may have promised to contribute;

(2) To answer for eviction in case the partnership is deprived of the determinate property contributed; and

(3) To answer to the partnership for the fruits of the property the contribution of which he delayed, from the date they should have been contributed up to the time of actual delivery.

In addition, the partner has the obligation:

(4) To preserve said property with the diligence of a good father of a family pending delivery to the partnership (Art. 1163.); and

(5) To indemnify the partnership for any damage caused to it by the retention of the same or by the delay in its contribution. (Arts. 1788, 1170.)

The money or property contributed by a partner becomes the property of the partnership. It necessarily follows that the same cannot be withdrawn or disposed of by the contributing partner without the consent or approval of the partnership or of the other partners. (Lozana vs. Depakakibo, 107 Phil. 728 [1960].)

Effect of failure to contribute property promised.

The mutual contribution to a common fund being of the essence of the contract of partnership (Art. 1767.), for without the contributions the partnership is useless, it is but logical that the failure to contribute is to make the partner *ipso jure* a debtor of the partnership even in the absence of any demand. (see Art. 1169[1].)

Under this article, the remedy of the other partner or the partnership is not rescission but an action for specific performance (to collect what is owing) with damages and interest from the defaulting partner from the time he should have complied with his obligation. (Art. 1788.) Article 1191, which refers to resolution of reciprocal obligations in general, is not applicable. Articles 1786 and 1788 specifically refer to the contract of partnership in particular; and it is a well-known principle that special provisions prevail over general provisions. (Sancho vs. Lizaraga, 55 Phil. 60 [1930]; see, however, Uy vs. Puzon, 79 SCRA 598 [1977], cited under Art. 1788.)

Article 1838, however, allows rescission or annulment of a partnership contract on the ground of fraud or misrepresentation committed by one of the parties thereto.

Liability of partner in case of eviction.

The partner is bound in the same cases and in the same manner as the vendor is bound with respect to the vendee with regard to specific and determinate things which he may have contributed to the partnership. This matter is, therefore, governed by the law on sales.

Under the law on sales, *eviction* shall take place whenever by a final judgment based on a right prior to the sale or an act imputable to the vendor, the vendee is deprived of the whole or a part of the thing purchased.[2] This obligation of warranty in case of eviction is in consequence of the character of the contract of partnership which is an onerous contract. (Art. 1767.)

Liability of partner for fruits of property in case of delay.

Here, again, no demand is necessary to put the partner in default.

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[2]Art. 1547. In a contract of sale, unless a contrary intention appears, there is:

(1) An implied warranty on the part of the seller that he has a right to sell the thing at the time when the ownership is to pass, and that the buyer shall from that time have and enjoy the legal and peaceful possession of the thing;

(2) An implied warranty that the thing shall be free from any hidden faults or defects, or any charge or encumbrance not declared or known to the buyer.

This article shall not, however, be held to render liable a sheriff, auctioneer, mortgagee, pledgee, or other person professing to sell by virtue of authority in fact or law, for the sale of a thing in which a third person has a legal or equitable interest. (n)

Art. 1548. Eviction shall take place whenever by a final judgment based on a right prior to the sale or an act imputable to the vendor, the vendee is deprived of the whole or of a part of the thing purchased.

The vendor shall answer for the eviction even though nothing has been said in the contract on the subject.

The contracting parties, however, may increase, diminish, or suppress this legal obligation of the vendor. (1475a)

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Art. 1557. The warranty cannot be enforced until a final judgment has been rendered, whereby the vendee loses the thing acquired or part thereof. (1480)

Art. 1558. The vendor shall not be obliged to make good the proper warranty, unless he is summoned in the suit for eviction at the instance of the vendee. (1481a)

From the mere fact that the property which a partner ought to deliver does not pass to the common fund on time, the partnership fails to receive the fruits or benefits which the said contribution produced as well as those it ought to produce, thus prejudicing the common purpose of obtaining from them the greatest possible profits through some means of speculation or investment. The injury, therefore, to the partnership is constant. (see 11 Manresa 332-335.)

Liability of partner for failure to perform service stipulated.

Is a partner who fails to perform the personal services which he has stipulated to render to the partnership, liable to the other partners for the value of the services?

(1) *Partner generally not liable.* — Unless there is a special agreement to that effect, the partners are not entitled to charge each other, or the partnership of which they are members, for their services in the firm business. The doctrine seems to be that every partner is bound to work to the extent of his ability for the benefit of the whole, without regard to the services of his co-partners, however unequal in value or amount, and to require a partner to account for the value of his services would be, in effect, allowing compensation to the other members of the partnership for the services they rendered.[3]

(2) *Exception.* — The general rule that partners are not entitled to compensation for their services is inapplicable where the reason of it fails.

(a) If a partner neglects or refuses, without reasonable cause, to render the service which he agreed to perform by reason of which the partnership suffered loss, no good reason can be suggested why the erring partner should not be just as responsible for the breach of his agreement to render personal service to the partnership as for the breach of any other stipulation in the partnership contract. (Marsh's Appeal, 69 Pa. St. 30.)

[3]See "Compensation for services rendered" under Article 1800.

(b) If the partner is compelled to make good the loss, each member of the firm, including himself, will receive his proportion of the amount in the distribution of the partnership assets, and in no just sense can this be regarded as compensation for the services individually rendered. The proper measure of damages in such case is the value of the services wrongfully withheld. *(Ibid.)*

(c) If under the circumstances of the case the proper measure of the damages or loss (which may include unrealized profits) is the value of the services wrongfully withheld, then the defendant should be charged this value. If the defendant had made profit by engaging in other business in violation of the contract, he is liable to account for the same. *(Ibid.)*

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)

Appraisal of goods or property contributed.

(1) The appraisal of the value of the goods contributed is necessary to determine how much has been contributed by the partners. In the absence of an stipulation, the share of each partner in the profits and losses is in proportion to what he may have contributed. (Art. 1797.)

The appraisal is made, firstly, in the manner prescribed by the contract of partnership; secondly, in the absence of stipulation, by experts chosen by the partners and according to current prices.

After the goods have been contributed, the partnership bears the risk or gets the benefit of subsequent changes in their value.

(2) In the case of immovable property, the appraisal is made in the inventory of said property (see Arts. 1773, 1795.); otherwise,

it may be made as provided in Article 1787. There is no reason why the rule in Article 1787 should not also apply with respect to other kinds of property.

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)

Obligations with respect to contribution of money and money converted to personal use.

This article contemplates two distinct cases. The first paragraph refers to money promised but not given on time and the second, to partnership money converted to the personal use of the partner.

The following are the obligations of the partners with respect to the partnership capital under Article 1788:

(1) To contribute on the date due the amount he has undertaken to contribute to the partnership;

(2) To reimburse any amount he may have taken from the partnership coffers and converted to his own use;

(3) To pay the agreed or legal interest, if he fails to pay his contribution on time or in case he takes any amount from the common fund and converts it to his own use; and

(4) To indemnify the partnership for the damages caused to it by the delay in the contribution or the conversion of any sum for his personal benefit.

Liability of guilty partner for interest and damages.

The guilty partner is liable for interest and damages not from the time judicial or extrajudicial demand is made but from the

time he should have complied with his obligation or from the time he converted the amount to his own use, as the case may be. Unless there is a stipulation fixing a different time, this obligation of a partner to give his promised contribution arises from the commencement of the partnership, that is, upon perfection of the contract.

This double responsibility of the partner is an exception to the general rule in damages that in obligations consisting in the payment of a sum of money, the indemnity for damages shall be only the payment of interest agreed upon or, in the absence of stipulation, the legal interest.[4] (Art. 2209.) It is in harmony with the principle laid down in Article 1794 that every partner is responsible to the partnership for damages[5] suffered by it through his fault and is justified by the nature of the contract of partnership.

In a case, a partner in a construction venture, who, contrary to the terms of the partnership, failed to contribute his share in the capital of the partnership, was ordered by the court to reimburse his co-partner whatever amount the latter invested in or spent for the partnership on account of the construction projects. (Uy vs. Puzon, 79 SCRA 598 [1977]; see Moran, Jr. vs. Court of Appeals, 133 SCRA 88 [1984].)

Liability of partner for failure to return partnership money received.

(1) *Where fraudulent misappropriation committed.* — A partner is guilty of estafa (Art. 315, Revised Penal Code.) if he misappropriates partnership money or property received by him for a specific purpose of the partnership. (Liwanag vs. Court of Appeals, 281 SCRA 1225 [1997].)

(2) *Where there was mere failure to return.* — The mere failure on the part of an industrial partner to return to the capitalist

[4]Now 12%.

[5]Under Article 2200 of the Civil Code, 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. In other words, *lucrum lessans* is also a basis for indemnification. (Uy vs. Puzon, 79 SCRA 598 [1977].)

partner the capital brought by him into the partnership is not an act constituting the crime of estafa. The money having been received by the partnership, the business commenced and profits accrued, the action that lies with the partner who furnished capital for the recovery of his money is a civil one arising from the partnership contract for a liquidation of the partnership and a levy on its assets if there should be any. (U.S. vs. Clarin, 17 Phil. 84 [1910]; see also People vs. Alegre, 48 O.G. 534 [1952].)

In this case, there was mere failure on the part of the industrial partner to liquidate partnership affairs and to account to persons interested the amounts respectively due them. A partner is guilty of estafa if he fraudulently appropriates partnership property delivered to him, with specific directions to apply it to partnership purposes. (People vs. Campos, *supra*.)

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)

Obligations of industrial partner.

An *industrial partner* is one who contributes his industry, labor, or services to the partnership. He is considered the owner of his services, which is his contribution to the common fund. (Limuco vs. Calina, [C.A.] No. 10099-R, Sept. 9, 1953, citing Padilla's Civil Code, pp. 225-226, Vol. 3, 1951 ed.)

Unless the contrary is stipulated, he becomes a debtor of the partnership for his work or services from the moment the partnership relation begins. In effect, the partnership acquires an exclusive right to avail itself of his industry. Consequently, if he engages in business for himself, such act is considered prejudicial to the interest of the other partners.

An action for specific performance to compel the partner to perform the promised work or service is not available as a

remedy because this will amount to involuntary servitude which, as a rule, is prohibited by the Constitution. (Art. III, Sec. 18[2] thereof.)

Prohibition against engaging in business.

(1) *As regards an industrial partner.* — The prohibition is absolute and applies whether the industrial partner is to engage in the same business in which the partnership is engaged or in any kind of business. It is clear that the reason for the prohibition exists in both cases, which is to prevent any conflict of interest between the industrial partner and the partnership and to insure faithful compliance by said partner with his prestation. (Evangelista & Co. vs. Abad Santos, 51 SCRA 416 [1973].)

(2) *As regards capitalist partners.* — The prohibition extends only to any operation which is of the same kind of business in which the partnership is engaged unless there is a stipulation to the contrary. (Art. 1808.)

Remedies where industrial partner engages in business.

If the industrial partner engages in business for himself, without the express permission of the partnership, the capitalist partners have the right either to exclude him from the firm or to avail themselves of the benefits which he may have obtained. In either case, the capitalist partners have a right to damages. Note that the permission given must be express; hence, mere toleration by the partnership will not exempt the industrial partner from liability.

Although the law mentions only the capitalist partners, it is believed that industrial partners are also entitled to the remedy granted since they are equally prejudiced by the act of their co-partner engaging in business for himself.

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

Extent of contribution to partnership capital.

The partners can stipulate the contribution of unequal shares to the common fund, but in the absence of such stipulation, the presumption is that their contribution shall be in equal shares. This principle is just and reasonable and is consistent with the rule that partners are deemed to have equal rights and obligations. (Art. 1770, par. 1.)

Obviously, the above rule is not applicable to an industrial partner unless, besides his services, he has contributed capital pursuant to an agreement to that effect. (see Art. 1797, par. 2.)

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)

Obligation of capitalist partner to contribute additional capital.

As a general rule, a capitalist partner is not bound to contribute to the partnership more than what he agreed to contribute but in case of an imminent loss of the business, and there is no agreement to the contrary, he is under obligation to contribute an additional share to save the venture. If he refuses to contribute, he shall be obliged to sell his interest to the other partners.

(1) *Requisites for application of rule.* — The following are the requisites before a capitalist partner may be obliged to sell his interest to the others:

(a) There is an imminent loss of the business of the partnership;

(b) The majority of the capitalist partners are of the opinion that an additional contribution to the common fund would save the business;

(c) The capitalist partner refuses deliberately (not because of his financial inability to do so), to contribute an additional share to the capital; and

(d) There is no agreement that even in case of an imminent loss of the business the partners are not obliged to contribute.

It is to be noted that the industrial partner is exempted from the requirement to contribute an additional share. Having contributed his entire industry, he can do nothing further.

(2) *Reason for the sanction.* — The refusal of the partner to contribute his additional share reflects his lack of interest in the continuance of the partnership. It would be unjust for him to remain and reap the benefits of the efforts of the others while he himself refuses to help. Hence, the law provides a remedy which, incidentally, is just to both parties since the partner who refuses to contribute is paid the value of his interest while the other partners are thereby relieved from the burden of continuing their association with him in the business.

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)

Obligation of managing partner who collects debt.

Where a person is separately indebted to the partnership and to the managing partner at the same time, any sum received

by the managing partner shall be applied to the two credits in proportion to their amounts, except where he received it for the account of the partnership, in which case the whole sum shall be applied to the partnership credit only.

(1) *Requisites for application of rule.* — The following are the requisites for the application of this article:

(a) There exist at least two debts, one where the collecting partner is creditor, and the other, where the partnership is the creditor;

(b) Both debts are demandable; and

(c) The partner who collects is authorized to manage and *actually* manages the partnership.

EXAMPLE:

A and B are partners in X and Co., with A as the managing partner. C is indebted to A in the sum of P2,000.00. C is also indebted to the partnership in the sum of P4,000.00. Both debts are demandable. A collects the amount of P1,500.00 from C.

If A issues a receipt to the effect that it is in payment of his (A's) credit, P500.00 will be applied only to his credit, the partnership being entitled to a proportionate amount of P1,000.00 in the payment made by C. But if A gives a receipt for the account only of the partnership credit, the amount of P1,500.00 will be fully applied to the latter.

(2) *Reason for applying payment to partnership credit.* — The law safeguards the interests of the partnership by preventing the possibility of their being subordinated by the managing partner to his own interest to the prejudice of the other partners. Good faith demands that the partner vested with the management of the partnership attend more to the interest of the partnership than to his own and he should not intentionally fail to effect the collection of the credit of the partnership in order to effect the collection of his own. (11 Manresa 351.)

The article does not apply where the partner who collects for his own credit only is not authorized to manage, for there can be no ground for suspicion that he may have acted improperly

to create an undue advantage to himself. However, where the manner of management has not been agreed upon and all the partners participate in the management of the partnership (see Art. 1803.), then every partner shall be considered a managing partner for purposes of Article 1792.

(3) *Right of debtor to application of payment.* — Under the second paragraph, the debtor is given the right to prefer payment of the credit of the partner if it should be more onerous to him in accordance with his right to application of payment. (Art. 1252.[6])

EXAMPLE:

In the example given above, if the obligation in favor of A bears 18% interest *per annum* while that in favor of the partnership is 16% interest *per annum*, the credit of A being more onerous or burdensome, the law allows C to prefer the payment of A's credit in case he so desires.

ART. 1793. A partner who has received, in whole or in part, his share of a partnership, 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)

Obligation of partner who receives share of partnership credit.

The case contemplated under this article is different from that referred to in Article 1792, which treats of two distinct credits, one in favor of the partnership and another in favor of the managing partner. In the present article, there is only one credit — credit in favor of the partnership. Furthermore, the present article applies whether the partner who receives his share of the partnership credit is authorized to manage or not.

[6]Art. 1252. He who has various debts of the same kind in favor of one and the same creditor, may declare at the time of making the payment, to which of them the same must be applied. Unless the parties so stipulate, or when the application of payment is made by the party for whose benefit the term has been constituted, application shall not be made as to debts which are not yet due.

(1) *Requisites for application of rule.* — The requisites for the application of this article are as follows:

(a) A partner has received, in whole or in part, his share of the partnership credit;

(b) The other partners have not collected their shares; and

(c) The partnership debtor has become insolvent.

EXAMPLE:

D owes partnership X and Co. P4,500.00. A, a partner, received a share of P1,500.00 ahead of B and C, the two other partners. When B and C were collecting from D, the latter was already insolvent.

In this case, even if A had given a receipt for his share only, he can be required to share the P1,500.00 with B and C.

(2) *Reason for imposing obligation to return.* — The debt of D becomes a bad debt. It would be unjust or unfair for A not to share in the loss with B and C or for him to obtain more and B and C, less. The above provision is based on the community of interest among the partners, which is one of the underlying principles of the contract of partnership. (11 Manresa 353; Art. 1770, par. 1.)

Credit collected after dissolution of the partnership.

Does the obligation of the partner to bring to the partnership capital what he has collected refer only to that collected during the existence of the partnership, or does it also refer to that collected after the dissolution of the same?

(1) *Obligation to bring amount collected to the partnership fund.* — For example, upon the dissolution of the partnership, a partnership credit is divided among the partners in such a manner that each partner assumes the responsibility of collecting the portion pertaining to him. One of them who is more diligent collects the share corresponding to him before the debtor becomes insolvent. May the other partners demand that he bring

to the partnership fund what he had been able to collect and that said amount so collected be divided among the partners in proportion to their respective shares?

Some commentators answer this question in the affirmative, basing their answer in the community and equality which ought to exist among all the partners.

(2) *Contrary view.* — Manresa and Ricci believed otherwise. Their reasons are:

> (a) It would not be just that he who has been diligent and collected his quota should suffer the consequence of the negligence of his associates, thus making him responsible for the default of the latter.
>
> (b) Upon the dissolution of the partnership, the tie that unites the partnership ceases. This being the case, the reason for the obligation disappears. Article 1793 presupposes that there exists a partnership capital. Upon the dissolution of the partnership and the return to each principal of what he contributed, the community of interest between them disappears altogether and it cannot be said that there is still a partnership capital or common property. If a common credit remains among the partners after the dissolution of the partnership, there would be among them a mere simple credit owned in common but not a partnership credit. (Espiritu and Sibal, *op. cit.*, citing 11 Manresa 352-353.)

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)

Obligation of partner for damages to partnership.

This article follows the general rule applicable to all contracts that any person guilty of negligence or fault in the fulfillment

of his obligation shall be liable for damages. (Art. 1170.) The partner's fault, however, must be determined in accordance with the nature of the obligation and the circumstances of the person, the time, and the place. (Art. 1173.)

Compensation of damages with profits earned for partnership by guilty partner.

(1) *Damages not generally subject to set-off.* — As a general rule, the damages caused by a partner to the partnership cannot be offset by the profits or benefits which he may have earned for the partnership by his industry.

(a) The partner has the obligation to secure benefits for the partnership. Hence, the profits which he may have earned pertain as a matter of law or right, to the partnership.

(b) He has also the obligation to exercise diligence in the performance of his obligation as a partner. Consequently, inasmuch as a partner is a debtor to the partnership for his industry, and at the same time is obliged to repair the injury which he might have occasioned through his fault, there can not be any compensation. Compensation requires that the negligent partner be both a creditor and a debtor of the partnership. (Art. 1278; 11 Manresa 356-357.)

Of course, the amount of insurance, if any, received by the partnership shall be deducted from the liability of the erring partner.

(2) *Exception.* — If unusual profits are realized through the extraordinary efforts of the partner at fault, the courts may equitably mitigate or lessen his liability for damages. This rule rests on equity. Note that even in this case, the partner at fault is not allowed to compensate such damages with the profits earned. The law does not specify as to when profits may be considered "unusual." The question depends upon the circumstances of the particular case.

ART. 1795. The risk of specific and determinate things, which are not fungible, contributed to the partnership so that only their use and fruits may be for the

common benefit, shall be borne by the partner who owns them.

If the things contributed are fungible, or cannot be kept without deteriorating, or if they were contributed to be sold, the risk shall be borne by the partnership. In the absence of stipulation, the risks 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. (1687)

Risk of loss of things contributed.

There are five cases contemplated by the present article for the determination of the risk of the things contributed to the partnership, namely:

(1) *Specific and determinate things which are not fungible where only the use is contributed.* — The risk of loss is borne by the partner because he remains the owner of the things (like car);

(2) *Specific and determinate things the ownership of which is transferred to the partnership.* — The risk of loss is for the account of the partnership, being the owner;

(3) *Fungible*[7] *things or things which cannot be kept without deteriorating even if they are contributed only for the use of the partnership.* — The risk of loss is borne by the partnership for evidently the ownership was being transferred since use is impossible without the things (*e.g.*, oil, wine) being consumed or impaired;

(4) *Things contributed to be sold.* — The partnership bears risk of loss for there cannot be any doubt that the partnership was intended to be the owner; otherwise, the partnership could not effect the sale; and

(5) *Things brought and appraised in the inventory.* — The partnership bears the risk of loss because the intention of the

[7]The more appropriate term is "consumable."

Art. 418. Movable property is either consumable or non-consumable. To the first class belong those movables which cannot be used in a manner appropriate to their nature without their being consumed; to the second class belong all the others. (337)

parties was to contribute to the partnership the price of the things contributed with an appraisal in the inventory. There is thus an implied sale making the partnership owner of the said things, the price being represented by their appraised value.

The above presuppose that the things contributed have been delivered actually or constructively to the partnership. Before delivery, the risk of loss is borne by the partner since he remains their owner. He is a debtor of the partnership for whatever he may have promised to contribute. (Art. 1786; see Arts. 712, 1164, 1262, 1263.) If the loss is due to the fault of any of the partners, he shall be liable for damages to the partnership in accordance with the provision of the preceding article.

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)

Responsibility of the partnership to the partners.

In the absence of any stipulation to the contrary, every partner is an agent of the partnership for the purpose of its business. (Art. 1818.) Hence, the partnership has the obligation to:

(1) refund amounts disbursed by the partner in behalf of the partnership plus the corresponding interest from the time the expenses are made (not from the date of demand). Here, the law refers to loans or advances made by a partner to the partnership other than capital contributed by him;

(2) answer for the obligations the partner may have contracted in good faith in the interest of the partnership business; and

(3) answer for risks in consequence of its management.

Being a mere agent, the partner is not personally liable, provided, however, that he is free from all fault (see Art. 1912.)

and he acted within the scope of his authority. (see Arts. 1897, 1898, 1910, par. 2.) But unlike an ordinary agent, he is not given the right of retention if he is not reimbursed or indemnified. (see Art. 1914.)

In the absence of an aggreement to the contrary, no partner is entitled to compensation for his services to the partnership without the consent of all the partners unless it can be implied from the circumstances that the parties intended a partner to receive additional compensation where the partner's work was beyond normal partnership functions. *(infra.)*

EXAMPLE:

The articles of a trading partnership composed of A, B, and C provides that any purchase in excess of P5,000.00 must first be approved by all the partners. This rule was strictly observed in all transactions of the partnership. C made a purchase of goods out of his personal funds for P7,000 without the knowledge of A and B. The partnership incurred a loss.

C is not entitled to be reimbursed for the purchase.

ILLUSTRATIVE CASE:

A partner seeks an accounting from the other partners who received from him money to be invested by them in a business.

Facts: A delivered P1,500.00 to B and C who, in a private document, acknowledged the receipt of the money with the agreement that "we are to invest the amount in a store, the profits and losses of which we are to divide with the former in equal shares." A filed a complaint to compel B and C to render an accounting of the partnership as agreed to.

Issue: From what date should the payment of interest be counted?

Held: Inasmuch as in this case nothing appears other than the failure to fulfill an obligation on the part of a partner who acted as agent in receiving money for a given purpose, for which he has rendered no accounting, such agent is responsible only for the losses which, by a violation of the law, he incurred. This being an obligation to pay in cash, there are no other losses than the legal interest which interest is not due except from the

time of the judicial demand (see Art. 2212.) or, in the present case, from the filing of the complaint.

Article 1796 is not applicable insofar as it provides that "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," for the reason that no other money than that contributed as capital is involved. *(Martinez vs. Ong Pong Co., 14 Phil. 726 [1909].)*

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)

Rules for distribution of profits and losses.

This article and the two succeeding ones regulate the distribution of profits and losses among the partners. They do not refer to the liability of the partners to third persons which is governed by Article 1816.

(1) *Distribution of profits:*

(a) The partners share the profits according to their agreement subject to Article 1799.

(b) If there is no such agreement:

1) The share of each capitalist partner shall be in proportion to his capital contribution. This rule is based on the presumed will of the partners.

2) The industrial partner shall receive such share, which must be satisfied first before the capitalist partners shall divide the profits, as may be just and equitable under the circumstances. The share of an industrial partner in the profits is not fixed, as in the case of the capitalist partners, as it is very difficult to ascertain the value of the services of a person. Under the Code of Commerce (Art. 140 thereof.), the industrial partner was "placed in the distribution in the same position as the capitalist partner having the smallest interest."

In a case, where two brothers engaged in a business venture, with one furnishing the capital and the other contributing his industry, the Supreme Court ruled that "Justice and equity dictate that the two share equally the fruit of their joint investment and efforts," because it was through the "industry and geniuses" of the industrial partner that the property of the venture was developed and improved into a valuable asset worth more than P22 million. (Ramnani vs. Court of Appeals, 196 SCRA 731 [1991].)

EXAMPLE:

A, B, and C formed a partnership, whereby each of them contributed P30,000.00. They agreed that should the partnership realize profits, the same shall be distributed in the following proportions:

A, as managing partner	40%
B	30%
C	30%

In this case, the partners shall share the profits in conformity with their agreement. If there is no agreement with respect to the share of each partner, then, they shall share the profits equally.

Suppose, the contributions of the partners are as follows:

A	P 72,000.00
B	48,000.00
C	24,000.00
Total	P144,000.00

In the absence of stipulation, the share of each of the partners shall be in proportion to his contribution, that is:

A	3/6
B	2/6
C	1/6

If D is an industrial partner, he shall receive such share as may be just and equitable under the circumstances. Assuming that the partnership makes a profit of P51,000.00, the partners may determine considering all the circumstances, that D, as industrial partner, is entitled to P6,000.00. The balance of P45,000.00 will be divided among A, B and C in proportion to their respective capital contributions: P22,500.00, P15,000.00 and P7,500.00, respectively.

Now, if D aside from his services, contributed P36,000, then he will also share in the balance of P45,000.00 in proportion to his contribution, which is 3/15 (P36,000.00/P180,000.00) or P9,000.00, while A, B, and C will share P18,000.00, P12,000.00 and P6,000.00, respectively.

A partner is entitled to receive only his share of the profits actually realized by the venture. Even when an assurance was made by a partner that they would earn a huge amount of profits, in the absence of fraud, the other partner cannot claim a right to recover the profits promised where the business was highly speculative and turned out to be a failure. Hidden risks in any business venture have to be considered. (Moran, Jr. vs. Court of Appeals, 133 SCRA 88 [1984].)

(2) *Distribution of losses:*

(a) The losses shall be distributed according to their agreement subject to Article 1799.

(b) If there is no such agreement, but the contract provides for the share of the partners in the profits, the share of each in the losses shall be in accordance with the profit-sharing ratio, but the industrial partner shall not be liable for losses. The profits or losses of the partnership cannot be determined by taking into account the result of one particular transaction but of all the transactions had.

(c) If there is also no profit-sharing stipulated in the contract, then losses shall be borne by the partners in proportion to their capital contributions, but the *purely* industrial partner shall not be liable for the losses.

EXAMPLE:

In the same example, the partners will share in the losses in conformity with their agreement. If they failed to agree as to the sharing of losses, the share of each partner in the losses shall be in the same proportion stipulated with regard to the share of each in the profits, to wit:

A	40%
B	30%
C	30%

If there is also no profit-sharing ratio stipulated, then the losses shall be divided in proportion to their capital contributions. D, however, being an industrial partner, shall not be liable for losses but the same shall be borne by A, B, and C, the capitalist partners. However, if D is also a capitalist partner, then he shall share in the losses in proportion to his contribution.

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

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

Designation by a third person of share in profits and losses.

(1) *Delegation to a third person.* — The designation of the share in the profits and losses may be delegated to a third person by common consent. This article speaks of a third person, not a

partner, following the general rule in contracts that the fulfillment of a contract cannot be left to the will of one of the contracting parties alone. (Arts. 1308, 1309.)

The prohibition in the second paragraph (Art. 1798.) is necessary to guarantee the utmost impartiality in the distribution of shares in the profits and losses. (11 Manresa 375.)

(2) *Binding force of designation by third person.* — The designation by the third person would generally be binding unless manifestly inequitable. Even then, a partner who has begun to execute the decision of the third person or who fails to impugn the same within three months from the time he had knowledge of it can no longer complain. In such case, the partner is guilty of estoppel or is deemed to have given his consent or ratification to the designation.

The reason behind the comparatively short period of three months within which to impugn the designation is to forestall any paralyzation in the operations of the partnership. *(Ibid.)*

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

Stipulation excluding a partner from any share in profits or losses.

(1) *Stipulation generally void, but partnership subsists.* — The law does not, as a general rule, allow a stipulation excluding one or more partners from any share in the profits and losses. The partnership must exist for the common benefit and interest of the partners. (Art. 1770.) Hence, such an agreement would contravene the very purpose of a partnership contract, that is, profit-sharing among the partners. However, although the stipulation is void, the partnership, if otherwise valid, subsists and the profits or losses shall be apportioned as if there were no stipulation on the same. (see Art. 1797, par. 2.)

(2) *Stipulation, a factor to show no partnership exists.* — Where the parties expressly stipulate that there shall be no liability for

losses, or where from the nature of the contract, it is clear that a party did not intend to share in the losses, such fact may be a factor in determining that no partnership exists. Thus, in a case, it was held that where one party sells personalty to another for use in a business, and agrees in payment to take one-half of the profits that might be made, he does not thereby agree to share in the losses. (Danills vs. Fitch, 8 Pa. 495, cited in Teller, p. 17.)

(3) *Where person excluded not intended by parties to become a partner.* — Where the one excluded from any share in the profits or losses is not intended by the parties to become a partner, the stipulation is, of course, valid. Thus, where one of several persons engaged in an enterprise agreed to assist by advancing money, and to share in the losses, if any, but not to receive any part of the profits, which are to be divided among the others exclusively, such one is not to be deemed a partner as between the others and himself. However, if he holds himself out, or allows himself to be held, as a partner to a third person who, under the belief that he is such, enters into a contract with them, he is liable on such contract. (31 Words and Phrases 282; see Art. 1825.)

(4) *Where person excluded from losses is industrial partner.* — With reference to the industrial partner, since the law itself excludes him from losses (Art. 1797, par. 2.), a stipulation exempting him from the losses is naturally valid as an exception to the general rule in Article 1799. This is without prejudice, however, to the rights of third persons. (Art. 1817.) The industrial partner is not liable for losses because he cannot withdraw the work or labor already done by him, unlike the capitalist partners who can withdraw their capital. Furthermore, if the partnership fails to realize any profits, then he has labored in vain and in a real sense, he has already contributed his share in the loss. (11 Manresa 377.)

(5) *Where stipulation provides for unequal shares.* — The limitation does not mean that the partners cannot stipulate for unequal shares in the profits or losses even if their respective contributions are equal, unless the inequality is so gross that it is, in effect, a simulated form or attempt to exclude a partner from any share in the profits or losses. (see Espiritu and Sibal, *op. cit.*, p. 113, citing 11 Manresa 377.)

Stipulation exempting a partner from losses should be allowed.

"The provision of Article 1799 which declares void an agreement excluding one or more partners from sharing in the losses of the partnership is difficult to explain. x x x. To declare also void an agreement which merely exempts or tends to exempt one or more partners from sharing or contributing in the partnership losses as far as it affects the partners alone, is without any foundation either on reason or justice; because if, in order to induce a person to become a member of the firm, it becomes necessary to guaranty him against his suffering any financial losses thereby, without which guaranty such person may not be willing to become a member of the partnership and yet his connection thereto is considered as absolutely necessary by the other partners willing to guaranty him against losses, such partnership may never materialize on account of the provision of said Article 1799.

It seems, therefore, that if a person can make a gift to another, there is no sound reason why a person cannot also agree to bear all the losses that a partnership may suffer, in order to exempt his co-partners from sharing in the said losses.

Of course, as far as third persons are concerned, any agreement which tends to excuse or exclude one or more partners from satisfying the partnership liability caused through partnership losses may be properly declared void." (Espiritu and Sibal, *op. cit.*, pp. 172-173.)

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)

Rights and obligations with respect to management.

Unless the partnership agreement provides otherwise, each partner in a general partnership has a right to an equal voice in the conduct and management of the partnership business. This right is not dependent on the amount or size of the partner's capital contribution or services to the business. Of course, the partners may select a managing partner or make such allocation of functions as the needs of the business dictate especially in a large partnership.

Article 1800 speaks of two distinct cases of appointments.

(1) *Appointment as manager in the articles of partnership.* — The partner appointed by common agreement in the articles of partnership may execute all acts of administration (not those of strict ownership such as those enumerated in Art. 1818, par. 3.) notwithstanding the opposition of the other partners, unless he should act in bad faith. His power is revocable only upon just and lawful cause (see Art. 1920.) and upon the vote of the partners representing the controlling interest.

The reason for this principle is that the revocation represents a change in the terms of the contract. The law presumes that the appointment thus constituted is, in effect, one of the conditions of the contract and it is only logical that such appointment should not be revoked without the consent of all the partners, including the partner thus appointed. It is an elementary rule that no party to a contract can violate the law of the contract without the consent of the others. (11 Manresa 380.)

In case of mismanagement, the other partners may avail of the usual remedies allowed by law, including an application for dissolution of the partnership by a judicial decree. (see Art. 1831.)

(2) *Appointment as manager after the constitution of the partnership.* — But the management granted by the partners after the partnership has been constituted independently of the articles of partnership may be revoked at any time for any cause whatsoever.

The reason for this provision is that in such case, the revocation is not founded on a change of will on the part of the part-

ners, the appointment not being a condition of the contract. It is merely a simple contract of agency, which may be revoked at any time. (Art. 1920.) It is believed that the vote for revocation must also represent the controlling interest.

It should be noted that Article 1800 refers to a partner, not a stranger, who has been appointed manager. As a rule, a partner is not entitled to compensation for his services other than his share of the profits.

Scope of power of a managing partner.

As a general rule, a partner appointed as manager has all the powers of a general agent as well as all the incidental powers necessary to carry out the object of the partnership in the transaction of its business. The exception is when the powers of the manager are specifically restricted.

(1) Hence, unless expressly withheld, the minor power to issue receipts is included in the general powers of the manager, as this is in keeping with present day business dealings. (Ng Ya vs. Sugbu Commercial Co., [C.A.] 50 O.G. 4913.)

(2) Similarly, the manager of a partnership engaged in buying and selling is clothed with sufficient authority even without approval of the other partners to purchase on credit, as it is customary to buy and sell on credit. (Smith, Bell & Co. vs. Aznar & Co., [C.A.] 40 O.G. 1882.)

(3) It has also been held that the managing partner has authority to secure loans to complete the construction of a "casco" for use in the business and necessary to carry out the express object of the partnership (Agustin vs. Inocencio, 9 Phil. 135.); or to dismiss an employee, particularly, when there is a justifiable cause for dismissal as when the employee hurled at the manager abusive and unsavory remarks in the presence of the customers of the firm (Matela vs. Chua Sintek, [C.A.] No. 12165-R, April 6, 1965.); or to employ a bookkeeper although the contract made was not in writing. (Fortis vs. Gutierrez Hermanos, 6 Phil. 100 [1906].)

(4) A partnership may sue or be sued in its name or by its duly authorized representative. Thus, the managing partner

may execute all acts of administration, including the right to sue debtors of the partnership. (Tai Tong Chuache & Co. vs. Insurance Commission, 158 SCRA 366 [1988].)

(5) But a partner designated as one of the managers to take charge of "selling fish in Manila and the purchase of supplies" has no authority to purchase for the partnership a "barge, a truck and an adding machine," inasmuch as neither of these properties could be considered as "supplies for the partnership business" (Teague vs. Martin, 53 Phil. 504 [1929].); nor can the managing partner of a partnership formed for the purpose of operating a tailoring shop sell or convey the tailoring shop which is partnership property without the consent of all the partners. (Santos vs. Villanueva, [C.A.] 50 O.G. 175.)

(6) A managing partner may not bind the partnership by a contract wholly foreign to its business. Thus, he has no authority to execute a mortgage on the firm's property to secure the debt of a third person for which the firm is not liable. (68 C.J.S. 577.)

Compensation for services rendered.

(1) *Partner generally not entitled to compensation.* — In the absence of an agreement to the contrary, each member of the partnership assumes the duty to give his time, attention, and skill to the management of its affairs, so far, at least, as may be reasonably necessary to the success of the common enterprise; and for this service a share of the profits is his only compensation.

Each partner in taking care of the joint property, managing the partnership affairs, and directing the partnership business is practically taking care of his own interest or managing his own business. He is not, in the absence of a contract, express or implied, entitled to compensation beyond his share of the profits for services rendered by him to the partnership business, although the services rendered by him may be greater in proportion than the services rendered by other members of the partnership, by reason of having assumed the position of managing partner, or even by reason of extra services necessitated by his partner's illness and consequent inability to render his own just share of the services. (40 Am. Jur. 213.)

In the absence of any prohibition in the articles of partnership for the payment of salaries to general partners, there is nothing to prevent the partners to enter into a collateral verbal agreement to that effect.

(2) *Exceptions.* — In proper cases, however, the law may imply a contract for compensation. Thus:

(a) A partner engaged by his co-partners to perform services not required of him in fulfillment of the duties which the partnership relation imposes and in a capacity other than that of a partner (*e.g.,* to perform clerical services in carrying on the business of the firm) is entitled to receive the compensation agreed upon therefor.

(b) A contract for compensation may be implied where there is extraordinary neglect on the part of one partner to perform his duties toward the firm's business, thereby imposing the entire burden on the remaining partner.

(c) One partner may employ his co-partner to do work for him outside of and independent of the co-partnership, and become personally liable therefor.

(d) Partners exempted by the terms of partnership from rendering services to the firm may demand pay for services rendered.

(e) Where one partner is entrusted with the management of the partnership business and devotes his whole time and attention thereto, at the instance of the other partners who are attending to their individual business and giving no time or attention to the business of the firm, the case presents unusual conditions, is taken out of the general rule as to compensation and warrants the implication of an agreement to make compensation. In such cases, the amount of the compensation depends, of course, upon the agreement of the parties, express or implied, as well as upon the particular circumstances of the case. (40 Am. Jur. 213-216.)

It has also been held that the way to deal with such a situation or where a partner willfully fails to perform the services which he agreed to perform, as a result of which the other partners are burdened with greater work, is to calculate

the value of the unperformed services, make it an asset of the partnership chargeable against the defaulting partner, and divide among all the partners (including the defaulting partner) as any other partnership profit. (Teller, *op. cit.*, p. 77, citing Olivier vs. Uleberg, [N.D.] 23 N.W. [2d] 39.)

(f) The rule requiring services of partners without compensation does not also apply where, by the contract of partnership, one partner is exempted from the duty of rendering personal services to the concerned, if he afterwards does render such service at the instance and request of his co-partners (*Ibid*., citing Lewis vs. Moffett, 11 Ill. 392.), or where the services rendered are extraordinary. Thus, in a case, the surviving partner who discovered a firm claim more than thirteen years after the liquidating partner's death, and prosecuted it for four years to a successful conclusion was allowed, because of the exceptional situation, extra compensation. (*Ibid*., citing Zell's Appeal, 126 Pa. 329.)

ILLUSTRATIVE CASE:

Under the contract, a partner was to receive a weekly amount termed as "drawing account" from a partnership that was upon a "50-50" basis, and he claimed that the amounts were received by him as compensation for his services but there was no specific agreement that he should receive salary.

Facts: A and B entered into a partnership under the name of "New England Neon Sign Company" for the purpose of manufacturing and selling neon signs. B agreed to furnish all the necessary financial backing, and A was to receive $60 a week, which was termed as a "drawing account." A, who had received over $15,000 instituted action for an accounting of the partnership affairs. He claims that the money was received as compensation for services. B contends that the money was received as a partial distribution of profits.

It appears that the parties agreed "to go 50-50," and, in answer to the question to A as to whether it was his understanding of the agreement that he was to be paid and B was not to be paid for services, he replied: "We were to go 50-50." When he answered this question, he knew that he had received over $15,000 by way of a drawing account, and B had never received anything by way of distribution of earnings.

Issue: Should the money received by A be considered as compensation for his services, or as partial distribution of profits?

Held: As a partial distribution of profits. A was a glass blower and was recommended to B as one who was familiar with, and had the ability to build, neon signs. B was "to furnish the necessary financial backing" and it is a reasonable inference that A, in turn, was to devote himself to the manufacture, at least, of the signs.

Under such arrangement and the specific agreement "to go 50-50," neither partner was entitled to compensation for services in the absence of an express or implied agreement. There was no specific agreement that A should receive any salary, as such. A's drawing account is a well-recognized modern business method of furnishing the employee with means of maintenance while engaged in a service from which wages and commissions are to accrue. In any event, he did not stipulate, in any terms, for the payment of any salary. He was merely to receive a weekly amount, termed a "drawing account," from a partnership that was upon a "50-50" basis.

Upon all the findings, A's drawing account was against possible profits, and not by way of payment for his services. *(Boyer vs. Bowles, 37 N.E. 2d 489 [Mass. 1941].)*

ART. 1801. If two or more partners have been intrusted with the management of the partnership without specification of their respective duties, or without 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 tie, the matter shall be decided by the partners owning the controlling interest. (1693a)

Where respective duties of two or more managing partners not specified.

(1) *Each one may separately perform acts of administration.* — The rule in this case is that each one may separately perform acts of administration.

(a) If one or more of the managing partners shall oppose the acts of the others, then the decision of the majority (per head) of the managing partners shall prevail. Note that the right to oppose can be exercised only by those entrusted with the management of the partnership and not by any partner.

(b) In case of tie, the matter shall have to be decided by the vote of the partners owning the controlling interest, that is, more than 50% of the capital investment. (see Art. 492.)

When the articles of partnership do not specify the respective duties of the partners and the limitations of management, one partner has no more powers than the others in the conduct and management of the firm's business. If there is a specification of the respective duties of the managing partners, the decision of the partner concerned shall prevail subject only to the limitation that he should act in good faith.

(2) *Requisites for application of rule.* — This article applies only when the following requisites are present:

(a) Two or more partners have been appointed as managers;

(b) There is no specification of their respective duties; and

(c) There is no stipulation that one of them shall not act without the consent of all the others.

EXAMPLES:

The respective interests of the partners in a partnership are as follows: A — 5%; B — 10%; C — 15%; D — 15%; E — 20%; and F — 35%.

(1) A, B, and E were appointed as managing partners without specification of their respective duties. A contract entered into by A, if with the conformity of B although against the objection of E, is valid.

(2) If the managing partners are A, B, C, and E, and C sided with E so that there was a tie and when the matter was put to a vote of all the partners, A, B, and D were in favor, with C, E, and F against, the contract is not valid; if A and E were the ones who originally voted in favor of the contract and subsequently,

F sided with them, the transaction is deemed ratified by the controlling interest in the partnership.

(3) Suppose after a tie, the voting is as follows: A, B, and F — in favor, and C, D, and E — against, both sides representing 50% of the interest, with neither side willing to give way to the other, what shall be the rule? The law is silent on this point. It is believed that in such case the contract should be considered as having been entered into without authority. In other words, when the partners are equally divided, those who vote against the contract or who resist change must prevail.

The best solution is for the partners to dissolve the partnership. A shall be responsible for damages if it is found that he was at fault. (see Art. 1794.)

If the contract is merely proposed, it may or may not be entered into depending upon the decision of the majority of the managing partners or of the controlling interest, as the case may be.

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 validity of the acts, and the absence or disability of any one of them cannot be alleged, unless there is imminent danger of grave or irreparable injury to the partnership. (1694)

Where unanimity of action stipulated.

(1) *Concurrence necessary for validity of acts.* — The partners may stipulate that none of the managing partners shall act without the consent of the others. In such a case, the unanimous consent of all the managing partners shall be necessary for the validity of their acts. (see Art. 1818 as to rights of third persons.) This consent is so indispensable that neither the absence nor disability of any one of them may be alleged as excuse or justification to dispense with this requirement.

The only exception is when there is an imminent danger of grave or irreparable injury to the partnership, in which case, a partner may act alone without the consent of the partner who is

absent or under disability, without prejudice to his liability for damages under Article 1794.

(2) *Rule where there is opposition by a managing partner.* — The rule which authorizes any of the managing partners to proceed alone without the consent of the other in case of "imminent danger of grave or irreparable injury to the partnership" is not applicable when one of the managers, in the exercise of his right to oppose, objects to the proposed act. The reason is that one of the essential conditions of the authority conferred on the managing partner is that the management should be with the consent of all the partners, and inasmuch as in this case such unanimous consent is manifestly wanting, there is no doubt that the proposed act is outside the scope of his authority. (Espiritu and Sibal, *op. cit.*, p. 127, citing 11 Manresa 388-389.)

ILLUSTRATIVE CASE:

A third person seeks the enforcement of a contract entered into by a partner in violation of stipulation that none of the partners shall act without the consent of the others.

Facts: A sold to B, one of the managing partners of Partnership X, the other being C, a certain number of mining claims without the consent of C. In an action by A to recover the unpaid balance of the purchase price against Partnership X, C claims that the contract is not binding upon the partnership for the reason that under the articles of partnership, there is a stipulation that one of the partners cannot bind the firm by a written contract without the consent of the others.

Issue: Is the transaction made by B binding upon the partnership?

Held: Yes. The stipulation undoubtedly creates an obligation between the two partners, which consists in asking the other's consent before contracting for the partnership. This obligation, of course, is not imposed upon a third person who contracts with a partnership.

A third person may, and has a right to, presume that the managing partners with whom he contracts has, in the ordinary and usual course of business, the consent of his co-partner for otherwise he would not enter into the contract. The third person would naturally not presume that the partner with

whom he enters into the transaction is violating the articles of partnership but, on the contrary, is acting in accordance therewith. The reason or purpose is no other than to protect a third person who contracts with one of the managing partners from fraud or deceit to which he can be an easy victim. *(Litton vs. Hill & Ceron, 67 Phil. 509 [1939].)*

(3) *Consent of managing partners not necessary in routine transactions.* — It has been held that where the business of the partnership is to buy and sell merchandise of all kinds, an industrial partner who is authorized to "manage, operate and direct the affairs, businesses and activities of the partnership" and "to make, sign, seal and execute and deliver contracts, documents, x x x upon terms and conditions acceptable to him duly approved in writing by the capitalist partners," can purchase "on credit" in the name of the firm certain goods, regularly purchased by the company without first securing the approval of the capitalist partners since it is usual or customary to buy and sell on credit. Moreover, the authority to purchase carries with it the implied authority to purchase on credit.

The requirement of written authority refers evidently to formal and unusual written contracts. (Smith, Bell & Co. vs. Aznar, [C.A.] 40 O.G. 1882.)

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

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

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

Rules when manner of management has not been agreed upon.

(1) *All partners considered managers and agents.* — The partners may fail to designate who among them shall act as manager, either when their contract is perfected or subsequently. In such a case, all partners shall have equal rights in the management and conduct of partnership affairs. This is true regardless of the amount of their capital contributions or extent of their services to the partnership. All of them shall be considered managers and agents (Art. 1818.) and whatever any one of them may do alone shall bind the partnership, subject, however, to the provision of Article 1801 that in case of timely opposition of any partner, the matter shall first be decided by the majority vote, for the presumed intent is for all the partners to manage regardless of the amount of capital they contributed. In case of a tie, then the matter shall be decided by the vote of the partners representing the controlling interest.

Article 1803(1) should be read in relation to Article 1818. (par. 3.)

EXAMPLE:

Partnership X is composed of five members, A, B, C, D, and E. In a suit brought by F against the partnership, F accepted an offer of compromise from A, B, and C to settle the suit. Prior to F's acceptance of the offer, D and E informed F that they opposed the offer.

Is the compromise binding upon the partnership?

No. Under Article 1803, in relation to Article 1801, the acts of the majority shall prevail over the opposition of the minority as to all matters within the scope of the partnership business in the absence of any stipulation to the contrary. Under Article 1818 (par. 2[5].), however, except when authorized by the other partners or unless they have abandoned the business, less than all the partners have no authority to "enter into a compromise concerning partnership claim or liability."

The authority of the partners to bind the partnership by contract under Article 1801(1) are limited to acts of administration or, as expressed in Article 1818 (par. 1.), acts "for apparently carrying on in the usual way the business of the partnership."

(2) *Unanimous consent required for alteration of immovable property.* — Under the second paragraph, the unanimous consent of all the partners is necessary for any important alteration in the immovable property of the partnership. The consent need not be express. It may be presumed from the fact of knowledge of the alteration without interposing any objection.

(a) The prohibition applies only to immovable property because of the greater importance of this kind of property as compared to movable property (11 Manresa 391-392.), and the alteration thereof must be important. Any important alteration in the immovable property of the partnership is an act of strict dominion. (see Art. 1818, pars. 2, 3.) Hence, even the managing partner cannot make such alteration, notwithstanding that it is useful to the partnership, without the consent of all the partners.

(b) If the refusal to give consent by the other partners is manifestly prejudicial to the interest of the partnership, the intervention by the court may be sought for authority to make the necessary alteration. Such consent may be presumed from the silence of the other partners who did not interpose any opposition to the making of the alteration, notwithstanding knowledge on their part to the making of the alteration.

(c) The second paragraph speaks of alteration "even if it may be useful to the partnership." If the alteration is necessary for the preservation of the property, it would seem that the consent of the other partners is not required.

ILLUSTRATIVE CASES:

1. *A contract was entered into by a partner without the consent of the others, there being no agreement with regard to the manner of management.*

Facts: A, B, and C organized a partnership for the purpose of engaging in the transportation business. Without a previous express authority, A contracted an indebtedness for automobile supplies and accessories.

Issue: Are the partnership and the partners liable for said indebtedness?

Held: Yes. There being no agreement with regard to the manner of management, all the partners are considered agents

of the partnership. A must be deemed to have authority to contract the indebtedness in question inasmuch as it was incurred in the prosecution of the partnership business. *(Bachrach vs. "La Protectora," 37 Phil. 441 [1918].)*

_____ _____ _____

2. *A third person seeks enforcement of a contract entered into by a partner who, under the articles, was not empowered to make the contract.*

Facts: Veterans Army was organized to perpetuate the spirit of patriotism and fraternity among its members, and to promote the welfare of each member. It was provided in its articles that it shall be composed of a department and two or more posts, with a commander for the department and each post and that the members of the department shall constitute a quorum for the transaction of business.

CRM brought an action against Veterans Army to recover unpaid rent under a contract of lease entered into by it with one of Veterans Army's posts, known as Lawton Post.

Issue: Is the contract of lease binding upon Veterans Army?

Held: No. Any partner is empowered to contract in the name of the partnership only when the articles make no provision for the management of the partnership business. In this case, the articles do so provide. They declare what the duties of the several officers are. The power of making contracts is not expressly given to any officers. The department could not be bound unless by resolution adopted at some meeting where at least six members of the department were present. (*Council of Red Men vs. Veterans Army, 7 Phil. 685 [1907];* see, however, Litton vs. Hill & Ceron, *supra,* and Art. 1818.)

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)

Contract of subpartnership.

A partner may associate another person with him in his share without the consent of the other partners. Such associate is sometimes referred to as a *subpartner*.

(1) *Nature.* — The partnership formed between a member of a partnership and a third person for a division of the profits coming to him from the partnership enterprise is termed *subpartnership*. How profits between the members of a subpartnership are to be divided is immaterial, and the mere fact that the one who is not a partner of the original partnership is to receive the entire profits of the business will not prevent the formation of a subpartnership. (59 Am. Jur. 2d 941.)

In effect, a subpartnership is a partnership within a partnership *and* is distinct and separate from the main or principal partnership.

(2) *Right of person associated with partner's share.* — Subpartnership agreements do not in any wise affect the composition, existence, or operations of the firm. The sub-partners are partners *inter se,* but, in the absence of the mutual assent of all the parties, a subpartner does not become a member of the partnership, even though the agreement is known to the other members of the firm. (68 C.J.S. 460.)

Not being a member of the partnership, he does not acquire the rights of a partner nor is he liable for its debts.

EXAMPLE:

A, B, and C are partners. A may contract with D, whereby the latter will participate in his (A's) share in the profits of the partnership. This A can do independently of the partnership and in accordance with the principle of freedom to contract.

The original contract of partnership between A, B, and C is not in any manner altered. D is considered merely a creditor of A who associated him in his share. Consequently, D has no right to intervene in the partnership to which he is a mere stranger. Like an assignee, D cannot interfere in the management or administration of the partnership business, require information or account, or inspect partnership books. (Art. 1813.)

A continues in the enjoyment of the rights and remains subject to the liabilities of a partner as though no contract has been made by him with D. (see Machuca vs. Chuidian, 2 Phil. 210 [1903].)

D does not become a partner nor is he liable for the partnership debts even if the agreement between A and D is with the knowledge and assent of B and C. D is an investor.

(3) *Reason for the rule.* — In the above example, for D to become a partner, A, B, and C must consent even if A should be the manager because a partnership is based on mutual trust and confidence among the partners. Furthermore, the inclusion of D as a new partner will in effect be a modification of the original contract of partnership requiring the unanimous consent of all the partners. It would seem that the prohibition applies even if the person associated is already a partner.

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)

Keeping of partnership books.

(1) *Partner with duty to keep partnership books.* — The duty to keep true and correct books showing the firm's accounts, such books being at all times open to inspection of all members of the firm, primarily rests on the managing or active partner. (40 Am. Jur. 356.) or the particular partner given record-keeping duties. It is presumed that the partners have knowledge of the contents of the partnership books and that said books state accurately the state of accounts, but errors can be corrected. (Crane, *op. cit.*, pp. 356-357.)

(2) *Rights with respect to partnership books.* — Subject to any agreement to the contrary, the partnership books should be kept at the principal place of business as each partner has a right to free access to them and to inspect or copy any of them at any reasonable time, even after dissolution. This right is granted to enable the partners to have true and full information of all things affecting the partnership. (Art. 1806.)

A partner is a co-owner of the partnership properties (Art. 1811.), which include the books of the partnership, and has a

right to participate equally in the management of its affairs. They should not, therefore, be in the exclusive custody or control of any one partner, and should not be removed from the principal place of business of the partnership without the consent of all the partners.

The partners inspection rights are not absolute. He can be restrained from using the information gathered for other than partnership purpose.

(3) *Access to partnership books.* — Article 1805 declares that the rights of the partners with respect to partnership books can be exercised at "any reasonable hour." This phrase has been interpreted to mean reasonable hours on business days throughout the year and not merely during some arbitrary period of a few days chosen by the managing partners (Pardo vs. Lumber Co. and Ferrer, 47 Phil. 964 [1925].), *e.g.*, from December 21 to 31 every year.

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)

Duty to render information.

Under the same principle of mutual trust and confidence among partners, there must be no concealment between them in all matters affecting the partnership. Hence, the duty to render true and full information of all things affecting the same upon request or demand. The information, to be sure, must be used only for a partnership purpose.

The use of the words "on demand" does not mean that a partner is under no obligation to make a voluntary disclosure of information affecting the partnership. Not only is a partner bound to give information on demand but in certain circumstances, he is under the duty of voluntary disclosure of material facts (Crane, *op. cit.*, pp. 359-360.) within his knowledge relating to or affecting

partnership affairs. (see Art. 1821.) But the duty to render information does not arise with respect to matters appearing in the partnership books since each partner has the right to inspect the books.

Good faith not only requires that a partner should not make any false statement but also that he should abstain from any concealment. (Poss vs. Gottlieb, 193 N.Y.S. 418, 421.)

EXAMPLES:

(1) A and B are partners engaged in the real estate business. A learned that C was interested in buying a certain parcel of land owned by the partnership, even for a high price. Without informing B, A was able to make B sell to him (A) his (B's) share in the partnership. Then, A sold the land at a big profit.

In this case, A is liable to B for the latter's share in the profits. When A purchased B's interests, A was under the duty to make disclosure of facts having a bearing on the value of such interests which were not known to B.

(2) If A discovered a valuable mine on a land of the partnership, he is under a duty to disclose such information before purchasing the interest of B.

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)

Partner accountable as fiduciary.

The relation between the partners is essentially fiduciary involving trust and confidence, each partner being considered in law, as he is, in fact, the confidential agent of the others. The duties of a partner are analogous to those of a trustee.

(1) *Duty to act for common benefit*. — It is, therefore, the obligation of a partner to act for the common benefit of all in all

transactions[8] relating to the partnership business or affairs. He cannot, at the expense or to the detriment of the other partners, use or apply exclusively to his own individual benefit partnership assets or the results of the knowledge and information gained in the character of partner. (Pang Lim & Galvez vs. Lo Seng, 42 Phil. 283 [1921].)

Managing partners particularly owe a fiduciary duty to inactive partners.

(2) *Duty begins during formation of partnership.* — The principle of utmost good faith covers not only dealings and transactions occurring during the partnership but also those taking place during the negotiations leading to the formation of the partnership. (Allen vs. Steinberg, 223 A. 2d 240.) Hence, where one partner procures the other to sign an agreement, which is manifestly unjust and unfair, the agreement will not be upheld (see Art. 1838.) if it be made to appear that the injured party's signature was obtained by a promise which was never, and could not be, carried into effect. (George vs. Sohn's Adm'r., 230 S.W. 904.)

Also, a person who agreed with another to form a partnership has the obligation to account for commissions and discounts received in acquiring property for the future partnership.

(3) *Duty continues even after dissolution of partnership.* — The duty of a partner to act with utmost good faith towards his co-partners continues throughout the entire life of the partnership even after dissolution for whatever reason or whatever means, until the relationship is terminated, *i.e.*, the winding up of partnership affairs is completed. (see Art. 1829.) In dealings

[8]The courts have interpreted the word "transaction," as used in Article 1807, as the justice of the case demanded rather than by any abstract definition; and have given the word a broad, comprehensive meaning whenever necessary to meet the intention and purpose of the law. In its ordinary and popular sense, it has been defined as signifying "the doing or performing of any affair; that which is done or in the process of being done," and again "as a matter or affair completed or *in the course of completion*." It is enough to constitute a given transaction a business transaction, if it carries a reasonable prospect of future advantage even though the anticipated values may be lost in subsequent negotiations designed to bring it to fruition. This is also true, even though it has no present market value in the hands of the partnership or cannot be made the basis if a legal claim against parties outside of the firm. (Chance vs. Carter, 158 P. 947; Fouchek vs. Janicek, 225 P. 2d. 783.)

affecting the winding up of the partnership and the proper preservation of partnership assets during that time, "the good faith and full disclosure exacted of partners continues." (Lavin vs. Enrlich, 363 N.Y.S. 2d 50; Hamilton Co. vs. Hamilton Tile Corp., 197 N.Y. 2d 384.)

(4) *Duty to account for secret and similar profits.* — The duty of a partner to account as a fiduciary operates to prevent from making a secret profit out of the operation of the partnership (Art. 1807.) and from carrying on the business of the partnership for his private advantage or a business in competition or rivalry with the business of his firm without the consent of the other partners. (Art. 1808.) The violation of this duty may be a ground for a petition for judicial dissolution of the partnership. (See Art. 1831, par. 1[3, 4, 6].)

(5) *Duty to account for earnings accruing even after termination of partnership.* — The duty of a former partner to share profits with his former associates may extend to earnings accruing after the termination of the partnership. The true rule, according to a case, is: "when a partner wrongfully snatches a seed of opportunity from the granary of his firm, he cannot thereafter excuse himself from sharing with his co-partners the fruits of its planting, even though the harvest occur after they have terminated the association."

Or to put it otherwise: "if a member of a partnership avails himself of information obtained by him in the course of the transaction of partnership business which is within the scope of the firm's business, and thereafter applies it to his own account without the consent or knowledge of his co-partners, he is liable to account to the partnership for any benefit he may obtain from the use of such information." (See Am. Jur. 221.)

(6) *Duty to make full disclosure of information belonging to partnership.* — A partner is also subject to the fiduciary duty of undivided loyalty and complete diclosure of information of all things affecting the partnership. (Art. 1806.)

By *information* is meant information which can be used for the purposes of the partnership. Information belongs to the partnership in the sense of property in which it has a valuable right, if it is of the character which might be employed to the

partnership's advantage. Such information cannot be used by one partner for his private gain. This is true no matter when his wrongful enterprise springs into profitable operation, even though it happens after the termination of the partnership from whence he obtained it. (Fouchek vs. Janicek, 225 P. 2d 783.)

(7) *Duty not to acquire interest or right adverse to partnership.* — A partner may not purchase, for his own benefit, property of any kind in which the partnership is interested, or lease property when the firm is entitled to the benefit of such lease, or secure a valuable contract for himself which it is his duty to secure for the firm, or obtain secretly any right that should belong to the partnership, and put it to his own individual profit. If he does, he holds in trust for the benefit of the partnership the property so purchased, or leased, or the contract he has obtained, and must account to the firm for the profits of the transaction, unless it appears that the co-partner consented to the transaction. The same result will follow any attempt by one partner to appropriate firm property or funds to his individual benefit (such as payment of his debts) without the consent of his co-partners. (68 C.J.S. 548-549.)

The consent required to be secured from the other partners must necessarily be an "informed consent" with knowledge of the facts necessary to the giving of an intelligent consent. (Starr vs. International Realty Ltd., 533 P. 2d 165.)

EXAMPLE:

A and B are partners engaged in the real estate business. A bought a parcel of land with partnership funds in his own name and subsequently sold the same at a profit.

B has a right to share in the profit and A holds as trustee the profits derived by him from the transaction.

ILLUSTRATIVE CASES:

1. *A partner redeemed with his own private funds foreclosed property of partnership.*

Facts: A and B were partners in the operation of a cinema business. The theatre was mortgaged to C who foreclosed the

mortgaged debt. A, in his own behalf, redeemed the property with his own private funds.

Subsequently, A filed a petition for the cancellation of the old title of the partnership and the issuance of another title in his name alone.

Issue: Did A become the absolute owner of the property?

Held: No. In this case, when A redeemed the property in question he became a trustee for the benefit of his co-partner, B, subject to his right to demand from the latter his contribution to the price of redemption plus legal interest. *(Catalan vs. Gatchalian, 105 Phil. 1270 [1959].)*

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2. *A partner, after selling to his co-partner his interest in a partnership and acquiring from a lessor the plant and land leased by the partnership, seeks to terminate the lease.*

Facts: A and B were partners under the firm name of Lo Seng & Co. in the business of running a distillery. Upon the expiration of the original contract of lease of the land on which said distillery was located as well as the buildings and improvements thereon which were then the property of X, a new contract was executed on behalf of the partnership as lessee by the partners themselves.

Later, A sold all his interest in the distillery plant to B. Thereafter, X sold all his interest in the distillery including the land to A.

Upon the refusal of B to yield the property, A brought action (under Art. 1676 of the Civil Code), the lease not having been recorded in the Registry of Property.

Issue: Has A the right to terminate the lease?

Held: No. A occupied a double role in the transactions which gave rise to the litigation: first, as lessee, and secondly, as a purchaser seeking to terminate the lease. While yet a partner, A participated in the creation of the lease to the partnership; and when he sold out his interest in the firm to B, this operated as transfer to B of his interest in the firm assets, including the lease; and A cannot now be permitted, in the guise of a purchaser, to destroy an interest derived from himself and for which he has received full value.

A acted in bad faith. He had been in relation of confidence with B and in that position had acquired knowledge of the possibilities of the property. On account of his status as partner, A knew that the original lease had been extended and the extent of the valuable improvements that had been made thereon.

It would be shocking to the moral sense if the condition of the law were found to be such that A, after profiting from the sale of his interest in a business, worthless without the lease, could intervene as purchaser of the property, and confiscate for his own benefit the property which he had sold for a valuable consideration to B. Above all other persons in business relations, partners are required to exhibit towards each other the highest degree of good faith. *(Pang Lim and Galvez vs. Lo Seng, 42 Phil. 282 [1921].)*

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3. *Plaintiff seeks accounting of his share in the profits of a company rehabilitated by defendants after the former defaulted in his obligation to raise funds for the rehabilitation of said company.*

Facts: A, B, C, and D entered into a contract to promote the rehabilitation of a mining company. The parties agreed to raise money on the said plan within six months by obtaining subscriptions to shares of the mining company. It was expressly stipulated that the failure of one to perform within the stipulated period would discharge the others. A defaulted in his part.

Under the contract, B and C were discharged from their obligations. Thereafter, B and C considered themselves released from the said contract, and presented a new plan for the rehabilitation of the company. The new plan was adopted and B and C succeeded in raising the price of the stock of the company and made large profits.

A brought action to compel B and C to account for his share in the profits which he claimed B and C obtained by virtue of their contract.

Issue: Are B and C accountable to A as a fiduciary for the profits?

Held: No. After the termination of an agency, partnership, or joint adventure, the party who stood in a fiduciary relation to another is free to act in his own interest with respect to the

same subject matter provided he has done nothing during the continuance of the relation to lay a foundation for an undue advantage to himself. To act as fiduciary of another does not necessarily imply the creation of a permanent disability in the fiduciary to act for himself in regard to the same subject matter. *(Hanlon vs. Hausserman and Beam, 40 Phil. 796 [1920].)*

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4. *Widow of deceased partner seeks accounting from surviving partners who acquired with partnership assets, properties long after the dissolution of the partnership as a result of the death of the deceased partner who was in control of partnership affairs during his lifetime.*

Facts: A, widow of B, a deceased partner, filed an action for accounting against C and D, surviving partners, alleging that during the lifetime of B, C and D managed to use huge amounts of the funds and assets of the partnership for personal purposes and, after the death of B, they, without liquidation continued the partnership by purportedly organizing a corporation and acquired lands using the money and assets of the partnership.

It appears that B was in control of the affairs and the running of the partnership and the lands in question were acquired by C and D long after the partnership had been automatically dissolved as a result of the death of B.

Issue: Is A entitled to an accounting?

Held: No. Article 1807 is not applicable. Since B was in control of the affairs of the partnership, it is hard to believe that C and D could have defrauded B of the amounts A claims. The more logical inference is that if C and D had obtained any portion of the funds of the partnership for themselves, it must have been with the knowledge and consent of B, for which reason no accounting could be demanded from them therefor, considering that Article 1807 refers only to what is taken by a partner without the consent of the other partner or partners.

Since the properties supposed to have been acquired by C and D with partnership funds appear to have been transferred to their names long after the dissolution of the partnership, C and D have no obligation to account to anyone for such acquisitions in the absence of clear proof that they had violated the trust of B, the deceased partner, during the existence of the partnership. *(Lim Tanhu vs. Ramolete, 66 SCRA 425 [1975].)*

5. *Plaintiff seeks his share of option money paid to partnership and forfeited for failure of optioner to exercise privilege to buy shares in the corporation which substituted the partnership.*

Facts: A, B, C, D, E, and F were partners operating a bus line under the name of "Western Kentucky Stages." B and C, after negotiations, entered into an agreement with Greyhound, Inc., by the terms of which Greyhound, Inc., agreed to pay $27,500.00 for an option to buy 60% of Western's stock in the event Western would alter its status from a partnership to that of a corporation. The reason offered for this change, among other things, was that they desired to be relieved of the personal liability imposed by the partnership set-up.

F opposed substituting the partnership for a corporation for some time but he finally yielded to the plan.

After the partnership became a corporation, the option money was forfeited by the refusal of Greyhound, Inc. to complete its deal. The $37,500.00 was divided among A, B, C, D, and E. F, then, instituted action, claiming his share of the $37,500.00.

Issue: Are A, B, C, D, and E duty-bound to account to, and share the $37,500.00 with A?

Held: Yes. There is no relation of trust or confidence known to the law that requires of the parties a higher degree of good faith than that of partnership. Nothing less than absolute fairness will suffice. Each partner is the confidential agent of all the other and each has the right to know all that the others know. Nor will one partner be permitted to benefit at the expense of the firm. A, B, C, D, and E were under a legal obligation as partners to share proportionately with F the option money which was obtained by the optioners by virtue of the partnership relationship.

The important factor is that they received money which should have gone into the partnership treasury and then should be divided proportionately among all of the partners. When they received the money under the conditions recited, they became, in effect, trustees of this fund for the benefit of F for his share in the proceeds. *(Van Hooser vs. Keenon, 271 S.W. 2d 270 [Ky., 1954].)*

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)

Prohibition against partner engaging in business.

(1) *Prohibition relative.* — The prohibition against the capitalist partner to engage in business is relative, unlike the industrial partner who is absolutely prohibited from engaging in any business for himself. (Art. 1789.)

(a) The capitalist partner is only prohibited from engaging for his own account in any operation which is the same as or similar to the business in which the partnership is engaged and which is competitive with said business. Any capitalist partner violating this prohibition shall be under obligation to bring to the common fund any profits derived by him from his transactions and, in case of losses, he shall bear them alone. The partners, however, by stipulation may permit the capitalist partner to engage in the same kind of business.

(b) The law does not prohibit a partner from engaging in enterprises in his own behalf during the period that he is a member of a firm but permits him to carry on a business activity not connected or competing with that of the partnership, so long as the partnership agreement does not prohibit such activity. Any other rule, it is said, would prevent a member of a partnership from investing his private funds. (see 40 Am. Jur. 220.)

(c) The law is silent on whether a capitalist partner can engage in the same line of business for the account of another. It would seem that the prohibition still applies. A partner occupies a fiduciary position with respect to his co-partners imposing duties of utmost good faith, and he may not carry

on any other business in rivalry with the business of the partnership whether in his own name or for the account of another at the expense of the partnership.

(2) *Reason for the prohibition.* — It is universal that a capitalist partner, without the consent of his co-partners, cannot carry on a business of the same nature and in competition with that of the firm. Since the relationship of partners is fiduciary and imposes upon them the obligation of the utmost good faith in their dealings with one another with respect to partnership affairs, one partner will not be permitted to retain for himself alone as against his co-partners benefits from the partnership relation.

The rule prevents a partner from availing himself personally of information obtained by him in the course of the transaction of the partnership business or by reason of his connection with the firm regarding the business secrets and clientele of the firm to its prejudice. (see *Ibid*., 220-221.)

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)

Right of partner to a formal account.

(1) *General rule.* — In general, during the existence of the partnership, a partner is not entitled to a formal account of partnership affairs. The reason is that the rights of the partner to know partnership affairs are amply protected in Articles 1805 and 1806. Furthermore, to entitle any partner to the right to constantly demand or ask for a formal accounting will cause much inconvenience and unnecessary waste of time. Thus, a suit

for accounting usually is filed only when the partnership has been dissolved. A formal account is a necessary incident to the dissolution of the partnership.

(2) *Exceptions.* — However, in the special and unusual situations enumerated under Article 1809, the justification for a formal accounting even before dissolution of the partnership cannot be doubted. An example under No. (4) of Article 1809 is where a partner has been assigned abroad for a long period of time in connection with the partnership business and the partnership books during such period being in the possession of the other partners.

The right of a partner to demand an accounting without bringing about or seeking a dissolution is a necessary corollary to his right to share in the profits.

(3) *Prescriptive period.* — The obligation to account is one which rests especially on the shoulders of a managing or active partner, and is one of the special tasks of a liquidating or surviving partner. (40 Am. Jur. 333.) Articles 1806, 1807, and 1809 show that the right to demand accounting exists as long as the partnership lasts. Prescription begins to run only upon the dissolution of the partnership when the final accounting is done. (Fue Leung vs. Intermediate Appellate Court, 169 SCRA 746 [1989]; Emnace vs. Court of Appeals, 370 SCRA 431 [2001].)

(4) *Nature of action for accounting.* — An action for accounting, asking that the assets of the partnership be accounted for, sold and distributed according to the agreement of the partners is a personal action which under the Rules of Court, may be commenced and tried where the defendent resides or may be found or where the plaintiffs reside, at the election of the latter. The fact that the some of the assets of the partnership are real property does not materially change the nature of the action. It is an action *in personam* because it is an action against a person for the performance of a personal duty on his part, and not an action *in rem* where the action is against the thing itself. It is only incidental that part of the assets of the partnership subject to accounting or under liquidation happen to be real property. (Emnace vs. Court of Appeal, *supra*.)

ILLUSTRATIVE CASES:

1. *A partner seeks to recover 1/2 of the proceeds of a partnership transaction without liquidation of the business.*

Facts: A seeks to recover from B 1/2 of the purchase price of lumber sold by the partnership to the United States Army. A's complaint does not show why he should be entitled to the sum he claims. It does not allege that there has been a liquidation of the partnership business and the said sum has been found to be due him as his share of the profits.

Issue: Should the proceeds from the sale of the lumber be considered profits?

Held: They cannot be considered profits until costs and expenses have been deducted. Moreover, the profits of a business cannot be determined by taking into account the result of one particular transaction instead of all the transactions had. Hence, the need for a general liquidation before a member of a partnership may claim a specific sum as his share of the profits. *(Sison vs. H. McQuaid, 94 Phil. 201 [1953].)*

_____ _____ _____

2. *Right of a partner who received his capital contribution to demand accounting from managing partners.*

Facts: A and B entered into a verbal contract of partnership. In view of their failure to agree upon the partnership articles, A returned to B the money contributed by the latter to the capital of the partnership.

Issue: Did the return to B of the money effect a waiver by him of his right to an accounting of the profits already realized by the partnership as well as a termination of the partnership?

Held: No. There was no intention on the part of B to relinquish his rights as a partner nor did he give any ground whatever to make A believe that he intended to relinquish them. On the contrary, B notified A when he accepted the money that he waived none of his rights in the partnership.

Furthermore, the money fell short of the capital contributed by B and it was possible that profits might have been realized from the business during the period in which A was administering it and if so, still retained in A's hands. For these reasons, the acceptance of the money was not in itself inconsistent with the continuance of the partnership relations, as

would have been the case had B withdrawn his entire interest in the partnership.

There was, therefore, nothing upon which a waiver, express or implied, could be predicated. *(Fernandez vs. De la Rosa, 1 Phil. 671 [1902].)*

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3. *In questioning the accuracy of the account made, a partner merely made a general allegation of the probability of mistake.*

Facts: By mutual agreement, A and B dissolved their partnership. A brought action to recover from B who had been left in charge of the books and the funds of the firm, the amount of the capital he had contributed. While B was more especially burdened with the care of the books of the partnership, they were at all times opened to the inspection of A.

B claimed losses in the conduct of the business. A contended himself with a general allegation to the effect that there must be some mistake as to accuracy of the account, as he did not and could not believe that the business had been conducted at a loss.

Issue: What is the effect of A's failure to point out specifically any fraudulent or erroneous items appearing in the account?

Held: Such failure should be construed as a strong circumstance indicating the accuracy of the account. *(Garrido vs. Ascencio, 10 Phil. 691 [1908].)*

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4. *Without objecting to a statement of accounts, a partner promised to sign the same after receiving his shares, and after he has been paid, refused to sign and instead demanded a liquidation.*

Facts: A submitted a statement of accounts to B, his co-partner. Instead of objecting to said statement, B promised to sign the same as soon as he received his shares as shown in said statement. After said shares had been paid by A and accepted by B without reservation, the latter refused to sign the statement. B demanded a new liquidation, claiming that he was entitled to more than what the statement of account shows.

Issue: Is B entitled to a further liquidation?

Held: No. After accepting his shares without any reservation, B virtually confirmed his approval of the statement of accounts,

and its signing thereby became a mere formality to be complied with by B exclusively. His refusal to sign, after receiving the shares, amounted to a waiver of that formality in favor of A who had already performed his obligation. This approval precludes any right on the part of B to a further liquidation, unless he can show there was fraud or mistake in said approval. *(Ornum vs. Lasala, 74 Phil. 241 [1943].)*

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5. *Plaintiff was excluded as industrial partner after she filed a complaint for formal accounting, the defendants having always known her government position and other work when she joined the partnership.*

Facts: The articles of a partnership were amended to include A, as an industrial partner, with B, C, and D, the original capitalist partners. The amended articles provided that "the contribution of A consists of her industry being an industrial partner" and that she shall be entitled to 30% of the net profits that may be realized by the partnership from June 7, 1955 until the mortgage loan obtained from the Rehabilitation Finance Corporation shall have been fully paid.

After nine (9) years, B, C, and D reached an agreement whereby A has been excluded from the partnership, and deprived of her alleged share as an alleged industrial partner on the ground that she had never contributed her industry to the partnership and instead she has been and still is a judge of the City Court of Manila devoting her time to the performance of her duties as such judge and enjoying the privileges and emoluments appertaining to said office, aside from teaching in law schools in Manila, without the express consent of the other partners.

Issue: Has A the right to demand for a formal accounting?

Held: Yes. A has faithfully complied with her prestation with respect to the other partners. This is clearly shown by the fact that it was only after the filing of the complaint by A and the answer thereto that appellants (B, C, and D) exercised their right to exclusion by alleging in their supplemental answer dated July 29, 1964 — or after around nine (9) years from June 7, 1955 — the agreement aforementioned.

Having always known A as a City Judge even before she joined the appellant company as an industrial partner, it

took the appellants so many years before excluding her from said company. There was no pretense even on the part of the appellants that A engaged in any business antagonistic to that of appellant company. Furthermore, the theory that A has never been an industrial partner cannot be reconciled with the agreement evidenced by the amended articles of partnership.

As an industrial partner, A has the right under Article 1809 for a formal accounting and to receive her share in the net profit that may result from such an accounting. *(Evangelista & Co. vs. Abad Santos, 51 SCRA 416 [1973].)*

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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)

Extent of property rights of a partner.

(1) *Principal rights.* — The property rights of a partner enumerated under Article 1810 are as follows:

(a) His rights in specific partnership property (Art. 1811.);

(b) His interest in the partnership (Art. 1812.); and

(c) His right to participate in the management. (Art. 1803.)

(2) *Related rights.* — A partner has other rights which are related to the above, namely:

(a) the right to reimbursement for amounts advanced to the partnership and to indemnification for risks in consequence of management (Art. 1796.);

(b) the right of access and inspection of partnership books (Art. 1805.);

(c) the right to true and full information of all things affecting the partnership (Art. 1806.);

(d) the right to a formal account of partnership affairs under certain circumstances (Art. 1809.); and

(e) the right to have the partnership dissolved also under certain conditions. (Arts. 1830-1831.)

Partnership property and partnership capital distinguished.

The distinctions are:

(1) *Changes in value.* — Partnership property is variable — its value may vary from day to day with changes in the market value of the partnership assets, while partnership capital is constant — it remains unchanged as the amount fixed by agreement of the partners, and is not affected by fluctuations in the value of partnership property, although it may be increased or diminished by unanimous consent of the partners;[1] and

(2) *Assets included.* — Partnership property includes not only the original capital contributions of the partners, but all property subsequently acquired on account of the partnership, or in the partnership name with partnership funds, unless a contrary intention is shown, including partnership name and the goodwill of the partnership, while partnership capital represents the aggregate of the individual contributions made by the partners (see Babb & Martin, *op. cit*., p. 240.) in establishing or continuing the partnership.

Ownership of certain property.

(1) *Property used by the partnership.* — Where there is no express agreement that property used by a partnership constitutes partnership property, such use does not make it partnership property, and whether it is so or not depends on the intention of the parties, which may be shown by proving an express agreement or acts of particular conduct. (Teller, *op. cit*., p. 45, citing Blakeslee vs. Blakeslee, 265 Ill. 48.)

It is not unusual for an individual partner to allow his property to be used in the partnership business, without intending to transfer ownership of it. A partner may contribute to the partnership only the use or enjoyment of property, reserving the ownership thereof (Art. 1830[4].); or he may allow the partnership to

[1]As an amount it remains unchanged, but as an asset, its value is affected by the changing fortunes of the partnership business.

use his separate property without having it become part of partnership property. Also, he may hold title to partnership property in his own name without having it belong to him. (see Art. 1819.)

To solve the confusion that may arise, the intent of the parties — whether the property in question shall belong to the partnership or themselves — is the controlling factor.

(2) *Property acquired by a partner with partnership funds.* — Unless a contrary intention appears, property acquired by a partner in his own name with partnership funds is presumed to be partnership property. The presumption created by the use of such funds can be overcome only by a great deal of contrary evidence. But if the property was acquired after dissolution but before the winding up of the partnership affairs, it would be his separate property but he would be liable to account to the partnership for the funds used in its acquisition.

(3) *Property carried in partnership books as partnership asset.* — This fact creates a very strong inference that it is partnership properly. The inference is stronger if the records carry as a partnership liability an unpaid balance on the property.

(4) *Other factors tending to indicate property ownership.* — The fact that the income generated by the property is received by the partnership or the taxes thereon are paid by the partnership is evidence that the partnership is the owner. But the sole fact that partnership funds were later used to repair or maintain property purchased with funds of an individual partner is not sufficient as basis to show that the property now belongs to the partnership.

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. (n)

Nature of a partner's right in specific partnership property.

A partner, as such, does not actually own any part of partnership property or property owned by the partnership as a separate business entity, although he does have rights in specific partnership assets.

Article 1811 contemplates tangible property, such as a car, truck, or a piece of land, but not intangible thing such as the beneficial right to a land of the public domain like a fishpond. A fishpond of the public domain can never be considered a specific partnership property because only its use and enjoyment, never its title or ownership, is granted to specific private persons. (Deluao vs. Casteel, 29 SCRA 250 [1969].)

A partner is a co-owner with his partners of specific partnership property,[2] but the rules on co-ownership do not necessarily apply. The legal incidents of this tenancy in partnership are dis-

[2]This statement in Article 1811 is not accurate because specific partnership property is owned not by the partners in common but by the partnership as a juridical person. In contemplation of law, a partnership is a distinct and separate entity from the partners who compose it. (see Art. 1768.) The Uniform Partnership Act regards a partnership as an "association" (see Art. 1767.) and not as a legal entity; hence, it cannot hold title to partnership property in its name. However, the incidents of the co-ownership enumerated are consistent with the legal entity theory of a partnership.

tinctively characteristic of the partnership relation. They are as follows:

(1) *Equal right of possession for partnership purposes.* — Ordinarily, a partner has an equal right to possess specific partnership property for partnership purposes. None of the partners can possess and use the specific partnership property other than for "partnership purposes" (*e.g.,* for his own individual purpose) without the consent of the other partners.

(a) Should any of them use the property for his own profit or benefit to the exclusion of his partner or partners, he must account, like any stranger, to the others for the profits derived therefrom (see Arts. 1807, 1788, par. 2.) or the value of his wrongful possession or occupation. A partner who is wrongfully excluded from the possession of partnership property by his co-partner has a right to formal account from the latter (Art. 1809[1].), and even apply to a judicial decree of dissolution. (see Art. 1831[3, 4, 6].)

(b) On the death of a partner, his right in specific partnership property vests in the surviving partners, not in the legal representative of the deceased partner (except when he was the last surviving partner). That is to say, the surviving partners have the right to wind up the business, and the executor of a deceased partner cannot insist on participating in the winding up process. (Babb & Martin, *op. cit*., p. 243; see Art. 1842.)

(c) By agreement, the right to possess specific partnership property may be surrendered, and this is especially true of a partnership with large membership, where the management and possession are concentrated in the managing partners. (Crane, *op. cit*., p. 200.) It is not beyond the scope of partnership articles to provide for the vesting of exclusive control in one partner. In the absence of special agreement, however, neither partner separately owns, or has the exclusive right of possession of, any particular partnership property; nor does he own any proportional part of any particular partnership property, but each has dominion over such property and over the entire partnership property. (40 Am. Jur. 210.)

(d) The possession of partnership property by one partner is the possession of all partners until his possession becomes adverse. A partner cannot initiate title to property by adverse possession as against his co-partner, until and unless he makes an adverse claim of title under such circumstances as will charge his co-partner with notice of the adverse claim. (68 C.J.S. 527-528.)

(2) *Right not assignable.* — A partner cannot separately assign his right to specific partnership property but all of them can assign their rights in the same property.

(a) A partner's right in specific partnership property is not assignable because it is impossible to determine the extent of his beneficial interest in the property until after the liquidation of partnership affairs. As property of the partnership, the same could not be disposed of or mortgaged even by the partner who contributed the same without the consent or approval of the partnership or of the other partners. (Clemente vs. Galvan, 67 Phil. 565 [1939]; Lozana vs. Depakakibo, 107 Phil. 728 [1960].)

(b) The consent of all the partners, either express or implied, is the source and limit of a partner's right to deal with partnership property for any but a partnership purpose.

(c) The primary reasons for the non-assignability of a partner's right in specific partnership property are that it prevents interference by outsiders in partnership affairs; it protects the right of other partners and partnership creditors to have partnership assets applied to firm debts; and it is often impossible to measure or value a partner's beneficial interest in a particular partnership asset. (*In re* Decker, 295 F. Supp. 501 [1909]; Goldberg vs. Goldbeck, 375 Pa. 78; Commissioners' Note, 7 ULA, Partnership, p. 146 [1949].)

(d) Why it is often impossible to determine a partner's beneficial interest in a specific partnership property has been explained as follows:

x x x. In a sense, each partner, having thus a beneficial interest in the partnership property considered as a whole, has a beneficial interest in each part, and such

beneficial interest might be regarded as assignable if it were not impossible, except by purely arbitrary and artificial rules, to measure partner's beneficial interest in a specific chattel belonging to the partnership, or any other specific portion of partnership property.

A single illustration will make clear the impossibility of determining a partner's beneficial interest in any single piece of partnership property.

Let us suppose A and B are partners. The value of partnership property is $100,000; the liabilities amount to $50,000. A has contributed $15,000 and has a three-fourths interest in the profits; B has $10,000 and one-fourth interest in the profits. A attempts to assign his interest in certain definite chattels belonging to the partnership, the value of these chattels being $5,000. The chattels themselves must be still used for partnership purposes. On dissolution, if still part of the partnership property, they must be sold. If A conveyed anything, it was not a right in these chattels, but in a fractional part of his interest in the partnership.

But how is it to be determined of what fractional part of his interest in the partnership A intended to assign? Did he intend to give B a lien for $5,000 on his interest; or a lien on his interest for three-fourths — his share of the profits — $5,000? Or did he intend to give him a lien on his interest in the partnership which in amount should bear the same proportion to the total value of the chattel, $5,000 as the amount which he would receive should the partnership be liquidated, bears to the total of the present partnership property?

It is impossible to answer these questions. If the assigning partner did not intend to dissolve the partnership it is even impossible to analyze the possible intentions. Of course, in practice, a partner who assigns his "interest in particular partnership chattels" has only the vaguest notion of what he intends. (Commissioners' Note, 7 U.L.A. 146 [1949].)

(e) Where, however, none of the above reasons apply, an authorized assignment by a partner of his right in specific

partnership property is void, but it may be regarded as a valid assignment of the partner's interest in the partnership. The rationale of this rule is stated thus: "Where an assignment is not clearly intended to convey a partner's interest in specific partnership property, that is, his right to use partnership property for partnership purposes, but is intended to convey some interest in partnership property, the fact that the parties did not couch their assignment in proper terms does not justify a court holding their transaction void when there exists evidence establishing a basis upon which the transaction can be consistent and valid." (*In re* Decker, 295 F. Supp. 50; Shapiro vs. United States, 83 F. Supp. 375.)

The law allows a retiring partner to assign his rights in partnership property to the partner or partners continuing the business. (see Art. 1840[1, 2].)

(3) *Right limited to share of what remains after partnership debts have been paid.* — Strictly speaking, no particular partnership property or any specific or an aliquot part thereof can be considered the separate or individual property of any partner. The whole of partnership property belongs to the partnership considered as a juridical person (Art. 1768.), and a partner has no interest in it but his share of what remains after all partnership debts are paid. (Art. 1812.)

(a) Consequently, specific partnership property is not subject to attachment, execution, garnishment, or injunction, without the consent of all partners except on a claim against the partnership. "If a partner's right in specific partnership property is not assignable by voluntary assignment for a separate purpose of the assigning partner, his separate creditors should not be able to force an involuntary assignment. The beneficial rights of the separate creditors of a partner in partnership property should be no greater than the beneficial right of their debtor." (Commissioners' Note, 7 U.L.A., p. 150 [1949].)

(b) For the same reason that the property belongs to the partnership, the partners cannot claim any right under the homestead or exemption laws when it is attached for

partnership debts. A contrary rule would, in effect, allow the use of partnership property for other than partnership purposes and result in the diminution, as far as partnership creditors are concerned, of partnership property to the extent of the exemption granted. But a partner's interest in the partnership itself may be levied upon by a judgment creditor because it is actually his property, by means of a "charging order." (Art. 1814.)

(c) The right of the partners to specific partnership property is not subject to legal support under Article 195[3] of the Family Code. The reason is also because the property belongs to the partnership and not to the partners. But their interest in the partnership (Art. 1812.) is, of course, subject to legal support. (Art. 1814.)

(d) The method of reaching a judgment debtor's interest in partnership property is specifically set forth in Article 1814.

It is clear from the above that although separate creditors of an individual partner may reach the interest of a partner in the partnership, they cannot go after any specific partner property.

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

Nature of partner's interest in the partnership.

A partner's right in specific partnership property belonging to the firm to be used for business purposes *(supra.)* is to be

[3]"Art. 195. Subject to the provisions of the succeeding articles, the following are obliged to support each other to the whole extent set forth in the preceding article:
(1) The spouses;
(2) Legitimate ascendants and descendants;
(3) Parents and their legitimate children and the legitimate and illegitimate children of the latter;
(4) Parents and their illegitimate children and the legitimate and illegitimate children of the latter; and
(5) Legitimate brothers and sisters, whether of full or half-blood. (291a)"

distinguished from a partner's right to share in the firm's earned profits.

(1) *Share of the profits and surplus.* — The partner's interest in the partnership consists of his proportionale share in the undistributed profits during the life of the partnership as a going concern and his share in the undistributed surplus after its dissolution.

(a) *Profit* means the excess of returns over expenditure in a transaction or series of transactions; or the net income of the partnership for a given period of time. (see Webster's 3rd Int. Dict., p. 1811.)

(b) *Surplus* refers to the assets of the partnership after partnership debts and liabilities are paid and settled and the rights of the partners among themselves are adjusted. (see Art. 1839.) It is the excess of assets over liabilities. If the liabilities are more than the assets, the difference represents the extent of the loss.

(2) *Extent of the partner's interest.* — Nothing is to be considered as the share of a partner but his proportion of the residue or balance after an account has been taken of the debts and credits, including the amount paid by the several partners in liquidating firm debts or in making advances to the partnership, and until that occurs, it is impossible to determine the extent of his interest. This interest in the surplus alone which remains after the firm's debts have been paid and the equities between the partner and his co-partners have been adjusted and the partner's share has been ascertained and set apart, is available for the satisfaction of the separate debts of the partners. (Art. 1814; 40 Am. Jur. 209-210; Fish vs. Wood, 158 S.W. 267.)

(3) *Partner's interest not a debt due from partnership.* — A partner is not a creditor of the partnership for the amount of his share. (The Leyte-Samar Sales and K. Tomassi vs. S. Cea and O. Castrilla, 93 Phil. 100 [1953].) The interest of a partner in a going partnership business where there has been no settlement of his account is not a debt due to the partner by partnership and, therefore, is not subject to attachment or execution on a judgment recovered against the individual partner. (Northampton Brewery vs. Lande, 2A. 2d 553.)

ART. 1813. A conveyance by a partner of his whole interest in the partnership does not of itself dissolve the partnership, or, 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. 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)

Effect of assignment of partner's whole interest in partnership.

A partner's right in specific partnership property is not assignable (Art. 1811[2].) but he may assign his interest in the partnership (Art. 1812.) to any of his co-partners or to a third person without the consent of the other partners, in the absence of agreement to the contrary.

(1) *Rights withheld from assignee.* — This article permits the conveyance by a partner of his whole interest in the partnership (*e.g.*, sale, donation, as collateral security for a loan) without causing dissolution. However, such assignment does not grant the assignee the right:

(a) To interfere in the management;

(b) To require any information or account; or

(c) To inspect any of the partnership books.

(2) *Status and rights of assignor as partner unaffected.* — The legal effect of such a conveyance is the same as that of a partner associating another in his share or interest. (Art. 1804.) Partnership

is a relation in which *delectus personae* is an important element. No one may be introduced into the firm as a partner without the unanimous consent of the other partners. The assignment does not divest the assignor of his status and rights as a partner nor operate as a dissolution of the partnership. The law, however, provides the non-assigning partners with a ground for dissolving the partnership if they so desire. (Art. 1830[1, c].)

Remedy of other partners.

At common law, the mere assignment of a partner's interest dissolved the partnership because it was conceived to give rise to a situation incompatible with the prosecution of a partnership. The law has been changed under the Uniform Partnership Act from which Article 1813 was taken.

(1) *Dissolution of partnership not intended.* — The new rule is preferable for many partnership assignments are made merely as security for loans, the assigning partner never intending to destroy the partnership relation. Moreover, if the assigning partner neglects his partnership duties after assignment, the other partners may dissolve the partnership under Article 1830(1, c) which provides that "Dissolution is caused . . . 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." (Teller, *op. cit.*, p. 53.)

(2) *Dissolution of partnership intended.* — A partner's conveyance of his interest in the partnership operates as a dissolution of the partnership only when it is clear that the parties contemplated and intended the entire withdrawal from the partnership of such partner and the termination of the partnership as between the partners. (Johnson vs. Munsell, 104 N.W. 2d 314.)

Rights of assignee of partner's interest.

The only rights of the transferee or assignee are as follows:

(1) To receive in accordance with his contract the profits accruing to the assigning partner (see Machuca vs. Chuidian, 2 Phil. 210 [1903].);

(2) To avail himself of the usual remedies provided by law in the event of fraud in the management;

(3) To receive the assignor's interest in case of dissolution; and

(4) To require an account of partnership affairs, but only in case the partnership is dissolved, and such account shall cover the period from the date only of the last account agreed to by all the partners.

The mere act of assignment with nothing more, does not bring about the dissolution of the partnership. The purchaser of a partner's interest under Articles 1813 or 1814 may, however, apply to the court for the dissolution of the partnership, after the termination of the specified term or undertaking or at any time if the partnership is one at will. (Art. 1831, par. 2.)

EXAMPLE:

A, a partner, mortgaged his interest in partnership X then worth P500,000.00 to B, a bank, for P300,000.00. Subsequently, the partnership suffered losses, wiping out A's interest.

In this case, B has no legal claim against the partnership to the extent of P300,000.00. Under Article 1813, the mortgage merely entitles it to receive in accordance with its contract the profits to which A would otherwise be entitled.

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 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)

Remedies of separate judgment creditor of a partner.

(1) *Application for a "charging order" after securing judgment on his credit.* — While a separate creditor of a partner cannot attach or levy upon specific partnership property for the satisfaction of his credit (Art. 1811[3].) because partnership assets are reserved for partnership creditors (Art. 1827.), he can secure a judgment on his credit and then apply to the proper court for a "charging order," subjecting the interest of the debtor partner in the partnership (Art. 1812.) with the payment of the unsatisfied amount of such judgment with interest thereon with the least interference with the partnership business and the rights of the other partners. By virtue of the charging order, any amount or portion thereof which the partnership would otherwise pay to the debtor-partner should instead be given to the judgment creditor.

This remedy is, however, without prejudice to the preferred rights of partnership creditors under Article 1827. It means that the claims of partnership creditors must be satisfied first before the separate creditors of the partners can be paid out of the interest charged. (See Art. 1839[8].)

(2) *Availability of other remedies.* — In providing for the charging order above described, Article 1814 seems to have made

this an exclusive remedy so that a writ of execution will not be proper. (Teller, *op. cit.*, pp. 55-57.) The court may resort to other courses of action provided in Article 1814 (*i.e.*, appointment of receiver, sale of the interest, etc.) if the judgment debt remains unsatisfied, notwithstanding the issuance of the charging order.

A similar procedure is established by Article 1862 as to private creditors of a limited partner.

EXAMPLE:

T recovers a judgment against A, a member of partnership X composed of A and B, on A's individual liability.

May T attach any portion of the partnership property or execute against the same?

No. T's remedy is to apply for a charging order against the partnership. No specific property is attached. The partnership continues and T's judgment is satisfied out of partnership assets. The partnership need not be necessarily dissolved. (*Ibid.*, p. 190, citing Scott vs. Platt, 177 Ore. 515.)

Redemption or purchase of interest charged.

(1) *Redemptioner.* — The interest of the debtor-partner so charged may be redeemed or purchased with the separate property of any one or more of the partners, or with partnership property but with the consent of all the partners whose interests are not so charged or sold.

(2) *Redemption price.* — In an ordinary sale, the price of the thing sold theoretically represents its market or actual value. This is not true in a foreclosure sale where mere inadequacy of the price obtained (normally the amount of the creditor's claim) at the sheriff's sale is not material because the mortgagor is given the right to redeem. By the same token, the value of the partner's interest in the partnership has no bearing on the redemption price which is likely to be lower since it will be dependent on the amount of the unsatisfied judgment debt.

(3) *Right of redeeming non-debtor partner.* — For this reason, the redeeming non-debtor partner, it is believed, does not acquire

absolute ownership over the debtor-partner's interest but holds it in trust for him consistent with principles of fiduciary relationship.

EXAMPLE:

A, B, and C are partners. A is personally indebted to X in the sum of P5,000.00. X filed a complaint against A and obtained from the court a final judgment in his favor. If A is insolvent, X can ask the same court or any competent court for a "charging order" so that A's interest in the partnership be attached or levied upon for the payment of his debt.

The other partners, B and C, may redeem or purchase the charged interest of A, the debtor-partner, before foreclosure (*i.e.*, sale) or before the expiration of the redemption period fixed by the court in its order of sale, without dissolving the partnership[4] but such redemption or purchase is a ground for the other partners to ask for the dissolution of the partnership. (Art. 1830[c].)

Right of partner under exemption laws.

Under Article 1811, a partner cannot claim any right under the homestead laws or exemption laws when specific partnership property is attached for partnership debt.

With respect, however, to the partner's interest in the partnership as distinguished from his interest in specific partnership property, the partner may avail himself of the exemption laws after partnership debts have been paid. A partner's interest or share in the partnership is really his property. (Art. 1812.)

[4]Does the redeeming or purchasing partner acquire the interest of the debtor-partner? In case of redemption, the price ordinarily would be the amount of the creditor's claim against the debtor-partner, and the payment would be in the nature of advance to the latter. On the other hand, in case of purchase, the price would have to be based on the value of the interest purchased. It would seem that the non-debtor partner will acquire the interest of the debtor-partner in the second situation but not in the first.

ILLUSTRATIVE CASE:

Judgment creditor and the receiver of interest of judgment debtor-partners seek to annul mortgages of property executed by the latter, individually, in favor of a third party.

Facts: C, a bank, has unsatisfied judgment against A and B, partners in Partnership X. C procured the appointment of D as receiver of all rights and interests of A and B in and to the partnership, and also got an order sharing their interest in the firm with payment of the judgment debt. C and D brought action to annul certain mortgages encumbering livestock, farm equipment, and other specific chattels executed in favor of E not by or for the firm but by A and B, individually.

It is claimed for plaintiffs that the mortgages in question are void. The principal argument for defendants is that, whatever the status of the mortgages, neither plaintiff can question them.

Issue: Is the argument of the defendants tenable?

Held: No. (1) *Partner's interest, not in specific partnership property, but in partnership itself.* — Tenancy in partnership is a restricted adaptation of the common-law joint tenancy to the particular needs of the partnership relation. One of those needs arose from the formerly conflicting claims to specific partnership property of (1) separate creditors of a partner, and (2) assignees of a partner's share in an aliquot part of the firm assets.

To meet that need, two simple "incidents" have been attached to the tenancy of the partnership: (1) expressly, the interest of each tenant or partner in specific partnership property is put beyond reach of his separate creditors; and (2) it has been made non-assignable. This means simply that the partner-owner is deprived of all power of separate disposition even by will.

All a partner has now, subject to his power of individual disposition, and all that is subject to the claims of his separate creditors, is his interest, not in specific partnership property, but in the partnership itself. Plain is the purpose that all partnership property is to be kept intact for partnership purposes and creditors.

(2) *Receiver of partner's "share in profits" entitled to relief.* — It follows that a receiver of a partner's "share of profits," acting under a charging order and Section 28 (Art. 1814.) has the right in a proper action to have adjudicated the nullity of any mortgage

or any other assignment by some but not all of the partners of their interest in specific property of the partnership less than the whole. Such a receiver is entitled to any relief under the language of the statute "which the circumstances of the case may require" to accomplish justice under the law. Obviously, a part of such relief is the avoidance of any unauthorized attempt to dispose of the partnership property.

Such a receiver is entitled to the "share of the profits and surplus" of the partner who happens to be the judgment debtor. While he is not entitled to the management of the firm as a partner, the receiver would be of little use if he could not protect "profits and surplus" by preventing such unauthorized and illegal dissipations of firm assets. *(Windom National Bank vs. Klein, 254 N.W. 602 [Minn. 1934].)*

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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)

Requirement of a firm name.

(1) *Meaning of word "firm."* — The word "firm" is defined as the name, title, or style under which a company transacts business; a partnership of two or more persons; a commercial house. In its common acceptation, the term implies a partnership. The term is also used as synonymous with "company," "house," and "concern." (68 C.J.S. 405, 488; 31 Words and Phrases 324.)

(2) *Importance of having a firm name.* — A partnership must have a firm name under which it will operate. A firm name is necessary to distinguish the partnership which has a distinct and separate juridical personality (Art. 1768.) from the individuals composing the partnership and from other partnerships and entities. Under the Business Name Law (Sec. 1, Act No. 3883, as amended.), such firm name must be registered with the Bureau of Commerce (now with the Intellectual Property Office created under R.A. No. 8293).

(3) *Right of partners to choose firm name.* — The partners enjoy the utmost freedom in the selection of the partnership name. As a general rule, they may adopt any firm name desired. The firm name of a partnership may be that of an individual partner, the surnames of all the partners, or the surname of one or more of the members with the addition of "and Company," or it may consist

of individual names wholly distinct from the names of any of the members, or it may be a name purely fanciful or fictitious. But whatever the firm name may be, the signature of the firm name is, in law, the signature of the several partners' name. (68 C.J.S. 487-488.)

(a) *Use of misleading name.* — The partners cannot use a name that is "identical or deceptively confusingly similar to that of any existing [partnership] or corporation or to any other name already protected by law or is patently deceptive, confusing or contrary to existing laws" (Sec. 18, Corporation Code.), as to mislead the public by passing itself off as another partnership or corporation, or its goods or services as those of such other company.

(b) *Use of names of deceased partners.* — The Supreme Court has ruled that a partnership cannot continue to use in its firm name, the names of deceased partners for such use "will run counter to Article 1815. It is clearly tacit in the above provision that names in a firm name of a partnership must either be those of living partners and, in the case of non-partners, should be living persons who can be subjected to liability. In fact, Article 1825 prohibits a third person from including his name in the firm name under pain of assuming the liability of a partner." (In the Matter of the Petition for authority to continue use of the firm name "SyCip, Salazar, etc." / "Ozaeta, Romulo, etc.," 92 SCRA 1 [1979].)

This ruling must be considered abandoned in view of Rule 3.02 of the Code of Professional Responsibility approved and adopted by the Supreme Court on June 21, 1988 which provides: "In the choice of a firm name, no false, misleading or assumed name shall be used. The continued use of the name of a deceased partner is permissible provided that the firm indicates in all its communications that said partner is deceased."

EXAMPLE:

A, who retired as a member of partnership X, executed a legacy to the partnership then composed of B, C, and D. A few years later, A died. At the time of his death, the partnership

was composed of E, F, and G, the former members having predeceased A. The partnership was continued by agreement of the parties whenever there was a change in membership.

The legacy vests in partnership X, notwithstanding that E, F, and G were unknown to A during his lifetime. It may be argued, however, that the intention of A was to give the legacy to the old partnership which no longer exists.

ILLUSTRATIVE CASE:

A law firm seeks the continued use of the name of a deceased partner in the firm name.

Facts: "A, B, C, D, and E" (which are family names) is the firm name of a law partnership. A passed away. B, C, and D, the surviving partners, filed a petition for authority to continue use of the firm name "A, B, C, D, and E."

Issue: May the partnership continue the use of the name of the deceased partner?

Held: No. The use of the name of A will run counter to Article 1815. In fact Article 1830(5) clearly ordains that a partnership is dissolved by the death of any partner. Unlike in the United States, in our jurisdiction there is no local custom that sanctions the practice of allowing the continued use of a deceased or former partner's name in the firm name of law partnerships, and even if such a custom exists, the same cannot be applied as it is contrary to law. Firm names, under our custom, identify the more active and/or more senior members or partners of the law firm.

Prescinding the law, there could be practical objections to allowing the use by law firms of the names of deceased partners. The public relations value of the use of an old firm name can tend to create undue advantages and disadvantages in the practice of the profession. An able lawyer without connections will have to make a name for himself starting from scratch. Another able lawyer, who can join an old firm, can initially ride on that old firm's reputation established by deceased partners.

Moreover, the possibility of deception upon the public, real or consequential, cannot be ruled out. A person in search of legal counsel might be guided by the familiar ring of a distinguished name appearing in a firm title.

The name of a deceased partner may, however, be included in the listing of individuals who have been partners in the firm indicating the years during which they served as such. *(Ibid.)*

Note: As mentioned before, Rule 3.02 of the Code of Professional Responsibility allows or permits the surviving partners of a law firm the continued use of the name of a deceased partner provided there is an indication that the said partner is already dead.

Liability for inclusion of name in firm name.

Persons who, not being partners, include their names in the firm name do not acquire the rights of a partner (see Art. 1767.) but under Article 1815, they shall be subject to the liability of a partner (Art. 1816.) insofar as third persons without notice are concerned. (see Jo Chung Cang vs. Pacific Commercial Co., 45 Phil. 142 [1923]; Phil. National Bank vs. Lo, 50 Phil. 803 [1927].) Such persons become partners by estoppel. (Art. 1825.)

Article 1815 does not cover the case of a limited partner who allows his name to be included in the firm name (Art. 1846.), or of a person continuing the business of a partnership after dissolution, who uses the name of the dissolved partnership or the name of a deceased partner as part thereof. (Art. 1840, last par.)

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)

Liability for contractual obligations of the partnership.

(1) *Partnership liability.* — Partners are principals to the other partners and agents for them and the partnership. They are liable

to third persons who have dealt with one of them in the same way that a principal is liable to third persons who have dealt with an agent. (see Art. 1818.)

The general rule is that a partner has the right to make all partners liable for contracts he makes for the partnership in the name and for the account of the partnership but only if the partner was authorized, *i.e.*, he had actual (or apparent) authority. The authority can be expressly granted in the partnership agreement or by the other partners subsequently. A partner has implied authority to bind the partnership in transactions that are for the purpose of "carrying on in the usual way the business of the partnership." (Art. 1818, par. 1.)

(2) *Individual liability.* — A partner, however, may assume a separate undertaking in his name with a third party to perform a partnership contract or make himself solidarily liable on a partnership contract. In such case, the partner is personally bound by his contract even if only the partnership is shown to have derived benefits from it.

Nature of individual liability of partners.

Article 1816 lays down the rule that the partners, including the industrial partner, are liable to creditors of the partnership for the obligations contracted by a partner in the name and for the account of the partnership. The debts and obligations of the partnership are, in substance, also the debts and obligations of each individual member of the firm. Their individual liability to creditors is *pro rata* and subsidiary.[1]

(1) *Pro rata*. — As used in the law, the term must be understood to mean equally or jointly, and not proportionately which is its literal meaning, because the pro-rating is based on the number of partners and not on the amount of their contributions to the common fund, subject to adjustment among the partners. (see Art. 1839[4].)

[1]All persons (not stockholders or members) who assume to act as a corporation knowing it without authority to do so, shall be liable as general partners for all debts, liabilities and damages incurred or arising as a result thereof. (Sec. 21, B.P. Blg. 68 [Corporation Code of the Philippines].)

The fact that a partner has left the country and the payment of his share of the liability cannot be enforced (see Co-Pitco vs. Yulo, 8 Phil. 544 [1907].); or his liability is condoned by the creditor (Island Sales, Inc. vs. United Pioneers Gen. Construction Co., 65 SCRA 544 [1975].) cannot increase the liability of the other partners. Article 1816 refers to the extent of the share of the partners in the partnership liability for its contractual debts. It should be read together with Article 1824 where a third person can hold the partners solidarily liable for the whole obligation if his case falls under Article 1822 or Article 1823. (Muñasque vs. Court of Appeals, 139 SCRA 533 [1985].)

Under Article 127 of the Code of Commerce, all members of a general partnership "are liable personally and *in solidum* with all their property." The basic rule (Art. 1698.) in the old Civil Code on the personal but subsidiary liability of the partners *pro rata* for the obligations of the partnership has been retained. (now Arts. 1816 and 1817.) "The Commission considers the solidary liability laid down in the Code of Commerce as inadvisable, such liability being one of the causes of the reluctance and fear with which the formation of business partnerships has been regarded by all." (Report of the Code Commission, pp. 148-149.)

(2) *Subsidiary or secondary.* — It is subsidiary or secondary because the partners become personally liable only after all the partnership assets have been exhausted. (see, however, Arts. 1826, 1834 [par. 2], 1835 [par. 2, 1840], 2nd and last pars.) Thus, the partners are liable as guarantors[2] in favor of partnership creditors to the extent that the assets of the firm are not sufficient to meet its obligations. They may be joined as party defendants in the same action against the partnership subject to their right to prior exhaustion of partnership property. (Compania Maritima vs. Muñoz, 9 Phil. 326 [1907]; see De los Reyes vs. Tukban, 35 Phil. 757 [1916]; Vda. de Chan Diaco vs. Peng, 53 Phil. 906 [1929]; Phil. National Bank vs. Lo, 52 Phil. 802 [1929].)

[2]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.
x x x. (1822a)

(3) *Liability of industrial partner.* — Even the industrial partner who, ordinarily, is not liable for losses (Art. 1797.) would have to pay but, of course, he can recover the amount he has paid from the capitalist partners unless there is an agreement to the contrary. Neither on principle nor on authority can the industrial partner be relieved from liability to third persons for the debts of the partnership. (Compania Maritima vs. Muñoz, 9 Phil. 326 [1907].)

ILLUSTRATIVE CASE:

In a complaint against a partnership and five partners, the complaint as to one of the partners was dismissed, and the four claimed that the liability of each of them should not exceed 1/5 of the entire obligation.

Facts: X company, a general partnership, purchased from A a motor vehicle on installment basis. Upon failure of the partnership to pay an installment, A sued it and the five partners, B, C, D, E, and F. B failed to file an answer and was declared in default. Subsequently on motion of A, the complaint was dismissed insofar as F was concerned. The rest of defendants failed to appear at the hearing and were declared in default.

Judgment was rendered against the partnership and the four partners, B, C, D, and E. B and C moved to reconsider, saying that since there were five general partners, the joint and subsidiary liability of each partner should not exceed one-fifth of the obligations of the company. The lower court denied the motion, hence the appeal.

Issue: Should B, C, D, and E alone be held liable for the obligation of the company in view of the dismissal of the complaint with respect to F?

Held: No. In the instant case, there were five general partners when the promissory note in question was executed for and in behalf of the partnership. Since the liability of the partners are *pro rata*, the liability of each partner shall be limited to only one-fifth of the obligations of X company. The fact that the complaint against F was dismissed, upon motion of A, does not unmake F as a general partner in the defendant company. (*Island Sales, Inc. vs. United Pioneers General Construction Company, 65 SCRA 554 [1975];* see Dietrich vs. Freeman, 18 Phil. 341 [1911]; Co-Pitco vs. Yulo, 8 Phil. 544 [1907].)

Distinction between a liability and a loss.

There is a marked distinction between a liability and a loss.

(1) The inability of a partnership to pay debt to a third party at a particular time does not necessarily mean that the partnership business, as a whole, has been operated at a loss. The partnership may have outstanding credits which for the moment may be unavailable for the payment of debts, but which eventually may be realized upon and yield profits more than sufficient to cover all losses.

(2) The exemption of the industrial partner to pay *losses* relates exclusively to the settlement of the partnership affairs among the partners themselves and has nothing to do with the *liabilities* of the partners to third persons. An industrial partner is not exempted from liability to third persons for the debts of the partnership. (Compania Maritima vs. Muñoz, 9 Phil. 326 [1907].)

Article 1816 refers to "liabilities" while Article 1797 speaks of "losses." There is, therefore, no conflict between the two articles. (Pacific Commercial Co. vs. Aboitiz & Martinez, 48 Phil. 841 [1926].)

No distinction between obligations and losses.

During the existence of a partnership, the gains or the losses are set off, the one against the other, and the difference is either in favor of or against the concern. As to the industrial partner, it is not a matter of striking a balance from time to time, but one of the final adjustment of assets and liabilities. As long as there is property belonging to the partnership, obligations in favor of third persons are covered by the primary and direct responsibility of the partnership.

The question arises when the assets of the partnership are exhausted and it becomes necessary to enforce the subsidiary liability of the private property of the partners. In this case, such obligations constitute the extreme losses in the liquidation of the partnership. (Compania Maritima vs. Muñoz, *supra.*)

EXAMPLE:

A and B are capitalist partners, with C as an industrial partner. A and B contributed P10,000.00 each to the capital of the partnership. A contractual liability of P26,000.00 was incurred by the partnership in favor of D.

Under Article 1816, D can sue the firm and all the partners including C, the industrial partner. The capital assets of P20,000.00 shall first be exhausted thereby leaving an unsatisfied liability of P6,000.00. D can recover the amount from A, B, and C jointly or *pro rata* at P2,000.00 each. After paying D, C can recover for reimbursement of P1,000.00 each from A and B. Under Article 1797, he is exempted from the loss of P6,000.00 as among themselves, unless there is a stipulation to the contrary.

If, in the same example, the capital contributions of A and B are P15,000.00 and P5,000.00, respectively, in the absence of stipulation, they share in the loss of P6,000.00 in proportion to their contributions, to wit: A — 3/4 or P4,500.00, and B — 1/4 or P1,500.00. Hence, B can recover P500.00 and C, P2,000.00 from A.

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

Stipulation against liability.

A stipulation among the partners contrary to the *pro rata* and subsidiary liability expressly imposed by Article 1816 is void and of no effect insofar as it affects the rights of third persons. It is valid and enforceable only as among the partners.

EXAMPLE:

A, B, and C are partners in a business. Each of them contributed P10,000.00 each. They stipulated that the liability of A shall not exceed his capital contribution.

Thus, if the partnership assets have been exhausted and there still remains an unpaid balance of P9,000.00 in favor of creditor D, the latter can still recover P3,000.00 each from the partners as their stipulation cannot adversely affect him. However, since the agreement is binding among the partners,

A is entitled to credit from B and C for the amount of P3,000.00 paid by him to D. A, however, cannot recover his contribution of P10,000.00. (see Art. 1799.)

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

An act of a partner which is not apparently for the carrying on of the 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)

Power of partner as agent of partnership.

In the absence of an agreement to the contrary, all partners have equal rights in the management and conduct of the partnership business. (Art. 1803.)

(1) *As among themselves.* — When a partner performs an act within the scope of his actual, implied, or apparent authority, he is not only a principal as to himself, but is also for all purposes, an agent as to his co-partners or to the partnership, considered as a group. Thus, his act concerning partnership business and every contract signed in the partnership name bind the firm. The general rules of law applicable to agents likewise apply to partners. Each partner is a fiduciary of the other partners.

As a matter of fact, the law of partnership is a branch of the law of agency. Accordingly, the liability of one partner for the acts of his co-partners is founded on the principle of mutual agency.[3] (40 Am. Jur. 224.)

(2) *As to third persons.* — Limitations upon the authority of any one of the partners are not binding upon innocent third persons dealing with the partnership (Art. 1818, par. 4.), who have the right to assume that every general partner has power to bind the partnership especially those partners acting with ostensible authority, by whatever is proper for the transaction in the ordinary and usual manner of the business of the partnership.

(a) *No duty to make inquiries as to acting partner's authority.* — Third persons are not bound, in entering into a contract with any of the partners, to ascertain whether or not the partner with whom the transaction is made has the consent of the other partners. The public should not make inquiries as to the agreements had between the partners. The regular course of a business procedure does not require that each time a third person contracts with one of the managing partners, he should inquire as to the latter's authority to do so, or that he should first ascertain whether or not the other partners

[3]While to a great extent partnership law derives from the agency law, the former is distinct from the latter. (see "Agency distinguished from partnership" under Article 1868, Chap. 1, Part II.)

had given their consent thereto. His knowledge is enough that he is contracting with a partner.

(b) *Presumption that acting partner has authority to bind partnership.* — There is a general presumption that each individual partner is an agent of the firm and that he has authority to bind the firm in carrying on the partnership transactions. The presumption is sufficient to permit third persons to hold the firm liable on transactions entered into by any one of the members of the firm acting apparently in its behalf and within the scope of his authority. (Litton vs. Hill & Ceron, 67 Phil. 513 [1939], cited under Art. 1802; Goquiolay vs. Sycip, 105 Phil. 984 [1960] and 9 SCRA 663 [1963]; see Muñasque vs. Court of Appeals, 139 SCRA 533 [1985].)

(c) *No right to assume that acting partner has unlimited authority.* — The apparent scope of the partner's authority is the whole scope of the partnership's customary business. However, third parties should not assume that a partner has unlimited authority. Generally, a partner has no authority to do the acts enumerated in the third paragraph of Article 1818. When a third party deals with a partner who has no express, implied, or apparent authority, the partnership is not liable for his acts unless the other partners ratify his acts or are estopped from asserting the partner's lack of authority.

Liability of partnership for acts of partners.

The acts of a partner mentioned in Article 1818 may be grouped into three.

(1) *Acts for apparently carrying on in the usual way the business of the partnership (par. 1.).* — Every partner is an agent and may execute such acts with binding effect on the partnership even if he has in fact no authority unless the third person has knowledge of such lack of authority.

In other words, there are two requisites in order that the partnership will not be liable:

(a) The partner so acting has in fact no authority; and

(b) The third person knows that the acting partner has no authority.

EXAMPLES:

(1) A, B, and C are partners in the buying and selling of home appliances. The sale of a refrigerator by C to D is binding upon the partnership because it is apparently for carrying on in the usual way the business of the partnership even if C had, in fact, no authority.

But if D had knowledge of such lack of authority, then the partnership would not be bound by the act of C.

(2) Where the partnership business is to deal in merchandise and goods, *i.e.*, movable property, the sale of its real property (immovables) is not within the ordinary powers of a partner, because it is not in line with the normal business of the firm.

But where the express and avowed purpose of the partnership is to buy and sell real estate, the immovables thus acquired by the firm form part of its stock-in-trade (not merely as business site), and the sale thereof is in pursuance of partnership purposes, hence, within the ordinary powers of the partner. (Goquiolay vs. Sycip, 9 SCRA 663 [1963].)

Usual way may be interpreted as meaning usual for the particular partnership or usual for similar partnerships. (Crane, *op. cit*., p. 243.) Actually, the acts mentioned in No. (1) refer only to acts of administration (see Art. 1800.) as distinguished from acts of strict dominion or ownership.

EXAMPLE:

P, partner, makes an agreement with T to sell the furnishings of an office maintained by the partnership in connection with its business.

May T enforce the agreement against the partnership?

No. The general rule is that a single partner has no implied power to sell partnership property not held for sale. (Teller, *op. cit*., p. 185.)

(2) *Acts of strict dominion or ownership (pars. 2 and 3.).* — For acts which are not apparently for carrying on in the usual way the business of the partnership, the partnership is not bound, unless authorized by *all* the other partners or unless they have abandoned the business. The general rule is that powers not specifically delegated in a partnership agreement are presumed to be withheld.

(a) The instances of acts which are generally outside the implied power of a partner are enumerated in the third paragraph. They constitute limitations to the authority granted to the partners to bind the partnership.

(b) Whatever acts are done by any partner in regard to partnership property or contracts beyond the scope and objects of the partnership, must, in general, to bind the partnership, be derived from such further authority, express or implied, conferred upon such partner, beyond that resulting from his character as partner. This principle is incorporated in the second paragraph of Article 1818. In the application of this principle, it is held that where a partnership is limited to a particular trade or business, one partner cannot bind his co-partner by any contract not relating to such trade or business, or by any contract made after such business is concluded.

(c) Similarly, if the purposes of a partnership are limited or special, third persons cannot obtain credit on the faith of the firm in relation to a matter foreign to its objects, although if the objects of the partnership are general, the power to bind may be equally general. (40 Am. Jur. 227.)

(3) *Acts in contravention of a restriction on authority (par. 4.).* — The partnership is not liable to third persons having actual or presumptive knowledge of the restrictions, whether or not the acts are for apparently carrying on in the usual way the business of the partnership. For example, when a partnership is formed for a special purpose and is limited, and a partner gives promissory notes in the name of the firm for his individual obligation, the other partner is not liable, if the notes are issued without the latter's knowledge or consent, and the person receiving them is aware that they are not issued for a firm debt.

On the other hand, persons not having such notice have a right to assume that the authority of a partner is co-extensive with the business transacted by his firm. Thus, it is always presumed, when there is no evidence to the contrary, that when a member of a firm borrows money or gives a note in the name of the firm, the transaction is for a partnership purpose, and the burden of proof is on the firm to show the contrary, and a contract made by a partner in the name of the firm is *prima facie* binding on the firm unless it is made outside the firm's business. (40 Am. Jur. 230-231.)

Liability of partner acting without authority.

As a general rule, the particular partner who undertakes to bind his co-partners by a contract without authority is himself personally liable on such contract.

Such partner binds himself no matter in what name he contracts. The fact that he attempts to bind his co-partners and does not succeed does not avoid his own act. He cannot be admitted to say that he was not authorized to make a contract, as he is estopped to deny its effect or validity. (*Ibid*., 235.)

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

Where the title to real property is in the name of one or more or all 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 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)

Conveyance of real property belonging to the partnership.

(1) *Prima facie ownership of real property.* — The ownership of real estate is *prima facie* that indicated by the muniment of title. Ordinarily, title to real property or interest therein belonging to the partnership is registered in the partnership name. However, for one reason or another, the title to the property is not held by the partnership, although as between the partners there is no question that it is a partnership property. The presumption is that, property purchased with partnership funds belongs to the partnership unless a contrary intent is shown.

(2) *Legal effects of conveyance.* — Article 1819 gives the legal effects of the conveyance of real property belonging to the partnership depending in whose name it is registered and in

whose name it is conveyed. Under the article, the real property may be registered or owned in the name of:

(a) The partnership (pars. 1, 2.);

(b) One or more but not all the partners (par. 3.);

(c) One or more or all the partners, or in a third person in trust for the partnership (par. 4.); or

(d) All the partners. (par. 5.)

(3) *Scope of term "conveyance."* — It will be noticed that under paragraphs 1, 3, and 5 of Article 1819, what is conveyed is title or ownership, while under paragraphs 2 and 4, what is conveyed is merely the equitable interest. The term "conveyance" used in the last paragraph, which is taken from Section 10 of the American Uniform Partnership Act, has been interpreted to include a mortgage. Thus, the right to mortgage is included in the right to convey. This is different from the rule in agency (Art. 1879.) that a special power to sell excludes the power to mortgage. (Santiago Syjuco, Inc. vs. Castro, 175 SCRA 171 [1989].)

EXAMPLES:

(1) *Title in partnership name, conveyance in partnership name (par. 1.).* — A, B, and C are partners in a partnership known as X & Co. A sold a parcel of land registered in the name of X & Co. to D without express authority.

The conveyance passes title to D; but X & Co. can recover the property if (a) the conveyance was not in the usual way of business, or (b) D had knowledge of the fact that A has no authority even though the conveyance was made in the usual way of business.

In no case may the partnership recover if D had, in turn, conveyed the property to E who had no knowledge of A's lack of actual authority in making the conveyance to D.

(2) *Title in partnership name, conveyance in partner's name (par. 2.).* — In the same example, if the sale was executed by A in his own name to D, the latter does not become the owner of the land. He gets only the equitable interest of X & Co., assuming that the selling of the land is in the usual course of business of the partnership.

D would not be entitled even to the equitable interest if:

(a) X & Co. is not engaged in the buying and selling of lands; or

(b) D had knowledge of A's lack of authority although the sale was made in the usual course of business.

Equitable interest or title is one not duly recognized by law but in equity alone; it is a right or interest in property which is imperfect and unenforceable at law but which, under well-recognized equitable principles, should be and is convertible into a legal right or title. (30 C.J.S. 401.)

(3) *Title in name of one or more partners, conveyance in name of partner or partners in whose name title stands (par. 3.).* — Although the parcel of land in question really belongs to the partnership X & Co., it is, however, registered in the name of A and the record does not disclose the right of X & Co. In this case, if A sold the land in his own name to D, title is conveyed to D. The effect is the same as in paragraph 1.

(4) *Title in name of one or more or all partners or a third person in trust for partnership, conveyance executed in partnership name or in name of partner.* — Suppose the parcel of land is in the name of A in trust for the partnership X & Co. If A sells the land to D in the name of X & Co. or in his (A's) name, the conveyance will pass only the equitable interest of X & Co., A, being a mere trustee of the partnership. The rule is the same as in paragraph 2.

(5) *Title in name of all partners, conveyance in name of all partners.* — If the parcel of land is registered in the name of A, B, and C, conveyance made by all of the partners to D will pass title to the property for the law says "a conveyance by all the partners passes all their rights in such property." The effect obviously would be the same though the sale is not in the usual course of business of X & Co.

Innocent purchasers without notice.

Regardless of the fact that one partner cannot convey partnership realty without the concurrence of his co-partners, it is fundamental that innocent purchasers without notice may be protected.

(1) Where the legal title is in the partner making the conveyance, although the equitable title is in the firm, a purchaser with-

out notice may acquire a valid title, since he has the right to presume that possession or interest of the partnership is subordinate to and not inconsistent with the record title.

(2) Under Article 1819, a conveyance by a partner of partnership property in the partnership name even though without authority, cannot be recovered by the partnership where it has been conveyed by the grantee to a holder for value and without notice or knowledge that the partner, in making the conveyance, had exceeded his authority. (par. 1.)

(3) The purchaser need not have either actual or constructive notice of any trust or other condition limiting the authority of the partner making the conveyance. Notice of a partnership interest in real property is not created by mere knowledge of the fact that the holder of the legal title is a member of a partnership which is using the property for partnership purposes. The title of such purchaser will be protected. (40 Am. Jur. 251.)

Authorization or ratification of conveyance.

A conveyance of partnership realty by one partner may be authorized by his co-partners, or when made without authority, may be ratified by them. Such authority or ratification must affirmatively appear, for the authority of one partner to make and acknowledge a deed for the partnership will not be presumed.

(1) After the lapse of many years from the time of execution of a conveyance by a partner purporting to act for the partnership, authority or ratification will be presumed.

(2) It has sometimes been said that the authority to execute a deed in behalf of a firm should be conferred in writing and not by parol (see Art. 1874.), although the decisions on the point are not wholly uniform, partners having been held bound because of previous parol authority.

(3) It has also been held that one partner, in the presence of his co-partners, may, by parol authority, execute a deed for them which will amount to an execution of the deed of all the partners.

(4) The authority may also be implied from the nature of the partnership business, and where a firm is engaged in the business

of buying and selling real estate, a contract of sale executed by one of the partners in the firm name is valid.

(5) When a deed is executed on behalf of a firm by one partner, the other partner will also be bound if there is subsequent adoption of the act.

(6) A ratification may be inferred from the presence of the other partners at the execution and delivery, or from their acting under it or knowingly taking the benefits arising therefrom. (40 Am. Jur. 251-256.)

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)

Admission by a partner.

As a general rule, a person is not bound by the act, admission, statement, or agreement of another of which he has no knowledge or to which he has not given his consent except by virtue of a particular relation between them. (Samilliano vs. Samilliano, [C.A.] 52 O.G. 4296.)

(1) Admissions by a party as testified to by a third person are admissible in evidence against him in litigation.

(2) Admissions by another are received against a party if the former is acting in the capacity of agent of the latter. Thus, under Article 1820, the admission of a partner made during the existence of the partnership are binding against the partnership (and co-partners) when such admissions refer to a matter concerning partnership affairs and made within the scope of his authority.

(3) When a partner makes admissions for himself only without purporting to act for the partnership, he alone shall be chargeable with his admissions.

(4) After dissolution, admission made by a partner will bind the co-partners if connected with the winding up of partnership affairs. (see Art. 1834.)

EXAMPLES:

(1) A borrowed P1,000 from B in whose favor he executed a promissory note. A made the statement that he was acting for C and that the money was intended for C. C never authorized A to borrow money from B. The declaration of A that he was acting for C and that the money was intended for C is not admissible against C as to make him liable to B.

(2) Suppose C said on one occasion in the presence of D that he received the money or that the contract was entered into by A with his (C's) consent, this statement can be testified to by D in a litigation by B against C.

(3) If A was really an agent of C in the transaction, then, whatever is said or done by A while acting within the scope of his authority is admissible against C, his principal, the same as if C personally entered into the contract with B.

(4) Assuming that A is a partner and C is the partnership, it is clear, on the same legal principle, that the statement of A while transacting the business of the partnership within the scope of his authority is evidence against the partnership.

(5) Where, however, A acted in his own name and B extended the loan on the personal credit of A, any admission made by A is not binding on C, the partnership.

ILLUSTRATIVE CASE:

A partner made an admission to victim of accident caused by son of another partner that son was on business for the firm when accident occurred.

Facts: T sued partnership X composed of A, B, and C for injuries he suffered as a result of an accident caused by the son of A, who was driving a car owned by the partnership. B admitted to T that the son was on business for the partnership when the accident occurred. Subsequently, A and C denied B's statement.

Issue: Does the admission of B make the partnership liable?

Held: No. (1) *Admission made not connected with partnership business.* — Whether the admission of liability made by a partner binds the partnership depends on whether the partner was acting within the scope of express, implied, or apparent

authority at the time of making the statements or declarations. One partner is not the agent of the firm for purposes of admitting either the existence of the partnership or that a transaction was a part of the partnership's business. A partner cannot by his declaration alone bring a transaction within the scope of the business when the facts show that it has no connection with the partnership business.

The evidence did not show that B was carrying out the partnership's business when he admitted the son's purpose.

(2) *Admission made without knowledge or consent of other partners.* — Statements of a partner bind the partnership only if they are made in the course of, related to, and are material to, the transaction of the partnership's business. A partnership is a joint affair, and to charge it with liability there must be joint words or actions. An individual partner cannot do this.

Neither A nor C spoke for the firm; neither consented for B to speak. *(Caswell vs. Maplewood Garage, 149 A 746 [Sup. Ct. N.H. 1930].)*

Existence of partnership must be proved.

(1) Before the partnership can be charged with the admission of a partner under Article 1820, the partnership relation must be shown and proof of that fact must be made by evidence other than the admission itself. (Sec. 29, Rule 130,[4] Rules of Court.) Hence, if in the example given (No. 4.), the existence of the partnership is denied, B must first prove the same by evidence other than the statement of A before such statement can be used as evidence against the partnership.

(2) Once the existence of the partnership relation has been proven by other independent evidence, statements or admissions, made by any partner speaking for the partnership concerning

[4]Sec. 29. *Admissions by co-partner or agent.* — The act or declaration of a partner or agent of the party within the scope of his authority and during the existence of the partnership or agency, may be given in evidence against such party after the partnership or agency is shown by evidence other than such act or declaration. The same rule applies to the act or declaration of a joint owner, joint debtor, or other person jointly interested with the party.

partnership affairs while acting within the scope of his authority are admissible as evidence against the partnership.

(3) Admissions or declarations made in the presence of the person to be charged as a partner are admissible to prove the existence of the partnership. Thus, where A states in the presence of C that A is a partner in partnership X composed of A and C, and C remains silent, the statement may be offered in evidence to show that A and C are partners.

(4) It has been held that an admission made by a partner who was no longer a partner at the time of the declaration is not admissible in evidence against the partnership. (Congco vs. Trilliana, 13 Phil. 194 [1909].)

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)

Notice to, or knowledge of, a partner of matter affecting partnership affairs.

Like the law of agency, the law of partnership imputes notice to, or knowledge[5] of, any partner of any matter relating to partnership affairs to the partnership except in case of fraud. The reason is that members of a partnership stand in a fiduciary relationship to one another, and it is presumed that the partners disclose to one another all relevant information concerning partnership business.

A third person desiring to give notice to a partnership of some matter pertaining to the partnership business need not

[5]As to meaning of "notice" and "knowledge," see comments under Article 1833.

communicate with all the partners. If notice is delivered to a partner, that is an effective communication to the partnership notwithstanding the failure of the partner to communicate such notice or knowledge to his co-partners.

Cases of knowledge of a partner.

Article 1821 speaks of three cases of knowledge, namely:

(1) Knowledge of the partner acting in the particular matter acquired while a partner;

(2) Knowledge of the partner acting in the particular matter then present to his mind; and

(3) Knowledge of any other partner who reasonably could and should have communicated it to the acting partner.

EXAMPLES:

(1) A, B, and C are partners in partnership X and Co. D filed an action against X and Co. on a contract. The service of notice of the complaint made on A only, operates as service to the partnership or to all the partners.

(2) A, acting for the partnership, bought a parcel of land from D. Before the sale, A acquired some knowledge that the land is involved in litigation in which E claims to be the owner. Nevertheless, A did not convey the information to the partnership. Later on, E was able to recover the land. In this case, A's knowledge is knowledge of the partnership.

The knowledge by A may have been acquired before he became a partner provided the same was then present to his mind. This proviso involves a question of fact and it may be difficult to prove that such knowledge was present to A's mind. It is believed, however, that once prior knowledge by the acting partner is shown, such knowledge must be presumed to be "then present to his mind," unless the partnership proves otherwise.

(3) If B (he is not the acting partner) had received the information and it is reasonable to believe that he could and should have communicated it to A (the acting partner), B's knowledge also operates as knowledge of the partnership. However, if B acquired knowledge or notice before he became

a partner, then, there is neither notice to nor knowledge of the partnership.

(4) If A, in the second example, deliberately did not inform the partnership regarding the claim of E for a consideration paid or promised by D, the notice to or knowledge of A cannot be imputed to the partnership, because the law says "except in the case of a fraud on the partnership committed by or with the consent of that partner."

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)

Liability arising from partner's wrongful act or omission or breach of trust.

(1) *Solidary liability.* — The above three articles provide for the solidary liability of the partners and also the partnership to third persons (Art. 1824.) for the wrongful act or omission (Art. 1822.) or breach of trust (Art. 1823.) of a partner acting within the scope of the firm's business or with the authority of his co-partners. This is true even though the other partners did not participate

in, or ratify, or had no knowledge of the act or omission, without prejudice to their right to recover from the guilty partner.

It has been held that in workmen's compensation cases, the liability of business partners arising from compensable injury or death of an employee should be solidary. (Liwanag and Reyes vs. Workmen's Compensation Commission, 105 Phil. 741 [1959].)

(2) *Different from liability under Article 1816.* — This liability of the partners under the above articles is different from their liability for *contractual* obligations as defined in Article 1816. Here, it is solidary, while in Article 1816, it is joint and subsidiary. Furthermore, while the liability in Article 1816 refers to partnership obligations, this article covers the liability of the partnership arising from the wrongful acts or omissions of any partner. The act or omission is called "quasi-delict"[6] or "tort" when it does not constitute a crime or felony punishable by law.

(2) *Reason for imposition of wider liability.* — The reason for the law's imposition of wider liability on the partnership with respect to torts and breach of trust is based on public policy. The rule of *respondeat superior* (also called the rule of vicarious liability) applies to the law of partnership in the same manner as other rules governing the agency relationship. (Teller, *op. cit.*, p. 61.)

The obligation is solidary because the law protects him who, in good faith, relied upon the authority of a partner, whether such authority is real or apparent. This is the reason why under Article 1824 all partners, whether innocent or guilty, as well as the legal entity which is the partnership, are solidarily liable. (Muñasque vs. Court of Appeals, 139 SCRA 533 [1985].)

(3) *Injured party may proceed against partnership or any partner.* — Since the partners are liable solidarily, the party aggrieved has

[6]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)

his election to sue the firm or to sue one or more of its members. He may even single out for suit a partner who, personally, was in no wise involved in the commission of the tort or breach of trust. (40 Am. Jur. 261.)

(4) *Requisites for liability.* — The following are the requisites for liability under Article 1822:

(a) The partner must be guilty of a wrongful act or omission; and

(b) He must be acting in the ordinary course of business, or with the authority of his co-partners even if the act is unconnected with the business.

So, the partners are liable for the negligent operation of a vehicle by a partner, acting in the course of the business which results in a traffic accident. But if he is driving a partnership-owned vehicle for purposes of his own, although with the permission of the other partners, the acting partner alone is liable. (Crane, *op. cit*., 280-281.) The partnership is not liable if the partner acted on his own and not for the benefit of the partnership in the course of some transaction not connected with the partnership business, even though he was in a position to commit the act (*e.g.*, fraud) only because of his being a partner in the business. Neither is the partnership liable if the wrongful act or omission was committed after its dissolution and the same was not connected with the winding up of partnership affairs.

(5) *Criminal liability for criminal acts.* — A non-acting partner in a partnership engaged in a lawful business is not criminally liable for the criminal acts of another partner but he is criminally liable if the partnership is involved in an unlawful enterprise with his knowledge or consent.

Partnership liability under Article 1822 does not extend to criminal liability, such as embezzlement, where the wrongdoing is regarded as individual in character. So, it has been held that one member of a law partnership is not subject to disbarment or discipline for the misconduct of his partner where he had no knowledge of the misconduct, nor consented to it nor participated in it. But where the crime is statutory, especially where it involves a fine rather than imprisonment, even criminal liability may be

imposed. Thus, in a case, a partnership fine was imposed for a partner's illegal blasting. (*Ibid*., p. 62, citing Muñoz vs. State, 87 Fla. 2209; *In re* Brown, 389 Ill. 516; Spokane vs. Paterson, 46 Wash. 93.) Article 1822 speaks of "any penalty x x x incurred."

Misapplication of money or property of a third person.

Under Article 1823, the partnership is liable for any losses suffered by a third person whose money or property is misappropriated by a partner who received it within the scope of his authority or by any other partner after it was received by the partnership in the ordinary course of business while in its custody.

EXAMPLES:

(1) A, B, and C are partners in partnership X & Co. engaged in a pawnshop business. A received from D a diamond ring as security for a loan D obtained from the partnership.

In case of the conversion of the ring by A, who received the same or by B, all of the partners are solidarily liable for the loss with X & Co. to D. Even the innocent partners are personally liable without prejudice, of course, to their right to recover from the guilty partner.

(2) A, B, and C are partners in X & Co., an investment firm. C fraudulently obtained D's money in the ordinary course of the firm's business and used the money for personal expenses rather than investing it. A and C did not consent to or participate in the breach of trust. As a matter of fact, they came to know of the breach only some years after it had occurred.

All partners are solidarily liable to D.

ILLUSTRATIVE CASES:

1. *Partner of a law firm engaged in the practice of labor law misappropriated money received from a client for investment in the stock market.*

Facts: T hired X, a law firm, to represent Y, T's company, in labor negotiation and to advise it on labor matters. P, a senior partner of X, was responsible for advising Y. T gave P

money to invest in the common stock of another company. P misappropriated the money.

Issue: Is X responsible for the loss?

Held: No. A partner cannot bind the partnership beyond the normal scope of his authority. In this case, the investment of money in the stock market was not a function of the practice of law, and counselling about investments was not a part of X's business, which was limited to the practice of labor law. The criminal conduct of P was not a part of his anticipated services and T had no right to rely on the firm for the acts of a partner in excess of the partner's authority. *(Zimmerman vs. Hoag & Allen, 207 SE 2d 287 [App. Ct.] N.C., 1974.)*

_____ _____ _____

2. *A partner misappropriated payments to partnership with the result that creditors who supplied materials on credit were not paid.*

Facts: M entered into a contract with T for the renovation of the latter's building on behalf of the partnership of "G and M." M received the first payment of T with a check made out in his (M's) name. M indorsed the check in favor of G so that the latter could pay for the materials and labor used in the project.

G was able to encash the second check after T changed the name of the payee from "M" to "G and M," the duly registered name of the partnership under which name a mayor's permit to do construction business was issued. G misappropriated the proceeds.

C and D supplied materials on credit to the partnership. M denied that he and G were partners.

Issues:

(1) Is the payment by T to G valid?

(2) Is the liability of the partners to C and D joint or solidary?

Held: (1) Yes. M indorsed the first check in favor of G. T, therefore, had every right to presume that G and M were true partners. If they were not, then M had only himself to blame for making the relationship appear otherwise, not only to T but to their other creditors as well.

(2) It is solidary. Article 1816 should be construed together with Article 1824 (in connection with Articles 1822 and 1823).

While the liability of the partners is 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 Articles 1822 and 1823.

As between the partners G and M, justice dictates that M be reimbursed by G for the payments made by M representing the liability of their partnership to C and D as it was satisfactorily established that G acted in bad faith in his dealings with M as partner. *(Muñasque vs. Court of Appeals, 139 SCRA 533 [1985].)*

Note: The Court of Appeals correctly ruled that the liability of the partners is joint or *pro rata* under Article 1816. The money was received by G from T, not from C or D. (See Art. 1823.)

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

Partner by estoppel; partnership by estoppel.

A partnership is ordinarily created by contract among the parties. Article 1825 recognizes another form of partnership — partnership by estoppel. It is, however, strictly speaking not a partnership.

(1) *Meaning and effect of estoppel. — Estoppel* is a bar which precludes a person from denying or asserting anything contrary to that which has been established as the truth by his own deed or representation, either express or implied. (19 Am. Jur. 61.) Through estoppel, an admission or representation is rendered conclusive upon the person making it and cannot be denied or disapproved as against the person relying thereon. (Art. 1431.)

(2) *When person a partner by estoppel. —* Persons who are not partners as to each other are not partners as to third persons. (Art. 1709[1].) No one can be held liable nor claim rights as a partner unless he has given his consent to become such. An exception to this rule is provided by Article 1825. Due to the doctrine of estoppel, one may become liable as a partner even though he is not a partner in fact.

A person not a partner may become a partner by estoppel and thus be held liable to third persons as if he were a partner, when by words or by conduct he:

(a) Directly represents himself to anyone as a partner in an existing partnership or in a non-existing partnership (with one or more persons not actual partners); or

(b) Indirectly represents himself by consenting to another representing him as a partner in an existing partnership or in a non-existing partnership.

In other words, the holding out as a partner may be done by the person himself, or by his consent or with his knowledge. To hold the party liable, the third person must prove such misrepresentation by the purported partner and that a *bona fide* or justifiable reliance by him upon it caused him injury.

(3) *When partnership liability results.* — If all the actual partners consented to the representation, then the liability of the person who represented himself to be a partner or who consented to such representation and the actual partners is considered a partnership liability. This is a case of partnership by estoppel. (par. 1[1].) The person becomes an agent of the partnership and his act or obligation that of the partnership. (par. 2.)

(4) *When liability pro rata.* — When there is no existing partnership and all those represented as partners consented to the representation, or not all of the partners of an existing partnership consented to the representation, then, the liability of the person who represented himself to be a partner *or* who consented to his being represented as partner, *and* all those who made and consented to such representation, is joint or *pro rata*. (par. 1[2].)

(5) *When liability separate.* — When there is no existing partnership and not all but only some of those represented as partners consented to the representation, or none of the partners in an existing partnership consented to such representation, then the liability will be *separate* — that of the person who represented himself as a partner or who consented to his being represented as a partner, and those who made and consented to the representation, or that only of the person who represented himself as partner. *(Ibid.)*

(6) *Estoppel does not create partnership.* — It must be emphasized that Article 1825 does not create a partnership as between the alleged partners. A contract, express or implied, is essential to the formation of a partnership. The law considers them as partners and the association as a partnership only insofar as it is favorable to third persons by reason of the equitable principle of estoppel. (McDonald vs. National City Bank of New York, 99 Phil. 156 [1956].)

In other words, the actual partnership is one thing and liability as partners, another and different thing. It is to be noted that liability is created only in favor of persons who, on the faith of the representation, gave credit to the actual or apparent partnership.

(7) *Liability as partners may arise contrary to their intentions.* — The liability as a partner of a person who holds himself out as a partner, or permits another to do so, is predicated on the doctrine of estoppel and on the policy of the law seeking to prevent frauds upon those who lend their money on the apparent credit of those who are held out as partners. This liability as partners may arise contrary to their own intentions. Thus, one who has received profits from an apparent partnership transaction is estopped from denying the relationship on the ground that the partnership agreement was void. The question of liability is not what the parties intended by their contract but whether third persons had a right to rely on their joint credit. (40 Am. Jur. 180-181.)

It is important to understand that one who is deemed to be liable as a partner by reason of estoppel does not thereby obtain full rights as a partner. (Barrett & Seago, *op. cit.*, p. 45.)

EXAMPLES:

(1) A, B, and C are partners in X & Co. D represented himself as a partner in X & Co. to E who, on the faith of such representation, extended credit to X & Co.

D is a partner by estoppel. He is liable to E as though he is an actual member of X & Co.

If all the partners A, B, and C consented to the representation, then a partnership liability results. This is a case of partnership by estoppel. All the partners and D are liable. (par. 1[1].) Note that in this case there is an existing partnership and all the partners consented to the representation.

(2) If only A and B consented to the representation, there is no partnership liability. Only A, B, and D are partners by estoppel. They are liable *pro rata* to E. (par. 1[2].)

(3) But if D acted alone without the consent of A, B, and C, then he alone is liable to E. He is liable separately. *(Ibid.)*

(4) Suppose A, B, and C are not really partners, and D represented himself as a partner of A, B, and C to E.

If the representation was made without the consent of A, B, and C, D alone shall be liable separately to E. If it was made with the consent of A, B, and C, then all of them (A, B, C, and D) shall be liable *pro rata* to E. They are partners by estoppel.

If only A consented to the representation, separate liability is created only against A and D. Of course, if D is represented as a partner in an existing or non-existing partnership without his consent, he is not liable to E.

In all the cases when there is no existing partnership (Example No. 4), or there is no consent by all the members of an existing partnership (Example No. 2), it is the joint act or obligation of the person acting and the persons consenting to the representation. (par. 2.)

(5) A is held out with his consent as a partner of B who is in business by himself. E relied on the representation of B.

Has E a priority on the property in the business of B over F, a creditor of B, who trusted only B and not the supposed partnership of A and B?

No. A and B would be liable jointly, but, as there was, in fact, no partnership fund, E, who thought there was a partnership of A and B, would have no priority on the assets which B had in his business as distinguished from his other assets. (see Commissioners' Note to Sec. 16, U.P.A., from which Art. 1825 was taken.)

ILLUSTRATIVE CASE:

The misrepresentation that one is a partner was made after the contract in question was entered into.

Facts: A entered into a sub-lease contract with B. After the contract was entered into, B represented to A that he (B) was a partner of C.

Issue: Can B be held liable as a partner by estoppel of C?

Held: No. A did not enter into the sub-lease contract on the basis of representation on the part of B that he was a partner of C. In other words, for partnership by estoppel to exist, the holding out of a person who is charged as being a partner by estoppel must have been made before the contract with the

third person was entered into and the third person must have been induced into entering into said contract by reason of such "holding out" of the partner by estoppel. *(Peralta vs. Manalang, 9 C.A. Rep. 397.)*

(8) *Application of estoppel as between partners.* — The doctrine of estoppel has no application as between actual partners. Partners become such by agreement and not by estoppel. (No. 6.) It is true that a single partner or one or more partners in a partnership may become liable to third persons beyond the limits fixed by the partnership agreement by holding out as partners to an extent greater than that specified in the partnership agreement. As between the partners, such an action might be the basis for a dissolution of the partnership but it would apply primarily to third persons who had acted on the representations to their detriment. (Barrett & Seago, *op. cit*., pp. 46-47.)

(9) *Application of estoppel as to third parties.* — It is in this area that the doctrine of estoppel has been applied. (No. 6.) A person or persons is or are held to be liable as partners because of their representing themselves to be such, or by allowing others with their consent and knowledge, to so hold them out to be partners. The law will not permit a denial of such representation where third parties have in the exercise of reasonable diligence relied thereon to their detriment. There is a *dictum* to the effect that the holding out as a partner may have been so public and open that the presumption is thus created that the third person did, in fact, rely upon it. As to whether or not a person has held himself out to be a partner or has permitted another to so hold him out is a question of fact (*Ibid*., pp. 47-48.) to be determined by evidence; so each case rests upon its own merits.

It is obvious, however, that no one can be charged as a partner where the acts relied on for that purpose are neither his own acts, nor acts of others authorized by or known to him. Even though it were generally, supposed, believed, and understood that a person is a "partner" in a concern, this would be insufficient evidence to prove that he was a partner. (31 Words and Phrases 278.)

The cases arising under Article 1825 must be distinguished from the situation covered by the last paragraph of Article 1834 which is not, properly speaking, a situation where partnership by estoppel results. It is rather a partnership liability which continues for lack of proper termination. (Teller, *op. cit*., p. 141.)

(10) *Applicability of general provisions on partnership.* — If the law recognizes a defectively organized partnership as *de facto* as far as third persons are concerned, for purposes of its *de facto* existence, it should have such attribute of a partnership as domicile. Although it has no legal standing or juridical personality, it is a partnership *de facto* and the general provisions of the Civil Code applicable to all partnerships apply to it. The domicile of such a partnership is at the place where it conducts its business so that registration of a chattel mortgage therein is valid in accordance with Section 4 of the Chattel Mortgage Law. (Peralta vs. Manalang, *supra.*)

Elements to establish liability as a partner on ground of estoppel.

The basic elements in connection with establishment of liability as a partner if based on the doctrine of estoppel must encompass:

(1) Proof by plaintiff that he was individually aware of the defendant's representations as to his being a partner or that such representations were made by others and not denied or refuted by the defendant;

(2) Reliance on such representations by the plaintiff; and

(3) Lack of any denial or refutation of the statements by the defendant; such denial need not precede plaintiff's acting thereon if the denial was forthcoming promptly upon hearing of the representations, and if, by prudence and diligence the plaintiff might have learned of the truth or untruth of the representations.

Defendant need not be proved to be a man of financial ability. Sole reliance is not a requisite with respect to dealings involving the one representing or represented to be a partner. (Barrett & Seago, *op. cit*., pp. 48-49.)

Liability as general partners of persons who assume to act as a corporation.

The Corporation Code (B.P. Blg. 68.) provides:

"Sec. 21. *Corporation by estoppel.* — All persons who assume to act as a corporation knowing it to be without authority to do so shall be liable as general partners for all debts, liabilities and damages incurred or arising as a result thereof: *Provided, however,* That when any such ostensible corporation is sued on any transaction entered by it as a corporation or on any tort committed by it as such, it shall not be allowed to use as a defense its lack of corporate personality. x x x ."

The law makes liable as general partners "all persons who *assume to act* as a corporation" and may include persons who attempt, but fail to form a corporation and who carry on business under the corporate name. A *de facto* partnership among them is created. (De Leon & De Leon, Jr., The Corporation Code of the Phils. Annotated [2006 ed.], p. 206.) Only the active members of the unsuccessfully attempted corporation should be liable as general partners. Subscribers to stocks who take no part in the supposed corporation are not personally liable.

ILLUSTRATIVE CASE:

Investors in a proposed corporation which was never incorporated are being held liable for losses incurred by the person who induced them to make contributions to the corporation the said person would form.

Facts: Petitioner L, engaged in the airline business, as sole proprietor, executed a contract with JDA for the purchase of two (2) aircraft, with P, insurance company, as surety for the balance of the purchase price. Respondents B, C, and M contributed some funds used in the purchase, supposed to be their contributions to a new corporation proposed by L to expand his airline business. They executed two (2) indemnity agreements in favor of P. L defaulted.

P, after paying JDA, filed a petition for the extrajudicial foreclosure of the aircraft subject of a chattel mortgage executed in its favor by L. Respondents filed a third party claim alleging that they are co-owners of the aircraft. Subsequently, P filed an

action for judicial foreclosure with an application for a writ of preliminary attachment against respondents.

Issues:

(1) What legal rules govern the relationship among co-investors whose agreement was to do business through the corporate vehicle but who failed to incorporate the entity in which they had chosen to invest?

(2) How are the losses to be treated in situations where their contributions to the intended "corporation" were invested not through the corporate form?

It is the theory of petitioner that as a result of the failure of petitioner and respondents to incorporate, a *de facto* partnership among them was created and that as a consequence of such a relationship all must share in the losses and/or gains of the venture in proportion to their contributions.

Held: (1) *Where intention of parties was to form a corporation.* — "While it has been held that as between themselves the rights of the stockholders in a defectively incorporated association should be governed by the supposed charter and the laws of the state relating thereto and not by the rules governing partners, it is ordinarily held that persons who attempt, but fail, to form a corporation and who carry on business under the corporate name occupy the position of partners *inter se.* Thus, where persons associate themselves together under articles to purchase property to carry on a business, and their organization is so defective as to come short of creating a corporation within the statute, they become, in legal effect, partners *inter se*, and their rights as members of the company to the property acquired by the company will be recognized. (Smith vs. Schoodoc Pond Packing Co., 84 A. 268, 109 Me. 555; Whipple vs. Parker, 29 Mich. 369.)

So, where certain persons associated themselves as a corporation for the development of land for irrigation purposes, and each conveyed land to the corporation, and two of them contracted to pay a third the difference in the proportionate value of the land conveyed by him, and no stock was ever issued in the corporation, it was treated as a trustee for the associates in an action between them for an accounting, and its capital stock was treated as partnership assets, sold, and the proceeds distributed among them in proportion to the value of

the property contributed by each. (Shorb vs. Beaudry, 56 Ca. 446.)"

(2) *Where participation of a party was limited to subscribing to proposed corporation.* — "However, such a relation does not necessarily exist, for ordinarily, persons cannot be made to assume the relation of partners, as among themselves, when their purpose is that no partnership shall exist, and it should be implied only when necessary to do justice between the parties; thus, one who takes no part except to subscribe for stock in a proposed corporation which is never legally formed does not become a partner with other subscribers who engage in business under the name of the pretended corporation, so as to be liable as such in an action for settlement of the alleged partnership and contribution.

It has been held that a partnership relation between certain stockholders and other stockholders, who were also directors, will not be implied in the absence of an agreement, so as to make the former liable to contribute for payment of debts illegally contracted by the latter. (Heald vs. Owen, 44 N.W. 210, 79 Iowa 23.)"

(3) *Where party was fraudulently induced to subscribe to proposed corporation.* — "The record showed that L never had any intention to form a corporation with the respondents despite his representations to them, giving credence to the cross-claims of the respondents to the effect that they were induced and lured by the petitioner to make contributions to a proposed corporation which was never formed because the petitioner reneged on their agreement.

Applying the principles of law cited to the facts of the case, necessarily, no *de facto* partnership was created among the parties which would entitle L to a reimbursement of the supposed losses of the proposed corporation. L acted on his own and not in behalf of his other would-be incorporators in the transaction." *(Pioneer Insurance & Security Corporation vs. Court of Appeals, 175 SCRA 668 [1989].)*

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 in-

curred, except that this liability shall be satisfied only out of partnership property, unless there is a stipulation to the contrary. (n)

Liability of incoming partner for partnership obligations.

(1) *Limited to his share in partnership property for existing obligations.* — When a person is admitted as a partner into an existing partnership, he is liable for all obligations existing at the time of his admission as though he was already a partner when such obligations were incurred. For such obligations, his liability is limited to his share in the partnership property, unless there is a stipulation to the contrary. It has been said that the credit of a new member of a partnership does not enter into the consideration of the creditors of the old partnership, and it would be manifestly unjust to hold the new partner liable unless he, by an express or implied agreement, assumed the debts of the old firm. (40 Am. Jur. 273.)

(2) *Extends to his separate property for subsequent obligations.* — Those who were already partners at the time when the obligations were incurred are liable with their separate property. (Art. 1816.) For all the obligations accruing subsequent to the admission of the new partner, all the partners are liable with their separate properties. Such obligations may have been incurred by virtue of a contract made before his admission. (see *infra.*)

Rights of existing and subsequent creditors.

It, therefore, results that existing and subsequent creditors have equal rights as against partnership property and separate property of the previously existing members of the partnership while only subsequent creditors have rights against the separate estate of the newly admitted partner.

(1) *Where business is continued.* — Section 1826 should be read in connection with Section 1840 which provides for liability of persons continuing the business in certain cases.

Both sections are based on the principle that where there has been one continuous business the fact that a new partner has been admitted to the partnership, or a partner ceased to be connected with it, should not be allowed to cause, as before, endless confusion as to the claims of the creditors on the property employed in the business; but that all creditors of the partnership, irrespective of the times when they became creditors and the exact combinations of persons owning the business should have equal rights in such property. The rule has solved one of the most perplexing problems of partnership law. (Commissioners' Note, Uniform Laws Annotated, p. 27, cited in A. Padilla's Civil Code, Vol. IV, [1974], pp. 132-133.)

(2) *Where incoming partner has assumed obligation of retiring partner.* — Suppose, an incoming partner has assumed the obligation of the retiring partner as one of the terms of the contract by which he is admitted into the firm, is he liable directly to the old partnership creditors such that the latter has a right of action against the incoming partner?

The answer is in the affirmative if the assumption was made primarily to benefit the firm creditors. This situation is governed by Article 1311 (par. 2.) of the Civil Code which states: "If a contract should contain some stipulation in favor of a third person, he may demand its fulfillment provided he communicated his acceptance to the obligor before its revocation. A mere incidental benefit or interest of a person is not sufficient. The contracting parties must have clearly and deliberately conferred a favor upon a third person."

(3) *Reason for rule making the new partner liable.* — The rule making an incoming partner liable even for partnership obligations contracted before his admission cannot be considered harsh for the new partner because he "partakes of the benefits of the partnership property and an established business. He has every means of obtaining full knowledge of the debts of the partnership and protecting himself because he may insist on the liquidation or settlement of existing partnership debts. On the other hand, these means are not afforded the creditor." *(Ibid.)*

EXAMPLE:

A, B, and C are partners engaged in a drug store business. Their contribution is P10,000.00 each. D is admitted as a new partner with a contribution of P4,000.00. At the time of his admission, the partnership has an outstanding obligation to E in the amount of P40,000.00.

In this case, D is also liable to E for this obligation of P40,000.00. Thus, if the assets of the partnership amount to P34,000.00, the same will be exhausted thereby leaving a balance of P6,000.00 for which only A, B, and C shall be liable jointly or *pro rata,* out of their separate property. D is not personally liable in the absence of an agreement.

However, if the obligation was incurred by the partnership subsequent to the admission of D, there would be no difference between old and new partners, as all of them shall be personally liable *pro rata* or P1,500.00 each. (Art. 1816.) D is entitled to a proportional reimbursement from A, B, and C the amount he has paid in excess of his share of the liability as follows:

Shares of A, B, and C (10/34 of P6,000) = P1,764.70 each

Shares of D (4/34 of P6,000) = P705.88

So A, B and C are liable for P264.70 each to D for the excess of P794.12, the difference between P1,500.00 and P705.88.

ILLUSTRATIVE CASE:

The contract of lease was executed by the partnership before the admission of the new partner who claims that by reason thereof he is not liable out of his separate property for rents accruing subsequently.

Facts: B, a bank, leased real property to a partnership. Subsequently, on April 28, 1931, C was taken in as a partner and the new partnership paid the rent up to March, 1932. An action was brought by B to recover the rent claimed to be due for the period commencing March 1, 1932, and ending January 25, 1933.

C claims that, as an incoming partner, his personal assets cannot be reached in satisfaction of the judgment.

Issue: May C's liability as an incoming partner be satisfied by resort to his personal assets?

Held: Yes. (1) *New partnership liable for other obligations.* — C contends that since the lease was executed before he

became a partner, the obligation of the lease arose before his admission and, therefore, his liability can only be satisfied out of partnership property. The contention of C would be sound if the only obligation of the partnership in this transaction was one which arose prior to his admission to the firm.

(2) *New partnership liable as lessee.* — When C became a member, the first partnership was, in legal theory, dissolved and a new partnership came into being, composed of the old members and C. This second partnership did not expressly assume the obligations of the lease, but it occupied the premises. Whether it was liable contractually on the lease is immaterial; it became liable for rent as a tenant. Strangers coming in with consent and occupying the premises would be liable; tenants would be liable even if there were no lease at all; and this second partnership and all its members were liable regardless of any lack of assumption of the obligations of the lease.

(3) *Lessee's obligation is a continuing one.* — C's theory is that he, as a member of the second partnership, may receive the benefits of years of occupancy under the lease, but that his personal assets cannot be reached in satisfaction of liability therefor if the lease was executed before he became a member of the partnership. Under the general law, the obligation of tenant arising from the occupation of the premises is a continuing one; that is, it arises and binds him continually throughout the period of his occupation. The obligation on the part of C first arose when the new partnership, of which he was a member, occupied the premises as a tenant. It follows that his obligation as a tenant arose after his admission to the partnership. *(Ellingson vs. Walsh, O'Connor & Barneson, 104 P. 2d 507 [Cal. 1940].)*

Liability of outgoing partner/ incoming partner.

(1) *Contract made before retirement or withdrawal.* — Where a partner gives notice of his retirement or withdrawal from the partnership, he is freed from any liability on contracts entered into thereafter, but his liability on existing incomplete contracts continues. Thus, he is liable for goods sold and delivered after his retirement or withdrawal and notice thereof, if the sale

was pursuant to a contract made before such retirement or withdrawal.

(2) *Performance after admission of new partner.* — In the case of an incoming partner, he is not personally liable for the existing partnership obligations unless there is a stipulation to the contrary (see Art. 1840, par. 2.), but in a parallel situation above, he is liable for goods delivered to the partnership after his admission to it, where the goods so delivered are in the performance of a contract made before his admission. The result is that both the retiring and the incoming persons are liable for the debt created by delivery of such goods. Thus, the creditor, without further exertion, obtains two debtors where before he had only one. (Teller, *op. cit.*, pp. 110-111, citing Freeman vs. Hutleg Sash & Door Co., 105 Tex. 550.)

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)

Preference of partnership creditors in partnership property.

With respect to partnership assets, the partnership creditors are entitled to priority of payment. (see Art. 1839[2, 3, 8].) This rule is based upon the theory that the partnership, treated as a legal entity distinct and separate from the members composing it (Art. 1768.), should apply its property to the payment of its debts in preference to the claim of any partner or his creditors.

The rule applies only in the event of the disposition of partnership property among its creditors to pay partnership debts. The partners may deal with partnership property in the usual course of business as they see fit.

Both the partnership and the separate partners thereof may be joined in the same action. But the private property of the partners cannot be taken in payment of partnership debts until

the common property of the concern is exhausted. (Viuda de Chan vs. Peng, 53 Phil. 906 [1929].)

Remedy of private creditors of a partner.

Without prejudice to the right to preference of partnership creditors, the creditors of each partner may ask for the attachment and public sale of the share of the latter in the partnership assets. (Art. 1814.) Such share really belongs to the partner. (Art. 1812.)

The purchaser at the public sale does not become a partner. (Arts. 1767, 1813.)

EXAMPLE:

A, B, and C are partners in a partnership known as X & Co. They contributed equally to the partnership. As they have no stipulation regarding the share of each partner in the profits, they share equally in the partnership assets, namely: 1/3. After a year of operation, the assets of the partnership amounted to P40,000.00. It is indebted to D in the amount of P28,000.00. E is a separate creditor of A for P6,000.00.

The different claims shall be settled as follows:

As partnership creditor is preferred, D shall be paid first the amount of P28,000.00, thereby leaving the partnership assets to only P12,000.00. Each partner shall, therefore, get only P4,000.00 as his share in the assets. Hence, E can collect only P4,000.00 from the assets of the partnership. His remedy is to recover the balance of P2,000.00 from the private property of A. (see Art. 1839[9].)

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Chapter 3

DISSOLUTION AND WINDING UP

Sources of provisions.

"The provisions on 'Dissolution and Winding Up' (Arts. 1828-1842.) were adopted, with suitable modifications, from the Uniform Partnership Act. It was considered advisable to do so because these provisions are ample and comprehensive on the subject, while the lone provision of the present Civil Code[1] (Art. 1708.) that 'The partition among the partners shall be governed by the rules for the partition of inheritances, with regard to its form as well as the obligations arising therefrom,' is deemed unsatisfactory there being no similarity between a partnership and an inheritance." (Report of the Code Commission, p. 149.)

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)

Effects of change in membership of a partnership.

(1) *Dissolution of existing partnership and formation of a new one.* — Any change in the membership of a partnership, either by the retirement or death of partner,[2] or by the admission of new members into the partnership, produces, technically, an

[1]Old Civil Code.

[2]"The acquisition of 82% of the partnership interest by new partners, coupled with the retirement or withdrawal of the partners who had originally owned such 82% interest, was enough to constitute a new partnership." (Yu vs. National Labor Relations Commission, 223 SCRA 75 [1993].)

immediate dissolution of the existing partnership relation, and the formation of a new one, although common business usage speaks of the admission of a partner to a firm and regards the firm as subsisting so long as the course of its business is not materially interrupted.

(2) *Transformation of all partners into incoming partners.* — Therefore, strictly and technically speaking, there is no such thing as "incoming partner," or "the admission of a person into an existing firm." All persons forming the new partnership upon the admission of the new person into the business are "incoming partners," even though the same business had theretofore been conducted by the others through the medium of partnership.[3]

(3) *Continuance by remaining partners of partnership as before.* — A partnership is a contractual and fiduciary relation dependent upon the personality of its members, and the withdrawal or admission of a member changes so radically the contractual rights and duties *inter se* as to produce essentially a new relation, even though the parties contemplate no actual dissolution of the firm and continue to carry on business under the original articles of partnership and with the same account books. (40 Am. Jur. 267; see Art. 1840.)

In other words, the change in the relation of the partners will dissolve the partnership but will not disturb the continuance by the remaining partners or by the existing and new partners of the business as before. (but see Art. 1814.)

Dissolution, winding up, and termination defined.

A partnership, of course, does not last forever. When it ends, it involves these three separate stages.

[3]Note that the admission of a new partner into an existing partnership which has the effect of dissolving the partnership (see Art. 1840[1].) is not "caused by any partner ceasing to be associated in the carrying on as distinguished from the winding up of the business." This "change in the relation of the partners" causes the dissolution which, in turn, results in the old partners ceasing to be associated in carrying on of the business of the dissolved partnership, and if the business is continued without liquidation, a new partnership comes into being composed of the old partners and the new partner. The definition in Article 1825 is thus not broad enough to cover this kind of dissolution resulting from the admission of a new partner.

The above terms are often confused. As they are used:

(1) *Dissolution* is the change in the relation of the partners caused by any partner ceasing to be associated in the carrying on of the business. (Art. 1828.) It is that point in time when the partners cease to carry on the business together. It represents the demise of a partnership. (68 C.J.S. 842.) Thus, any time a partner leaves the business, the partnership is dissolved.

(2) *Winding up* is the actual process of settling the business or partnership affairs after dissolution, involving the collection and distribution of partnership assets, payment of debts, and determination of the value of each partner's interest in the partnership. It is the final step after dissolution in the termination of the partnership.

(3) *Termination* is that point in time when all partnership affairs are completely wound up and finally settled. It signifies the end of the partnership life. It takes place after both dissolution and winding up have occurred.

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

Effects of dissolution.

(1) *Partnership not terminated.* — The dissolution of a partnership must not be understood in the absolute and strict sense so that at the termination of the object for which it was created the partnership is extinguished. (Testate Estate of Mota vs. Serra, 47 Phil. 464 [1926].) Dissolution does not automatically result in the termination of the legal personality of the partnership, or the cessation of his business, nor the relations of the partners among themselves who remain as co-partners until the partnership is terminated.

(2) *Partnership continues for a limited purpose.* — After dissolution, a partnership is considered as maintaining a limited existence for the purpose of making good all outstanding engagements, of taking and settling all accounts, and collecting all the property, means and assets of the partnership existing at the time

of its dissolution for the benefit of all interested. (40 Am. Jur., p. 312.)

(3) *Transaction of new business prohibited.* — After dissolution, the partnership as a business enterprise remains viable only for the purpose of winding up its affairs. The principal significance of dissolution is that thereafter, no new partnership business should be undertaken, but affairs should be liquidated and distribution made to those entitled to the partners' interest. (Crane, *op. cit.*, 394; Testate Estate of Mota vs. Serra, *supra.*) Whether the remaining partners may be allowed to continue the business or require to terminate the business depends on the method and manner of dissolution. (Art. 1830.)

It is only after winding up is accomplished that the existence of the partnership is terminated. Thus, dissolution refers to the change in partnership relation and not the actual cessation of the partnership business. It is not necessarily followed by a winding up of partnership affairs. (see Arts. 1837, 1840.)

Dissolution of a partnership must be distinguished from a mere suspension in the conduct of its business or operations. (68 C.J.S. 842.)

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, 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)

Causes of dissolution.

(1) *Statutory enumeration exclusive.* — Articles 1830 and 1831 *(infra.)* provide for the causes of dissolution. The events that cause dissolution of a partnership may be divided into four (4) categories: act of the parties not in violation of their agreement; act of the parties in violation of their agreement; operation of law; and court decree. Other causes are provided in Article 1840.

(a) Under Article 1830, extrajudicial dissolution may be caused *without violation* of the agreement between the partners (No. 1.) or *in contravention* of said agreement. (No. 2.) It may be *voluntary* when caused by the will of one or more or all of the partners (Nos. 1 and 2.) or *involuntary* when brought about independently of the will of the partners or *by operation of law*. (Nos. 3, 4, 5, 6, 7, and 8.)

The voluntary dissolution of partnership may be effected extrajudicially (Nos. 1 to 7.) or *judicially*, that is, by decree of court. (No. 8, in relation to Art. 1831.) It will be observed that the causes provided in Article 1830 result in the *automatic dissolution* of the partnership.

(b) In Article 1840, automatic dissolution also takes place when a new partner is admitted or when a partner retires, withdraws, or is expelled from the partnership.

(c) There is no automatic dissolution under Article 1831 which enumerates the grounds for the *judicial dissolution* of the partnership. Article 1838 seems to recognize the right of a partner entitled to rescind on the ground of fraud or misrepresentation to ask for judicial dissolution. (see also Art. 1831[6].)

(d) It has been held that the statutory enumeration of the causes of dissolution precludes dissolution for any other cause. (Kurtzon vs. Kurtzon, 90 N.E. 2d 245.)

Note that once a partnership is dissolved, the same partners may form a new partnership to continue the business under the same terms.

(2) *Effect of sale or assignment by one partner of his entire interest in the partnership to a third person.* — It does not *ipso facto* bring about the dissolution of the partnership.[4] That it produces dissolution may be inferred, however, from the definition of dissolution under Article 1828. But the dissolution created in such case is only technical, and not actual, *i.e.*, only in the sense that his connection with the partnership is terminated.

In practice, the Securities and Exchange Commission accepts for registration amended articles of partnership together with the deed of sale of the interest of the withdrawing partner. (see SEC Opinion, June 29, 1960.)

[4]See Article 1813. The assignment merely provides a ground for the other partners to dissolve the partnership (Art. 1830[c].) or for the purchaser to petition for a judicial decree of dissolution. (Art. 1831, par. 2.)

Dissolution effected without violation of partnership agreement.

There are four ways by which a partnership may be dissolved without violation of the partnership agreement:

(1) *Termination of the definite term or particular undertaking.* — A partnership may be constituted for a fixed term or it may have for its object a specific undertaking. (Arts. 1785, 1783.) After the expiration of the term or particular undertaking, the partnership is automatically dissolved without the partners extending the said term or continuing the undertaking. (see Art. 1785.) The dissolution of the partnership will be but in pursuance of the agreement of the partners, which is the law between them. (Art. 1159.)

If after said expiration the partners continue the partnership without making a new agreement, the firm becomes a partnership at will. (see Art. 1785.)

(2) *By the express will of any partner.* — A partnership at will, regardless of whether the business is profitable or unprofitable, may be dissolved at any time by any partner without the consent of his co-partners without breach of contract, provided, the said partner acts in good faith. Here, each partner has both the power and the right to terminate the relation at any time. If there is bad faith, the dissolution is wrongful.

(a) The existence of good faith will absolve the partner exercising the right to dissolve the partnership from liability for damages which result to his co-partners by reason of his action. (68 C.J.S. 844.)

In a case, where the withdrawal of a partner has been spurred by "interpersonal conflict" among the partners, it would not be right to let any of the partners remain in the partnership under such an atmosphere of animosity and, certainly, not against their will. Indeed, for as long as the reason for withdrawal of a partner is not contrary to the dictates of justice and fairness, nor for the purpose of unduly causing harm and damage upon the partnership, bad faith cannot be said to characterize the act. In the context used in

the law, *bad faith* is no different from its normal concept of a conscious and intentional design to do a wrongful act for a dishonest purpose or moral obliquity. (Ortega vs. Court of Appeals, 245 SCRA 529 [1995].)

(b) While the attendance of bad faith cannot prevent the dissolution of a partnership, it can result in liability for damages. *(Ibid.)* The guilty partner would be liable for wrongful dissolution as provided in Article 1837.

(c) A violation of the partnership agreement by the exclusion of a partner from participation in the management of the business of the firm has been held to give the excluded partner the right to declare the partnership dissolved. (68 C.J.S. 844.)

(d) The partner who breaks off the partnership with an unfair design, or for selfish objects, discharges his co-partners from all liabilities to him but he does not thereby free himself from his obligations to them. When he quits the partnership that he may buy for himself what the partnership has a right to purchase, or that he may make a profit for his own advantage and to their prejudice, he is answerable to the partnership for the loss and damage; and so, if he quits at an unreasonable time, which occasioned a deprivation of profit to the partnership, it is but right that he should repair and make good such loss. (Howell vs. Harvey, 39 Am. Dec. 37.)

(3) *By the express will of all the partners.* — No particular form of agreement is necessary to dissolve a partnership by consent. Such dissolution may be accomplished either by an express agreement or by words and acts implying an intention to dissolve. (68 C.J.S. 847.)

(a) The agreement to dissolve the partnership before the termination of the specified term or particular undertaking must be unanimous. The majority alone cannot dissolve the partnership without breach of contract.

(b) That the consent of the partners who have assigned their interests or suffered them to be charged for their separate debts (Art. 1814.) is not required to effect dissolution

without breach of the partnership agreement. They are not given the right to have a voice or vote in the dissolution of the partnership. (68 C.J.S. 847.) The remaining partners alone may dissolve the partnership.

(4) *By expulsion of any partner.* — The expulsion has the effect of decreasing the number of the partners, hence, the dissolution. The expulsion must be made in good faith, and strictly in accordance with the power conferred by the agreement between the partners. This power may be vested in one partner exclusively. The partner expelled in bad faith can claim damages.

Dissolution effected in contravention of partnership agreement.

(1) *Dissolution may be for any cause or reason.* — Any partner may cause the dissolution of the partnership at any time without the consent of his co-partners for any reason which he deems sufficient by expressly withdrawing therefrom even though the partnership was entered into for a definite term or particular undertaking. Dissolution of such a partnership is, however, a contravention of the agreement.

(2) *Legal effects of dissolution.* — The withdrawing partner is liable for damages for unjustified dissolution but in no case can he be compelled to remain in the partnership. With his withdrawal, the number of members is decreased; hence, its dissolution. (Dojas vs. Maglana, 192 SCRA 110 [1990].) The legal effects of this dissolution are laid down in Article 1837, par. 2, Nos. 1, 2, and 3.

A partner guilty of wrongful dissolution is not given the right to wind up partnership affairs. (Art. 1836.) But a minor cannot be guilty of wrongful dissolution since he has the legal right to avoid his contract.

(3) *Power of dissolution always exists.* — No person can be compelled either to become a partner or to remain one. The relation of partners is one of mutual agency. The agency is such an intimate personal one that equity cannot enforce it even where the agreement provides that the partnership shall continue for a definite time. The right of a partner to dissolve is inseparably

incident to every partnership and there can be no indissoluble partnership. (see Barrett & Seago, *op. cit*., Vol. 2, pp. 469-470.)

Note that there is no such thing as an indissoluble partnership only in the sense that there always exists the *power*, as opposed to the *right*, of dissolution. (Collins vs. Lewis, 283 S.W. 2d 258 Tex. [1955].) The doctrine of *delectus personae* allows the partners to have the power, although not necessarily the right, to dissolve the partnership. An unjustified dissolution by a partner can subject him to a possible action for damages. (Tocao vs. Court of Appeals, 342 SCRA 20 [2000].)

ILLUSTRATIVE CASES:

1. *A partner questions the right of another to withdraw from the partnership.*

Facts: A brought an action for withdrawal of his capital contribution from the partnership formed by him and B, which would mean its dissolution because the partnership was for a definite term.

Issue: In impugning A's right to maintain the suit, B cited Articles 1808 and 1830 and A's alleged bad faith.

Held: Article 1808 only requires the capitalist partner (who violates the prohibition against engaging for his own account in any operation which is of the kind of business in which the partnership is engaged) to bring to the common fund of the partnership, profits he might have realized. (2nd par.) It does not prevent him from withdrawing from the partnership. *(Lee Tee vs. Ching Chiong, [C.A.] No. 14712-R, July 7, 1958.)*

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2. *The intention to dissolve the partnership is shown by acts and words of the partners.*

Facts: A and B formed a partnership to exploit a fishpond and thereafter to divide it between them into two equal parts. Succeeding events reveal the intent of both parties to terminate the partnership by refusing to share the fishpond with the other — in direct violation of the undertaking for which they have established their partnership — which resolution they articulated in letters to each other.

Issue: Should the partnership be considered dissolved?

Held: Yes. Both A and B must be deemed to have expressly withdrawn from the partnership, thereby causing its dissolution pursuant to Article 1830(2) which provides, *inter alia*, that dissolution is caused "by the express will of any partner" at any time. *(Deluao vs. Casteel, 26 SCRA 475 [1968].)*

Business becomes unlawful.

Dissolution may be caused involuntarily when a supervening event makes the business itself of the partnership unlawful (*e.g.*, a law makes the continuance of the business illegal; declaration of war between countries of which the partners are respectively citizens) or makes it unlawful for the partners to carry it on together. A partnership must have a lawful object or purpose. (see Art. 1770.) The partners, however, can change the nature of their business and continue the partnership with the new business.

EXAMPLE:

J is a partner in a law firm. Later on, J is appointed Judge of the Regional Trial Court. Under the law, a Judge of the Regional Trial Court is prohibited from engaging in the practice of law. In this case, it would be unlawful for J to continue as a partner in the law firm. His appointment dissolves the partnership of which he is a member.

Contracts of partnership are necessarily dissolved by a state of war between the countries where the respective parties are citizens or where they become alien enemies, or by a civil war, since in both cases commercial intercourse is rendered unlawful between the partners belonging to opposing sides. This rule is based upon consideration of public policy, and is not affected by the intention of the parties. (see 40 Am. Jur. 307.)

Loss of specific thing.

This provision of Article 1830 refers only to specific things. When the thing to be contributed is not specific, Articles 1786 (par. 1.) and 1788 shall govern.

(1) *Loss before delivery.* — If the specific thing to be contributed by a partner is lost before delivery, the partnership is dissolved

because there is no contribution inasmuch as the thing to be contributed cannot be substituted with another. There is here a failure of a partner to fulfill his part of the obligation.

(2) *Loss after delivery.* — If the loss occurred after the delivery of the thing promised, then the partnership is not dissolved, but it assumes the loss of the thing having acquired ownership thereof. The partners may contribute additional capital to save the venture. (see Art. 1791.)

(3) *Loss where only use or enjoyment contributed.* — If only the use or enjoyment of the thing is contributed, the partner having reserved the ownership thereof, the loss of the same before or after delivery dissolves the partnership because in either case, the partner cannot fulfill his undertaking to make available the use of the specific thing contributed. Here, the partner bears the loss and, therefore, he is considered in default with respect to his contribution. (Art. 1795, par. 1.) Upon dissolution, the partners may demand for an accounting and liquidation.

The mere failure by a partner to contribute his share of capital pursuant to an agreement to form a partnership does not prevent the existence of a firm. (see Art. 1786.) Such failure may be waived by the other parties to the agreement. (68 C.J.S. 414.)

Death of any partner.

The deceased partner ceases to be associated in the carrying of the business; hence, the *ipso facto* dissolution of the partnership by his death by operation of law. The surviving partners have no authority to continue the business except so far as is necessary to wind up (see Art. 1836.) except as provided in Article 1833. (see Art. 1840[3].)

(1) *Status of partnership*. — The subsequent legal status of a partnership dissolved by the death of a partner is that of a partnership in liquidation, and the only rights inherited by the heirs are those resulting from the said liquidation in favor of the deceased partner, and nothing more. Before this liquidation is made, it is impossible to determine what rights or interests, if any, the deceased partner had. (Bearneza vs. Dequilla, 43 Phil. 237 [1922].)

(2) *Liquidation of its affairs.* — The liquidation of its affairs is by law entrusted to the surviving partners, or to liquidators appointed by them and not to the administrator or executor of the deceased partner. (Guidote vs. Borja, 53 Phil. 900 [1929]; Lota vs. Tolentino, 90 Phil. 829 [1952].)

(3) *Continuation of business without liquidation.* — A clause in the articles of co-partnership providing for the continuation of the firm notwithstanding the death of one of the partners is legal. (Goquiolay vs. Sycip, 108 Phil. 947 [1960].)

A view has been expressed that the death of one of the partners does not *ipso facto* dissolve the partnership when, by common agreement, the surviving partners and the heirs of the deceased decide to continue, the said agreement being in such case considered as a continuation of the original contract of partnership.[5] (Espiritu and Sibal, *op. cit.*, p. 245, citing 11 Manresa 407-408.) In such a case, however, there is a dissolution of the partnership without winding up, and a continuance of the business of the dissolved partnership by a new partnership, of which the surviving partners and the heirs of the deceased or executors are the members becoming liable as the old to the creditors of the firm. (see Art. 1840[3].)

It will be seen from the foregoing that it is possible to continue a partnership (actually, a new one) after the death of a partner, thereby increasing the usefulness of the partnership device, and decreasing its disadvantage as compared with the corporate firm. (see Teller, *op. cit.*, p. 88.)

ILLUSTRATIVE CASE:

The widow of a deceased, who became the new partner in accordance with the articles of partnership, sold partnership property after she was authorized by the surviving partner to manage the affairs of the partnership which was engaged in the real estate business.

[5]Under the rules of the Securities and Exchange Commission, the heirs of a deceased partner may be admitted as partners when so authorized by the articles of partnership. To reflect the substitution, the articles must be amended; likewise, an affidavit of adjudication or extrajudicial partition of the estate of the deceased must be submitted. Under the rules, only the heirs and not the estate may be admitted as a partner into the partnership before or after the settlement of the estate of the deceased partner. (SEC Opinion, June 20, 1975.)

Facts: A, a partner in a partnership engaged in the real estate business, died. The articles of partnership expressly stipulates that in the event of the death of any of the partners, the firm shall not be dissolved but will have to be continued and the deceased partner shall be represented by his heirs or assignee in said partnership.

B, the widow of A, sought authority, and was authorized by C, the surviving partner, to manage the partnership property. Subsequently, B sold lands belonging to the partnership.

Now, C questions the validity of the sale, claiming that B never became more than a limited partner, thus, incapacitated by law to manage the affairs of the partnership.

Issues:

(1) Is B a general or a limited partner?

(2) Is the sale valid?

Held: (1) *B is a general partner.* — By seeking authority to manage partnership property, B showed that she desired to be considered a general partner. By authorizing B to manage partnership property (which a limited partner could not be authorized to do), C recognized her as such partner, and is in estoppel to deny her position as a general partner with authority to administer and alienate partnership property. While the heir *ordinarily* becomes a limited partner for his own protection, he may disregard it and instead elect to become a general partner as B in this case did.

Furthermore, the contractual stipulation in the articles of partnership contemplates that the heirs would become *general partners* rather than limited partners. The partnership certainly could not be *continued* if it were to be converted into a *limited* partnership, since the difference between the two kinds of association is fundamental (see Art. 1843, Chapter 4.); and especially because the conversion into a limited association would leave the heirs of the deceased partner without a share in the management.

The stipulation, however, would not bind the heirs of the deceased partner should they refuse to assume personal and unlimited responsibility for the obligations of the firm.

(2) *B had authority to sell the real estate of the firm.* — When the partnership business is to deal in real estate, *i.e.*, to buy and

sell real estate, as in the present case, one partner has ample authority as a general agent of the firm to enter into a contract for the sale of real estate. It must also be remembered that a third person has a right to presume that a general partner dealing with partnership property in pursuance of partnership purpose has the requisite authority from his co-partners. *(Goquiolay vs. Sycip, 9 SCRA 663 [1963], Resolution of Motion for Reconsideration.)*

Insolvency of any partner or of partnership.

The insolvency of the partner or of the partnership must be adjudged by a court.[6]

(1) The insolvency of a partner subjects his interest in the partnership to the right of his creditors (see Art. 1814.) and makes it impossible for him to satisfy with his property partnership obligations to its creditors in the event that partnership assets have been exhausted. (see Art. 1816.) Thus, by his insolvency, its credit is impaired. An insolvent partner has no authority to act for the partnership nor the other partners to act for him. (Art. 1833.)

(2) The insolvency of the partnership renders its property in the hands of the partners liable for the satisfaction of partnership obligations resulting in their inability to continue the business, which practically amounts to a dissolution.[7] But the reconvey-

[6]Sec. 32. As soon as an assignee is elected or appointed and qualified, the clerk of the court shall, by an instrument under his hand and seal of the court, assign and convey to the assignee all the real and personal property, estate, and effects of the debtor with all his deed, books, and papers relating thereto, and such assignment shall relate back to the commencement of the proceedings in insolvency, and shall relate back to the acts upon which the adjudication was founded, and by operation of law shall vest the title to all such property, estate, and effects in the assignee, although the same is then attached on mesne process, as the property of the debtor. Such assignment shall operate to vest in the assignee all of the estate of the insolvent debtor not exempt by law from execution. It shall also dissolve any attachment levied within one month next preceding the commencement of the insolvency proceedings and vacate and set aside any judgment entered in any action commenced within thirty days immediately prior to the commencement of insolvency proceedings and shall vacate and set aside any execution issued thereon and shall vacate and set aside any judgment entered by default or consent of the debtor within thirty days immediately prior to the commencement of the insolvency proceedings. (Act No. 1956, otherwise known as The Insolvency Law.)

[7]"Sec. 51. A partnership, during the continuation of the partnership business, or after its dissolution and before the final settlement thereof, may be adjudged insolvent,

ance by the assignee of the properties of the partnership pursuant to an order of the court after the termination of insolvency proceedings involving the partnership has the effect of restoring the partnership to its *status quo.* (Ng Cho Cio vs. Ng Diong, 1 SCRA 275 [1961].)

Civil interdiction of any partner.

A partnership requires the capacity of the partners. A person under civil interdiction (or civil death) cannot validly give consent (Art. 1327.), as his capacity to act is limited thereby. (Art. 38.)

Civil interdiction deprives the offender during the time of his sentence of the right to manage his property and dispose of such property by any act or any conveyance *inter vivos*. (Art.

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either on the petition of the partners, or any of them, or on the petition of three or more creditors of the partnership, qualified as provided in Section twenty of this Act, in either of which cases the court shall issue an order in the manner provided by this Act upon which all the property of the partnership, and also all the separate property of each of the partners, if they are liable, shall be taken, excepting such parts thereof as may be exempt by law; and all creditors of the partnership, and the separate creditors of each partner, shall be allowed to prove their respective claims; and the assignee shall be chosen by the creditors of the partnership and shall also keep separate accounts of the property of the partnership, and of the separate estate of each member thereof. The expenses of the proceedings shall be paid from the partnership property and the individual property of the partners in such proportions as the court shall determine. The net proceeds of the partnership property shall be appropriated to the payment of the partnership debts and the net proceeds of the individual estate of each partner shall be applied to the payment of his individual debts. Should any surplus remain of the property of any partner after paying his individual debts, such surplus shall be added to the partnership assets and be applied to the payment of the partnership debts. Should any surplus of the partnership property remain after paying the partnership debts, such surplus shall be added to the assets of the individual partners in the proportion of their respective interests in the partnership. Certificate of discharge shall be granted or refused to each partner as the same would or ought to be if the proceedings had been by or against him alone under this Act; and in all other respects the proceedings as to the partners shall be conducted in like manner as if they had been commenced and prosecuted by or against one person alone. If such partners reside in different provinces, the court in which the petition is first filed shall retain exclusive jurisdiction over the case. If the petition be filed by less than all the partners of a partnership, those partners who do not join the petition shall be ordered to show cause why they, as individuals, and said partnership, should not be adjudged to be insolvent, in the same manner as other debtors are required to show cause upon a creditor's petition, as in this Act provided; and no order of adjudication shall be made in said proceedings until after the hearing of said order to show cause." (Act No. 1956, as amended [The Insolvency Law].) *(Ibid.)*

34, Revised Penal Code.) Surely, one who is without capacity to manage his own property should not be allowed to manage partnership property.

Right to expel a partner.

In the absence of an express agreement to that effect, there exists no right or power of any member, or even a majority of the members, to expel all other members of the firm at will. Nor can they at will forfeit the share or interest of a member or members and compel him or them to quit the firm, even paying what is due him. (40 Am. Jur. 211.)

(1) *Partner guilty of extreme and gross faults.* — Mere derelictions of a member, such as failure to pay his part of the expenses or to promptly and faithfully perform his part of the services agreed to, do not *ipso facto* forfeit his right, or even authorize a court to forfeit his right, to the common property or assets of the partnership. There may be, however, extreme and gross faults which would work a forfeiture, especially where there was an extreme emergency for him to perform his duty, and to be prompt and faithful. *(Ibid.)*

(2) *Industrial partner engaging in business for himself.* — The law authorizes the capitalist partners to exclude from the firm an industrial partner who engages in business for himself without the express permission of the partnership. (Art. 1789.)

(3) *Power expressly given by agreement.* — A power of expulsion of a partner may be expressly given by agreement. The power is not validly exercised if it is shown to have been exercised unfairly and without regard to the general interest of the partnership. In theory, such power must be understood to exist not for the benefit of any particular parties holding control of firm membership, but for the benefit of the whole partnership. Therefore, it cannot be exercised merely to enable the continuing partners to appropriate to themselves the share of the expelled partner at a fixed value less than the true value. (40 Am. Jur. 211.)

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)

Judicial determination as to dissolution.

Events which make it impossible to carry on the business as intended may have such serious effect that the partnership ought to be dissolved by decree of the court. Such events as unlawfulness, death, or insolvency of a partner are certain and unequivocal. Their occurrence and effect is not a matter of dispute or doubt.

On the other hand, the facts may be so far open to dispute or difference of opinion as to make a necessary judicial determination as to dissolution rather than allow them to be the occasion for

automatic dissolution by operation of law. Among the facts or acts which will warrant a dissolution by judicial decree are those enumerated in the first paragraph of Article 1831. (Crane, *op. cit*., pp. 409-410.)

Grounds for dissolution by decree of court.

Dissolution of a partnership may be decreed judicially on application, either (1) by a partner in the cases mentioned in paragraph 1, Nos. 1-6; or (2) by the purchaser or assignee of a partner's interest under paragraph 2, Nos. 1 and 2.

(1) *On application by a partner:*

(a) *Insanity.* — The partner may have been previously declared insane in a judicial proceeding; otherwise, the fact of his being of unsound mind must be duly proved. An insane person is incapacitated to enter into a contract. (Art. 1327[2].) The insanity must materially affect the capacity of the partner to perform his contractual duties as a partner.

(b) *Incapacity.* — Obviously, this refers to incapacity other than insanity. Independent of any express stipulation, a partner impliedly undertakes to advance the success of the partnership of which he is a member by devoting to it, within reasonable limits, his time, effort, and ability. His co-partners are entitled to his contribution and if, for any reason, he fails to fulfill his duties they are thereby deprived, in greater or less degree, according to the extent of his failure, of the benefits of the contract which they have made, and of the fruits thereof to which they are legitimately entitled. Hence, the rule that courts have the power to decree dissolution of a partnership because of incapacity of a partner which materially affects his ability to discharge the duties imposed by his partnership contract. (Barclay vs. Barrie, 102 N.E. 102.)

However, it is not the mere fact of the existence of insanity, infirmity, or other disability supervening that will justify a court to decree a dissolution. The incapacity contemplated by law is incapacity which is lasting, from which the prospect of recovery is remote. If the disability be of a temporary nature,

if it be merely an occasional malady or accidental illness, if there be a fair prospect of recovery within a reasonable time, then, and in such cases, there is no fit ground to decree a dissolution, for every partnership must be presumed to be entered into, subject to the common incidents of life such as temporary illness, infirmity, or insanity. (*Ibid*., citing Story on Partnership, Sec. 297.)

(c) *Misconduct and persistent breach of partnership agreement.* — Like incapacity, conduct prejudicial to the carrying on of the business (*e.g.*, inveterate drunkenness) and persistent breach of the partnership agreement (*e.g.,* keeping and rendering false accounts, misuse or misappropriation of partnership funds) are grounds for judicial dissolution, for they defeat and materially affect and obstruct the purpose of the partnership.

Temporary grievances, discourtesies, disagreements, or mistakes of judgments that involve no permanent mischief or injury will not suffice as the basis for a judicial decree of dissolution.

But courts may order the dissolution of a partnership where the quarrels and disagreements are of such a nature and to such extent that all confidence and cooperation between the parties have been destroyed, or where one of the parties, by his misbehaviour, materially hinders a proper conduct of the partnership business. It is not only large affairs which produce trouble. The continuance of overbearing and vexatious petty treatment of one partner by another frequently is more serious in its disruptive character than would be larger differences which would be discussed and settled. For the purpose of demonstrating his own preeminence in the business, one partner cannot constantly minimize and depreciate the importance of the other without undermining the basic status upon which a successful partnership rests. (Owen vs. Owen, 119 P. 2d 713.)

Where a partner is guilty of serious misconduct, the only remedy ordinarily available to co-partners is to apply to the court for dissolution. But the partnership agreement may

expressly confer the power to expel a partner under specified conditions. (see Art. 1830[1, d].) When this power is exercised in good faith, it causes dissolution (without violation of the partnership agreement) although no suit has been instituted to that end. (Babb & Martin, *op. cit*., pp. 259-260.)

(d) *Business can be carried on only at a loss.* — Since the purpose of a partnership is the carrying of a business for profit, it may be dissolved by decree of court when it becomes apparent that it is unprofitable with no reasonable prospects of success.

Where a partnership had lost all its capital, or had become insolvent, or that the enterprise for which it had been organized had been concluded or utterly abandoned, a provision in the articles of partnership prohibiting the dissolution of the partnership except by the consent and agreement of two-thirds of its partners, can in no wise limit or restrict the right of a less number of the partners to effect a dissolution of the partnership through judicial intervention or otherwise. It would be absurd and unreasonable to hold that such an association could never be dissolved and liquidated without the consent and agreement of two-thirds of all the partners. (Lichauco vs. Lichauco, 33 Phil. 350 [1916].)

A court is authorized to decree a dissolution notwithstanding that the partnership has been making profits where it appears at the time of the application that the business can only be carried on at a loss.

(e) *Other circumstances.* — Examples of circumstances which render a dissolution equitable are abandonment of the business, fraud in the management of the business, refusal without justifiable cause to render accounting of partnership affairs, etc. In a case, it was held that the sale of all real property (lots) of a partnership did not work the dissolution of the firm which was left without the real property it originally had because the firm was not organized to exploit the lots sold but to engage in buying and selling real estate, and "in general real estate agency, and brokerage business." (Goquiolay vs. Sycip, 108 Phil. 984 [1960].)

ILLUSTRATIVE CASE:

In an action for damages against the managing partner by reason of fraudulent administration, liquidation is not prayed for.

Facts: A filed a complaint against B for damages allegedly suffered by him by reason of the fraudulent administration by B of a partnership of which A, B, and C are members. It is not alleged in the complaint that a liquidation of the partnership has been effected nor is it prayed that it be made.

Issue: Is there reason or cause for A to institute the action which he claims from the managing partner B?

Held: None. The complaint of A does not contain sufficient facts to constitute a cause of action. For the purpose of adjudicating to A damages which he alleges to have suffered as a partner as a result of the fraudulent management of the partnership, it is first necessary that a liquidation of the business thereof be made to the end that the profits and losses may be known, and the causes of the latter and the responsibility of the managing partner, as well as the damages which each partner may have suffered, may be determined. *(Soncuya vs. De Luna, 67 Phil. 646 [1939].)*

(2) *On application by a purchaser of a partner's interest.* — In either of the two cases mentioned in the last paragraph, a purchaser of a partner's interest under Article 1813 or 1814 may apply for judicial dissolution of a partnership.

EXAMPLES:

(1) A, B, and C formed a partnership to continue for a term of five (5) years. On the third year, C sold his entire interest to D. Under Article 1813, such conveyance does not dissolve the partnership, and D does not become a partner, his only right being to receive the profits to which C would otherwise be entitled. Hence, D cannot ask for judicial dissolution of the partnership.

However, if after the fifth year, the partnership is continued, D is entitled to ask for judicial dissolution. The partnership as continued may or may not be a partnership at will.

(2) Suppose now, after the fifth year, the partnership was continued by the partners without any express agreement, becoming a partnership at will. (see Art. 1785.) If C's interest

was purchased by D or a charging order was issued against C in favor of D, his judgment creditor, as provided in Article 1814, when the partnership was already a partnership at will, D, at any time, may ask for judicial dissolution.

Note that the rule in Article 1831 (par. 2[2].) applies only if in continuing the business, a partnership at will is created, or the partnership is a partnership at will from the beginning.

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)

Effect of dissolution on authority of partner.

(1) *General rule.* — Unless otherwise stipulated, every partner is considered the agent of the partnership with authority to bind the partnership as well as the other partners with respect to the transaction of its business. (Art. 1803.) Upon dissolution, the partnership ceases to be a going concern and the partner's power of representation is confined only to acts incident to winding up or completing transactions begun but not then finished.

The event of dissolution, therefore, terminates the actual authority of a partner to undertake new business for the partnership.

(2) *Qualifications to the rule.* — The foregoing, however, is a general rule that is subject to the qualifications set forth in Articles 1833 and 1834 in relation to Article 1832.

(a) *In so far as the partners themselves are concerned,* the authority of any partner to bind the partnership by a new contract is immediately terminated when the dissolution is not by the act, insolvency, or death of a partner. (Art. 1832.) When the dissolution is by such act, insolvency, or death, the termination of authority depends upon whether or not the partner had knowledge or notice of the dissolution as provided in Article 1833.

(b) *With respect to third persons* (Art. 1834.), the partnership is generally bound by the new contract although the authority of the acting partner as it affects his co-partners is already deemed terminated under Articles 1832 and 1833. In such a case, however, the innocent partners can always recover from the acting partner.

EXAMPLE:

A, B, and C were partners in X & Co. The term of existence of the partnership as fixed in the articles of partnership expired yesterday. Therefore, it was dissolved. Here, the dissolution was caused not by the act, insolvency, or death of a partner.

If today A enters into a new transaction (not necessarily for winding up or to complete a transaction begun but not yet finished) with D, he (A) alone assumes whatever liability may arise under the contract because his authority to act for the partnership X & Co. as to bind B and C terminated as of yesterday, when the partnership was dissolved. If the partnership is liable to D under Article 1834, B and C are entitled to indemnity from A.

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.

Right of partner to contribution from co-partners.

The above article speaks of dissolution caused by the act, insolvency, or death of a partner.

Where a partner enters into a new contract with a third person after dissolution, the new contract generally will bind the partners. (Art. 1834, par. 1.) Each of them is liable for his share of any liability created by the acting partner as if the partnership had not been dissolved.

Authority of partners *inter se* to act for the partnership.

The authority of a partner as it affects his co-partners (not third persons) is not deemed terminated except in two instances, namely:

(1) The cause of the dissolution is the act of a partner and the acting partner had *knowledge* of such dissolution; and

(2) The cause of the dissolution is the death or insolvency of a partner and the acting partner had knowledge or notice of the death or insolvency.

The rule in No. 1 is designed to protect the remaining partner or partners who might continue to act for the partnership as a going concern, not having actual knowledge of the dissolution. The rule in No. 2 discards the fiction that everybody is presumed to have knowledge of death or insolvency.

Knowledge or notice of cause of dissolution.

(1) *Dissolution by death or insolvency.* — Under Article 1833, the authority of a partner to act for the partnership may still continue notwithstanding its dissolution. In the case of death, to hold that

a partner acting for the partnership *bona fide* in ignorance of the death or his co-partners must assume the entire liability, even though all other partners are ignorant of the death of the partner, and even though such deceased partner was entirely inactive and may have resided at any distance from the actual place of business, is entirely unjust to the acting partner or partners.

What has been said of the death of a partner applies also to the bankruptcy of a partner.[8] If there are a number of partners, and one of them becomes bankrupt, and another having no knowledge or notice of this fact makes a contract in the ordinary course of the business, there appears no reason why he should not be able to call on his other partners, not bankrupt or deceased, to contribute towards any loss which his separate estate may sustain on account of the contract. (7 Unif. L. Ann. 191-192 [1949].)

(2) *Dissolution by court decree or resulting from unlawfulness.* — No substantial problem exists where dissolution is brought about, for example, by court decree, since this brings actual notice of the dissolution to all of the partners nor is a problem presented where dissolution results from unlawfulness, since the general rules governing actions arising out of illegal transactions would control in such cases. (Teller, *op. cit*., p. 101.)

When a partner has knowledge or notice of a fact.

The Uniform Partnership Act defines the two terms as follows:

(1) "A person has *knowledge of a fact* within the meaning of this Act not only when he has actual knowledge thereof, but also when he has knowledge of such other facts as in the circumstances show bad faith."

[8]In common law, dissolution of a firm by death or bankruptcy of one of the partners puts an end to the liability of the estate of such dead or bankrupt partner, and any new contract entered into by the survivor in the firm bind only the survivor. This result was followed even though the other or surviving partners were ignorant of the death or bankruptcy unless, of course, the contract was entered into for the purpose and within the scope of dissolution. This was because the common law viewed death or bankruptcy as a public and notorious act which acted as constructive notice. (Teller, *op. cit*., p. 102, citing Marlett vs. Jackson, 85 Mass. 287.)

(2) "A person has *notice of a fact*[9] within the meaning of this Act when the person who claims the benefit of the notice:

(a) States the fact to such person, or

(b) Delivers through the mail or by other means of communication, a written statement of the fact to such person or to a proper person at his place of business or residence." (Sec. 3, U.P.A.)

EXAMPLES:

(1) A, B, and C were partners. A informed B that the former was resigning or withdrawing from the partnership. The partnership was thus dissolved by the act of A.

C had no knowledge of the dissolution. If partnership liability is incurred by a contract entered into by C, A and B are bound to contribute their share of the liability as if the partnership had not been dissolved. To avoid being liable for his share of partnership liability arising after the dissolution, A should prove knowledge on the part of C that A had already dissolved the partnership at the time the contract was made.

If the contract was entered into by B despite his knowledge of the dissolution, A and C can recover from B. In the end, only B will assume the entire liability. Suppose B learned of the resignation of A only from C. In this case, B had merely notice (as distinguished from knowledge) of the dissolution. Hence, A and C can be called upon to contribute their share in the liability.

(2) If A had died or had become insolvent, knowledge or notice on the part of B will justify non-liability on the part of the other partners.

It must be noted that Article 1833 applies only if the contract of the partner binds the partnership. If the partnership is not bound (Art. 1834, par. 4.), only the acting partner is personally liable.

[9]Under the Negotiable Instruments Law, "where the parties to be notified are partners, notice to any partner is notice to the firm, even though there has been a dissolution." (Sec. 99, Act No. 2031.)

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

(1) By an 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 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 had no authority to wind up partnership affairs, except by a transaction with one who —

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

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

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

Power of partner to bind dissolved partnership to third persons.

Article 1834 enumerates the cases when a partner continues to bind the partnership even after dissolution (par. 1, Nos. 1 and 2.) and the case when he cannot bind the partnership after dissolution. (par. 3, Nos. 1, 2, and 3.)

(1) *Where there is no notice to third persons of dissolution.* — Upon the dissolution of the partnership, as between themselves, the power of one partner to act and bind the others is effectively terminated. (Arts. 1832, 1833.) But the authority of a partner may apparently continue as regards third persons on the assumption that the partnership is still existing. Since a partnership once established is, in the absence of anything to indicate its termination, presumed to exist, the law, for the protection of innocent third persons, imposes upon partners the duty of giving notice of the dissolution of the partnership.

(2) *Where there is actual or constructive knowledge by third persons of dissolution.* — The measure of the right of third persons

who continue to deal with a dissolved partnership depends upon the question of whether they knew or should have known of the fact of dissolution. If they did, the validity of their transactions is governed by the question whether those transactions were necessary to liquidate the partnership affairs. (Teller, *op. cit*., p. 102.)

EXAMPLES:

Where A, B, and C are active and ostensible partners, A's retirement terminates the actual authority of A, B, or C to impose new obligations on the partnership, except such as may be necessary to wind up the business or to complete transactions begun but not then finished.

Assume that D has extended credit to the partnership prior to A's retirement, and has no knowledge of A's retirement, and that no notice thereof has been communicated to X, by mail or otherwise, then on the ground of estoppel:

(1) If B or C, purporting to act on behalf of the partnership, contracts with D (*e.g.,* orders goods), the partnership (A, B, and C, jointly) is liable to D.

(2) If A, purporting to act on behalf of the partnership, contracts with D, the partnership (A, B, and C, jointly) is liable to D. (Babb & Martin, *op. cit*., pp. 262-263.)

Notice of dissolution to creditors.

(1) *As to persons who extended credit to partnership prior to dissolution.* — Customers of the partnership or persons who extended credit to the partnership prior to its dissolution must have knowledge or notice of the dissolution to relieve the partnership from liability.

(2) *As to persons who had known of partnership's existence.* — As to persons who had not so extended credit prior to its dissolution, but who had known of its existence, the fact that the dissolution had been published in the newspaper would be sufficient (par. 1, No. 2[a, b].), even if they did not actually read the advertisement.

(3) *Where acting partner has no authority to wind up partnership affairs.* — Under the third paragraph, notice of dissolution is unnecessary except in case No. 3, where the partner has no

authority to wind up partnership affairs. Third persons dealing with the partner without such authority are protected under the same circumstances mentioned in paragraph 1, No. (2)(a) and (b).

(4) *Where acting partner has become insolvent.* — As to insolvency, the law makes a distinction between the right of a partner who has no knowledge or notice of the other partner's insolvency to bind the partnership and the right of a third person to claim that his contract with the partnership is valid, notwithstanding its dissolution through insolvency of the partner with whom the contract was made.

The former is recognized under Article 1833(2), while the latter is denied under Article 1834 (par. 3, No. 2.), *i.e.*, the innocent partner is protected in his continued right to make binding partnership agreements, but no similar protection is extended to a third party who innocently makes a contract with an insolvent partner because it is incumbent upon him to know the status of the insolvent partner.

(5) *Where dissolution caused by death of a partner.* — As to death, no such distinction is made, largely because the deceased partner no longer exists. Death, then, is not considered to be notice *per se* whether as to the surviving partner or as to third persons. (Teller, *op. cit*., pp. 104, 108.)

Character of notice required.

The character of notice required to relieve a retiring partner or the representatives of a deceased partner from subsequent liability on partnership obligations varies in accordance with the class of persons required to be notified.

(1) *As to prior dealers.* — Notice must be actual. Mere mailing of a letter to a former dealer is insufficient to relieve the retiring partner from subsequent liability, where the notice was never received. Furthermore, there is no duty on the part of a prior dealer to inquire into the question of retirement, even though the prior dealer had the means of obtaining knowledge of such retirement but failed to make use of it. So, it was held that a prior dealer entitled as such to actual notice, may not be said as

a matter of law to have received notice by reason merely of the fact that the retirement was mentioned in a newspaper to which the prior dealer subscribed, or although the fact of dissolution was mentioned editorially in the local newspaper. (Teller, *op. cit.*, p. 105, citing Austin vs. Holland, 69 N.Y. 571; Smart & Co. vs. Breckinridge Bank, 28 Kg. L. 646; Zollar vs. Janorin, 47 N.H. 324; Anglin vs. Marr Canning Co., 152 Ark 1.)

A *prior* or *former dealer* is one who has extended credit on the faith of the partnership, through confidence in the solvency and probity of the firm. Mere dealing with a firm on a cash basis does not constitute one a prior dealer. One who purchases goods from the supposed partnership is not a prior dealer. (*Ibid*., citing Hokew vs. Silman, 95 Ga. 678.)

(2) *As to all others.* — Notice is accomplished by an advertisement in a local newspaper. Actual notification is not necessary. It should be noted, however, that the requirement of newspaper notice appears to exist only where the third party knew of the partnership prior to dissolution. If he did not, he is entitled to no notice whatsoever. It is not clear whether notice to others other than prior dealers, who had knowledge of the partnership prior to dissolution, was sufficient if given in ways other than by newspaper notification. Apparently, the law has made newspaper notification an exclusive method for giving notice. (Teller, *op. cit.*, p. 106.)

EXAMPLE:

T purchased goods from a partnership. Thereafter, the partnership was dissolved. Notice of the dissolution was advertised in the local newspaper. Without knowledge of the dissolution, T thereafter extended credit to the supposed partnership at the request of one of its members in connection with a transaction not necessary for the liquidation of the business.

May T hold the partnership liable on the transaction?

No. Prior dealers must be given actual notice of the dissolution of a partnership in order to prevent the continuance of partnership liability. T, however, is not a prior dealer. Hence, he is considered to have received notice as a matter of law when

the fact of dissolution was advertised in the local newspaper. (*Ibid*., pp. 179-180, 187.)

ILLUSTRATIVE CASE:

A third person, without notice, extended credit to a partnership after withdrawal of a partner and its continuation by the other partners.

Facts: A withdrew from the partnership "Isabela Sawmill" composed of A, B, and C. It does not appear that the withdrawal of A from the partnership was published in the newspapers. There was no liquidation of the partnership assets. On the contrary, it was expressly stipulated in a memorandum-agreement among A, B, and C that the remaining partners, B and C, had constituted themselves as the partnership entity, the "Isabela Sawmill." B and C continued the business, using the properties of the partnership.

To secure the obligations of B and C to A, B and C executed a chattel mortgage over certain properties of the partnership in favor of A who was issued a certificate of sale over the same as a result of the judicial foreclosure of the mortgage. In the meantime, X, etc. extended credit to the partnership.

Issue: Is A liable to X, etc. for the properties of the partnership which were mortgaged to her and which she purchased at public auction?

Held: Yes. The judicial foreclosure of the chattel mortgage executed in favor of A did not relieve her from liability to the creditors of the partnership. X, etc. and the public in general had a right to expect that whatever credit they extended to B and C doing the business in the name of the partnership could be enforced against the properties of the partnership.

Although A acted in good faith, X, etc. also acted in good faith in extending credit to the firm. Where one of two innocent persons must suffer, the person who gave occasion for the damages to be caused must bear the consequences. *(Singson vs. Isabela Sawmill, 88 SCRA 623 [1979].)*

Dormant partner need not give notice.

Under the second paragraph, the liability of a partner unknown as such to the person with whom the contract is made

or so far unknown and inactive in partnership affairs shall be satisfied out of partnership assets alone. This is a qualification of the rule that partners are liable *pro rata* with all their property after the assets of the partnership have been exhausted for partnership obligations. (Art. 1816.)

A dormant partner is both inactive and secret. His connection with the partnership not having known, it cannot in any degree have contributed towards establishing its reputation or credit. Third persons, not having dealt with the partnership in reliance upon the membership of the dormant partner, are accordingly not entitled to notice of his withdrawal. The principle of estoppel cannot operate to continue his liability or his authority after dissolution since prior thereto, he was never known or held out as a partner. He will, of course, be personally liable for partnership debts arising at the time of his retirement. (Babb and Martin, *op. cit*., pp. 264-265.)

Partnership by estoppel after dissolution.

Article 1834 (last par.) touches upon the subject of partnership by estoppel (Art. 1825.), since a partnership is held to exist as to third persons though it does not exist as a going concern so far as the partners themselves are concerned. The situation differs from a partnership by estoppel, however, in that a partnership did once exist and liability is based upon its continuance as a matter of law as far as third persons are concerned. A partnership by estoppel involves a "holding out" by parties as partners when, in fact, they are not partners.

Article 1825 deals with partnership by estoppel. It will be seen that Article 1769(1) is not entirely accurate in stating that "Except as provided by Article 1825, persons who are not partners as to each other are not partners as to third persons," since this overlooks the circumstances under which by virtue of Article 1834, third persons may claim the validity of contracts made with dissolved partnerships in disregard of the fact of dissolution. (Teller, *op. cit*., p. 103.)

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)

Effect of dissolution on partner's existing liability.

The dissolution of a partnership does not of itself discharge the existing liability of a partner. (Testate Estate of Mota vs. Serra, 47 Phil. 464 [1925].)

A partner may be relieved from all existing liabilities upon dissolution only by an agreement to that effect between himself, the partnership creditor, and the other partners. The consent, however, of the creditor and the other partners to the novation may be implied from their conduct.

Liability of estate of deceased partner.

In accordance with Article 1816, the individual property of a deceased partner shall be liable for all obligations of the partnership incurred while he was a partner. Note that the individual creditors of the deceased partner are to be preferred over partnership creditors with respect to the separate property of said deceased partner. (Art. 1839[8].)

EXAMPLE:

If A, B, and C are partners and A retires, all three (A, as well as B and C) continue to be personally liable for partnership debts existing at the time of A's retirement.

Similarly, if A dies, his individual estate is available to partnership creditors, subject, however, to the claims of A's personal creditors. Even an agreement among A, B, and C whereby B and C promised to assume the partnership debts does not release A, unless the creditors assent to such substitution of debtors, either by express agreement (novation) or by agreement inferable from course of dealing. (Babb and Martin, *op. cit.*, p. 262.)

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)

Manner of winding up.

The winding up of the dissolved partnership may be done either:

(1) *judicially,* under the control and direction of the proper court upon cause shown by any partner, his legal representative, or his assignee; or

(2) *extrajudicially,* by the partners themselves without intervention of the court.

Nature of action for liquidation.

An action for the liquidation of a partnership is a personal one; hence, it may be brought in the place of residence of either the plaintiff or the defendant.

Thus, the fact that the plaintiff prays for the sale of the assets of the partnership including a fishpond located in a province other than that where the action was brought, does not change

the nature or character of the action, such sale being merely a necessary incident to the liquidation of the partnership, which should precede and/or is a part of its proper liquidation. (Claridades vs. Mercader, 17 SCRA 1 [1966].)

Persons authorized to wind up.

(1) The following are authorized to wind up the affairs of the partnership:

(a) The partners designated by the agreement;

(b) In the absence of such agreement, all the partners who have not wrongfully dissolved the partnership; or

(c) The legal representative (executor or administrator) of the last surviving partner (when all the partners are already dead), not insolvent. (Art. 1830[6].)

(2) The court may, in its discretion, after considering all the facts and circumstances of the particular case, appoint a receiver to wind up the partnership affairs where such step is shown to be to the best interests of all persons concerned. An insolvent partner does not have the right to wind up partnership affairs. (see Arts. 1830[6]; 1833.)

Survivor's right and duty to liquidate.

When a member of a partnership dies, the duty of liquidating its affairs devolves upon the surviving member or members of the firm, not upon the legal representative of the deceased partner (except when such partner was the last surviving partner). (Lota vs. Tolentino, 90 Phil. 829 [1952]; Po Yeng Cheo vs. Lim Ka Yan, 44 Phil. 172 [1922]; Guidote vs. Borja, 53 Phil. 950 [1929].)

(1) The legal representative has no right to interfere with the partnership business, so long as the surviving partner proceeds in good faith to settle its affairs, and it makes no difference how well qualified such representative may be to assist. The executor or administrator of a deceased partner cannot insist on continuing the business in the absence of some controlling agreement to that effect. (40 Am. Jur. 333.)

(2) Under the Uniform Partnership Act, "x x x a surviving partner is entitled to reasonable compensation for his services in winding up partnership affairs." (Sec. 18[f] thereof.) Our law is silent on this point. It is believed, however, that even in the absence of agreement, the surviving partner or liquidating partner is entitled to reasonable compensation in exceptional situations as where the services rendered are extraordinary or substantial in nature.

Powers of liquidating partner.

(1) *Make new contracts.* — For the purpose of winding up the partnership, a liquidating partner is sole agent of the partnership, but merely for that one specific purpose. Thus, without express authorization, he cannot make new contracts or create new liabilities, as by giving promissory notes binding on the firm nor can he extend the time for the payment of existing obligations to the firm, or make acknowledgments of the validity of claims against the firm.

(2) *Raise money to pay partnership debts.* — For the purpose of winding up the concern, however, the liquidating partner has the same general power to bind the firm as he had before, and he may bind the partnership by borrowing money to meet its accruing liabilities, and may sell its real estate to raise money to pay its debts. (40 Am. Jur. 325.)

(3) *Incur obligations to complete existing contracts or preserve partnership assets.* — A liquidating partner has power to incur obligations necessary to the completion of existing contracts, and to incur debts or other obligations necessary for the reasonable preservation of partnership assets or in procuring a favorable market for their disposal. (40 Am. Jur. [1960] Supp. 36.)

(4) *Incur expenses necessary in the conduct of litigation.* — Where a liquidating partner is confronted with the necessity of litigation in order to perform his duty in winding up the affairs of the partnership, he has power to employ an attorney, with resultant obligations, to prosecute and defend the action or to incur other expenses necessary in the conduct of such litigation. *(Ibid.)*

In other words, for the purpose of winding up the affairs of a dissolved partnership, the surviving partner has full authority to do every thing that may be necessary, but his power is limited to the performance of acts which are indispensable to that end. The deceased partner's estate is not liable for any subsequent debts or losses incurred by the surviving partners who continued the partnership business without the consent of the estate.

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

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

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

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

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

(2) The partners who have not caused the dissolution wrongfully, if they all desire to continue the business in the same name either by themselves or jointly with others, may do so, during the agreed term for the partnership and for that purpose may possess the part-

nership 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 good will of the business shall not be considered. (n)

Right of partner to application of partnership property on dissolution.

The liquidation of the assets of the partnership following its dissolution is governed by various provisions of the Civil Code such as Article 1837. However, an agreement of the partners, like any other contract, is binding among them and normally takes precedence to the extent applicable over the general provisions of the Civil Code. (Ortega vs. Court of Appeals, 245 SCRA 529 [1995].)

The objectives of Article 1837 are, in the main, to provide for the payment of the partner who leaves the firm, and to indemnify

him against existing or possible future liability. (Teller, *op. cit*., p. 110.)

The right of every partner, on a dissolution, against the other partners and persons claiming through them in respect of their interests as partners, to have the partnership property applied to discharge partnership liabilities and the surplus assets, if any, distributed in cash to the respective partners, after deducting what may be due to the firm from them as partners, constitutes what is known as the "partner's lien." (31 Words and Phrases 380.) The extent of this right depends on whether the dissolution is caused without violation of the partnership agreement, or in violation of the partnership agreement. The guilty partner is given by law certain rights.

Rights where dissolution not in contravention of agreement.

Unless otherwise agreed, the rights of each partner in case of dissolution without violation of partnership agreement are as follows:

(1) To have the partnership property applied to discharge the liabilities of the partnership; and

(2) To have the surplus, if any, applied to pay in cash the net amount owing to the respective partners.

When the dissolution is caused by expulsion of a partner *bona fide* (so without violation of the partnership agreement), such expelled partner may be discharged from all partnership liabilities either by payment or by an agreement between him, the partnership creditors, and the other partners. (Art. 1835.) He shall have the right only to receive in cash the net amount due him from the partnership.

If the dissolution is proper or rightful, no partner is liable for any loss sustained as a result of the dissolution.

Rights where dissolution in contravention of agreement.

When the partnership is dissolved in violation of the part-

nership agreement, the rights of a partner vary depending upon whether he is the innocent or the guilty partner.

(1) *Rights of partner who has not caused the dissolution wrongfully:*

(a) To have partnership property applied for the payment of its liabilities and to receive in cash his share of the surplus;

(b) To be indemnified for damages caused by the partner guilty of wrongful dissolution;

(c) To continue the business in the same name during the agreed term of the partnership, by themselves or jointly with others; and

(d) To possess partnership property should they decide to continue the business.

(2) *Rights of partner who has wrongfully caused the dissolution:*

(a) If the business is not continued by the other partners, to have the partnership property applied to discharge its liabilities and to receive in cash his share of the surplus less damages caused by his wrongful dissolution.

(b) If the business is continued:

1) To have the value of his interest in the partnership at the time of the dissolution, less any damage caused by the dissolution to his co-partners, ascertained and paid in cash or secured by bond approved by the court; and

2) To be released from all existing and future liabilities of the partnership.

Note that the innocent partners have more rights than the guilty partners and that the latter are made liable for damages caused by their wrongful dissolution, and in ascertaining the value of their interest, the value of the goodwill of the business is not considered, obviously as a penalty for their bad faith. If the innocent partners decide to buy the guilty partner's interest, they may continue the partnership business in the same firm name. The guilty partner is entitled to his share of the appraised value of the business less the damages recoverable by the innocent partners. If they decide otherwise, they may wind up the partnership business.

Goodwill of a business.

The *goodwill of a business* may be defined to be the advantage which it has from its establishment or from the patronage of its customers, over and above the mere value of its property and capital. The goodwill of a partnership rests in the probability that its old customers will continue their custom and will commend the partnership to others, making the latter new customers. It may also include the advantages which may be derived from the partners holding themselves out as carrying on the business identified with the name of a particular firm.

(1) *Goodwill as part of partnership assets.* — Inasmuch as the word "assets" in the law of partnership is not to be confined to assets at law, but includes all assets applicable to the payment of the partnership debts, the goodwill of the partnership, if of money value, is usually considered part of the property and assets of the firm, in the absence of a contract, express or implied, to the contrary.

(2) *Firm name as part of goodwill.* — The name of a firm is an important part of the goodwill and its use may be protected accordingly. The firm name of the partnership, as distinguished from the name of an individual, is an element of the partnership enterprise, a substantial asset thereof, and passes with a sale of the partnership property and goodwill. (40 Am. Jur. 204.) Being unquestionably partnership property, the representative of a deceased partner, therefore, is entitled to have an accounting of the value of the goodwill of the partnership and a partner may insist that upon dissolution, the goodwill should be sold as part of the partnership assets.

(3) *Existence of saleable goodwill.* — The goodwill of a business is a proper subject of sale. However, a saleable goodwill can exist only in a commercial partnership. It cannot arise in a professional partnership, such as partnership of attorneys or physicians, the reputation of which depends on the individual skill or personal qualifications of its members. (In the Matter of the Petition for Authority to Continue Use of the Firm Name "Ozaeta, Romulo, etc.," 92 SCRA 1 [1979].)

Where the goodwill of the business is dependent solely on the skill or professional ability, reputation or standing of the partners (as attorneys, physicians) its goodwill is not subject to sale, and the name by which it is known may not be appropriated by any person to the exclusion of any other person. (see Teller, *op. cit*., p. 97, citing Baily vs. Bett, 241 N.Y. 22; *cf.* Hunt vs. Street, 182 Tenn. 167.)

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 on, 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 of making the representation against all debts and liabilities of the partnership. (n)

Right of partner to rescind contract of partnership.

If one is induced by fraud or misrepresentation to become a partner, the contract is voidable or annullable. (Art. 1390[2].)

If the contract is annulled, the injured partner is entitled to restitution. (Art. 1398.) Here, the fraud or misrepresentation vitiates consent. (Art. 1330.) However, until the partnership contract is annulled by a proper action in court, the partnership relations exist (Art. 1390.) and the defrauded partner is liable for all obligations to third persons.

Rights of injured partner where partnership contract rescinded.

This article speaks of the rights of the injured partner where the partnership contract is rescinded (should be "annulled") on the ground of fraud or misrepresentation. They are as follows:

(1) Right of a lien on, or retention of, the surplus of partnership property after satisfying partnership liabilities for any sum of money paid or contributed by him;

(2) Right to subrogation in place of partnership creditors after payment of partnership liabilities; and

(3) Right of indemnification by the guilty partner against all debts and liabilities of the partnership.

It is to be noted that the rights of the partner entitled to rescind (to annul) are without prejudice to any other rights under other provisions of law.

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 contributions. (n)

Liquidation and distribution of assets of dissolved partnership.

The process of winding up, where the business of the dissolved partnership is not continued, consists in liquidating partnership property (turning it into cash), paying outstanding debts, collecting outstanding receivables, distributing the proceeds, and any other actions required to bring partnership business to a close. Until the partnership accounts are determined, it cannot

be determined how much any of the partners is entitled, if at all. Partners severally have the implied authority to sell partnership property and to collect obligations due to the partnership. These powers may be delegated to one or more of their number as liquidating partner or partners.

The law, however, does not require a partnership to convert all its assets into cash before making a distribution to the partners. It is within the power of the court to order a distribution of its assets in cash, property, or a combination of both.

(1) Property which may be made available for distribution includes, in addition to the partnership property, contributions which may be collected from the partners so far as may be necessary for the payment of partnership obligations to creditors and to partners. (Crane, *op. cit*., pp. 476-477.)

(2) A partner has a right to have debts owing to the partnership from his co-partners deducted from their respective shares. This right is called "equitable lien" or "quasi-lien" in American law. It exists only when the affairs of the partnership are rounded up and the shares of the partners are computed after dissolution.

(3) Each partner is entitled to a share in the surplus property of the partnership, if any, in proportion to his interest in the partnership. (see Art. 1812.) This rule is called the "partner's lien law" in American law.

Rules in settling accounts between partners after dissolution.

Article 1839 sets forth a priority system for the distribution of partnership property (see Art. 1810.) and individual property when a partnership is dissolved to those entitled thereto.

The following rules as to distribution are subject to variation by agreement of the partners, either in their original partnership agreement or in a dissolution agreement *(Ibid.),* subject to the rights of partnership creditors.

(1) *Assets of the partnership.* — They are:

(a) Partnership property (including goodwill); and

(b) Contributions of the partners necessary for the payment of all liabilities in accordance with Article 1797.

(2) *Order of application of the assets.* — The partnership assets shall be applied to the satisfaction of the liabilities of the partnership in the following order:

(a) First, those owing to partnership creditors;

(b) Second, those owing to partners other than for capital and profits such as loans given by the partners or advances for business expenses;

(c) Third, those owing for the return of the capital contributed by the partners; and

(d) Finally, if any partnership assets remain, they are distributed as profits to the partners in the proportion in which profits are to be shared.

(3) *Loans and advances made by partners.* — Loans and advances made by partners to the partnership are not capital. Nor are undivided profits, unless otherwise agreed. Capital contributions are returnable only on dissolution, but loans are payable at maturity and accumulated profits may be withdrawn at any time by consent of a majority. (Babb and Martin, *op. cit*., p. 240.)

Amounts paid into the partnership in excess of a partner's agreed capital contributions constitute loans or advances which draw interest on which they are made. Accumulated profits do not draw interest, as they are not regarded as loans and advances merely because they are left with the firm. (*Ibid*., p. 248.)

(4) *Capital contributed by partners.* — Capital represents a debt of the firm to the contributing partners. If, on dissolution, partnership assets are insufficient to repay capital investments, the deficit is a capital loss which requires contribution like any other loss. *(Ibid.)* The return of the amount equivalent to the capital contribution of each partner shall be increased by his share of undistributed profits or decreased by his share of net losses.

A partner who furnishes no capital but contributes merely his skill and services is not entitled to any part of the firm capital

on dissolution in the absence of agreement. He must look for his compensation to his share of the profits remaining after repayment of the capital to the contributors. (*Ibid*., *op. cit*., p. 96, citing Mosely vs. Taylor, 173 N.C. 286.)

The total capital contribution of the partners is not equivalent to the gross assets to be distributed to the partners at the time of the dissolution of the partnership. It may be impaired or become unavailable for distribution or return to the partners because of losses sustained by the partnership. (see Villareal vs. Ramirez, 406 SCRA 145 [2003].)

(5) *Right of a partner where assets insufficient.* — If the assets enumerated in No. 1 are insufficient (*i.e.,* there is an overall loss), the deficit is a capital loss which requires contribution like any other loss. Any partner or his legal representative (to the extent of the amount which he has paid in excess of his share of the liability), or any assignee for the benefit of creditors or any person appointed by the court, shall have the right to enforce the contributions of the partners provided in Article 1797. If any of the partners does not pay his share of the loss, the remaining partners have to pay but they can sue the non-paying partner for indemnification.

(6) *Liability of deceased partner's individual property.* — The individual property of a deceased partner shall be liable for his share of the contributions necessary to satisfy the liabilities of the partnership incurred while he was a partner. (Arts. 1816, 1835, par. 3.)

(7) *Priority to payment of partnership creditors/partners' creditors.* — When partnership property and the individual properties of the partners are in possession of the court for distribution, partnership creditors shall first be paid from partnership property and separate creditors from the individual properties of the partners. (see Sec. 51, Act No. 1956 [The Insolvency Law], as amended.) Neither class of creditors is allowed to trespass on the fund belonging to the other until the claims of that other shall have been satisfied. (40 Am. Jur. 402-403.)

Stated otherwise, the general rule is: "Partnership assets to partnership creditors, individual assets to individual creditors;

anything left from either goes to the other." It involves the ranking of assets in a certain order toward the payment of outstanding debts. This rule is known as the *doctrine of the marshalling of assets.* In an American case, it was held that the United States does not have the right to be paid its income taxes due from individual partners out of the assets of a bankrupt firm in preference to the claim of partnership creditors. (United States vs. Kauffman, 267 U.S. 408, cited by Teller, p. 120.) In line with the rule is the second paragraph of Article 1835.

Suppose one is a creditor of all the partners solidarily on a transaction independent of the partnership, may he, under the bankruptcy law, share *pari passu* with the partnership creditors in its assets? No. This is so even though both the partnership and its members are in bankruptcy. Having secured priority over the firm creditors against the individual property of the firm members, the creditors are relegated to a secondary position to the firm creditors, since the claim is not based on a firm obligation. (*In re* Nashville Laundry Co., 240 Fed. 795, cited in Teller, p. 120.) Furthermore, partnership is regarded as a legal entity separate and distinct from its members.

(8) *Distribution of property of insolvent partner.* — If a partner is insolvent, his individual property shall be distributed as follows:

(a) First, to those owing to separate creditors;

(b) Then, to those owing to partnership creditors; and

(c) Lastly, to those owing to partners by way of contribution.

The preference of the individual creditors of a partner in the distribution of his separate estate results, as a principle of equity, from the preference of partnership creditors in the partnership funds. The separate creditor of an individual partner can execute against the assets of the firm only to the extent of the interest of the partner in the firm assets, which is nothing more than a right to any surplus remaining after firm creditors have been paid. (Teller, *op. cit.*, p. 121.)

EXAMPLES:

(1) A, B, and C, are partners. A contributed P150,000.00, B P100,000.00, and C, P50,000.00. On dissolution, the assets of the partnership amounted to P500,000.00. The partnership owes D the amount of P70,000.00, E, P50,000.00, and A, P20,000.00.

(2) The accounts of the partnership shall be settled as follows:

(a) D and E, who are partnership creditors, shall be paid first the total sum of P120,000.00, leaving a balance of P380,000.00;

(b) Then, A, who is also a creditor, will be paid his credit of P20,000.00, leaving a balance of P360,000.00;

(c) Afterwards, the contributions of A, B, and C to the partnership capital shall be returned to them in the total sum of P300,000.00, thereby leaving a balance of P60,000.00;

(d) The balance of P60,000.00 constitutes the profit which shall be divided among A, B, and C (unless there is an agreement to the contrary [Art. 1839, 1st par.] which, however, cannot prejudice the rights of third persons) in proportion to their capital contributions. Therefore, A is entitled to 3/6 or P30,000.00, B, 2/6 or P20,000.00 and C, 1/6 or P10,000.00.

(3) Suppose, in the same example, the liabilities of the partnership amount to P560,000.00. The partnership assets, then shall be exhausted to satisfy these liabilities thereby leaving an unpaid balance of P60,000.00. The partners shall then contribute to the loss, in the absence of an agreement to the contrary, in accordance with their capital contributions. Consequently, A is liable out of his separate property in the amount of P30,000.00, B, P20,000.00, and C, P10,000.00.

These contributions which are necessary to pay the liabilities of the partnership are considered partnership assets (No. 1[b].) and any assignee for the benefit of creditors and any person appointed by the court may enforce the contributions.

In case C paid the whole amount of P60,000.00, then, he has a right to recover the amount which he has paid in excess of his share of the liability from A, P30,000.00 and from B, P20,000.00.

(4) If B is already dead, his estate is still liable for the contributions needed to pay off the partnership obligations provided they were incurred while he was still a partner.

(5) Suppose now that under Nos. 1 and 2 above, C owes F P40,000.00. Following the rule that partnership creditors have preference regarding partnership property, only the share of C in the amount of P10,000.00 can be used to pay his debt to F and the unpaid balance of P30,000.00 must be taken from the individual property, if any, of C.

(6) Suppose again, that the partnership debts amount to P560,000.00 as in No. 3. So, C is still liable out of his separate property to partnership creditors in the amount of P10,000.00. His separate property amounts to P45,000.00. In this case, his assets shall first be applied to pay his debt of P40,000.00 to F and the balance of P5,000.00 to pay part of his debt of P10,000.00 still owing to partnership creditors in accordance with the rule that regarding individual properties, individual creditors are preferred.

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 partner 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)

Dissolution of a partnership by change in membership.

(1) *Causes.* — The change in the relation of the partners resulting in the dissolution of the partnership may take place when a new partner is admitted; or when a partner retires; or dies; or when a partner withdraws; or is expelled from the partnership; or when the other partners assign their rights to the sole remaining partner (Bernardo vs. Pascual, 109 Phil. 936 [1960].); or when all the partners assign their rights in partnership property to third persons.

Any change in membership dissolves a partnership and creates a new one.

(2) *Continuation of partnership without liquidation.* — A partnership dissolved by any of these happenings need not undergo the procedure relating to dissolution and winding of its business affairs. The remaining partners (and/or new partners) may elect to continue the business of the old partnership without interruption by simply taking over the business enterprise owned by the preceding partner and continuing the use of the old name.[10] The rights and obligations of the partners as among themselves in case of such continuation are set forth in Article 1837.

As the partnership is the result of a contract, a change in the parties to the contract necessarily results in a new contract. Hence, a change in membership of a partnership creates a new partnership upon the continuation of the business by the partners.

Rights of creditors of dissolved partnership which is continued.

Article 1840 deals with the rights of creditors when the partnership is dissolved by a change of membership and its business is continued (Art. 1837[2].) by a former partner, either alone or with new partners, without liquidation of partnership affairs.

[10]There are tax considerations which underlie such an informal approach to business on the part of the remaining and/or new partners.

(1) *Equal rights of dissolved and new partnership creditors.* — In such case, the law makes the creditors of the dissolved partnership also creditors of the persons or partnership continuing the business. In other words, both classes of creditors, the old and the new, are treated alike, being given equal rights in partnership property. The purpose of the law is to maintain the preferential rights of the old creditors to the partnership property as against the separate creditors of the partners. It is immaterial to determine under which one or more of the six (6) cases mentioned in Article 1840 the dissolution falls — the creditors of the old partnership are also the creditors of the new partnership which continues the business of the old one without liquidation of the partnership affairs. (Yu vs. National Labor Relations Commission, 224 SCRA 75 [1993].)

EXAMPLE:

Assume that C is admitted as a new partner into the existing partnership of A and B.

Technically, the old firm of A and B is dissolved and a new firm composed of A, B, and C is formed. C will not be individually liable for the debts of the old firm. His investment, however, constituting a part of the firm assets, will be equally available to both creditors of the old and creditors of the new firm. (par. 2; Art. 1826.)

Various other changes in membership effect a technical dissolution, yet justice dictates that the two sets of creditors involved, those of the old and those of the new firm, be treated on an equal basis.

A note to Uniform Partnership Act provides: "Where there is a continuous business carried on first by A, B, and C, and then by A, B, C, and D, or by B and C, or by B and D, or by C and D, or by B, C, and D, without liquidation of the affairs of the dissolved partnership of A, B, and C, both justice and business convenience require that all creditors of the business, irrespective of the exact groupings of the owners at the time their respective claims had their origin, should be treated alike, all being given an equal claim on the property embarked in the business." (Babb & Martin, *op. cit*., p. 265.)

(2) *Liability of persons continuing business.* — Note that under paragraph 2, the liability of the new or incoming partners shall be satisfied out of partnership property only unless there is a stipulation to the contrary. (Art. 1826.)

Note that paragraph 1, No. 4, applies only when the third person continuing the business of the dissolved partnership promises to pay the debts of the partnership. Otherwise, creditors of the dissolved partnership have no claim on the person or partnership continuing the business or its property unless the assignment can be set aside as a fraud on creditors under paragraph 4.

EXAMPLE:

> If A, B, and C, partners, sell the partnership business to D, and if D promises to pay the debts and to continue the business, the creditors of the dissolved partnership of A, B, and C are also the creditors of D. (*Ibid*., *op. cit*., pp. 265-266.)

(3) *Prior right of dissolved partnership creditors as against purchaser.* — When a retiring or deceased partner has sold his interest in the partnership without a final settlement with creditors of the partnership, such creditors have an equitable lien on the consideration paid to the retiring or deceased partner by the purchaser thereof. This lien comes ahead of the claims of the separate creditors of the retired or deceased partner. Application of the rule set forth in paragraph 3 does and sometimes leave the retiring or deceased partner with a continuing liability the exact duration of which is not specified except that it shall apply only in favor of those creditors at the time of the retirement or death of a partner. (Barrett & Seago, *op. cit*., p. 480.)

Continuation of dissolved partnership business by another company.

(1) *When corporation deemed a mere continuation of prior partnership.* — The weight of authority supports the view that where a corporation was formed by, and consisted of, members of a partnership whose business and property was conveyed and

transferred to the corporation for the purpose of continuing its business, in payment for which corporate capital stock was issued, such corporation is presumed to have assumed partnership debts and is *prima facie* liable therefor.

The reason for the rule is that the members of the partnership may be said to have simply put a new coat, or taken on a corporate cloak, and the corporation is a mere continuation of the partnership. (Laguna Transportation Co., Inc. vs. Social Security System, 107 Phil. 833 [1960].)

(2) *When obligations of company bought out considered assumed by vendee.* — In some cases, when one company buys out another and continues the business of the latter company, the buyer may be said to assume the obligations of the company bought out when said obligations are not of considerable amount or value especially when incurred in the ordinary course, and when the business of the latter is continued.

However, when said obligation is of extraordinary value, and the company was bought out not to continue its business but to stop its operation in order to eliminate competition, it cannot be said that the vendee assumed all the obligations of the rival company. (Phil. Air Lines, Inc. vs. Balinguit, 99 Phil. 486 [1956].)

Exemption from liability of individual property of deceased partner.

(1) *Debts incurred by person or partnership continuing business.* — The last paragraph of Article 1840 primarily deals with the exemption from liability to creditors of a dissolved partnership of the individual property of the deceased partner for debts contracted by the person or partnership which continues the *business* using the partnership name or the name of the deceased partner as part thereof. What the law contemplates is a hold-over situation preparatory to formal reorganization.

(2) *Commercial partnership continued after dissolution.* — Article 1840 treats more of a *commercial* partnership with a goodwill to protect rather than a *professional* partnership (see Art. 1767, par. 2.) with no saleable goodwill but whose reputation depends on

the personal qualifications of its individual members. (In the Matter of the Petition for Authority to Continue Use of the Firm Name "Sycip, Salazar, etc."/"Ozaeta, Romulo, etc.," 92 SCRA 1 [1979].)

As a general rule, upon the dissolution of a commercial partnership, the succeeding partners or parties have the right to carry on the business under the old name, in the absence of stipulation forbidding it, since the name of a commercial partnership is a partnership asset inseparable from the goodwill of the firm. On the other hand, a professional partnership the reputation of which depends on the individual skill of the members, such as partnerships of attorneys or physicians, has no goodwill to be distributed as a firm asset on its dissolution, however intrinsically valuable such skill and reputation may be, especially where there is no provision in the partnership agreement relating to goodwill as an asset. (*Ibid*., citing 60 Am. Jur. 2d 115.)

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)

Rights of retiring, or of estate of deceased, partner when business is continued.

The business of the partnership is not always terminated after dissolution. This is true where the business has been profitable and some of the partner's may wish to continue the business rather than liquidate it. When the dissolution is caused by the retirement or death of a partner and the business is continued without settlement of accounts, the retiring partner or the legal representative of the deceased partner shall have the right:

(1) To have the value of the interest of the retiring partner or deceased partner in the partnership ascertained as of the date of dissolution (*i.e.*, date of retirement or death); and

(2) To receive thereafter, as an ordinary creditor, an amount equal to the value of his share in the dissolved partnership with interest, or, at his option, in lieu of interest, the profits attributable to the use of his right.

As provided in Article 1840, the creditors of a dissolved partnership have a prior right as against the separate creditors of the retired or deceased partner.

If the surviving partners (in case the dissolution is caused by the death of a partner) continue the business without the consent of the deceased partner's estate, they do so without any risk to the estate; if the estate consents, it, in effect, becomes a new partner and would be answerable for all debts and losses after the death but only to the extent of the decedent's share in the partnership's assets.

EXAMPLE:

A, B, and C are partners in X & Co. which is indebted to D in the amount of P50,000.00. Later on, X & Co. was dissolved by reason of the withdrawal of C. The business was continued by A and B without any settlement of account between A and B, on the one hand, and C, on the other.

C or his legal representative has the right to have the value of his interest in the partnership ascertained and paid to him. Assuming that the interest of C has been ascertained

to be P30,000.00, D has priority over the claim of C, his legal representative, or his separate creditor.

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)

Accrual and prescription of a partner's right to account of his interest.

(1) The right to demand an accounting of the value of his interest (Art. 1812.) accrues to any partner or his legal representative after dissolution in the absence of an agreement to the contrary.

(2) Prescription begins to run only upon the dissolution of the partnership when the final accounting is done. Under Articles 1806, 1807, and 1809, the right to demand an accounting exists as long as the partnership exists. (Fue Leung vs. Intermediate Appellate Court, 169 SCRA 746 [1989].)

Person liable to render an account.

This right of a partner or the one who represents him as owner of his interest to an account, *i.e.*, to a statement of the partnership affairs, and, in due course of liquidation, to a payment of the amount of his interest, may be exercised as against:

(1) The winding up partner;

(2) The surviving partner; or

(3) The person or partnership continuing the business.

Liquidation necessary for determination of partner's share.

(1) *Share of the profits.* — The profits of a business cannot be determined by taking into account the result of one particular transaction instead of all the transactions had. Hence, the need

for a general liquidation before a member of a partnership may claim a specific sum as his share of the profits. (Sison vs. McQuaid, 94 Phil. 201 [1953].)

When in liquidating a partnership the profits for a given period of time cannot be exactly determined for lack of evidence *(e.g.,* the books of accounts had been destroyed by white ants *[anay])*, but the profits for certain periods prior and subsequent thereto are known, the profits corresponding to the said given time may be determined by finding the average of those profits already known and multiplying it by the length of time included between said periods.

Thus, assuming the liquidation of the business of a partnership for the period from 1991 to 1995 could not be made, and the net profit for the period between 1989 and 1990 is P16,000.00, the average of the profits for each of these years is P8,000.00; and assuming the net profit for the year 1996 is P11,000.00, the average between the net profit for 1989 and 1990 and the net profit for 1996 is P9,000.00, which may be considered as the average of the net annual profits for the period between 1991 and 1995, which in five years make a total of P45,000.00. (see De la Rosa vs. Ortega Go-Cotay, 48 Phil. 605 [1926].)

(2) *Share in the partnership.* — A partner's share cannot be returned without first dissolving and liquidating the partnership, for the firm's outside creditors have preference over the assets of the enterprise (Arts. 1839[2], 1827.) and the firm's property cannot be diminished to their prejudice. (Magdusa vs. Albaran, 5 SCRA 511 [1962]; see Art. 1857.)

Upon the death of a partner, the partnership assumes the status of partnership in liquidation. The only right his heirs could have would be to what might result, after such liquidation, to belong to the deceased partner, and before this is finished, it is impossible to determine what rights and interests, if any, the deceased had. (Bearneza vs. Dequilla, 43 Phil. 237 [1922].) In other words, no specific amounts or properties may be adjudicated to the heir or legal representative of the deceased partner without the liquidation being first terminated. (Lim Tanhu vs. Ramolete, 66 SCRA 425 [1975].)

ILLUSTRATIVE CASE:

Action is brought by two retiring partners for the return of their shares against the managing partner who made a computation of their value which computation was not approved by the other partners, there being no proper liquidation made yet of partnership affairs.

Facts: A, B, C, D, and E formed a partnership for the sale of general merchandise with A as the manager. During the existence of the partnership, B and C expressed a desire to withdraw from the firm. A thereupon made a computation to determine the value of the partners' shares. The results of the computation were embodied in a document drawn in the handwriting of A. Thereafter, B and C made demands upon A for payment. A having refused, B and C filed a complaint against A.

The Court of Appeals ruled in favor of B and C, holding that the action is not one for dissolution and liquidation but one for recovery of a sum of money with A as principal defendant and the partnership as an alternative defendant only, as it is based on the allegation that A, having taken delivery of the shares of B and C, failed to pay their claims and, therefore, the liability is personal to A.

Issue: A's argument is that the action cannot be entertained because in the distribution of all or part of the partnership assets, all the partners have an interest and are indispensable parties without whose intervention no decree of distribution can be validly entered. Is this argument correct?

Held: Yes. (1) *Return of a partner's share.* — A partner's share cannot be returned without first dissolving and liquidating the partnership, for the return is dependent on the discharge of creditors, whose claims enjoy preference over those of the partners; and it is self-evident that all members of the partnership are interested in its assets and business, and are entitled to be heard in the matter of the firm's liquidation and the distribution of its property.

The liquidation prepared by A is not signed by D and E, the other partners; it does not appear that they have approved, authorized, or ratified the same and, therefore, it is not binding upon them. At the very least, they are entitled to be heard as to its correctness.

(2) *Repayment of capital shares of retiring partners.* — In addition, unless a proper accounting and liquidation of the partnership affairs is first had, the capital shares of B and C, as retiring partners, cannot be repaid, for the firm's outside creditors have preference over the assets of the enterprise, and the firm's property cannot be diminished to their prejudice.

(3) *Personal liability of manager.* — Finally, A cannot be held liable in his personal capacity for the payment of partners' shares, for he does not hold them except as a manager of or trustee for the partnership. It is the latter that must refund the shares to the retiring partners. (B and C.) Since not all the members have been impleaded, no judgment for refund can be rendered. *(Magdusa vs. Albaran, supra.)*

When liquidation not required.

As a general rule, when a partnership is dissolved, a partner or his legal representative is entitled to the payment of what may be due after a liquidation. But no liquidation is necessary when there is already a settlement or an agreement as to what he shall receive.

ILLUSTRATIVE CASES:

1. *Withdrawing partner agreed to relinquish all rights and interests in the partnership upon the return of his investment.*

Facts: A withdrew as partner from partnership X. It was the intention and understanding of the parties that A was relinquishing all his rights and interests in the partnership upon the return of all his investment, subject to the condition that A was to be repaid within three (3) days from the date the settlement was agreed upon.

This condition was fulfilled when on the following day, A was reimbursed the amount due him under the agreement.

Issue: Is A entitled to profits of the partnership at the time of dissolution?

Held: No liquidation was called for because there was already a settlement as to what A should receive. It appeared that the settlement was agreed upon the very day the partnership was dissolved. The acceptance by A of his investment was

understood and intended as a final settlement of whatever right or claim A might have in the dissolved partnership. A was precluded from claiming any share in the profits should there be any, at the time of dissolution. *(Bonnevie vs. Hernandez, 95 Phil. 175 [1954].)*

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2. *Plaintiff, in violation of his promise, refused to sign the final statement of accounts after receiving, without reservation, his share in the partnership.*

Facts: Partnership X was dissolved. A promised to sign the last and final statement of accounts as soon as he receives his shares as shown in said statement. A accepted such share without any reservation but he refused to sign the statement.

Issue: Is A still entitled to liquidation?

Held: No. The statement was deemed approved when A received his share without any reservation. The signing became a mere formality to be complied with by A exclusively and his refusal to sign, after receiving his shares, amounted to a waiver of that formality. This approval precludes any right on the part of A to a further liquidation unless he can show that there was fraud, deceit, error, or mistake in said approval. *(Ornum vs. Lasala, 74 Phil. 242 [1943].)*

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Chapter 4

LIMITED PARTNERSHIP (n)

Brief history.

Though the limited partnership came into general use only recently, its history is perhaps more ancient than that of the ordinary partnership. It is undoubtedly an outgrowth of the Roman Law, which provided that one or more persons might turn over property to a slave and avoid personal liability by trading through him.

Gradually, there grew up in the civil law, rules governing this form of business, substituting, of course, for the slaves, free persons who become general partners with unlimited liability. Louisiana, which uses the civil instead of the common law, recognized this form of organization. In 1822, the principal rules on limited partnership which grew up in the civil law were codified and enacted into a statute by the State of New York. New York's lead has been followed by most common law jurisdictions though England did not fall into line until 1907. (Charles W. Gerstenberg, "Organization and Control" [1919], 3 Modern Business, p. 50.)

Under the name of *la societé en commandite,* the system of limited partnership has existed in France. In the vulgar latinity of the Middle Ages it was styled *commanda,* and in Italy *accommenda.* In the Middle Ages, it was one of the most frequent combinations of trade, and was the basis of the active and widely extended commerce of the opulent maritime cities of Italy. At a period when capital was in the hands of nobles and clergy, who, from pride of caste, or canonical regulations, could not engage directly in trade, it afforded the means of secretly embarking in commercial enterprises, and reaping the profits of such lucrative

pursuits, without personal risk. The special partnership is, in fact, no novelty, but an institution of considerable antiquity, well known, understood and regulated.

The French Code permits a special partnership, of which the capital may be divided into shares of stock, transmissible from hand to hand. In such a case, the death of the special partner does not dissolve the firm, the creation of transmissible shares being a proof that the association is formed *respectu negotii,* and not *respectu personarum;* but even in such a partnership, the death of the general partner effects a dissolution, unless it is expressly stipulated otherwise. But it would be wrong to extend the rule that a partnership, of which the capital is divided into transmissible shares, is not dissolved by the death of a stockholder, to a special partnership, the capital of which is not so divided.

The statute of New York recognizes only the latter kind of partnership, the names of parties being required to be registered, and any change in the name working a dissolution, and turning the firm into a general partnership. Such a partnership has always been held to be dissolved by the death of the special partner. The partnership remains under the dominion of the common law. It has created between the special and general partner a tie, which is not subjected to the caprice of unforeseen changes; it has produced mutual relations of confidence, which the general partner cannot be forced to extend to strangers. (Ames vs. Doroning, Brad [N.Y. Surr. Cit.] 321, 329 [1850].)

Sources of Civil Code provisions.

"Chapter 4 (Arts. 1843 to 1867.) on limited partners was adopted, also with appropriate amendments, from the Uniform Limited Partnership Act. The provisions on limited partnerships in the Code of Commerce (Arts. 145 to 150.) were considered too meager and inadequate to govern this juridical institution." (Report of the Code Commission, p. 149; see Art. 1867.)

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.

Concept of limited partnership.

This article defines a *limited partnership*. The term is sometimes used to designate joint ventures and partnerships limited only in respect of the nature and scope of the business to be carried on. The correct usage of the term confines it to the form of business association composed of one or more general partners and one or more special partners, the latter not being personally liable for the partnership debts. (68 C.J.S. 1004.) A limited partnership is thus composed of two classes of partners.

It is so called because the liability to third persons of one or more of its members referred to as limited (or special) partners is limited to a fixed amount (Hoefer vs. Hall, 411 P.d. 230.), their capital contributions or the amount they have invested in the partnership. This limited liability is the key characteristic of the limited partnership.

Characteristics of limited partnership.

As a general rule, the characteristics of a limited partnership are as follows:

(1) A limited partnership is formed by compliance with the statutory requirements (Art. 1844.);

(2) One or more general partners control the business and are personally liable to creditors (Arts. 1848, 1850.);

(3) One or more limited partners contribute to the capital and share in the profits but do not participate in the management of the business and are not personally liable for partnership obligations beyond the amount of their capital contributions (Arts. 1845, 1848, 1856.);

(4) The limited partners may ask for the return of their capital contributions under the conditions prescribed by law (Arts. 1844[h], 1857.); and

(5) The partnership debts are paid out of common fund and the individual properties of the general partners.

The general partners are treated by the law much like a partner in an ordinary partnership. They are typically those who know how to manage the business. The limited partners are usually those who put money for the business. They are only *investors*. Their limited liability is an exception to the general rule that all partners, including industrial partners, are liable *pro rata* with all their property for partnership debts. (Art. 1816.) Thus, a limited partner has the same type of liability as stockholder in a corporation.

Business reason and purpose of statutes authorizing limited partnerships.

(1) *Secure capital from others for one's business and still retain control.* — "The business reason for the adoption of acts making provisions for limited or special partners is that men in business often desire to secure capital from others. There are at least three classes of contracts which can be made with those from whom the capital is secured: First, the ordinary loan on interest. Second, the loan where the lender, in lieu of interest, takes a share in the profits of the business. Third, those cases in which the person advancing the capital secures, besides a share in the profits, some measure of control over the business.

The lender who takes a share in the profits does not by reason of that fact, run a risk of being held as a partner. If, however, his contract falls within the third class mentioned and he has any measure of control over the business, he at once runs serious risk of being liable for the debts of the business as a partner." (Sec. 17, Commissioners' Note, 8 Uniform Laws Annotated, pp. 2-5.)

(2) *Share in profits of a business without risk of personal liability.* — "The policy of laws authorizing the formation of limited partnerships is to bring into trade and commerce funds of those not inclined to engage in that business, who are disposed to furnish capital upon such limited liability with a view to the share of profits which might be expected to result to them from its use." (40 Am. Jur. 474.)

(3) *Associate as partners with those having business skill.* — "The primary purpose of the statute authorizing the formation of limited partnerships is to encourage those having capital to become partners with those having skill, by limiting the liability of the former to the incidental amount actually contributed by them. The object of such a statute is to furnish reasonable protection to those dealing with the concern by requiring acts to be done and public notice thereof given so that all who desire may know the essential features of the arrangement." (68 C.J.S. 1006.)

Differences between a general partner/partnership and a limited partner/partnership.

They are the following:

(1) A general partner is personally liable for partnership obligations (Art. 1816.), while a limited partner's liability extends only to his capital contribution (Arts. 1845, 1848, 1856.);

(2) When the manner of management has not been agreed upon, all of the general partners have an equal right in the management of the business (Arts. 1803, 1810[3].), whether or not the general partner has made any capital contribution, while a limited partner has no share in the management of a limited partnership, his rights being limited to those enumerated in Article 1851, such that he renders himself liable to creditors as a general partner if he takes part in the control of the business (Art. 1848.);

(3) A general partner may contribute money, property, or industry to the partnership (Art. 1767.), while a limited partner must contribute cash or property to the partnership but not services (Art. 1845.);

(4) Unlike a general partner, a limited partner is not a proper party to proceedings by or against a partnership unless he is also a general partner (Art. 1853.), or where the object of the proceeding is to enforce a limited partner's right against, or liability to, the partnership (Art. 1866.);

(5) A general partner's interest in the partnership (Art. 1812.) may not be assigned as to make the assignee a new partner without the consent of the other partners (Art. 1813.) although he may associate a third person with him in his share (Art. 1804.), while a limited partner's interest is freely assignable, with the assignee acquiring all the rights of the limited partner subject to certain qualifications[1] (Art. 1859.);

(6) The name of a general partner may appear in the firm name (Art. 1815.), while, as a general rule, that of a limited partner must not (Art. 1846.);

(7) A general partner is prohibited from engaging in a business which is of the kind of business in which the partnership is engaged, if he is a capitalist partner (Art. 1808.), or in any business for himself if he is an industrial partner (Art. 1789.), while there is no such prohibition in the case of a limited partner who is considered as a mere contributor to the partnership (see Art. 1866.); and

(8) The retirement, death, insanity, or insolvency of a general partner dissolves the partnership (Arts. 1860, 1830, 1831.), while the retirement, etc. of a limited partner does not have the same effect, for his executor or administrator shall have the rights of a limited partner for the purpose of selling his estate. (Art. 1861.)

The above also indicate the differences between a general partnership and a limited partnership. The other differences are: a general partnership may, as a general rule, be constituted in any form by contract or conduct of the parties, while a limited partnership is created by the members after compliance with the requirements set forth by law; it is composed only of general partners; it must operate under a firm name which in the case of a limited partnership must be followed by the word "Limited" (Art. 1844[1, a].); and its dissolution and winding up are governed by different rules.

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[1]When it is said, in distinguishing a limited partnership from the general partnership, that a limited partner's interest is freely assignable by the limited partner while a general partner's interest is not assignable, it is meant that a limited partner causes no rupture of the partnership business by his assignment, while a general partner's assignment may cause such a rupture. (Teller, *op. cit.*, p. 54.)

A limited partnership, unless prohibited by law, may carry on any business which could be carried on by a general 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 description of and the agreed value of the other property contributed by each limited partner;

(g) The additional contributions, if any, to be made by each limited partner and the times at which or events on the happening of which they shall be made;

(h) The time, if agreed upon, when the contribution of each limited partner is to be returned;

(i) The share of the profits or the other compensation by way of income which each limited partner shall receive by reason of his contribution;

(j) The right, if given, of a limited partner to substitute an assignee as contributor in his place, and the terms and conditions of the substitution;

(k) The right, if given, of the partners to admit additional limited partners;

(l) The right, if given, of one or more of the limited partners to priority over other limited partners, as to contributions or as to compensation by way of income, and the nature of such priority;

(m) The right, if given, of the remaining general partner or partners to continue the business on the death, retirement, civil interdiction, insanity or insolvency of a general partner; and

(n) The right, if given, of a limited partner to demand and receive property other than cash in return of 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.

Limited partnership not created by mere voluntary agreement.

As owner of a business can avoid personal liability for business debts only if this is provided by statute. Since in a limited partnership a person is allowed to share in the profits without becoming personally liable to partnership creditors, a limited partnership can be created only where permitted by statute.

The creation of a limited partnership is a formal proceeding and is not a mere voluntary agreement, as in the case of a general partnership. Accordingly, the requirements of the statute must be followed (Barrett & Seago, *op. cit*., Vol. 2, p. 494.) so that public notice may be given to all who desire to know the essential features of the partnership. (see 68 C.J. 1006.) A limited partnership is formed if there has been substantial compliance in good faith with the requirements set forth in Article 1844. (last par.); otherwise, the liability of the limited partners becomes the same as that of general partners.

Requirements for formation of a limited partnership.

Under Article 1844, there are two essential requirements for the formation of a limited partnership:

(1) The certificate or articles of the limited partnership which states the matters enumerated in the article, must be signed and sworn to; and

(2) Such certificate must be filed for record in the Office of the Securities and Exchange Commission.

The purpose of requiring the filing of the certificate is to give actual or constructive notice to potential creditors or persons dealing with the partnership to acquaint them with its essential features, foremost among which is the limited liability of the limited partners so that they may not be defrauded or misled. As no time is fixed by the law for the filing of the certificate for a limited partnership, a reasonable time is allowed depending on the circumstances of the particular case. To show failure to comply with certificate requirements and resulting general liability, the burden is on the one seeking to fix general liability. *(Ibid.)*

Article 1844 does not specify the time within which the certificate must be filed with the Securities and Exchange Commission.

Execution of the prescribed certificate.

A prime requisite to the formation of a limited partnership, under Article 1844, is the execution of the prescribed certificate. This document, as a rule, must contain the matters enumerated in said article. Thus, a limited partnership cannot be constituted orally.

(1) The requirement of statements as to the names of the partners, the capital contributed by the limited partners, and the duration of the partnership, is manifestly designed for the protection of those who deal with the firm, and must be strictly observed by the partners. The certificate need not contain anything concerning the amounts to be contributed by the general partners.

(2) It is immaterial that the certificate purports to be one for the renewal or continuance of an existing limited partnership when it is in fact one for the formation of a new limited partnership, as long as the essential requirements of the law have been satisfied.

(3) The statements required in the certificate must be true at the time the certificate and other required papers are filed with the Securities and Exchange Commission. (68 C.J.S. 1010.)

(4) A person who files a false certificate thereby renders himself liable as a general partner. The filing of a false affidavit does not result in imposing personal liability as a penalty, but merely as a consequence of the fact that the law refuses protection to one filing a false affidavit. The perjurious "limited partner" becomes a general partner, since he is a contributor of capital to a partnership operating in his behalf. (Teller, *op. cit*., p. 31; see Art. 1847.)

Substantial compliance in good faith sufficient.

A strict compliance with the legal requirements is not necessary. It is sufficient that there is substantial compliance in good faith. If there is no substantial compliance, the partnership becomes a general partnership as far as third persons are concerned, in which all the members are liable as general partners. (see Jo Chung Cang vs. Pacific Commercial Co., 45 Phil. 142 [1923].)

(1) *Rules applicable where there is no substantial compliance.* — There is authority to the effect that the firm is such a general partnership only as to its relation to third persons; that the firm, in form is a limited partnership, subject to all the rules applicable to such partnership; that as between the partners they are bound by their agreement; and that all the limited partner's relations to his co-partners and their obligations to him growing out of the relation remain unimpaired. (68 C.J.S. 1016.)

Where neither the rights of third parties nor a partner's claim of limited liability is involved, it is difficult to see how the failure to comply with the legal requirements could affect the existence of a limited partnership insofar as the parties, *inter se,*

are concerned where the written agreement executed by them is clear and unambiguous. (Hoefer vs. Hall, 411 P.d. 230.) Thus, a limited partner treated as a general partner as far as third persons are concerned is entitled to reimbursement from the general partner or partners for whatever obligations he might have paid to partnership creditors beyond his capital contribution.

(2) *Rule where partnership creditor guilty of estoppel.* — Where a certificate of formation of a limited partnership is defective and shows on its face that the statutory requirements have not been complied with, it has been held that a court can on its own motion hold that a limited partnership has not been formed. (Vanhorn vs. Corcoran, 127 Pa. 255, 18 A 16, 4 LRA 386.) But if attaching creditors recognize and deal with a firm as a limited partnership, they will be estopped from insisting that there is no such partnership, or that the terms of the partnership were not sufficiently stated in the notice of its formation. (40 Am. Jur. 476.)

Presumption of general partnership.

A partnership transacting business is, *prima facie,* a general partnership and those who seek to avail themselves of the protection of laws permitting the creation of limited partnerships must show due compliance with such laws. In other words, to obtain the privilege of a limited partnership liability, one must conform to the statutory requirements regulating the formation of limited partnerships. (*Ibid*., 475.)

The failure of a limited partnership to extend its term when it expired (see Art. 1844[1, e].), and to register it anew with the Commission, has the effect of divesting the limited partners of the privilege of limited liability. As far as third persons are concerned, the law considers the firm as a general partnership (McDonald vs. Morky, U.S.L. 499, prom. May 21, 1956.) having juridical personality. (SEC Opinion, May 1968.)

Construction of provisions on limited partnerships.

In the construction of statutes regulating the organization of limited partnerships, it is a general rule that the courts should

adopt and enforce a reasonable construction which, on the one hand, will not defeat one of the objects of the law and, upon the other hand, will not, under cover of a substantial compliance with the requirements of the statute, fritter away the protection which the law has thrown around persons dealing with such partnerships. *(Ibid.)*

Accordingly, the courts must consider substance rather than form in construing the law. However, it should be construed to insure substantial compliance with all the statutory provisions which are designed for the protection of persons dealing with the partnership. (68 C.J.S. 1007.)

Who may become limited partners.

Under a statute which provides that the membership of a limited partnership consists of specified "persons" (see Art. 1843.), a partnership cannot become a limited partner. An existing general partnership may be changed into a limited one, and a partner in the former general partnership may become a limited partner in the limited partnership thus formed. (68 C.J.S. 1009.)

ART. 1845. The contributions of a limited partner may be cash or other property, but not services.

Limited partner's contribution.

(1) *Medium.* — A limited partner or special partner is not allowed to contribute services. He can contribute only money or property;[2] otherwise, he shall be considered an industrial *and* general partner, in which case, he shall not be exempted from personal liability.

(a) A partner may be a general partner and a limited partner in the same partnership at the same time, provided

[2]It is the policy of the Securities and Exchange Commission to require non-resident aliens forming a commercial partnership with Filipinos or resident aliens to pay in full their contributions in the partnership and to be accepted only as limited partners. The reason for this requirement is based upon the fact that once non-resident aliens leave the Philippines, it would be difficult to collect their unpaid contributions or to hold them liable for their share of partnership liabilities should they be allowed to become partners of the firm. (SEC Opinion, Feb. 19, 1963.)

that this fact shall be stated in the certificate provided for in Article 1844 (Art. 1853.), but a limited partner may not be an industrial partner without being a general partner in view of Article 1845 which requires that a limited partner must be a capital contributor. It is not clear whether the rule still applies if the contribution of services is made after the formation of the limited partnership.

EXAMPLE:

In a limited partnership composed of A, B, and C, the contributions may be as follows: A — cash (limited partner); B — cash (general partner); and C — services (general partner).

Any of the partners may be a general partner and a limited partner at the same time. The contribution may be cash or property only, or both capital and services. Thus, if A, in addition to cash, also contributes services, he becomes a general partner and a limited partner at the same time; if he contributes services only, he is a general partner.

If a partner contributes capital only, he is either a general partner or a limited partner, or both, depending upon the agreement as stated in the certificate.

(b) The law is not satisfied by the limited partner's contribution in promissory notes, checks, particularly if they are post-dated, or bonds, or by a contribution partly in cash or property and partly in notes or checks. However, a check may be treated as an actual payment in cash where the limited partner has money actually in the bank to his credit, and he gives the general partner absolute and final control of the amount named therein. Thus, a certified check or a manager's check satisfies the law. A check which is credited to the general partner by his bank as cash has been held to be cash payment by the limited partner. (68 C.J.S. 1011.)

(2) *Time.* — The contribution of each limited partner must be paid before the formation of the limited partnership (see Art. 1844[f].), although with respect to the additional contributions they may be paid after the limited partnership has been formed. (*Ibid.*, [g].)

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.

Effect where surname of limited partner appears in partnership name.

The limited partner violating this article is liable, as a general rule, to partnership creditors without, however, the rights of a general partner. Of course, such limited partner shall not be liable as a general partner with respect to third persons with actual knowledge that he is only a limited 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.

Liability for false statement in certificate.

Under this provision, any partner to the certificate containing a false statement is liable provided the following requisites are present:

(1) He knew the statement to be false at the time he signed the certificate, or subsequently, but having sufficient time to cancel

or amend it or file a petition for its cancellation or amendment, he failed to do so;

(2) The person seeking to enforce liability has relied upon the false statement in transacting business with the partnership; and

(3) The person suffered loss as a result of reliance upon such false statement.

It has been held that a limited partner whose capital contribution is greater than that specified in the certificate of limited partnership is not thereby liable for making a false statement under Section 6 of the Limited Partnership Act (Art. 1847.), since there is no liability without showing a loss, and such a loss can be established only by showing a capital contribution which is less, not greater, than that specified. (Gilman Paint and Varnish Co. vs. Legum, 197 Md. 665, 29 ALR 3d 286; 40 Am. Jur. [1960] Supp. 51.)

Article 1847 does not say that the guilty partner shall be liable as a general partner. The liability imposed by Article 1847 is merely a statutory penalty and does not make the limited partner a general partner for all purposes, even as to third persons.

EXAMPLES:

(1) A, a limited partner, appeared as a general partner in the certificate. If Article 1847 is applicable, he cannot raise the defense that he is merely a limited partner to escape personal liability to innocent third persons in case the other general partners are insolvent.

(2) The contribution of A, limited partner, is erroneously stated in the certificate as P15,000.00 instead of P10,000.00. If Article 1847 is applicable, he may be made liable to innocent third persons for the difference of P5,000.00.

In the above examples, A is not liable and is a limited partner with respect to his co-partners with knowledge of the falsity.

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.

Liability of limited partner for participating in management of partnership.

Under the express provision of Article 1848, a limited partner is liable as a general partner for the firm's obligations if he takes part or interfere in the management of the firm's business. His abstinence from participation in fact in the transaction of the business of the firm is essential to his exemption from liability for the debts of the firm. The bare grant of apparent control to a limited partner is not sufficient to make him liable as a general partner where he has not actually participated in the control of the partnership.

Whether the limited partner has participated in the management is to be determined by whether he has exercised a controlling power in the firm's transactions. What constitutes control of the business sufficient to make a limited partner liable as a general partner has not been clearly defined by the courts. (68 C.J.S. 629.)

Active management of partnership business contemplated.

It would seem that such control contemplates active participation in the management of the partnership business and does not comprehend the mere giving of advice to general partners as to specific matters which the latter may follow or not. Being also interested in the success of the partnership business, a limited partner does not thereby forfeit his right to make suggestions or express opinions as to the advisability of certain transactions. (Silvola vs. Reulett, 272 P.d. 287.)

The limited partner takes part in the management of the business and is liable generally for the firm's obligations where:

(1) The business of the partnership is in fact carried on by a board of directors chosen by the limited partners;

(2) By the terms of the contract between the parties, an appointee of the limited partner becomes the directing manager of the firm;

(3) The limited partner purchases the entire property of the partnership, taking title in himself and then carries on the business in his own name and for his own exclusive benefit; or

(4) He makes or is a party to a contract with creditors of an insolvent firm with respect to the disposal of the firm's assets in payment of the firm's debts. *(Ibid.)*

The interference contemplated by Article 1848 is with respect to an existing limited partnership. Accordingly, a limited partner is not subject to general liability for taking part in the management of the firm because he settles its affairs after dissolution. *(Ibid.)*

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.

Admission of additional limited partners.

After a limited partnership has been formed, additional limited partners may be admitted, provided there is proper amendment to the certificate which must be signed and sworn to by all of the partners, including the new limited partners, and filed in the Securities and Exchange Commission pursuant to 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 to do so 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.

Rights, powers, and liabilities of a general partner.

The essential feature of a limited partnership is the union of two classes or types of members — the limited partner and the general partner. The law expressly requires that there be at least one general partner (Art. 1843.) with unlimited liability. (40 Am. Jur. 477.)

(1) *Right of control/unlimited personal liability.* — A general partner in a limited partnership is vested with the entire control of the firm's business and has all the rights and powers and is subject to all the liabilities and restrictions of a partner in a partnership without limited partners, *i.e.,* in a general partnership. It is in consideration of his unlimited personal liability for the obligation of the partnership that he is granted the general authority to manage the firm's business.

In the absence of an agreement to the contrary, he is not entitled to compensation for his services beyond his share of the profits.

(2) *Acts of administration/acts of strict dominion.* — As a rule, he may bind the partnership by any act of administration, but he has no power to do the specific acts enumerated in Article 1850 (even if agreed to by all the general partners) without the written consent or at least ratification of all the limited partners. The said acts are acts of strict dominion or ownership and are,

therefore, beyond the scope of the authority of a general partner. (Art. 1818.)

(a) In No. (1), the act is in violation of the agreement of the partners as contained in the certificate;

(b) In Nos. (2) to (4), the acts are prejudicial to the interests of the limited partners;

(c) In Nos. (5) and (6), the rule is based on the highly fiduciary nature of the partnership relation; and

(d) In No. (7), any of the events mentioned results in the dissolution of the partnership. (see Art. 1860.)

The general partner who violates the requirement imposed by Article 1850 is liable for damages to the limited partners.

(3) *Other limitations.* — The general partners, of course, have no power to bind the limited partners beyond the latter's investment. (40 Am. Jur. 477.) Neither do they have the power to act for the firm beyond the purpose and scope of the partnership, and they have no authority to change the nature of the business without the consent of the limited partners. In this respect, the certificate duly filed binds all persons dealing with the firm to take notice of, and be charged with knowledge of, its contents. Duties and disabilities arising out of the firm's transactions with third persons rest solely on the general partners. (68 C.J.S. 1025.)

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.

Rights, in general, of a limited partner.

The limited partner is viewed as a partner only to a certain extent. His powers, actual or implied, are much more limited than those of a general partner. As between the members of the firm, the limited partner, in order to protect his interest in the firm, has the same right to compel the partners to account as a general partner has.

Wrongdoing or improper acts on the part of general partners may not give a limited partner greater rights than the law and what his contract grants him. (68 C.J.S. 1022.)

Specific rights of a limited partner.

Article 1851 enumerates the specific rights of the limited partner in the partnership. They are as follows:

(1) To require that the partnership books be kept at the principal place of business of the partnership (see Art. 1805.);

(2) To inspect and copy at a reasonable hour partnership books or any of them *(Ibid.)*;

(3) To demand true and full information of all things affecting the partnership (see Art. 1806.);

(4) To demand a formal account of partnership affairs whenever circumstances render it just and reasonable (see Art. 1809.);

(5) To ask for dissolution and winding up by decree of court (see Arts. 1831, 1857, par. 4.);

(6) To receive a share of the profits or other compensation by way of income (Art. 1856.); and

(7) To receive the return of his contribution provided the partnership assets are in excess of all its liabilities. (Art. 1857.)

The rights of a limited partner are necessarily lesser than those of a general partner. He cannot take part in the control of the business (Art. 1848.) which is left to the general partner or partners. But whenever the liability of a general partner is imposed on a limited partner, he is given the corresponding rights of a general partner. (40 Am. Jur. 478-479.)

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.

Status of partner where there is failure to create limited partnership.

In this regard, it is to be noted that the law (Art. 1844, par. 2.) provides that the limited partnership is formed where there has been substantial compliance in good faith with the requirements thereof. If the law is not complied with, the attempt to limit the liability of the limited partners will be ineffective, at least as to creditors who have not recognized, or dealt with, the firm as a limited partnership. However, it may be more accurate to say that sometimes the limited partnership exists in spite of the failure of the firm to comply with the law, and that the limited partner is merely made liable for the debts of the firm as if he were a general partner. (40 Am. Jur. 478.)

Article 1852 grants exemption from liability in favor of one 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, or in a general partnership thinking that it is a limited partnership. It introduces

a substantial modification of liability where there has been a failure to create a limited partnership.

Status of person erroneously believing himself to be a limited partner.

(1) *Conditions for exemption from liability as general partner.* — A person who has contributed capital to a partnership, erroneously believing that he has become a limited partner, as when his name appears in the certificate as a general partner or he is not designated as a limited partner (see Art. 1844[d].), is not personally liable as a general partner by reason of his exercise of the rights of a limited partner, provided:

(a) On ascertaining the mistake, he promptly renounces his interest in the profits of the business or other compensation by way of income (Art. 1852.);

(b) His surname does not appear in the partnership name (Art. 1846.); and

(c) He does not participate in the management of the business. (Art. 1848.)

(2) *Necessity of renouncing his interest.* — The person, however, must promptly renounce his interest (*e.g.,* selling it to the general partners) before the partnership has become liable to third persons who cannot be blamed for considering him a general partner. Where no partnership creditors are prejudiced, it would seem that renunciation of his interest is not necessary.

(3) *Obligation to pay back profits and compensation already received.* — An interesting question arises: whether it is necessary for such person to pay back all past profits and interest to avoid being held liable as a general partner, or whether he need only renounce all further interest in the profits of the business.

(a) It would seem that the requirement of renunciation refers only to profits or compensation not yet paid over for a person can hardly be said to have an interest in profits or compensation he has already received, and this is fortified by the general usage of the word "renounce" which does not commonly have the meaning of "return." Hence, there is

no obligation to return or pay back profits or compensation already received.

(b) However, the opposite view also has merit. The intention behind the provision should be given more importance than the actual words used. The most that the statute could have intended was to put partnership creditors in the position they would have occupied had there been no limited partner at the time the obligations were contracted. (see Gilman Paint & Varnish Co. vs. Legum, 29 A.L.R. 2d 286, 295.)

ILLUSTRATIVE CASE:

A limited partnership was organized under a law that had been repealed, and subsequently, bankruptcy proceedings were instituted against the firm and the members.

Facts: A and B, both stockbrokers, formed a limited partnership for the purpose of engaging in the stock brokerage business in the state of Illinois (U.S.A.). It turned out that the statute under which the firm was organized had been repealed with the adoption of the Uniform Limited Partnership Act by the State of Illinois. A and B had no knowledge of the repeal.

Subsequently, bankruptcy proceedings were instituted against the firm and all the members, including the limited partners.

Issue: Are the limited partners entitled to the benefits of Section 11 (Art. 1852.) of the Act?

Held: Yes. Only the general partners could be adjudicated bankrupt. *(Giles vs. Vette, 263 U.S. 553 [1924].)*

Status of heirs of a deceased general partner admitted as partners.

An heir of a deceased general partner (in a general or limited partnership), admitted as a partner under the articles of partnership providing for such admission, *ordinarily* (not necessarily) becomes a *limited* partner for his own protection, because he would normally prefer to avoid any liability in excess of the value of the estate inherited so as not to jeopardize his personal assets.

(1) *Right to elect to become general partner may be exercised.* — This statutory limitation of responsibility being designed to protect the heir, the latter may disregard it and instead elect to become a collective or general partner, with all the rights and privileges of one, and answering for the debts of the firm not only with the inheritance but also with the heir's personal fortune. This choice pertains exclusively to the heir and does not require the assent of the surviving partner or partners. (Goquiolay vs. Sycip, 9 SCRA 663 [1963].)

(2) *Right when given in articles of partnership may be waived.* — The articles of partnership may validly provide that in the event of the death of a partner "the partnership shall be continued and the deceased partner shall be represented by his heirs and assignees in said partnership" as general partners. Of course, the stipulation would not bind the heirs of the deceased partner should they refuse to assume personal and unlimited responsibility for the obligations of the firm. The heirs, in other words, cannot be compelled to become general partners against their wishes. But because they are not so compellable, it does not follow that they may not voluntarily choose to become general partners, waiving the protective mantle of the general laws of succession. *(Ibid.)*

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.

One person, both a general partner and a limited partner.

A person may be a general and a limited partner at the same time in the same partnership provided that this fact is stated in

the certificate signed, sworn to, and recorded in the Office of the Securities and Exchange Commission. (see Art. 1845.)

Generally, his rights and powers are those of a general partner. Hence, he is liable with his separate property to third persons. (Art. 1816.) However, with respect to his contribution as a limited partner, he would have the right of a limited partner insofar as the other partners are concerned. (Arts. 1855-1858.) This means that while he is not relieved from personal liability to third persons for partnership debts, he is entitled to recover from the general partners the amount he has paid to such third persons; and in settling accounts after dissolution, he shall have priority over general partners in the return of their respective contributions. (Art. 1863.)

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.

Loan and other business transactions with limited partnership.

(1) *Allowable transactions.* — Under this article, a limited partner (who is not also a general partner), being merely a contributor to the partnership (see Art. 1866.) without the right to participate in its management, is not prohibited from:

(a) Granting loans to the partnership;

(b) Transacting other business with it; and

(c) Receiving a *pro rata* share of the partnership assets with general creditors if he is not also a general partner.

(2) *Prohibited transactions.* — The limited partner, in respect of any such claim, is, however, prohibited from:

(a) Receiving or holding as collateral security any partnership property; or

(b) Receiving any payment, conveyance, or release from liability if it will prejudice the right of third persons.

Any violation of the prohibition will give rise to the presumption that it has been made to defraud partnership creditors.

It should be emphasized that Article 1854 does not prohibit absolutely the taking as collateral security by a limited partner of any partnership property. Nos. (1) and (2) of Article 1854 are modified by the requirement of sufficient assets to discharge the obligation of the partnership when any payment or conveyance is made or release is given to the limited partner by, or when he receives security from, the partnership.

(3) *Preferential rights of third persons.* — In transacting business with the partnership as a non-member, the limited partner is considered as a non-partner creditor. However, third persons always enjoy preferential rights insofar as partnership assets are concerned (see Art. 1827.) in view of the natural tendency of the partners to give preference to each other.

The rule is "designed to prevent illegal competition between the limited partner and creditors of the partnership for the assets of the partnership" in case there is insufficiency of partnership assets with which to discharge partnership liabilities to non-partner creditors. Such a competition is not a threat if the partnership has sufficient assets to discharge its liabilities to non-member creditors. (A.T.E. Financial Services, Inc. vs. Corson, 268 A. 2d 73.)

EXAMPLE:

A, B, and C are general partners with D as limited partner. The total assets of the partnership amount to P200,000.00. The partnership owes D P50,000.00 and E, a third party creditor, P250,000.00.

Since the assets of the partnership are not sufficient to discharge its liabilities to E, D cannot receive his claim of P50,000.00 and payment to him will be presumed to have been made to defraud E. It will likewise raise the same presumption if D is the one indebted to the partnership and he is released from liability.

D, however, is not prohibited from purchasing any partnership property if the purpose is to generate cash with which to pay off partnership obligations to third persons.

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.

Preferred limited partners.

By an agreement of all the members (general and limited partners) stated in the certificate, priority or preference may be given to some limited partners over other limited partners as to the:

(1) return of their contributions;

(2) their compensation by way of income; or

(3) any other matter.

In the absence of such statement in the certificate, even if there is an agreement, all the limited partners shall stand on equal footing in respect of these matters.

ART. 1856. A limited partner may receive from the partnership the share of the profits or the compensation by way of income stipulated for in the certificate; provided, that after such payment is made, whether from the property of the partnership or that of a general partner, the partnership assets are in excess of all liabilities of the partnership except liabilities to limited partners on account of their contributions and to general partners.

Compensation of limited partner.

The right of the limited partner to receive his share of the profits or compensation by way of income stipulated for in the certificate is subject to the condition that partnership assets will still be in excess of partnership liabilities after such payment. In other words, third-party creditors have priority over the limited partner's rights.

In determining the liabilities of the partnership, the liabilities to the limited partners for their contributions and to general partners, whether for contributions or not, are not included. (see Art. 1857.) Liabilities to limited partners other than on account of their contributions arising from business transactions by them with the partnership, enjoy protection, subject to the preferential rights of partnership creditors. (see Art. 1854.)

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 contributions:

(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.

Requisites for return of contribution of limited partner.

Under the first paragraph, the following conditions must exist before the contribution of a limited partner can be returned to him:

(1) All liabilities of the partnership have been paid or if they have not yet been paid, the assets of the partnership are sufficient to pay such liabilities. As in Article 1856, liabilities to limited partners on account of their contributions and to general partnership are not considered;

(2) The consent of all the members (general and limited partners) has been obtained except when the return may be rightfully demanded; and

(3) The certificate is cancelled or so amended as to set forth the withdrawal or reduction of the contribution.

EXAMPLE:

After operating for some time as a limited partnership, X & Co., composed of A, B, and C, as general partners, who contributed P30,000.00 each, and D and E, as limited partners, who contributed P20,000.00 each, has a total assets of P150,000.00 and the following liabilities:

(1) For return of contributions of limited partners (D and E)	P40,000.00
(2) Due to third party credits	50,000.00
(3) For loan extended by C	25,000.00
(4) For loan extended by D	35,000.00
(5) For taxes	15,000.00
(6) For indemnity to B for damages suffered in consequence of management	5,000.00
Total	P170,000.00

May E legally demand the return of his contribution, assuming that all the partners have given their consent and are willing to have the certificate amended as to set forth the withdrawal?

Yes. The total assets of P150,000.00 are well over the amount of P100,000.00, the total of the liabilities mentioned in Nos. (2), (4), and (5). The other liabilities are not considered in determining whether the contribution of E can be returned to him.

When return of contribution a matter of right.

Under the second paragraph, the limited partner may demand, as a matter of right, the return of his contribution provided

the conditions in paragraph 1, Nos. 1 and 3 have been complied with —

(1) On the dissolution of the partnership; or

(2) Upon the arrival of the date specified in the certificate for the return; or

(3) After the expiration of the 6 months' notice in writing given by him to the other partners if no time is fixed in the certificate for the return of the contribution or for the dissolution of the partnership.

Right of limited partner to cash in return for contribution.

Under the third paragraph, even if a limited partner has contributed property, he has only the right to demand and receive cash for his contribution. The exceptions are:

(1) When there is stipulation to the contrary in the certificate; or

(2) Where all the partners (general and limited) consent to the return other than in the form of cash.

When limited partner may have partnership dissolved.

The fourth paragraph provides for additional grounds for the dissolution of the partnership upon petition of a limited partner. (See Arts. 1851[3], 1831.) They are:

(1) When his demand for the return of his contribution is denied although he has a right to such return; or

(2) When his contribution is not paid although he is entitled to its return because the other liabilities of the partnership have not been paid or the partnership property is insufficient for their payment. In other words, were it not for this first condition in the first paragraph of Article 1857 which is not present, he would have been entitled to the return of his contribution because of the presence of the second and third conditions.

The limited partner must first ask the other partners to have the partnership dissolved; if they refuse, then he can seek the dissolution of the partnership by judicial decree.

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.

Liabilities of a limited partner.

(1) *To the partnership.* — As limited partners are not principals in the transaction of a partnership, their liability, as a rule, is to the partnership (Art. 1858.), not to the creditors of the partnership. (see Art. 1866.) The general partners cannot, however, waive any liability of the limited partners to the prejudice of such creditors. (Sec. 17, Commissioners' Note, 8 Uniform Laws Annotated, p. 5.)

(2) *To partnership creditors and other partners.* — A limited partner is liable for partnership obligations when he contributes services instead of only money or property to the partnership (Art. 1845.); when he allows his surname to appear in the firm name (Art. 1846.); when he fails to have a false statement in the certificate corrected, knowing it to be false (Art. 1847); when he takes part in the control of the business (Art. 1848.); when he receives partnership property as collateral security, payment, conveyance, or release in fraud of partnership creditors (Art. 1854); and when there is failure to substantially comply with the legal requirements governing the formation of limited partnerships. (Art. 1844, par. 2.)

(3) *To separate creditors.* — As in a general partnership, the creditor of a limited partner may, in addition to other remedies allowed under existing laws, apply to the proper court for a "charging order" subjecting the interest in the partnership of the debtor partner for the payment of his obligation. (Art. 1862.)

Liability for unpaid contribution.

Under the first paragraph of Article 1858, the limited partner is liable not only for the difference between the amount of his actual contributions and that stated in the certificate as having been made but also for any unpaid contribution he agreed to make at a future time.

EXAMPLE:

A and B are limited partners in a partnership. In the certificate of partnership, it appears that A contributed P10,000.00. Actually, he contributed only P8,000.00. In the certificate too, B promised to give an additional contribution of P4,000.00 at a specified date.

So, A should pay the difference of P2,000.00 and B, the amount of P4,000.00 on the date specified or now, if the date has arrived.

Liability as trustee.

Under the second paragraph of Article 1858, a limited partner is considered as trustee for the partnership for:

(1) Specific property stated in the certificate as contributed by him but which he had not contributed;

(2) Specific property of the partnership which had been wrongfully returned to him;

(3) Money wrongfully paid or conveyed to him on account of his contribution; and

(4) Other property wrongfully paid or conveyed to him on account of his contribution.

Requisites for waiver or compromise of liabilities.

Under the third paragraph of Article 1858, the liabilities of a limited partner may be waived or compromised, provided:

(1) The waiver or compromise is made with the consent of all the partners; and

(2) The waiver or compromise does not prejudice partnership creditors who extended credit or whose claims arose before the cancellation or amendment of the certificate.

EXAMPLE:

In the preceding illustration, suppose after the liabilities of A and B were waived or compromised with the consent of all the partners, X extended credit to the partnership. Later on, the certificate was amended to set forth the necessary change.

Here, the credit was extended after the filing but before the amendment of the certificate. If the remaining assets are insufficient, X can still enforce the liabilities of A and B.

Liability for return of contribution lawfully received.

Under the fourth paragraph of Article 1858, the limited partner is liable to the partnership for the return of contribution lawfully received by him (see Art. 1857.) to pay creditors who extended credit or whose claim arose before such return. His liability, of course, cannot exceed the sum received by him (Art. 1843.) with interest.

EXAMPLE:

Suppose that A lawfully received the return of his contribution in the amount of P10,000.00 on the date specified in the certificate. Subsequently, the partnership became liable to X.

In this case, if the assets of the partnership are insufficient, the claim of X should be directed against the general partners. But if X extended credit or his claim arose before A received the return of his contribution, then, A is liable to the partnership. Thus, if the partnership needs P7,000.00 to discharge the liabilities to X, then A is liable for the said amount plus interest. But in no case is A liable beyond P10,000.00 plus interest because he is only a limited partner.

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 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.

Effect of change in the relation of limited partners.

The substitution of a person as a limited partner in place of an existing limited partner (Art. 1859.), or the withdrawal, death, insolvency, insanity, or civil interdiction of a limited partner (Art. 1860.), or the addition of new limited partners (Art. 1849.) does not necessarily dissolve the partnership.

No limited partner, however, can withdraw his contribution until all liabilities to creditors are paid. (see Art. 1857.)

Rights of assignee of limited partner.

A limited partner may assign his interest in the partnership to another person. The assignee is only entitled to receive the share of the profits or other compensation by way of income or the return of the contribution to which the assignor would otherwise be entitled. His rights are similar to those of a person to whom a partner conveyed his whole interest in the partnership. (Art. 1813.) Hence, he has no right to require any information or account of partnership transactions or to inspect the partnership books.

The assignee acquires all the rights of the limited partner only when he becomes a substituted limited partner.

When assignee may become substituted limited partner.

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. The following are the requisites in order that the assignee may become a substituted limited partner:

(1) All the members must consent to the assignee becoming a substituted limited partner or the limited partner, being empowered by the certificate, must give the assignee the right to become a limited partner;

(2) The certificate must be amended in accordance with Article 1865; and

(3) The certificate as amended must be registered in the Securities and Exchange Commission.

Liability of substituted partner and assignor.

It must be observed that the substituted limited partner is liable for all the liabilities of his assignor except only those of which he was ignorant at the time he became a limited partner and which could not be ascertained from the certificate. Similarly, the assignor is not released from liability to persons who suffered damage by reliance on a false statement in the certificate (Art. 1847.) and to creditors who extended credit or whose claims arose before the substitution. (Art. 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 the right so to do stated in the certificate, or

(2) With the consent of all the members.

Effect of retirement, death, etc. of a general partner.

The retirement or withdrawal, death, insolvency, insanity, or civil interdiction of a general partner dissolves the partnership (see Art. 1830.), while any of such causes affecting a limited partner (see Art. 1861.) does not result in its dissolution unless, of course, there is only one limited partner. (see Art. 1843.)

If the business is continued by the remaining partners under the rights given in the certificate or with the consent of all the members, the limited partnership is not dissolved but the certificate must be amended as required by Article 1864, paragraph 2, No. (5) to reflect the change in order that the limited

partners may avail of the protection granted by law. (Lowe vs. Arizona Power & Light Co., 427 P.d. 366.)

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 as substituted limited partner.

The estate of a deceased limited partner shall be liable for all his liabilities as a limited partner.

Right of executor on death of a limited partner.

On the death of a limited partner, his executor or administrator shall acquire all the rights for purposes of settling the affairs of the limited partner (see Art. 1851.) and the right to constitute the deceased's assignee as substituted limited partner. Note that the executor or administrator may constitute the assignee as a substituted limited partner only if the deceased partner was empowered to do so in the certificate. (Art. 1859, par. 4.)

Under the second paragraph, the estate of the deceased limited partner is liable for all his liabilities contracted while he was a limited partner. (see Art. 1858.)

ART. 1862. On due application to a court of competent jurisdiction by any creditor of a limited partner, the court may charge the interest of the indebted limited partner with payment of the unsatisfied amount of such claim, and may appoint a receiver, and make all other orders, directions, and inquiries which the circumstances of the case may require.

The interest may be redeemed with the separate property of any general partner, but may not be redeemed with partnership property.

The remedies conferred by the first paragraph shall not be deemed exclusive of others which may exist.

Nothing in this Chapter shall be held to deprive a limited partner of his statutory exemption.

Rights of creditors of limited partner.

The creditor of a limited partner may apply to the proper court for an order charging the limited partner's interest in the partnership for the payment of any unsatisfied amount of his claim. The interest so charged may be redeemed with the separate property of any general partner but not with partnership property.

Under Article 1814, paragraph 2, No. (1), the interest of the debtor partner charged with the payment of the unsatisfied amount of the judgment debt may be redeemed with partnership property with the consent of all the partners whose interests are not so charged.

The limited partner's right under the exemption laws is also preserved under this article since his interest in the partnership (see Art. 1812.) is actually his property.

ART. 1863. In settling accounts after dissolution the liabilities of the partnership shall be entitled to payment in the following order:

(1) Those to creditors, in the order of priority as provided by law, except those to limited partners on account of their contributions, and to general partners;

(2) Those to limited partners in respect to their share of the profits and other compensation by way of income on their contributions;

(3) Those to limited partners in respect to the capital of their contributions;

(4) Those to general partners other than 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.

Dissolution of a limited partnership.

(1) *Causes.* — A limited partnership is dissolved in much the same way as an ordinary partnership. It may be dissolved for the misconduct of a general partner, for fraud practiced on the limited partner by the general partner (68 C.J.S. 1042.), or on the retirement, death, etc. of a general partner (Art. 1860.), or when all the limited partners ceased to be such (Art. 1864, par. 1.), or on the expiration of the term for which it was to exist (Art. 1844[1, e].), or by mutual consent of the partners before the expiration of the firm's original term.

(2) *Suit for dissolution.* — A limited partner may bring a suit for the dissolution of the firm, an accounting, and the appointment of a receiver when the misconduct of a general partner or the insolvency of the firm warrants it. Similarly, creditors of a limited partnership are entitled to such relief where the firm is insolvent. (68 C.J.S. 1044-1045.)

A limited partner may have the partnership dissolved and its affairs wound up when he rightfully but unsuccessfully demands the return of his contribution, or the other liabilities of the partnership, except liabilities to general partners and to limited partners on account of their contributions, have not been paid, or the partnership property is insufficient for their payment, and the limited partner would otherwise be entitled to the return of his contribution. (Art. 1857, par. 4; see Arts. 1830-1831.)

(3) *Notice of dissolution.* — When the firm is dissolved by the expiration of the term fixed in the certificate, notice of the dissolution need not be given since the papers filed and recorded in the Securities and Exchange Commission are notice to all the world of the term of the partnership. Where, however, the dissolution is by the express will of the partners, the certificate shall be cancelled, and a dissolution of the partnership is not effected until there has been compliance with the requirement in this respect.

(4) *Winding up.* — The consequences of the dissolution of a general partnership apply to limited partnership. Therefore, the partnership continues in operation while winding up.

When a limited partnership has been duly dissolved, the general partners have the right and power to wind up its affairs, as in a general partnership. It is not the duty of the limited partner or of the representative of a deceased limited partner to care for or collect the assets of the firm. (68 C.J.S. 1043.) The representatives of the general partners, not the limited partners, succeed the general partners.

Priority in the distribution of partnership assets.

Article 1863 expressly provides for priority in the distribution of the assets after dissolution. The partnership liabilities shall be settled in the following order:

(1) Those due to creditors, *including limited partners,* except those on account of their contributions, in the order of priority as provided by law (Arts. 1854, 1856, 1857[1].);

(2) Those due to limited partners in respect to their share of the profits and other compensation by way of income on their contributions;

(3) Those due to limited partners for the return of the capital contributed;

(4) Those due to general partners other than for capital and profits;

(5) Those due to general partners in respect to profits; and

(6) Those due to general partners for the return of the capital contributed.

Partnership creditors are entitled to first distribution, followed by limited partners who take priority over general partners.

Note that in a general partnership, the claims of the general partners in respect of capital enjoy preference over those in respect of profits. (see Art. 1839[1, c, d].)

Share of limited partners in partnership assets.

In the absence of any statement in the certificate as to the share of the profits which each partner shall receive by reason of his contribution (Art. 1844, par. 1[1].) and subject to any subsequent agreement, limited partners share in the partnership assets in respect to their claims for capital and profits in proportion to the respective amounts of such claims.

This proportional sharing by the limited partners takes place where the partnership assets are insufficient to pay such claims.

Priority of claims of limited partners.

The members of a limited partnership, as among themselves, may include in the partnership articles an agreement for priority of distribution on the winding up of partnership affairs. (68 C.J.S. 1024.) Such agreement ordinarily becomes controlling as between the partners themselves. (*Ibid*., 1043.) In the absence of any contrary agreement, all the limited partners stand upon equal footing.

The claims of limited partners for profits and other compensation by way of income and return of capital contributions rate ahead with respect to all claims of general partners. For claims arising from individual loans to, or other business transactions with, the partnership, other than for capital contributions, the limited partner is placed in the same category as a non-member creditor. (Art. 1854, par. 1.) If return is made to a limited partner of his contribution before creditors are paid, he is under an obligation to reimburse such payments, with interest, so far as necessary to satisfy the claims of creditors. (see Art. 1858, last par.)

In the event of insolvency of the partnership, its creditors take preference over both general and limited partners.

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 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.

When certificate shall be cancelled or amended.

(1) The certificate shall be cancelled, not merely amended:

(a) When the partnership is dissolved other than by reason of the expiration of the term of the partnership; or

(b) When all the limited partners cease to be such. A limited partnership cannot exist as such if there are no more limited partners. (Art. 1843.)

(2) In all other cases, only an amendment of the certificate is required. (Art. 1864, Nos. 1-10.)

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 the 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 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.

Requirements for amendment and cancellation of certificate.

(1) The following are the requirements to amend a certificate:

(a) The amendment must be in writing;

(b) It must be signed and sworn to by all the members including the new members, and the assigning limited partner in case of substitution or addition of a limited or general partner; and

(c) The certificate, as amended, must be filed for record in the Securities and Exchange Commission.

From the moment the amended certificate or a certified copy of a court order granting the petition for amendment has been filed, such amended certificate shall thereafter be for all purposes the certificate of the partnership under Article 1844.

(2) The cancellation of a certificate must also be in writing and signed by all the members and filed with the Office of the Securities and Exchange Commission. If the cancellation is ordered by the court, certified copy of such order shall be filed with the Commission.

The approval by the Commission of the amendment or cancellation is not required.

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.

Limited partner, a mere contributor.

A limited partner is referred to in Article 1866 as mere contributor. (see also Arts. 1846, 1848, 1854, 1857, 1858, 1860.) He is practically a stranger in the limited partnership whose liability is limited to his interest in the firm (Art. 1843.), without any right and power to participate in the management and control of the business. (see Arts. 1848, 1851.)

Unlike in the case of a general partner, the relationship between a limited partner, on the one hand, and the other partners and the partnership, on the other hand, is not one of trust and confidence. A limited partner is, therefore, not prohibited from engaging in business for himself even in competition with that conducted by the partnership (see Arts. 1789, 1808.) and may transact business with the partnership for ordinary purposes as though he were a stranger. (see Art. 1854.)

Parties to action by or against partnership.

Since limited partners are not principals in partnership transactions, their liability, as a general rule, is to the partnership, not to the creditors of the partnership. (see Art. 1858.) For the same reason, they have no right of action against third persons against whom the partnership has any enforceable claim.

Hence, unless a limited partner is also a general partner, or has become liable as a general partner, he is not a proper party to proceedings by or against the partnership.

When limited partner a proper party.

(1) The limited partner may maintain an action in his own name where the object is to enforce his individual rights against the partnership (Art. 1851.), and to recover damages for violation of such right. Similarly, he is a proper party to a proceeding to enforce his liability to the partnership. (Art. 1858.)

(2) An action at law may be maintained by creditors of a firm against a limited partner to account for and restore sums withdrawn by him from the capital of the firm with outstanding debts on a voluntary dissolution. But there is authority that such relief against limited partners who have withdrawn their contributions from an insolvent firm on dissolution is confined to judgment creditors of the firm with unsatisfied executions against the general partners, and this remedy has been denied to creditors who have not exhausted their remedies at law against the general partners. (68 C.J.S. 1045-1046.)

Nature of limited partner's interest in firm.

(1) A loan of money to a person engaged in business, under a detailed agreement for its payment and security, does not constitute a limited partnership. Conversely, the limited partner's contributions to the firm is *not a loan*, and he is *not a creditor* of the firm because of his contribution thereto.

(2) A limited partner's contribution is *not a mere investment*, as in the case of one purchasing stock in a corporation.

(3) A limited partner is, *in a sense, an owner,* which in interest in the capital of the firm and its business as such, but he has *no property right in the firm's assets.* He is not the owner of the property of the partnership any more than are the stockholders in the corporation; but in accordance with statutory provisions, a limited partner may be a *co-owner with his partners of partnership property*, holding as a tenant in partnership and his interest may be defined as a tenancy in partnership.

(4) A limited partner's interest is in *personal property*, and it is immaterial whether the firm's assets consist of realty or tangible or intangible personalty.

(5) The nature of the limited partner's interest in the firm *amounts to a share in the partnership assets* after its liabilities have been deducted and a balance struck. This interest is *a chose in action,* and hence, *intangible personal property*. (68 C.J.S. 1022-1023.)

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.

Provisions for existing limited partnerships.

A limited partnership formed under the former law (Articles 145-150, Code of Commerce.) may become a limited partnership under Chapter 4 by complying with the provisions of Article 1844, provided the certificate sets forth the information required by Article 1867. Until or unless it becomes a limited partnership under this chapter, it shall continue to be governed by the provisions of the old law.

By way of illustration, the requisite in No. (2) is satisfied by a limited partnership formed under the old law, with assets worth P100,000.00, liabilities to third persons in the amount of P70,000.00, and to limited partners on account of their contributions in the amount of P20,000.00, the difference of P30,000.00 being greater than the sum of P20,000.00; but if such difference is only P20,000.00 or less, it cannot become a limited partnership under the Code.

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PART II

TITLE X

AGENCY

(Arts. 1868-1932)

Chapter 1

NATURE, FORM, AND KINDS OF AGENCY

ARTICLE 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)

Concept of agency.

Article 1868 defines the *contract of agency*. The definition, which is very broad enough to include all situations in which one person is employed to render service for another, excludes, however, from its concept the relationship of employer and employee (Art.* 1700.), of master and servant (Art. 1680.), and of employer and independent contractor. (Art. 1713.)

Agency is a fiduciary relationship which implies a power in an agent to contract with a third person on behalf of a principal. It is this power to effect the principal's contractual relations with

*Unless otherwise indicated, refers to article in the Civil Code.

third persons that differentiates the agent from the employee, the servant, and the independent contractor.

Agency, properly speaking, relates to commercial or business transactions. Agency relationship may also arise in non-business situations, as for example, a person returns an article to a lender for a borrower-friend.

EXAMPLE:

P, owner of a land, wants to construct a building on it. He may do any of the following:

(1) He may hire C, a building contractor, to construct the building with the materials and labor to be furnished by C; or

(2) He himself may construct the building, buying the necessary materials and employing W, etc. (workers) who shall construct the building under his direction and supervision; or

(3) He may secure the services of A to supervise and to act for him in all matters connected with the construction work.

In the first case, C is an independent contractor; in the second, W, etc. are workers or employees of P, and in the third, A is an agent of P. Thus, the relationship between the parties — the hirer of service and the person whose service has been hired — and their rights and duties will depend upon the terms under which one works, represents, or acts for another.

Governing law.

As in the case of sales, partnership, loan, deposit, and guaranty, a distinction formerly existed under our law between civil agency and commercial agency. The former was governed by the Civil Code, the latter, by the Code of Commerce. This distinction has been abolished under the new Civil Code. (Art. 2270[2].)

At present, all agencies are governed by the Civil Code. (Arts. 1868-1932.)

Term used in other senses.

"Agency" is sometimes used in a sense other than to denote the relationship of principal and agent.

(1) Thus, it may be used to denote the place at which the business is transacted. When used in the sense of place of business, the relationship of principal and agent is not necessarily implied.

(2) Likewise, the term may be used in the sense of instrumentality by which a thing is done. (2 C.J. 1024.)

(3) It is also used to refer to the exclusive right of a person to sell a product of another in a specific territory.

Characteristics of a contract of agency.

The contract of agency is:

(1) *consensual,* because it is based on the agreement of the parties which is perfected by mere consent;

(2) *principal,* because it can stand by itself without need of another contract;

(3) *nominate*, because it has its own name;

(4) *unilateral,* if it is gratuitous because it creates obligations for only one of the parties, *i.e*., the agent; or *bilateral,* if it is for compensation because it gives rise to reciprocal rights and obligations; and

(5) *preparatory,* because it is entered into as a means to an end, *i.e*., the creation of other transactions or contracts.

Nature, basis, and purpose of agency.

The word "agency" when used in its broadest meaning is both a contract and a representative relation.

(1) *Nature.* — Since agency is a contract, it is essential that the minds of the parties should meet in making it. Article 1868 defines agency from the viewpoint of a contract.

(a) *Manifestation of consent.* — The principal must intend that the agent shall act for him, the agent must intend to accept the authority and act on it, and such intention of the parties must find expression either in words or conduct between them. Without such intention, there is generally

no agency. Thus, the mere fact that an entity may be 100% subsidiary corporation of another corporation does not necessarily mean that the former is a duly authorized agent of the latter because it is essential, for a contract of agency to exist, that the principal consents that the other party, the agent, shall act on its behalf and the agent consents so as to act. (Apex Mining Co., Inc. vs. Southeast Mindanao Gold Mining Corp., 492 SCRA 355 [2006].)

(b) *Agent, by legal fiction, becomes principal.* — In acting for the principal, the agent, by legal fiction, becomes the principal authorized to perform all acts which the latter would have him do. Such a relationship can only be effected "with the consent or authority" of the principal which cannot, in any way be compelled by law or by any court. (Orient Air Services & Hotel Representatives vs. Court of Appeals, 197 SCRA 645 [1991].)

(c) *Presence/absence of contract or consideration.* — Although the agency relationship is usually a contractual one, either express or implied, based upon a consideration (see Art. 1875.), this is not necessarily so; that is, the relationship may be created *by operation of law* (*e.g.*, agency by estoppel, *infra.*; see Arts. 1881, 1882, 1884, par. 2, 1885, 1929, 1931, 1932.), or a person who acts for another as principal may do so gratuitously. (3 Am. Jur. 2d 419-420.) Thus, without a contract or a consideration there can be an agency or agency powers. In the exercise of governmental functions, local governments or municipal corporations act as agents for the sovereign state. The legal consequences of agency may attach where one person acts for another without authority or in excess of his authority, and the latter subsequently ratifies it. (see Arts. 1881-1882.)

(2) *Basis.* — Agency is also a representative relation. The agent renders some service or does something "in representation or on behalf of another." (Art. 1868.)

(a) *Personal contract of representation.* — Representation constitutes the basis of agency. As it is a personal contract of representation based on trust and confidence reposed by

the principal on his agent, agency is generally revocable. (see Arts. 1920, 1927.)

(b) *Acts of agents, by legal fiction, acts of principal.* — The acts of the agent on behalf of the principal within the scope of his authority (Art. 1881.) produce the same legal and binding effects as if they were personally done by the principal. The distinguishing features of agency are its representative character and its derivative authority. (2 C.J.S. 1026.) "He who acts through another acts himself" or "He who does a thing by an agent is considered as doing it himself." By this legal fiction, the actual or real absence of the principal is converted into his legal or juridical presence. (Rallos vs. Felix Go Chan & Sons Realty Corp., 18 SCRA 251 [1978]; see Bordador vs. Luz, 283 SCRA 374 [1997].; Eurotech Industrial Technologies, Inc. vs. Cuizon, 521 SCRA 584 [2007].)

Thus, a person may make an offer to enter into a contract through an agent and such offer is accepted from the time acceptance is communicated to the agent who is deemed authorized to receive the acceptance. (Art. 1322.) Applying the same principle, where an agent purchased property in bad faith, the principal should also be deemed a purchaser in bad faith. (Caram, Jr. vs. Laureta, 103 SCRA 7 [1981].) Notice to the agent is, to all legal intents and purposes, notice to the principal. (Air France vs. Court of Appeals, 126 SCRA 448 [1983].)

(3) *Purpose.* — The purpose of agency is to extend the personality of the principal through the facility of the agent. (see Orient Air Service & Hotel Representatives vs. Court of Appeals, *supra*.) to render some service to do or something. It enables the activity of man which is naturally limited in its exercise by the impositions of his physiological conditions to be legally extended by permitting him to be constructively present in many different places and to perform diverse juridical acts and carry on many different activities through another when physical presence is impossible or inadvisable at the same time. (see 11 Manresa 434.)

With the expansion of commercial transactions and the consequent increase in business organizations conducted mainly through the combined efforts of individuals acting in a represen-

tative capacity, the subject of agency has grown in importance. (see Teller, Agency, 1948 ed., p. 2.)

The usefulness of the agency relationship in business transactions is obvious. In fact, with very few exceptions, a single individual will find it being difficult, if not impossible, to perform every act required to manage a business enterprise. Furthermore, many business enterprises are organized as corporations which can only act through agents.

Parties to the contract.

The two parties to the contract are the:

(1) *Principal.* — one whom the agent represents and from whom he derives his authority (2 C.J.S. 1024.); he is the person represented. Agency imports the contemporaneous existence of a principal, and there is no agency unless one is acting for and in behalf of another (2-A Words and Phrases 436.); and

(2) *Agent.* — one who acts for and represents another; he is the person acting in a representative capacity. The agent has derivative authority in carrying out the principal's business. He may employ his own agent in which case he becomes a principal with respect to the latter. (see Art. 1892.) If an act done by one person in behalf of another is, in its essential nature, one of "agency," the former is "agent" of the latter notwithstanding that he is not so called. (2-A Words and Phrases 436.)

From the time the agent acts or transacts the business for which he has been employed in representation of another, a *third* party is added to the agency relationship — the party with whom the business is transacted.

Essential elements of agency.

They are as follows:

(1) There is consent, express or implied, of the parties to establish the relationship;

(2) The object is the execution of a juridical act in relation to third persons;

(3) The agent acts as a representative and not for himself;[1] and

(4) The agent acts within the scope of his authority. (Rallos vs. Felix Go Chan & Sons Realty Corp. and Court of Appeals, 81 SCRA 251 [1978]; Tuazon vs. Heirs of B. Ramos, 463 SCRA 408 [2005].)

In addition, the parties must be competent to act as principal and agent. *(infra.)* Consideration is not required.

An agency relationship is consensual in nature. It is based on the concept that the parties mutually agree on its creation. A person may express his consent by contract (Art. 1868.), orally or in writing, by conduct (Art. 1869.), or by ratification (see Art. 1910.), or the consent may arise by presumption or operation of law. In certain situations, the law presumes that a person has authority to act for another. For example, in law, partners are considered agents of the partnership and of each other. (Art. 1818.)

Relationship of third party with principal and agent.

(1) Since an agent's contract is not his own but his principal's, a third party's liability on such contract is to the principal and not to the agent, and liability to such third party is enforceable against the principal, not the agent.

(2) Where an agency exists, the relationship of the third party with whom the agent has contracted, to the principal, is the same as that in a contract in which there is no agent.

(a) Normally, the agent has neither rights nor liabilities as against the third party. He cannot sue or be sued on the contract. Since a contract may be violated only by the parties

[1]Where the money used by a person to discharge the debtor's obligation rightfully belonged to the debtor, the payor cannot be considered a third party payor under Article 1302(2), which provides: "It is presumed that there is legal subrogation: x x x (2) When a third person, not interested in the obligation, pays with the express or tacit approval of the debtor x x x" but a conduit or merely an agent as defined in Article 1868. (Chemphil Export & Import Corp. vs. Court of Appeals, 251 SCRA 257 [1996].)

thereto as against each other, the real party-in-interest, either as plaintiff or defendant in an action upon that contract must, generally, be a party to said contract.[2]

The legal situation is, however, different where an agent is constituted as an assignee. In such a case, the agent may, in his own behalf, sue on a contract made for his principal, as an assignee of such contract. (Angeles vs. Phil. National Railways, 500 SCRA 444 [2006].)

(b) The fact that the agent did not obtain his commissions or recoup his advances because of the non-performance of the contract does not entitle him to file an action against the buyer where he does not appear as a beneficiary of a stipulation *pour autrui* under Article 1311[3] of the Civil Code. (Uy vs. Court of Appeals, 314 SCRA 69 [1999].)

(c) An agent, in his own behalf, may, however, bring an action founded on a contract made for his principal as an assignee of such contract. The rule requiring every action to be prosecuted in the name of the real party-in-interest recognizes the assignments of rights of action and also recognizes that when one has a right assigned to him, he is then the real party-in-interest and may maintain an action upon such claim or right. *(Ibid.)*

Capacity of the parties.

(1) *Principal.* — A principal must be capacitated (see Arts. 1327, 1329.[4]) or have the legal capacity to enter into contract in his

[2]In a foreclosure of a mortgage undertaken by an attorney-in-fact (agent) for his principal (mortgagee), the validity of a loan contract entered into between the mortgagee and the mortgagor cannot be raised against the agent as the matter is solely between his principal and the other party (mortgagor) to the contract. (Philipine National Bank vs. Ritratto Group, Inc., 362 SCRA 216 [2001].)

[3]Art. 1311. x x x

If a contract should contain some stipulation in favor of a third person, he may demand its fulfillment provided he communicated his acceptance to the obligor before its revocation. A mere incidental benefit or interest of a person is not sufficient. The contracting parties must have clearly and deliberately conferred a favor upon a third person. (1257a)

[4]Art. 1327. The following cannot give consent to a contract:

(1) Unemancipated minors;

own right. The logic is simple. A person who cannot legally enter into contracts directly should not be permitted to do it indirectly through another.

(a) The principal may be either a natural person or an artificial one. Thus, legal entities such as corporations and partnerships can be principals or agents. This is expressly recognized in Article 1919(4) which provides as one of the grounds for the extinguishment of agency "the dissolution of the firm or corporation which entrusted or accepted the agency." On the other hand, a voluntary association of persons which is not a legal entity has no legal existence and cannot sue or be sued; hence, it has no capacity to appoint an agent.

(b) Also, during the existence of a state of war, an enemy alien may not appoint an agent to act in the belligerent territory with which his nation is at war. (3 Am. Jur. 2d 424.)

(c) Inasmuch as one who acts through an agent in law does the act himself, the capacity to act by an agent depends in general on the capacity of the principal to do the act himself if he were present. (2 C.J.S. 1040.) It is a general rule that an agent who assumes to contract in the name of a principal without contractual capacity renders himself liable to third persons. The acts of an agent done for an incompetent principal may be ratified by the latter after he acquires capacity. The agent is not liable where he was ignorant of the principal's incapacity.

EXAMPLE:

A, agent, makes a contract on behalf of P without knowledge that P was a minor. P thereafter disaffirmed the contract.

Is A liable to the other party to the contract?

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(2) Insane or demented persons, and deaf-mutes who do not know how to write. (1263a)

x x x x x x x x x

Art. 1329. The incapacity declared in Article 1327 is subject to the modifications determined by law, and is understood to be without prejudice to special disqualifications established in the laws. (1264)

No. An agent warrants that he is acting within the scope of his authority, but being a mere mouthpiece of his principal, he does not warrant the full contractual capacity of his principal. (Patterson vs. Lippencott, 47 N.J.L. 457, cited in Teller, p. 228.)

ILLUSTRATIVE CASE:

Petitioner, who redeemed the share pro indiviso in a parcel of land upon authority given by children of the owner, claims ownership over said share.

Facts: A redeemed the share *pro indiviso* of B in a parcel of land, upon the authority of a special power of attorney executed in his favor by the children of B who is still alive. Relying upon the power of attorney and redemption made by him, A now claims to have acquired the share of B in the land.

Issue: Has A the right to have the portion he claims as his share segregated and a certificate of title issued in his name exclusively for said portion?

Held: No, for the following reasons:

(1) The special power of attorney authorized A to act for or on behalf of the children of B, and hence, it could not have possibly vested in him any property right in his own name;

(2) The children of B had no authority to execute said power of attorney, because their father is still alive; and

(3) In consequence of said power of attorney (if valid) and redemption, A could have acquired no more than the *pro indiviso* share of B in the lot in question so that he cannot, without the conformity of the other co-owners or a judicial decree of partition, adjudicate to himself in fee simple a determinate portion of said lot, as his share therein, to the exclusion of the other co-owners. *(Santos vs. Buenconsejo, 14 SCRA 407 [1965].)*

(2) *Agent.* — Generally, anyone can be an agent. His capacity is usually immaterial. In the case of the agent, since he assumes no personal liability, he does not have to possess full capacity to act for himself insofar as third persons are concerned. An agent derives his authority from the principal, and a contract made by the agent is legally viewed as a contract of the principal. Thus, even one under legal disability (*e.g.*, minor), whose contracts, therefore, are not binding upon him may nevertheless act as an

agent and bind his principal although he cannot be a principal appointing an agent.

(a) There is authority for the proposition that where one knowingly and without dissent permits another to act as his agent, the capacity of the latter will be conclusively presumed. (3 Am. Jur. 2d 426.) However, some mental capacity is necessary as an agent, and, therefore, persons who are absolutely incapacitated, such as insane persons, cannot be agents (2 C.J.S. 1041.) as they are completely incapable of understanding the task to be performed. Obviously, principals should appoint agents who are able to make sound decisions in carrying out the agency.

(b) In an ordinary case, a person of sound mind not otherwise incapacitated may act as agent for another since his agreements bind only the principal. But in some instances, additional qualifications must exist, the lack of which may void the relationship which the alleged agent assumed. An obvious illustration is that of an attorney to represent a principal in legal matters. (Teller, *op. cit*., p. 47.)

(c) Insofar as his obligations to his principal are concerned, the agent must be competent to bind himself. The extent to which an agent is a fiduciary and is subject to duties and liabilities to his principal depends upon his capacity. (see Restatement [Second] of Agency, Sec. 21, p. 93.)

(d) The relationship of trust and confidence which constitutes one of the three fundamental characteristics of the agency relationship results in the disqualification of agents to act for the principal when it is their duty to act inconsistently toward another. (Teller, *op. cit*., p. 46.)

Other names used to designate the parties.

The names "principal" and "agent," though the usual ones, are not the only terms used to designate the parties to this relation.

The agent is frequently called an attorney, or an attorney-in-fact, and occasionally is spoken of as a proxy, delegate, or rep-

resentative. The person represented, though usually called the principal, is sometimes called the employer, constituent, or chief. (Mechem, Sec. 26, cited in A. Padilla's Civil Code VI, 1974 ed., p. 199.)

Acts that may be/not be delegated to agents.

The general rule is that what a man may do in person, he may do thru another. Thus, a stockholder may delegate to another his right to inspect the books of the corporation because this is an act which he can lawfully do personally. (Philpotts vs. Phil. Mfg. Co., 40 Phil. 491 [1919].)

Some acts, however, cannot be done through an agent.

(1) *Personal acts.* — If personal performance is required by law or public policy or the agreement of the parties, the doing of the act by a person on behalf of another does not constitute performance by the latter.

(a) The right to vote during election cannot be delegated because voting is considered a purely personal act under the law.

(b) The making of a will is a strictly personal act; it cannot be accomplished through the instrumentality of an agent or an attorney. (Art. 784; see, however, Art. 805.)

(c) Obviously, statements which are required to be made under oath should be made personally.

(d) A member of the board of directors or trustees of a corporation cannot validly act by proxy because his right to attend the board meetings is personal to him. (Sec. 25, last par., B.P. Blg. 68.)

(e) An agent cannot delegate to a sub-agent the performance of acts which he has been appointed to perform in person. (see Arts. 1892-1893.) A re-delegation of the agency would be detrimental to the principal as the second agent has no privity of contract with the former. (Baltazar vs. Ombudsman, 510 SCRA 74 [2006].)

(2) *Criminal acts or acts not allowed by law.* — An attempt to delegate to another authority to do an act which, if done by the principal would be illegal, is void. There can be no agency in the perpetration of a crime or an unlawful act. (2 C.J.S. 1039-1040.)

(a) Since under our Constitution aliens are not allowed to own private agricultural lands (Art. XII, Secs. 3, 7.), an alien cannot purchase a land through a Filipino agent.

(b) Persons who, because of their position and relation with the persons under their charge or property under their control, are prohibited from acquiring said property, cannot acquire the same through the mediation of another.[5]

(c) The law on agency governing civil cases has no application in criminal cases. When a person participates in the commission of a crime, he cannot escape punishment on the ground that he simply acted as an agent of another party. (Ong vs. Court of Appeals, 401 SCRA 684 [2003].)

Determination of existence of agency.

In most circumstances, no formalities are required for the creation of an agency relationship. The question of whether an agency has been created is ordinarily a question which may be

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

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

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

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

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

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

(6) Any others specially disqualified by law. (1459a)

established in the same way as any other fact, either by direct or circumstantial evidence. The question is ultimately one of intention.[6]

(1) *Designation by the parties.* — The manner in which the parties designate the relationship is not controlling. If an act done by one person in behalf of another is in its essential nature one of agency, the former is the agent of the latter notwithstanding he is not so called. Conversely, the use of the words "agency agreement" and "agent" by the parties in a contract does not necessarily have the effect of making one an agent who, in fact, is not such. (*Ibid*., 43; see Albaladejo y Cia vs. Phil. Refining Co., 45 Phil. 556 [1923].)

(2) *Fact of existence.* — The question is to be determined by the fact that one represents and is acting for another, and not by the consideration that it will be inconvenient or unjust if he is not held to be the agent of such other; and if relations exist which will constitute an agency, it will be an agency whether the parties understood the exact nature of the relation or not. (3 Am. Jur. 2d 430-431.)

(3) *Presumption of existence.* — The relation of agency cannot be inferred from mere relationship or family ties unattended by conditions, acts, or conduct clearly implying an agency. (2 C.J., Sec. 35.) For the relation to exist, there must be consent by both parties, *i.e.,* the principal consents that the other party, the agent, shall act on his behalf and the agent consents so to act. The law makes no presumption thereof. It must exist as a fact. (see People vs. Yabut, 76 SCRA 624 [1977]; Lim vs. Court of Appeals, 251 SCRA 408 [1995].), proving its existence, nature and extent being incumbent upon the person alleging it. (Tuazon vs. Heirs of B. Ramos, 463 SCRA 408 [2005].)

(4) *Intention to create relationship.* — On the part of the principal, therefore, there must be either an actual intention to appoint, or an intention naturally inferable from his words or actions, and on the part of the agent, there must be an intention to accept the appointment and act on it, and in the absence of such

[6]Citing De Leon & De Leon, Jr., Comments and Cases on Partnership, Agency, and Trusts, 356-357 (1999).

intent, there is generally no agency. (2 C.J.S. 1041; see Dominion Insurance Corp. vs. Court of Appeals, 376 SCRA 239 [2002]; Amon Trading Corporation vs. Court of Appeals, 477 SCRA 582 [2005].) The declarations of the agent *alone* are generally insufficient to establish the fact or extent of his authority. (Litonjua vs. Fernandez, 427 SCRA 478 [2004]; Tuazon vs. Heirs of B. Ramos, *supra*; Litonjua, Jr. vs. Eternal Corporation, 490 SCRA 204 [2006]. However, if one professes to act as agent for another, he may be estopped to deny his agency both as against the asserted principal and the third persons interested in the transaction in which he is engaged. (Doles vs. Angeles, 492 SCRA 607 [2006].)

(5) *As between the principal and a third person.* — As between them, agency may exist without the direct assent of the agent. Thus, by directing a third person to deal with another as agent, the principal necessarily authorizes the agent to act for him. (2 C.J.S. 1043.) Neither is it necessary that the principal personally encounter the third person with whom the agent entire acts. Precisely, the purpose of agency is to extend the personality of the principal through the facility of the agent. (Doles vs. Angeles, *supra.*).

Nature of relations between principal and agent.

(1) *Relations fiduciary in character.* — The relations of an agent to his principal are fiduciary in character since they are based on trust and confidence (Severino vs. Severino, 44 Phil. 343 [1923].), on a degree which varies considerably from situation to situation. The agreement to act on behalf of the principal causes the agent to be a fiduciary, that is, a person having a duty, created by his undertaking, to act primarily for the benefit of another, the principal, in matters connected with his undertaking.[7] (Restate-

[7]The fiduciary nature of the relationship of agency is one which condemns as inaccurate fictions, uses of the term "agency" in situations where in fact no agency exists, as in the following:

(1) *Security devices.* — A lienholder, such as a pledgee, mortgagee or other lien or lienor is vested with a power to sell property covered by the lien, where the lienee defaults in the payment of the debt which gave rise to the security. It is commonly stated that the lienholder becomes "agent for the lienee" to foreclose the lien. This is inaccurate,

ment of the Law on Agency, p. 45.)

In some cases, the fiduciary duties imposed on the agent may continue even after the termination of the relationship. For example, a former agent is under obligation to account to the principal for all the profits arising out of the agency relationship.

(2) *Agent estopped from asserting interest adverse to his principal.* — It is an elementary and very old rule that in regard to property forming the subject matter of the agency, the agent is estopped from asserting or acquiring a title adverse to that of the principal. His position is analogous to that of a trustee and he cannot, consistently with the principles of good faith, be allowed to create in himself an interest in opposition to that of his principal or *cestui que trust*.[8]

The rule stands on the moral obligation to refrain from placing one's self in a position which ordinarily conflicts between self-interest and integrity. It seeks to remove the temptation that might arise out of such a relation to serve one's self-interest at the expense of one's integrity and duty to another, by making it impossible to profit by yielding to temptation. (Thomas vs. Pineda, 89 Phil. 312 [1951]; Palma vs. Cristobal, 77 Phil. 712 [1946].)

However, an agent does not, by accepting the agency, lose any prior claim which he himself may have to the property with which he deals, nor is he estopped to assert that money

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since the lienor in making such a sale acts for his own benefit, not for the benefit of the lienee;

(2) *Confession of judgment.* — It is commonly stated that the party authorized to enter judgment is the defendant's agent but this is inaccurate. Confessions of judgment are often if not always security for the plaintiff creditor. The creditor thus becomes the possessor of a "power" to effect the defendant's legal relations, but the absence of the fiduciary relationship militates against the use of the term "agent" in this connection; and

(3) *Assignment of non-negotiable choses in action.* — "The assignment for value of an intangible contract right may be most accurately looked upon as creating an irrevocable legal power of attorney to enforce the assignor's right with authority to keep the proceeds when reduced to possession, coupled with an equitable ownership of the right prior to its collection." (citing Williston on Contracts [Rev. ed.], Sec. 404.) But it is apparent that the assignee is not the agent of the assignor in the true sense of the word, for the assignee is not acting for the assignor but not for himself. (Teller, *op. cit.*, pp. 4-6.)

[8]Art. 1435. If a person in representation of another sells or alienates a thing, the former cannot subsequently set up his own title as against the buyer or grantee.

or property in his hands was not received by him as agent for the principal, or that the principal parted with his interest in the property subsequent to the delivery to him as agent, or that the property has been taken from the principal by a paramount title, or that he has been lawfully required to account for another, or that the title is in another to whom he would be liable if he should surrender the property to the principal. (3 C.J.S. 63.)

(3) *Agent must not act as an adverse party.* — In matters touching the agency, agents cannot act so as to bind their principals, where they have an adverse interest in themselves.

The rule is founded upon the plain and obvious consideration, that the principal bargains, in the employment, for the exercise of the disinterested skill, diligence and zeal of the agent, for his own exclusive benefit. Even if impartiality could possibly be presumed on the part of an agent, where his own interests were concerned, that is not what the principal bargains for; and in many cases, it is the very last thing which would advance his interests. (Andrew vs. Ramsay & Co., [1903] 2 K.D. 635, cited in Mechem, Selected Cases on the Law of Agency [3rd ed.], pp. 451-452.)

(a) An agent cannot acquire by purchase, even at public or judicial auction, either in person or through the mediation of another, the property whose administration or sale has been entrusted to him, unless the consent of the principal has been given.[9] (Art. 1491[2].) The agent's incapacity to buy his principal's property rests in the fact that the agent and the principal form one juridical person. The fear that greed might get the better of the sentiments of loyalty and disinterestedness which should animate an administrator or agent, is the reason underlying the incapacity. The ban connotes the idea of trust and confidence. (G. Araneta, Inc. vs. del Paterno, 91 Phil. 786 [1952].)

Unless the principal consents, such sale is voidable, notwithstanding that the price was fair and that the agent could

[9](10) *Acquiring Interest in Litigation.* — The lawyer should not purchase any interest in the subject matter of the litigation which he is conducting. (Canons of Professional Ethics.)

have done no better had he purchased the goods for the principal in the open market. (Babb & Martin, Business Law [1957], p. 143.)

An agent, however, can buy for himself the property placed in his hands for sale or administration after the termination of the agency (Valera vs. Velasco, 51 Phil. 695 [1928].), or if the principal gives his consent thereto (Cui vs. Cui, 100 Phil. 913 [1957].), or other properties different from those he has been commissioned to sell.

(b) Similarly, if the principal authorizes the agent to sell goods, the agent must not sell to himself. His duty (to get the highest price) here conflicts with his interest (to buy as cheaply as possible). (Babb & Martin, *op. cit*., p. 143.) The principal may recover damages for the wrongful sale. The measure of the damages is the difference between the value of the goods when sold and their value when the sale was made known to, and repudiated by, the principal. (Teller, *op. cit*., p. 137.)

But where it appears from the facts that the principal is interested in the receipt of a fixed price for the subject matter of the agency, he may sell to himself. Thus, where the agent employed to sell a parcel of land at a certain minimum price, any amount above the price being allowed to him as commission, the agent may purchase the property himself. Similarly, he may, under similar circumstances, act for both buyer and seller. (Teller, *op. cit*., pp. 139-140, citing Halton vs. Sherrard, 150 N.M. 135 and Empire vs. American Central Ins. Co., 138 N.Y. 446.)

(4) *Agent must not act for an adverse party.* — An agent cannot serve two masters, unless both consent, or unless he is a mere middleman or intermediary (*e.g*., real estate broker) with no independent initiative. (Babb & Martin, *op. cit*., p. 143; see Allied Free Worker's Union [PLUM] vs. Compania Maritima, 19 SCRA 258 [1967].) An agent cannot act as such for both parties to the same transaction, in the presence of conflicting interests, unless he acts with the knowledge and consent of both, and on failure so

to operate, either party may repudiate the transaction involved.[10] Compliance with this duty dictates that one cannot act as agent for both buyer and seller in the same transaction since it is to the interest of the vendor to secure the highest price and of the purchaser to pay the least, and the agent thereby assumes a conflicting interest. (3 C.J.S. 15-17.)

(a) Where a foreign company has an agent in the Philippines selling its goods and merchandise, it was held that the same agent could not very well act as agent for local buyers, because the interest of his foreign principal and those of the buyers would be in direct conflict. He could not serve two masters at the same time. (Far Eastern Export & Import Co. vs. Lim Teck Suan, 97 Phil. 171 [1955].)

(b) Where an agent acts for both parties without the knowledge or consent of either, he is chargeable as trustee for all the profits of the transaction, and is responsible for any loss sustained by the principal through such action, and cannot recover compensation from either principal. The rule has its foundation in reasons of public policy and it applies to all dual agency relationships, notwithstanding that the agent acts in good faith or that the principal objecting incurs no harm therefrom. (3 C.J.S. 15-17.) Either principal can rescind.

(c) Where the third party (second principal) is aware of the dual employment but the principal is not, the latter

[10](6) *Adverse Influences and Conflicting Interest.* — It is the duty of a lawyer at the time of retainer to disclose to the client all the circumstances of his relations to the parties, and any interest in or connection with the controversy, which might influence the client in the selection of counsel.

It is unprofessional to represent conflicting interests, except by express consent of all concerned given after a full disclosure of the facts. Within the meaning of this canon, a lawyer represents conflicting interests when, in behalf of one client, it is his duty to contend for that which duty to another client requires him to oppose.

The obligation to represent the client with undivided fidelity and not to divulge his secrets or confidences forbids also the subsequent acceptance of retainers or employment from others in matters adversely affecting any interest of the client with respect to which confidence has been reposed. (Canons of Professional Ethics.)

When the same law firm handles the civil case of the present client and a prospective client, the rule against representing conflicting interests applies. (Gonzales vs. Cabucana, Jr., 479 SCRA 320 [2005].)

has the right to affirm or rescind the transaction and recover damages from the third party and the agent irrespective of any proof of actual fraud or that an improper advantage has been gained over him.

(d) If the double employment is with the knowledge and consent of the principal, such principal is bound but he cannot recover from the other. (see comments under Art. 1875.) A principal with knowledge of double agency cannot complain of the agent's breach of faith.

(e) The prohibition against dual agency does not apply to cases where the principal possesses full knowledge of the facts and consents thereto, or in which the interests of the two principals are not conflicting and loyalty by the agent to one of them does not comprise a breach of his duty to the other, as may be where the agent exercises no discretion in the matter but acts merely to bring the parties together, and they themselves settle the terms of the agreement between them. Also, the rule does not disqualify one who is the agent of one party for a certain purpose from acting as agent of an adverse party for an entirely different purpose. (*Ibid*., 17-18.)

For purposes of the income tax law, the withholding agent is the agent of both the Government — in collecting and/or withholding the tax due from the taxpayer — and the taxpayer — in paying the tax withheld to the Government.

(5) *Agent must not use or disclose secret information.* — Requirements of good faith and loyalty demand of the agent the duty not to use or divulge confidential information obtained in the course of his agency for his own benefit to the principal's injury and expense.[11] After the agency is terminated, the agent is no longer un-

[11](37) *Confidences of a Client.* — It is the duty of a lawyer to preserve his client's confidences. This duty outlasts the lawyer's employment and extends as well as to his employees; and neither of them should accept employment which involves or may involve the disclosure or use of these confidences, either for the private advantages of the client, without his knowledge and consent, and even though there are other available sources of such information. A lawyer should not continue employment when he discovers that his obligation prevents the performance of his full duty to his former or to his new client. *(Ibid.)*

der a duty to abstain from competition and may then use general information as to business methods and processes and names of customers remembered (if not acquired in violation of his duty as agent), but he must still not injuriously use or disclose unique or confidential information entrusted to him only for the principal's use or acquired by him in violation of his duty. (Babb & Martin, *op. cit*., pp. 143-144; see comments under Art. 1919.)

(6) *Agent must give notice of material facts.* — Principles of good faith and loyalty to the principal's interests also require that an agent make known to his principal every and all material facts, of which the agent has cognizance, which concern the transaction and subject matter of the agency. On failure to do so, the agent may be held liable for damages for any loss suffered or injury incurred as a result of such breach. (3 C.J.S. 8.)

The principal also owes the agent the duty to act with outmost good faith. He may not keep from the agent information that has any bearing on their agency relationship.

Knowledge of agent imputed to principal.

(1) *Agents' duty of notification.* — The importance of the duty to give information of material facts becomes readily apparent when it is borne in mind that knowledge of the agent is imputed to the principal even though the agent never communicated such knowledge to the principal. (see Art. 1821.) Thus, it is only logical that the agent is required to notify the principal of all matters that came to his attention that are material to the subject matter of the agency. A typical illustration is where an agent, having authority to buy property, learns that the property is encumbered by an unrecorded mortgage. The knowledge of the agent will be imputed to the principal so that the principal acquires the property subject to the mortgage.

(2) *Relationship of attorney and client.* — The relationship being one of confidence, there is ever-present the need for the latter being adequately and fully informed of the mode and manner in which his interest is defended. He is entitled to the fullest disclosure of why certain steps are taken and why certain

matters are either included or excluded from the documents he is made to sign. (Oparel, Sr. vs. Abaria, Adm. Case No. 959, 40 SCRA 128 [1971].)

(3) *Knowledge of the principal.* — Note that the theory of imputed knowledge ascribes the knowledge of the agent to the principal, not the other way around. The knowledge of the principal cannot be imputed to his agent. (Sunace International Management Services, Inc. vs. National Labor Relations Commission, 480 SCRA 146 [2006].)

Exceptions to the rule.

There are at least three exceptions to the rule imputing knowledge of agent to the principal:

(1) Where the agent's interests are adverse to those of the principal;

(2) Where the agent's duty is not to disclose the information, as where he is informed by way of confidential information; and

(3) Where the person claiming the benefit of the rule colludes with the agent to defraud the principal. (Teller, *op. cit*., p. 150.)

Agent subject to principal's control.

(1) *Subject matter of agency.* — One factor which most clearly distinguishes agency from other legal concepts is control; one person — the agent — agrees to act under the control or direction of another — the principal. Indeed, the very "agency" has come to connote control by the principal. (Victorias Milling Co., Inc. vs. Court of Appeals, 333 SCRA 663 [2000].)

The agent is subject to his principal's control with respect to the matters relevant to the agency relationship. Many legal relationships are possessed of a fiduciary quality and the quality of a power in one of the parties, yet the relationship falls short of agency because of the absence of control on the part of one of the parties. Thus, "the directors of a corporation are fiduciary having power to affect its relations, but they are not agents of the *stockholders* since they have no duty to respond to the will of

the stockholders as to the details of management." (*Ibid*., citing Restatement of Agency, Sec. 14a.)

(2) *Act of agent.* — The extent of the principal's control over the agent's acts varies both with the type of the agency relationship and the facts of the particular case. But the general rule is that the principal may direct the acts of his agent even though the principal has promised not to do so. The principal, of course, becomes liable in damages for breach of his promise not to give direction, but the agent cannot act in disregard of the principal's demands, *i.e*., the principal's promise not to give directions is not susceptible of specific performance. (Teller, *op. cit*., p. 8.)

Agency and similar contracts or relations.

In order to classify a contract, due regard must be given to its essential clauses. A contract is what the law defines it to be and not what it is called by the contracting parties. (Quiroga vs. Parsons Hardware Co., 38 Phil. 501 [1918].) The essence of the contract determines what law should apply to the relation between the contracting parties. (American Rubber Co. vs. Collector of Internal Revenue, 64 SCRA 569 [1975].)

The important characteristic feature of an agency relationship which distinguishes it from similar contracts or relations is the agent's power to bring about business relations between his principal and third persons. This power is perhaps the most distinctive mark of the agent, as contrasted with others who act in representative capacities but are not agents.

Also, general agents (see Art. 1876.) are to be distinguished from certain particular kinds of agents. Thus, while attorneys-at-law, auctioneers, brokers, factors, partners, officers and agents of corporations, and public officers may, in some respects at least, be regarded as agents, they are distinguishable from general agents because their authority is of a special and limited character in most respects. (3 Am. Jur. 2d 420.)

Agency distinguished from loan.

Whether in a particular case the relation between the parties

is one of lender and borrower[12] or principal and agent depends on the terms of the contract between them and their intention.

(1) Where money advanced to another is expressly regarded as money lent, no agency results. One who borrows money to conduct a business in which the lender has no interest or concern in the manner of its conduct is not an agent of the lender, but the financing of operations to be carried on by another for the mutual advantage of both, without any obligation of such other to return the money advanced, makes such other an agent rather than a borrower. (2 C.J.S. 1030.)

(2) An agent may be given funds by the principal to advance the latter's business, while a borrower is given money for purposes of his own and he must generally return it whether or not his own business is successful. A lot, however, depends on the intent of the parties. (see *Ibid*.)

(3) Where checks are deposited with a collecting bank, the nature of the relationship created at that stage is one of agency, that is, the bank is to collect from the drawees of the checks the corresponding proceeds. After the checks are collected and converted into cash, the creditor and debtor relationship is created between the depositor and the bank. (see Jai-Alai Corp. of the Phils. vs. Bank of the Phil. Islands, 66 SCRA 29 [1975].)

(4) Where one deposits money with a bank with instructions to apply it in satisfaction of the debt of a third person, the conventional "debtor and creditor relationship" between the bank and the depositor is created, coupled with an "agency" on the part of the bank to pay the debt, which is revocable at the will of the depositor. (Brown vs. J.P. Morgan & Co., 31 N.V.S. 2d 323-333.)

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[12]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)

Agency distinguished from lease service.

The distinctions are the following:

(1) In agency, the basis is representation, while in lease of service[13] (see Art. 1689.), it is employment;

(2) In agency, the agent exercises discretionary powers, while in lease of service, the lessor (like a servant) ordinarily performs only ministerial functions (see Nielson & Co., Inc. vs. Lepanto Consolidated Mining Co., 26 SCRA 540 [1968].);

(3) In agency, three persons are involved: the principal, the agent, and the third person with whom the agent has contracted, while in lease of service, only two persons are involved: the lessor (master or employer) and the lessee (servant or employee); and

(4) Agency relates to commercial or business transactions, while lease of service (like in the case of master and servant) relates more to matters of mere manual or mechanical execution, in which the servant acts under the direction and control of the master. (Munn. vs. Wellsburg Banking & Trust Co., 66 S.E. 230, 231.)

The agent is employed in a capacity superior to that of the servant, being entitled, in general, to use his discretion as to the means to accomplish the end for which he is employed, while the servant is directed by the master, not only as to what is to be done, but how it shall be done; and the essential distinction is that the agent is employed to establish contractual relations between his principal and third persons, while the servant is not.[14] (2 C.J.S.

[13]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)

[14]Mechem on Agency (Sec. 37.) presents the same point. The Restatement of Agency (Sec. 22a.), on the other hand, presents a different view. It is the extent of control exercised by the principal, rather than the nature of the agent's function, which determines the relationship. The two views may be reconciled. An agent, to be sure, is always one whose normal function is to bring his principal into dealings with third parties. But the fact that a representative is, by the terms of the contract of representation, empowered to transact business and to enter into contracts with third persons on the principal's account does not *ipso facto* create the relationship of principal and agent. Thus, a cashier in a bank is a servant, although his very function is to bring his master into contractual relations with third persons. The term "servant" is, therefore, seen to be a term whose precise nature is,

1029.) Thus, one hired by a corporation to perform a specific task, that of acting as a special guard and staying at the main entrance of a moviehouse to stop gatecrashers and "to maintain peace and order within the premises" is a mere employee and not an agent as he is not employed to represent the corporation in its dealings with third persons. (De la Cruz vs. Northern Theatrical Enterprises, 95 Phil. 739 [1954].)

But a person may be employed to perform the duties of both agent and servant. Thus, a bookkeeper who is also authorized to purchase office supplies is in this respect acting as an agent. The law of principal and agent is really an outgrowth and expansion of the law of master and servant.[15]

ILLUSTRATIVE CASE:

Plaintiff agreed to operate mining claims of defendant subject to the general control of the latter.

Facts: Under a management contract, N agreed to explore, develop and operate the mining claims of L and to render for L other services specified in the contract. N was to take complete charge, subject at all times to the general control of the Board of Directors of L, of the exploration and development of the mining claims, hiring of staff and laborers, operation of the mill, and marketing of minerals.

N was also to act as purchasing agent of supplies but no purchase shall be made without the prior approval of L and no commission shall be claimed by N on such purchase. N was also authorized to make contracts subject to prior approval of L for the sale and marketing of minerals mined.

Issue: Under the management contract, is N an agent of L?

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though impossible of exact definition, determined by the characteristics both of economic subservience and function. (Teller, *op. cit.*, p. 13.)

[15]Where a security agency recruits, hires and assigns the work of its watchmen or security guards, the agency is the employer of such watchmen or guards, and not the clients or customers of such agency. The fact that a client company may give instructions or directions to the security guards assigned to it does not, by itself, render the client responsible as an employer of the security guards and liable for their wrongful acts or omissions. Those instructions or directions are ordinarily no more than request commonly envisaged in the contract for services entered into with the security agency. (Soleman, Jr. vs. Tuazon, 209 SCRA 51 [1992].)

Held: No. It appears from the above contract that the principal undertaking of N was the operation and development of the mine and operation of the mill. All the other undertakings mentioned in the contract are necessary or incidental to this principal undertaking. In the performance of this principal undertaking, N was not in any way executing juridical acts for L, destined to create, modify or extinguish business relations between L and third persons.

In other words, in performing its principal undertaking, N was not acting as an agent of L, in the sense that the term "agent" is interpreted under the law of agency but as one who was performing material acts for an employer for a compensation. *(Nielson & Co., Inc. vs. Lepanto Consolidated Mining Company, 26 SCRA 540 [1968].)*

Agency distinguished from independent contract.

Where one party to a contract undertakes to accomplish a certain result (as the construction of a house) according to his own method and without being subject to the other party's control except as to the result of the work, the contract is one for a piece of work[16] and not agency. (Fressel vs. Mariano Uy Chaco Sons & Co., 34 Phil. 122 [1915].)

In agency, the agent is subject to the control and direction of the principal whom he represents with respect to the matters entrusted to him. In a contract for a piece of work, the independent contractor, without being subject to the control of the employer except only as to the result of the work,[17] exercises

[16]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)

[17]Not every form of control that a party reserves to himself over the conduct of the other party in relation to the services being rendered may be accorded the effect of establishing an employer-employee relationship. Logically, the line should be drawn between rules that merely serve as guidelines towards the achievement of the mutually desired result without dictating the means or methods to be employed to attaining it, and those that control or fix the methodology and bind or restrict the party hired to the use of such means. (AFP Mutual Benefit Ass'n., Inc. vs. National Labor Relations Commission, 267 SCRA 47 [1997], citing Insular Life Assurance Co., Ltd. vs. National Labor Relations Commission, 179 SCRA 459 [1984].)

his employment independently, and not in representation of the employer. (see Shell Co. of the Phils., Ltd. vs. Firemen's Ins. of Newark, N.J., 100 Phil. 755 [1957].)

The distinctions are important because, as a general rule, the employer is not liable for the torts or injury inflicted by the independent contractor upon third persons or by the employees of such contractor. The employer, of course, is not relieved from liability if the injury is caused by his negligence or the result of his interference in the work of the independent contractor (in this case, the contractor is not independent). There are cases which hold the employer liable where the work contracted is intrinsically dangerous or a nuisance. (Newman vs. Sears, Roebuck & Co., 43 N.W. 2d 415.)

In a case, several individuals who agreed to sell the products of a softdrinks manufacturer under an Agreement to Peddle Soft Drinks, providing their own capital and hiring their own employees (delivery helpers) under their direction and responsibility were held as independent contractors, and consequently, the manufacturer was not liable to pay SSS premiums for such employees. (Social Security System vs. Court of Appeals and Manila Cosmos Aerated Water Factory, Inc., 112 SCRA 47 [1982].) For the acts of the agent or servant within the scope of his authority or employment, the principal or employer is, in general, liable.

ILLUSTRATIVE CASES:

1. *Licensee of a gasoline service station operates station and its equipment under the control of the owner.*

Facts: A fire broke out at a gasoline service station. It started while gasoline was being hosed from a tank into the underground storage. The fire spread to and burned several neighboring houses owned by C, etc.

The gasoline station as well as the equipment therein is owned by P (Caltex). It claims, however, that the business conducted at the service station in question was owned and operated by A.

Issue: Whether P should be held liable for the damages caused to C, etc. This question depends on whether A was an independent contractor or an agent of P.

Held: P should be held liable. Under the license agreement, A, as operator, would pay P purely nominal sum of P1.00 for the use of the premises and all equipment therein. A could sell only P's products. Maintenance of the station and its equipment was subject to the approval, in other words, control of P. A could not assign or transfer his rights as licensee without the consent of P. Termination of the contract was a right granted only to P but not to A.

These provisions of the contract show that A was virtually an employee of P, not an independent contractor. (*Africa vs. Caltex [Phils.], Inc., 16 SCRA 448 [1966];* see Shell Co. of the Phils., Ltd. vs. Firemen's Ins., Inc. of Newark, U.S., 100 Phil. 757 [1957] under Art. 1910.)

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2. *Lessee who was injured due to the fault of an independent contractor hired by the lessor seeks to hold lessor liable.*

Facts: P, owner of an apartment house, ordered folding beds from S and had A install one of them in one of his furnished apartments. T, a lessee, was seriously injured when the bed collapsed due to the fact that A used ordinary wood screws instead of the lag screws designated to hold the bed in place.

The court found A an independent contractor. T argues that even if A is held to have been an independent contractor, the nature of the work done was such as to render P, the employer, liable.

Issue: Is T's argument tenable?

Held: No. A distinction must be made between the cases in which the owner is held liable for work which he engaged an independent contractor to perform and that for which he is not held liable. Where the work, even if carried out according to the orders of the owner is inherently dangerous to people (*e.g.*, dynamiting, excavating, etc.) and it is manifest that injury is likely to result unless due precautions are taken, a duty rests upon him to see that such necessary precautions are taken. However, if the work is such which when accomplished is not in itself dangerous to people, the employer, in the absence of unusual circumstances, is not liable for the acts of the independent contractor.

In the case at bar, the folding bed itself when properly installed is not inherently dangerous and does not constitute

a nuisance *per se*. The use of the wood screws was not ordered by P and not known to him. Clearly, the work delegated to A comes within the second classification for which P cannot be held responsible. *(Newman vs. Sears, Roebuck & Co., 43 N.W. 2d 415.)*

One may be an independent contractor and, at the same time for certain purposes, be an agent of the employer. Thus, an independent contractor becomes an agent by his employer agreeing to be responsible for obligations incurred by him in the completion of his undertaking, but payment of workmen by an owner or employer does not necessarily transform an independent contractor into an agent. (2 C.J.S. 1029.)

Agency distinguished from partnership.

A contract of partnership[18] is a contract of agency, and it differs from a pure agency in that while an agent acts only for his principal, a partner acts not only for his co-partners and the partnership but also as principal of himself. In other words, each partner is regarded as an agent of his co-partners when he is acting and as principal of his co-partners when they are acting. This has been said to be the most certain test of partnership as distinguished from ordinary agency or employment. A partnership is, in effect, a contract of mutual agency.

In both cases, the agent or partner can bind the principal or his co-partner only by such contracts as are entered into within the scope of his authority. (Arts. 1910, 1803, 1818.) In general, both conceptions import the idea of a fiduciary relationship.

The agency which results from the relation of partnership is of a peculiar kind, *sui generis*, and must be distinguished sharply from the ordinary concept of agency in two important respects:

[18]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)

(1) *Control by the principal.* — An essential characteristic of the agency relationship, *i.e.*, control by the principal, which is not applicable to the partnership concept. It is fundamental in the law of agency that an agent must submit to the principal's right to control the agent's conduct in regard to the subject of the agency. Yet the partnership relation, while having many of the characteristics of the agency relationship, differs from it in that a partner's power to bind his co-partner is not subject to the co-partner's right to control, unless there is an agreement to that effect.

(2) *Liability of the agent.* — A partner acting as agent for the partnership binds not only the firm members but himself as well, while the ordinary agent assumes no personal liability where he acts within the scope of his authority. This is but a logical deduction from the proposition that a partner is both an agent and a principal at the same time when engaged in carrying on the partnership business. It is for this reason that Article 1822 of the Civil Code provides that, as to wrongful acts of partners done in the ordinary course of business "the partnership is liable therefor to the same extent as the partner so acting or omitting to act."

(3) *Sharing of profits.* — Now, what is the test to determine whether, in a given case, the parties have entered into a relationship of partner and partner, or principal and agent? The answer depends upon the manner in which the profits are shared: "If, when earned, the profits belong to all the parties as common proprietors in agreed proportions, the relation is one of partnership, but if the alleged owner or partner takes his agreed share of profits, not as owner but as an agreed measure of compensation for his services or the like, the relation is one of agency." Accordingly, Article 1769(4) of the Civil Code provides that the receipt by a person of the share of the profits of a business is not *prima facie* evidence that he is a partner in the business if such profits were received "as wages of an employee." (Teller, *op. cit*., pp. 22-23, citing Dinkelspeel vs. Lewis, 50 Wyo. 380; Person vs. Cartex, 7 N.C. 324; 2 Corp. Jur. 426.)

ILLUSTRATIVE CASE:

Branch manager of a travel agency company, who is a bona fide travel agent herself, had assumed solidary liability with the company for the payment of monthly rentals to the lessor.

Facts: A contract of lease was entered into between LS and the Tourist World Service, Inc. (TWS), whereby the latter leased the premises belonging to the former for use as a branch office. LS held herself solidarily liable with TWS for prompt payment of the monthly rental. When the branch office was opened, the same was run by LS who was designated as branch manager. Any airline fare brought in through the efforts of LS entitled her to receive 4% of the proceeds. LS was not in the company's payroll.

On mere suspicion that LS was connected with a rival firm, the office of branch manager was abolished.

Issue: What was the nature of the arrangement of LS and TWS?

Held: (1) *Employer-employee relationship not intended.* — It was not a case of employer-employee relation in view of the following:

(a) LS was not subject to the control by TWS either as to the result of the enterprise or as to the means used in connection therewith. A true employee cannot be made to part with his own money in pursuance of his employer's business or otherwise assume any liability thereof. "As to the means used" in soliciting airline fares, LS "obviously relied on her own gifts and capabilities;" and

(b) She was not in the company's payroll. Unlike an employee who usually earns a fixed salary, she earned compensation in fluctuating amounts, depending on her booking success. The fact that she was designated as "branch manager" did not make her an employee. Employment is determined by the "right of control" test and certain economic parameters, like the inclusion of the employee in the payroll.

(2) *Partnership not intended.* — The parties had not embarked on a partnership. LS herself did not recognize the existence of such a relation when in her letter, she expressly "concedes your (TWS) right to stop the operation of your branch

office," in effect, accepting its control over the manner in which the business was run. A joint venture, including a partnership, presupposes generally a parity of understanding between the joint co-venturers or partners in which each party has an equal proprietary interest in the capital or property contributed and where each party exercises equal rights in the conduct of the business. Furthermore, the partners did not hold themselves out as partners and the building itself was embellished with the electric sign "Tourist World Service, Inc.," in lieu of a distinct partnership name.

(3) *Principal-agent relationship intended.* — The parties have contemplated a principal-agent relationship. LS solicited airline fares but she did so for and on behalf of her principal, TWS. As compensation, she received 4% of the proceeds in the concept of commission. In her head letter, she presumed her principal's authority as owner of the business undertaking. The agency was one coupled with an interest (see Arts. 1927, 1930.) having been created for the mutual interest of the agent (LS was a *bona fide* travel agent herself) and the principal, and, therefore, could not be revoked at will. Accordingly, LS was entitled to damages. *(Sevilla vs. Court of Appeals, 160 SCRA 171 [1988].)*

Agency distinguished from negotiorum gestio.

In both agency and *negotiorum gestio*[19] or the management of the business or affairs of an absentee, there is representation.

The distinction lies in the fact that in the first, the representation is expressly conferred, while in the second, it is not only without the authority of the owner of the business but is without his

[19]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)

knowledge. While the agent acts according to the express will of the principal, the gestor acts according to the presumed will of the owner by exercising "all the diligence of a good father of a family." (Art. 2145.) Agency is a contract, while *negotiorum gestio* is a quasi-contract. Hence, their juridical relations are different.

Agency distinguished from brokerage.

A *broker* is one who is engaged for others on a commission; a negotiator between other parties, never acting in his own name but in the name of those who employed him. *Brokerage* refers to the trade or occupation of the broker. (Reyes vs. Rural Bank of San Miguel, 424 SCRA 135 [2004].)

(1) A commission agent (see Art. 1903.) is one engaged in the purchase or sale for another of personal property which for this purpose, is placed in his possession and at his disposal. He maintains a relation not only with his principal and the purchaser or vendor, but also with the property which is the subject matter of the transaction.

On the other hand, a broker[20] has no relation with the thing he buys or sells. He is merely an intermediary or negotiator between the purchaser and the vendor relative to the property with the custody or possession of which he has no concern. His only office is to bring together the parties to the transaction never acting in his own name but in the name of those who employed him. (Pacific Commercial Co. vs. Yatco, 63 Phil. 398 [1936]; Tan vs. Gullas, 393 SCRA 334 [2002].) In effecting a transaction, he, however, acts in a certain sense as the agent of both parties.

Brokers are generally classified in accordance with the type of property which they are authorized to sell or the type of contracts they are authorized to make, such as insurance brokers, real estate brokers, stock brokers, etc. They may be of two kinds: (1)

[20]The term "brokerage" may refer to the business of a broker or to the fee or commission for transacting business as a broker. (3rd Webster's Int. Dict., p. 282.) For definition of "indent" and "indentor," see Schmid & Oberly, Inc. vs. RJL Martinez Fishing Corp. (166 SCRA 493 [1988].) Since a brokerage relationship is essentially a contract for the employment of an agent, the principles of contract law also govern the broker-principal relationship. (Abacus Securities Corp. vs. Ampil, 483 SCRA 315 [2006].)

those authorized simply to secure customers for their principals, the resulting contract being made by the principal parties; and (2) those authorized to effect contracts. (Teller, *op. cit*., p. 10.)

(2) An agent receives a commission upon the successful conclusion of a transaction such as sale. On the other hand, a broker earns his pay merely by bringing the buyer and the seller together, even if no sale is eventually made. (Hahn vs. Court of Appeals, 266 SCRA 537 [1997].)

"Agent" is a broader term than "broker," for, while brokers are agents, their powers are limited, and when they have no charge or control of the property, but act only as go-betweens in executing a sale, they cannot be said to be agents in the larger sense entitled to receive payment for the goods delivered, unless specifically authorized. (Lawrence Gas Co. vs. Hawkeye Oil Co., 165 N.W. 445, 447.)

ILLUSTRATIVE CASE:

Owner of land refused to sell the land to plaintiff who had entered into a contract for the sale of the property with the owner's real estate broker.

Facts: T brought action against P. It appears that P wrote a letter to A & Co., a real estate agent, as follows: "x x x. I have offered my farm through you at extremely low rates for a year, hoping to make a sale. You may list it for twelve months next on the following terms: 732-1/2 acres at $16.00 per acre, payable as follows: 1/3 cash, balance in 1, 2, and 3 years; or I will take $10,000.00 cash. I will allow you a liberal commission if you can place the farm."

A and Co. thereafter purported to enter into a contract for the sale of the land to T. P refused to sell the land, and this action was brought for specific performance of the contract.

Issue: Is T entitled to specific performance?

Held: No. A real estate broker or agent is defined to be one who negotiates the sale of real property. His business generally is only to find a purchaser who is willing to buy the land upon the terms fixed by the owner. He has no authority to bind his principal by signing a contract of sale. A sale of real estate involves the adjustment of many matters besides fixing the price.

> The delivery of the possession has to be settled; generally, the title has to be examined; and the conveyance with its covenants, to be agreed upon and executed by the owner — all of which require conference and time for their completion. They are for the determination of the owner, and do not pertain to the duties, and are not within the authority, of a real estate agent. For obvious reasons, therefore, the law wisely withholds from him any implied authority to sign a contract of sale in behalf of his principal.
>
> A real estate agent is not a general agent, but a special agent, acting under limited power. He who deals with him, if the agent exceeds or deviates from his authority, deals with him at his peril. He cannot in such case, hold the principal bound, unless there has been an intelligent ratification of the unauthorized act of the agent, free from mistake or fraud. *(Halsey vs. Monteiro, 24 S.E. 258 [Va. 1896].)*

Agency distinguished from sale.

An agency to sell differs from sale[21] in the following ways:

(1) In an agency to sell, the agent receives the goods as the goods of the principal, while in a sale, the buyer receives the goods as owner (see Kerr & Co., Ltd. vs. Lingad, 38 SCRA 524 [1971].);

(2) In an agency to sell, the agent delivers the proceeds of the sale, while in a sale, the buyer pays the price;

(3) In an agency to sell, the agent can return the object in case he is unable to sell the same to a third person, while in a sale, the buyer, as general rule, cannot return the object sold; and

(4) In an agency to sell, the agent, in dealing with the thing received, is bound to act according to the instructions of his principal, while in a sale, the buyer can deal with the thing as he pleases, being the owner.

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

A contract of sale may be absolute or conditional. (1445a)

The elementary notion of sale is the transfer of title to a thing from one to another, while the essence of agency involves the idea of an appointment of one to act for another. Agency is a relationship which often results in a sale, but the sale is a subsequent step in the transaction. (Teller, *op. cit*., p. 26; see Commissioner of Internal Revenue vs. Manila Machinery & Supply Co., 135 SCRA 8 [1985].) An authorization given to another containing the phrase "for and in our behalf" does not necessarily establish an agency, as ultimately what is decisive is the intention of the parties. Thus, the use of the words "sold and endorsed" may mean that the parties intended a contract of sale, and not a contract of agency. (Victorias Milling Co., Inc. vs. Court of Appeals, 333 SCRA 663 [2000].)

EXAMPLES:

(1) P enters into a contract with A for the delivery to P of goods on a certain date and A commences to accumulate the goods for P. In determining whether A is P's agent or whether A is the vendor of the goods, two factors are relevant.

First, what is the nature of A's power in accumulating the goods, *i.e*., does he pledge his own credit or that of P? It will be recalled that an essential feature of agency is the agent's power to bind the principal personally. Similarly, the problem is important as to who, whether P or A, undertakes the risk of fluctuation in price. If A undertakes to deliver the goods at a fixed price, the transaction is more akin to sale rather than agency.

Second, what is the extent of control which P, by the term of the contract, reserves over A? If P, not A, is to determine from whom, and in what way the goods are to be purchased, the transaction is more likely one of agency and not one of sale. (Teller, *op. cit*., p. 27.)

(2) A signed a document that he received P615 kilos of leaf tobacco to be sold at P1.30 per kilo, "the proceeds to be given to P as soon as it was sold." Here, there is no contract of sale, but mere agency to sell, as the agreement negates transfer of ownership of the goods to A who has the obligation to return the tobacco if the same was not sold. (see Lim vs. People, 133 SCRA 333 [1984].)

ILLUSTRATIVE CASES:

1. *Importer ordered goods from abroad to be subsequently delivered to another who paid importer the price in advance.*

Facts: CN, in Manila, delivered to UT Corporation the price of 300 boxes of sunkist oranges to be obtained from the United States. UT Corporation ordered the said boxes from G Company of San Francisco which shipped the goods from that port to Manila "F.O.B. San Francisco." Part of the boxes were lost in transit.

CN sought to recover from UT Corporation the corresponding price paid to it in advance for the undelivered goods. UT Corporation refused to pay alleging it merely acted as agent of CN in purchasing the oranges.

Issue: Did UT Corporation merely agree to buy for and on behalf of CN, or did it agree to sell the oranges to CN?

Held: The circumstances indicate a sale:

(1) No commission was paid;

(2) The written agreement (Exhibit 1) between CN and UT Corporation says that "if balance is not paid within 48 hours of notification, merchandise *may be resold* by UT Corporation *and the deposit forfeited*. "Resold" implies the goods had been sold to CN;

(3) After executing Exhibit 1 wherein the oranges were quoted at $6.30 per box, UT Corporation placed an order for purchase of the same with GC at $6.00 per box, which UT Corporation could not properly do if it were acting as agent of CN and not as independent purchaser from GC;

(4) UT Corporation charged CN an amount for sales tax, thereby implying that the transaction was a sale; and

(5) UT Corporation had been pressing the claims for losses against the insurance company and against the shipping company for itself and instead of assigning said claims to CN, showing that the purchase had not been made on behalf of CN. *(Chua Ngo vs. Universal Trading Co., Inc., 87 Phil. 331 [1950].)*

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2. *Goods are sold to customer at a price which includes seller's "commission" from the supplier.*

Facts: A's mode of transacting business was to first ascertain the price of onions by requesting price quotations from P, with

whom he made prior arrangement for the inclusion of his 5% "commission" in the price quotations. A would then solicit orders from his customers, after which he directly ordered from B.

Issue: Does the stipulated commission make the relationship between A and P a fiduciary one?

Held: No. The "commissions" were not commissions in the true sense of the word. H asked for them in order to make sure that he would always get a profit even if he quotes to his customers the same price quotation given by P. The agreement for "commission" assured him of getting at least 5% profit on all orders he placed with P. *(G. Eidi & Co. vs. Cu Bong Liong, C.A.-G.R. No. 14607-R, Nov. 29, 1956.)*

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3. *An exclusive agent ordered equipment from its principal on behalf of another who agreed to pay the price and 10% commission in addition to the price, the agent binding itself to be responsible to such another for unforeseen events.*

Facts: GPS, Inc., exclusive agent in the Philippines for SP Company of Richmond, Indiana, U.S.A., and AA Company agreed that GPS would, on behalf of AA, order sound reproducing equipment from SP and that AA would pay GPS, in addition to the price of the equipment, a 10% commission, plus all expenses such as freight, insurance, etc. Upon receipt by GPS of the reply of SP to its cable inquiring about the price, GPS informed AA of the price of $1,700.00. Being agreeable to this price, AA formally authorized the order. AA discovered that the price quoted to them by GPS was not the net price but the list price and that GPS obtained a discount from SP.

AA instituted action to obtain a reduction from GPS or a reimbursement of what GPS obtained as a discount from SP on the theory that the relation between AA and GPS was that of principal and agent.

Issue: Is the contract one of purchase and sale or one of agency?

Held: It is one of purchase and sale for the following reasons:

(1) The contract between the parties is clear that AA agreed to purchase from GPS the equipment at prices indicated

($1,700.00, plus the 10% commission and plus all the expenses and charges) which are fixed and determinate and GPS agreed to sell said equipment to AA;

(2) Whatever unforeseen events might have taken place unfavorable to AA, such as change in prices, loss of the goods not covered by insurance, or failure of SP to properly fill the orders, AA should legally hold GPS to the price of $1,700. This is incompatible with the pretended relation of agency, because in agency, the agent is exempted from all liability in the discharge of his commission provided he acts in accordance with the instructions received from his principal, and the principal must indemnify the agent for all damages which the latter may incur in carrying out the agency without fault or imprudence on his part;

(3) While GPS was to receive a 10% commission, it did not necessarily make GPS an agent of AA as this provision is only an additional price which AA bound itself to pay, and which stipulation was not incompatible with the contract of purchase and sale; and

(4) To hold GPS an agent of AA in the purchase of the equipment from SP is incompatible with the admitted fact that GPS is the exclusive agent of SP in the Philippines. It is out of the ordinary for one to be the agent of both the vendor and the vendee. (*G. Puyat & Sons, Inc. vs. Arco Amusements Co., 72 Phil. 402 [1941];* see also Far Eastern Export & Import Co. vs. Lim Teck Suan, 97 Phil. 171 [1955].)

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4. *Contract, the title of which states that it is one of "purchase and sale," provides for the sale of floor wax by manufacturer to another who is, however, designated as sole distributor of the article within a certain territory.*

Facts: S (surety) contends that it should not be held liable on its bond for the reason that the latter was filed on the theory that the contract between P (manufacturer of floor wax) and A (P's sole distributor of said article in certain specified provinces) was one of agency as a result of which it guaranteed the faithful performance of A as agent, but that it turned out that said contract was one of purchase and sale, as shown by the very title of said contract, namely, "contract of purchase and sale."

However, the contract shows that while it provides for sale of the floor wax from P to A, it also designates A as the sole distributor of the article within a certain territory; besides, the contract provides that A is to furnish surety bond to cover all shipments made by P to him.

Issue: Is the contract between P and A one of agency so that breach thereof would come within the terms of the surety bond posted by S?

Held: The contract is partly agency and partly purchase and sale. While the contract is not entirely clear, S must have understood the same to be one, at least partly, of agency because (a) it also designates A as a sole distributor and (b) the bond itself says that A "has been appointed *exclusive agent"* for P.

Whether the article was purchased by A or whether it was consigned to him is immaterial. The contract provides that A was to furnish surety bond to cover all shipments made by P to A. It appeared to have been the sole concern and interest of P to be sure that it was paid the value of all shipments of the article to A, and S, by its bond, guaranteed its payment by A, either as purchaser or agent. *(Pearl Island Commercial Corp. vs. Lim Tan Tong, 101 Phil. 789 [1957].)*

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5. *Plaintiff seeks recovery of commission in connection with sale by defendant of his vessel, claiming that he was agent of the latter.*

Facts: A maintains that it was P's agent in the sale of certain vessels to IG (Indonesian Government). On the other hand, P claims that A undertook to buy the vessels from P with a view, in turn, of selling them, at its (A's) own risk and account, to IG and that this proposed sale to the latter by A having failed completely, P "alone" sold the vessels to IG without A's intervention.

A seeks recovery of the commission agreed upon as compensation for its services in connection with the sale of the vessel.

Issue: What is the nature of the relation between P and A under the transactions which culminated in the sale by P of the vessels in question to IG?

Held: A acted merely as a broker or intermediary between P and IG. One reason — among others — is that A's

representations to IG were *approved* by P and such approval was *transmitted* and made known to IG. As the sale appeared to have been the product of A's intervention, he is entitled to the commission agreed upon. *(J. Ysmael & Co., Inc. vs. William Lines, Inc., 103 Phil. [unrep.] 1135 [1958].)*

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6. *Plaintiff, designated as "buyer" and likewise "as agent of the seller," the defendant, agreed, at its (plaintiff's) expense to export rice and corn of the "seller" and to import collateral goods for the "seller" in exchange for the rice and corn and to buy said goods from the latter.*

Facts: Pursuant to a contract, D Corporation agreed to export a certain quantity of rice and corn of N (Naric) and import collateral goods in exchange therefor, and to buy from N the said collateral goods. The exportation and importation was on a no-dollar remittance or barter basis, that is to say, D was not to be paid by its foreign buyer in dollars but in commodities. D expected to make a profit out of its purchase from N of the said goods thereby covering up whatever expenses and losses it might incur in the exportation of the corn and rice which under the contract shall be for its account.

The contract designates N as the seller and D as the buyer, thereafter sets forth the role of the "buyer" (D) "as agent of the seller" (N) in the barter transaction. D had exported all the rice and corn at its expense and imported almost half of the commodities stipulated when barter transactions were stopped by a new succeeding administration.

N brought action for recovery of a sum of money representing the balance of the value of corn and rice exported by D which, according to N, D bought from N.

Issue: Did D buy the rice and corn in question or act merely as an agent of N in the exportation of the same?

Held: As an agent, in view of the following circumstances:

(1) Under its charter (Sec. 3, R.A. No. 633.), it is N alone which could export and import on barter basis;

(2) The contract itself clearly provides that D was to export the rice and corn, and to buy the collateral goods;

(3) There is nothing in the contract providing unconditionally that D was buying the rice and corn;

(4) N called bids for the purchase of the rice and corn but because of their poor quality, a direct purchase thereof even with the privilege of importing commodities did not attract good offers. That was where D came in with its offer to act as agent. In other words, the primary consideration of D was not the purchase of the corn but the purchase of the commodities to be imported from the proceeds of the corn;

(5) The mode of payment supports the theory of agency. The availability of the letters of credit opened by D to N was dependent upon the issuance of the export permit and the payment therefor depended on the importation of the collateral goods; and

(6) It appeared that the price fixed in the contract for the corn was given tentatively for the purpose of fixing the price in barter. The contract provided that the price of the imported commodities shall be equal to the total peso price offered for the corn in consideration of the high price offered by D. Then it set the value of the imported commodities not to exceed the sum of P2,880,000.00 or equivalent to the peso value of the corn and rice.

It was not the fault of D that the importation of the remaining collateral goods could not be effected due to the suspension by the government of barter transactions. (see Art. 1266.) It was the duty of N to make the necessary representations with the government to enable D to import the said goods. Consequently, N has no cause of action until it has secured the necessary import permit. *(National Rice and Corn Corp. vs. Court of Appeals, 91 SCRA 437 [1979].)*

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7. *Petitioner was granted by a non-resident foreign corporation the exclusive dealership of the latter's car in the Philippines.*

Facts: AH (petitioner,) a Filipino citizen and BMW (private respondent), a non-resident foreign corporation, executed on March 7, 1967 a Deed of Assignment with Special Power of Attorney whereby the former was granted the exclusive dealership of the latter's cars.

On February 24, 1993, AH received confirmation of the information from BMW which, in a letter, expressed dissatisfaction with various aspects of petitioner's business, mentioning among other things, decline in sales, deteriorating services, and inadequate showroom and warehouse facilities,

and petitioner's alleged failure to comply with the standards for an exclusive BMW dealer. Nonetheless, BMW expressed willingness to continue business relations with the petitioner on the basis of a "standard BMW importer" contract; otherwise, it said, if this was not acceptable to petitioner, BMW would have no alternative but to terminate petitioner's exclusive dealership effective June 30, 1993.

Because of AH's insistence on the former business relation, BMW withdrew on March 26, 1993 its offer of a "standard importer contract" and terminated the exclusive dealer relationship effective June 30, 1993.

Issue: The question is whether petitioner AH is the agent or distributor in the Philippines of private respondent BMW.

Held: (1) *Arrangement shows an agency*. — "An agent receives a commission upon the successful conclusion of a sale. On the other hand, a broker earns his pay merely by bringing the buyer and the seller together, even if no sale is eventually made."

(2) *BMW exercised control over AH's activities.* — "As to the service centers and showrooms which he said he had put up at his own expense, Hahn [AH] said that he had to follow BMW specifications as exclusive dealer of BMW in the Philippines. According to Hahn, BMW periodically inspected the service centers to see to it that BMW standards were maintained. Indeed, it would seem from BMW's letter to Hahn that it was for Hahn's alleged failure to maintain BMW standards that BMW was terminating Hahn's dealership.

The fact that Hahn invested his own money to put up these service centers and showrooms does not necessarily prove that he is not an agent of BMW. For as already noted, there are facts in the record which suggest that BMW exercised control over Hahn's premises to enforce compliance with BMW standards and specifications. For example, in its letter to Hahn dated February 23, 1996, BMW stated:

> In the last years, we have pointed out to you in several discussions and letters that we have to tackle the Philippine market more professionally and that we are, through your present activities, not adequately prepared to cope with the forthcoming challenges.

In effect, BMW was holding Hahn accountable to it under the 1967 Agreement."

(3) *BMW engaged in business in the Philippines with AH as its exclusive distributor.* — "This case fits into the mould of *Communications Materials & Design, Inc. vs. Court of Appeals* (260 SCRA 673 [1996].), in which the foreign corporation entered into a 'Representative Agreement' and a 'Licensing Agreement' with a domestic corporation, by virtue of which the latter was appointed 'exclusive representative' in the Philippines for a stipulated commission. Pursuant to these contracts, the domestic corporation sold products exported by the foreign corporation and put up a service center for the products sold locally. This Court held that these acts constituted doing business in the Philippines. The arrangement showed that the foreign corporation's purpose was to penetrate the Philippine market and establish its presence in the Philippines.

In addition, BMW held out private respondent Hahn as its exclusive distributor in the Philippines, even as it announced in the Asian region that Hahn was the 'official BMW agent' in the Philippines." *(Hahn vs. Court of Appeals, 266 SCRA 537 [1997].)*

Agency distinguished from bailment.

While a bailment[22] is frequently incident to the relation of principal and agent, as for example, where property is entrusted to another with authority to sell, ordinarily in cases of bailment, the relation of principal and agent does not exist as the bailor has no control over the bailee beyond what is given him by contract, and is not responsible to others for his acts. A bailee over whose actions the bailor has no control is not an agent, even though he acts for the benefit of the bailor, and a bailee acting on behalf of himself and whose interests are antagonistic to those of his bailor cannot be the agent of the bailor. (2 C.J.S. 1027.)

There are two other essential characteristics of agency that are not present in bailment, to wit: the bailee is possessed of no

[22]The delivery of property of one person to another in trust for a specific purpose with a contract, express or implied, that the trust shall be faithfully executed and the property returned or duly accounted for when the special purpose is accomplished or kept until the bailor reclaims it. (3 R.C.L. 73.) It contemplates the transfer of possession to a recipient, called the bailee, who is not subservient to the will of the bailor, except, in the usual case, in so far as the bailee is obliged to pay for the use of the object entrusted to his possession. (Teller, *op. cit.*, p. 24.)

power to bind the bailor in personal liability and he owes neither loyalty nor obedience to the bailor. A bailee, however, may be constituted an agent as to third parties, where, for example, he is vested with ostensible authority to sell or to make binding contracts with respect to the subject matter of the bailment. (see Teller, *op. cit*., p. 24.)

Agency distinguished from guardianship.

The distinctions are:

(1) While the agent derives his authority from his principal, the guardian,[23] although he acts for and on behalf of his ward, does not derive his authority so to act from the ward (2 C.J.S. 1027.);

(2) The relation of principal and agent is founded upon consent of the parties thereto, while that of guardian and ward may be created irrespective of the consent or capacity of the ward;

(3) Agents are subject to the control of their principals, while guardians are not subject to the direction of their wards;

(4) A legal guardian is substituted by law, while ordinarily an agent is the appointee of the principal and his power may at any time be abrogated or modified by the principal (see 3 Am. Jur. 2d 421.); and

(5) While an agent represents one who has capacity to contract for himself where he present, a guardian represents one who has no such capacity.

Agency distinguished from trust.

The essential distinctions between a trust[24] and an agency are found ordinarily in the fact that in a trust, the title and control

[23]The term "guardianship" refers to the relationship existing between guardian and ward. A guardian is one who has or is entitled or legally appointed to the care and management of the person or estate of a minor or incompetent. (see Rules 93-95, Rules of Court.)

[24]Art. 1440. A person who establishes a trust is called the trustor; one in whom confidence is reposed as regards property for the benefit of another person is known as the trustee; and the person for whose benefit the trust has been created is referred to as the beneficiary.

of the property under the trust instrument passes to the trustee who acts in his own name, while the agent represents and acts for his principal and in the further fact that while a trust may ordinarily be terminated only by the fulfillment of its purpose, an agency may in general be revoked at any time. (2 C.J.S. 1034.)

Agency is formed with the thought of constant supervision and control by principal, whereas a trust is based on the idea of discretion in the trustee and guidance by the settler or *cestui* only to a limited extent and when expressly provided for. (Stephens vs. Detroit Trust Co., 278 N.W. 799.) But while trust is not an agency, it is possible for a trustee to be an agent also where extensive direction and control are kept over the trustee. (First Wisconsin Trust Co. vs. Wisconsin Dept. of Taxation, 294 N.W. 868, 870.) Incidentally, a director of a corporation acts in a "fiduciary capacity" but the relationship is not of trust but agency. (Bainbridge vs. Stoner, 106 P. 2d 423-426; see 2-A Words and Phrases 456-457.)

Agency distinguished from judicial administration.

The provisions of law on agency should not apply to a judicial administration.

A judicial administrator is appointed by the court. He is not only the representative of the said court, but also of the heirs and creditors of the estate. A judicial administrator, before entering into his duties, is required to file a bond. These circumstances are not true in case of agency. The agent is only answerable to his principal. The protection which the law gives the principal, in limiting the powers and rights of an agent, stems from the fact that control by the principal can only be through agreements; whereas, the acts of a judicial administrator are subject to specific provisions of law and orders of the appointing court. (San Diego, Sr. vs. Nombre, 11 SCRA 165 [1964].)

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)

Kinds of agency.

Agency may be classified as follows:

(1) *As to manner of its creation:*

(a) *express.* — one where the agent has been actually authorized by the principal, either orally or in writing (Art. 1869.); or

(b) *implied.* — one which is 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 *(Ibid.)*, or from the acts of the agent which carry out the agency, or from his silence or inaction according to the circumstances. (Art. 1870.) An implied agency is an *actual* agency as much as an express agency.

The enumeration of cases of implied agency in Articles 1869 and 1870 is not exclusive.

Ratification may produce the effect of an express or implied agency.[25] It results in *agency by ratification.* (see Arts. 1901, 1910, par. 2.) The principal cannot deny the existence of the agency after third parties, relying on his conduct, have had dealings

[25]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. 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)

with the supposed agent. This method of creating an agency is known as *agency by estoppel or implication.* (see Art. 1911.)

An agency may exist by operation of law. (see Arts. 1884, par. 2; 1885, 1929, 1931, and 1932.)

(2) *As to its character:*

(a) *gratuitous.* — one where the agent receives no compensation for his services (Art. 1875.); or

(b) *compensated or onerous.* — one where the agent receives compensation for his services. *(Ibid.)*

(3) *As to extent of business covered:*

(a) *general.* — one which comprises all the business of the principal (Art. 1876.); or

(b) *special.* — one which comprises one or more specific transactions. *(Ibid.)*

(4) *As to authority conferred:*

(a) *couched in general terms.* — one which is created in general terms and is deemed to comprise only acts of administration (Art. 1877.); or

(b) *couched in specific terms.* — one authorizing only the performance of a specific act or acts. (see Art. 1878.)

(5) *As to its nature and effects:*

(a) *ostensible or representative.* — one where the agent acts in the name and representation of the principal (Art. 1868.); or

(b) *simple or commission.* — one where the agent acts in his own name but for the account of the principal.

Form of agency.

The usual method an agency is created is by contract which may be oral, written, or implied. There are some provisions of law which require certain formalities for particular contracts. The first is when the form is required for the validity of the contract; the second, when it is required to make the contract effective against third persons such as those mentioned in Articles 1357

and 1358 of the Civil Code; and the third, when it is required for the purpose of proving the existence of a contract such as those provided in the Statute of Frauds in Article 1403. (Lim vs. Court of Appeals, 254 SCRA 170 [1996].)

(1) In general, there are no formal requirements governing the appointment of an agent. The agent's authority may be oral or written. It may be in public or private writing. An instance when the law requires a specific form for the agency is Article 1874.

(2) Agency may even be implied from words and conduct of the parties and the circumstances of the particular case. (Arts. 1869-1872.) But agency cannot be inferred from mere relationship or family ties. (Sidle vs. Kaufman, 345 Pa. 549.) Thus, it has been held that a father who was unable to drive an automobile but who purchased one for pleasure and convenience of family was not liable for injuries inflicted by the automobile while driven by an adult son with the father's permission on trip to make arrangements for son's approaching marriage, as no "agency" of son for father was created. (Hildock vs. Grosso, 566 Pa. 222.)

EXAMPLES:

(1) *Acts of principal.* — A sold the goods belonging to P without the consent of the latter. With knowledge of the facts, P received the proceeds of the sale and even gave A a commission.

The acts of P constitute ratification (Art. 1317, par. 2.), thereby giving the contract the same effect as if he had originally authorized it.

(2) *Principal's silence or lack of action, or failure to repudiate agency.* — P's property was being administered by A. Later, B took charge of the administration of said property through the designation by A who had to absent himself from the place for reasons of health. P did not oppose the designation of B nor did P appoint a new agent although the designation was expressly communicated to him. He remained silent for nearly nine years allowing B to take charge of the property.

It must be concluded that B acted by virtue of an implied agency equivalent to a legitimate agency, tacitly conferred by P. (See De la Peña vs. Hidalgo, 16 Phil. 450 [1950].)

As indicated in Article 1869, the principal must know "that another person is acting on his behalf without authority" for an agency to be implied.

ILLUSTRATIVE CASE:

Vendees a retro did not repudiate the deed of repurchase signed by their son-in-law.

Facts: On April 7, 1938, S sold a parcel of land to P with right of repurchase within ten (10) years from the date of sale. On November 28, 1945, A, son-in-law of P, signed a document wherein it is stated that P has allowed the representative of S in the name of EA to repurchase the land, that P has received together with A the redemption price; and that S has repurchased the land. P, however, was not a signatory to the deed and there is nothing in said document showing that A was specifically authorized to act for and in behalf of P, the vendee *a retro.*

According to P, A signed the document merely to show that he had no objection to the repurchase and that A did not receive the redemption price inasmuch as he had no authority from P. On the other hand, S claimed that A signed the deed in representation of his father-in-law (P) who was then seriously sick and that A received the repurchase price. It appears that from the execution of the repurchase document, S has been in possession of the property, land taxes have been paid by him, and P never repudiated the deed that A had signed.

Issue: Has S validly exercised his right of repurchase?

Held: Yes. "If, as alleged, S exerted no effort to procure the signature of P after he had recovered from his illness, neither did P repudiate the deed that A had signed. Thus, an implied agency must be held to have been created from his silence or lack of action, or his failure to repudiate the agency." *(Conde vs. Court of Appeals, 119 SCRA 245 [1982].)*

Appointment of agent.

It is not essential that an agent should be appointed directly by the principal, but the appointment may be made through

another,[26] as by referring an applicant to another and representing that he has authority to act, or the relation may arise out of an agreement to employ the agent of another, such person then becoming the agent of the first party.

An agent appointed by the directors of a corporation to act for the corporation is an agent of the corporation and not of the directors. (2 C.J.S. 1044-1045.)

Presumption of agency.

(1) *General rule.* — Agency is generally not presumed. The relation between principal and agent must exist as a fact. Thus, it is held that where the relation of agency is dependent upon the acts of the parties, the law makes no presumption of agency, and it is always a fact to be proved, with the burden of proof resting upon the person alleging the agency to show, not only the fact of its existence, but also its nature and extent. (Antonio

[26]Sec. 6. *Duty of court to inform accused of his right to counsel.* — Before arraignment, the court shall inform the accused of his right to counsel and shall ask him if he desires to have one. Unless the accused is allowed to defend himself in person or has employed counsel of his choice, the court must assign a counsel *de oficio* to defend him. (Rule 116, Rules of Court.)

Sec. 13. *Appointment of counsel de oficio for accused on appeal.* — It shall be the duty of the clerk of court of the trial court, upon the filing of a notice of appeal to ascertain from the appellant, if confined in prison, whether he desires the Regional Trial Court, Court of Appeals or the Supreme Court to appoint a counsel *de oficio* and to transmit with the record, upon a form to be prepared by the clerk of court of the appellate court, a certificate of compliance with this duty and of the response of the appellant to his inquiry. (Rule 122, Rules of Court.)

Sec. 2. *Appointment of counsel de oficio for the accused.* — If it appears from the record of the case as transmitted: (a) that the accused is confined in prison, (b) without counsel *de parte* on appeal, or (c) has signed the notice of appeal himself, the Clerk of Court of the Court of Appeals shall designate a member of the bar to defend him, such designation to be made by rotation, unless otherwise directed by order of the court.

An accused-appellant not confined in prison shall not be entitled to a counsel *de oficio,* unless the appointment of such counsel is requested in the appellate court within ten (10) days from receipt of the notice to file brief and the right thereto is established by affidavit. (Rule 124, Rules of Court.)

Art. 381. When a person disappears from his domicile, his whereabouts being unknown, and without leaving an agent to administer his property, the judge, at the instances of an interested party, a relative, or a friend, may appoint a person to represent him in all that may be necessary.

This same rule shall be observed when under similar circumstances the power conferred by the absentee has expired. (181a)

vs. Enriquez, [C.A.] 51 O.G. 3536; Lopez vs. Tan Tioco, 8 Phil. 693 [1907]; Harry E. Keller Elec. Co. vs. Rodriguez, 44 Phil. 19 [1922].)

It is a rule that whatever statements or communications made by the parties (supposed principal and agent) between them, if anything thereto appears contrary to their intention, the latter will always prevail. (3 C.J.S. 252.)

(2) *Exceptions.* — A presumption of agency may arise, however, in those few cases where an agency may arise by operation of law[27] (3 Am. Jur. 706.) or to prevent unjust enrichment. Thus, it has been held that a shipper may be held liable for freightage on bills of ladings signed by another person where the shipper appears as shipper or consignee, on bills of lading where other persons appear as shippers, and on unsigned bills of lading, where the evidence shows that the goods shipped actually belong to such shipper. (Compania Maritima vs. Limson, 141 SCRA 407 [1986].)

Authority of attorney to appear on behalf of his client.

(1) *Authority in an action presumed.* — The pertinent provisions of Rule 138 of the Rules of Court state:

> "SEC. 21. *Authority of attorney to appear.* — An attorney is presumed to be properly authorized to represent any cause in which he appears, and no written power of attorney is required to authorize him to appear in court for his client, but the presiding judge may, on motion of either party and on reasonable grounds therefor being shown, require any attorney who assumes the right to appear in a case to produce or prove the authority under which he appears, and to disclose, whenever pertinent to any issue, the name of the

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

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

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

person who employed him, and may thereupon make such order as justice requires. An attorney wilfully appearing in court for a person without being employed, unless by leave of the court, may be punished for contempt as an officer of the court who has misbehaved in his official transactions.

SEC. 22. *Attorney who appears in lower court presumed to represent client on appeal.* — An attorney who appears *de parte* in a case before a lower court shall be presumed to continue representing his client on appeal, unless he files a formal petition withdrawing his appearance in the appellate court.

SEC. 23. *Authority of attorneys to bind clients.* — Attorneys have authority to bind their clients in any case by any agreement in relation thereto made in writing, and in taking appeals, and in all matters of ordinary judicial procedure. But they cannot, without special authority, compromise their client's litigation, or receive anything in discharge of a client's claim but the full amount in cash."

(2) *Scope of authority.* — An act performed by counsel within the scope of a "general or implied authority" is regarded as an act of the client. Consequently, the mistake or negligence of counsel may result in the rendition of an unfavorable judgment against the client. While the application of this general rule certainly depends upon the surrounding circumstances of a given case, there are recognized exceptions:

(a) Where reckless or gross negligence of counsel deprives the client of due process of law;

(b) When its application will result in outright deprivation of the client's liberty or property; or

(c) Where the interests of justice so require. (Air Phil. Corp. vs. International Business Aviation Services Phils., Inc., 438 SCRA 51 [2004].)

(3) *Authority outside of court.* — The relation of attorney and client is, in many respects, one of agency and the ordinary rules of agency apply to such relation. The extent of authority of a lawyer, when acting on behalf of his client outside of court is measured by the same test as that which is applied to an ordinary agent. Thus, in a case, the respondent lawyer who actively

participated in representing complainant and his co-heirs in a pending homestead patent application, could himself acquire the certificates of title and other documents without need of a special power of attorney from them. (Uytengsu II vs. Baduel, 477 SCRA 621 [2005].) But a lawyer (counsel) acts beyond the scope of his authority in questioning the compromise agreement entered into by his client for a client has the right to compromise a suit without the intervention of his lawyer the only qualification being that if such compromise is entered into with the intent of defrauding the lawyer of the fees justly due him, in which case the compromise must be subject to such fees. (J. Phil. Maine, Inc. vs. National Labor Relations Commission, 561 SCRA 675 [2008].)

ILLUSTRATIVE CASE:

Client confirmed in an affidavit authority of counsel to file petition in question, even as the filing was made before the date of execution of power of attorney.

Facts: On November 5, 1962, the law firm of A filed with the Philippine Patent Office a petition on behalf of P which petition was dismissed by the Director of Patents on the ground that on the date it was filed, A was not yet authorized by P to file the said pleading as the power of attorney was executed by P only on November 12, 1962. The petition was filed pursuant to a cablegram from P's patent agents in the United States.

In its motion for reconsideration, A attached an affidavit of P which states that the cablegram from its American agents was duly authorized. The motion was denied.

Issue: Was A authorized to represent P when A filed the petition on November 5, 1962?

Held: The relationship between counsel and client is strictly a personal one. It is a relationship the creation of which courts and administrative tribunals cannot but recognize on the faith of the client's word, especially when no substantial prejudice is thereby caused to any party. *(Pittsburgh Plate Glass Co. vs. The Director of Patents, 56 SCRA 243 [1974].)*

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)

Form of acceptance by agent.

Since agency is a contract, there must be consent by both parties. An agency is either express or implied, and this is true on the part of the principal (Art. 1869.) as well on that of the agent. (Art. 1870.) It does not depend upon express appointment and acceptance.

> "Articles 1870 to 1873 are new provisions concerning the constitution of an agency." (Report of the Code Commission, p. 149.)

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)

Acceptance between persons present.

As regards implied acceptance by the agent, the law distinguishes between cases (1) where persons are present (Art. 1871.) and (2) where persons are absent. (Art. 1872.) The agency is impliedly accepted if the agent receives a power of attorney from the principal himself personally without any objection, both being present.

The presumption of acceptance may be rebutted by contrary proof.

Definition and purpose of a power of attorney.

(1) A *power of attorney* is an instrument in writing by which one person, as principal, appoints another as his agent and confers upon him the authority to perform certain specified acts or kinds of acts on behalf of the principal. The written authorization itself is the power of attorney, and this is clearly indicated by the fact that it has also been called a "letter of attorney."

(2) Its primary purpose is not to define the authority of the agent as between himself and his principal but to evidence the authority of the agent to third parties within whom the agent deals; and the person holding a power of attorney is shown and

designated as an "attorney-in-fact," thus distinguishing such person from an attorney-at-law (3 Am. Jur. 2d 433.), a lawyer.

Except as may be required by statute, a power of attorney is valid although no notary public intervened in its execution.[28] (see Reyes vs. Santiago, C.A.-G.R. Nos. 47996-7-R, Nov. 27, 1975; see Angeles vs. Phil. National Railways, 500 SCRA 744 [2006].)

Construction of powers of attorney.

(1) *Rule of strict construction.* — It is the general rule that a power of attorney must be strictly construed and strictly pursued. Under this rule, the instrument will be held to grant only those powers which are specified and defined, and the agent may neither go beyond nor deviate from the power of attorney. In other words, the act done must be legally identical with that authorized to be done. Moreover, where the mode of exercising a power is prescribed in the instrument in which it is created, there must be a strict compliance therewith in every substantial particular.[29] This is but in accord with the disinclination of courts to enlarge the authority granted.

(2) *Qualification of the rule.* — The rule is not absolute and should not be applied to the extent of destroying the very purpose of the power. If the language will permit, a construction should be adopted which will carry out, instead of defeat, the purpose of the appointment. Even if there are repugnant clauses in a power of attorney, they should be reconciled, if possible, so

[28]A special power of attorney executed in a foreign country is generally not admissible in evidence as a public document in our courts. (Teotoco vs. Metropolitan Bank & Trust Co., 575 SRA 82 [2008]; see Sec. 25, Rule 132, Rules of Court.)

[29]Sec. 9. *Evidence of written agreements.* — When the terms of an agreement have been reduced to writing, it is considered as containing all the terms agreed upon and there can be, between the parties and their successors-in-interest, no evidence of such terms other than the contents of the written agreement.

However, a party may present evidence to modify, explain or add to the terms of the written agreement if he puts in issue in his pleading:

(a) An intrinsic ambiguity, mistake or imperfection in the written agreement;

(b) The failure of the written agreement to express the true intent and agreement of the parties thereto;

(c) The validity of the written agreement; or

(d) The existence of other terms agreed to by the parties or their successors in interest after the execution of the written agreement.

The term "agreement" includes wills. (Rule 130, Rules of Court.)

as to give effect to the instrument in keeping with its general intent or predominant purpose. Furthermore, the instrument should always be deemed to give such powers as are essential or usual and reasonably necessary and proper in effectuating the express powers. (3 Am. Jur. 2d., 437-438; Angeles vs. Philippine National Railways, 520 SCRA 444 [2006]; Mercado vs. Allied Banking Corporation, 528 SCRA 444 [2007].)

EXAMPLES:

(1) P gave A a written power of attorney to sell a parcel of land. The contract describes the property, provides in a general way the terms of the sale, and specifies A's commission. Is A also authorized to sign a contract of sale in behalf of P?

No. The power of a real estate broker or agent ordinarily extends only to finding a purchaser. Unless clearly authorized by his contract of employment to so sign a contract of sale so as to bind his employer, a broker or agent cannot so bind him. (See Brown vs. Hogan, 138 Md. 257, 113 A. 756 [1919].)[30]

(2) P authorized A to sell the former's horse and to receive the stipulated price. Is A also authorized to bind P by a warranty of title and soundness?

Yes. A, being empowered to sell, is entrusted with all powers proper for effectuating the sale, and a warranty of title and quality is both proper and a usual power for that purpose. The warranty may fairly be presumed within the scope of A's authority. (See Alexander vs. Gibson, 2 Camp. 555 [1811], cited in Cooley vs. Perrine, 41 N.J. 322 [1879], which held a contrary view.)

ILLUSTRATIVE CASES:

1. *Agent, who was authorized in writing to sell pianos of principal, sold a piano borrowed from the latter, to a person who acted in good faith.*

Facts: A piano was hired by P to A who later, sold the piano. The contract of bailment was in writing. A was at the same time, constituted by P as his agent to sell pianos and organs;

[30]Unless otherwise indicated, subsequent illustrative American and English cases have been adopted from Mechem, Selected Cases on the Law of Agency (3rd ed.).

and the authority was also in writing. It was provided that A was "to make all orders for the same to P" and that "the pianos are to be sent direct from the factory."

T purchased the piano in question from A without any notice of the limited agency or her want of authority to sell.

Issue: Did the sale confer title to the piano on T?

Held: No. The sale by A was an unauthorized conversion. The contract of letting for hire expressly took it out of the operation of the other agreement authorizing sales of pianos. Furthermore, it was clearly contemplated by the contract of agency that A was "to make all orders" to P for such pianos as might be sold, and that they were to be shipped "direct from the factory" by P.

Powers of attorney are ordinarily subjected to a strict construction as to preclude all authority not expressly given, or necessarily to be inferred. *(Cummins vs. Beaumont, 68 Ala. 204 [1880].)*

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2. *A retail dealer of pianos, acting as agent of manufacturer, sold a piano to a person from whom the piano is sought to be recovered by the manufacturer for not having received payment from the retail dealer.*

Facts: P, a manufacturer of pianos and organs, delivered the piano in question to A under a contract in writing signed by A in which he agreed "to sell the same [said piano] for account of P in cash" and they agreed that said piano should remain the property of P until paid for. P never received any payment from A for said piano which was sold to T.

Issue: Is P entitled to recover the piano from T?

Held: No. T had no knowledge of the existence of the contract between P and A. A was the consignee of the piano for the express purpose of selling it. He was a regular retail dealer in musical instruments. Having been entrusted with the possession of the piano as a retail dealer in goods of that kind with power and authority to sell, the sale by A to T, an innocent purchaser for value, should prevail against the reserved title of P.

In the *Cummins* case, *supra*, the agent was not a retail dealer in musical instruments, but a mere agent to solicit orders for such instruments to be filled directly by the principal. *(Bent vs. Jerkins, 112 Ala. 485, 20 SO 655 [1895].)*

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)

Acceptance between persons absent.

If both the principal and the agent are absent, acceptance of the agency by the agent is not implied from his silence or inaction. Since the agent is not bound to accept the agency, he can simply ignore the offer.

However, in the two cases mentioned in Article 1872, agency is implied. Thus, there is implied acceptance if the agent writes a letter acknowledging receipt of the power of attorney but offers no objection to the creation of the agency. (No. 1.) But his mere failure to give a reply does not mean that the agency has been accepted unless the "power of attorney is with respect to the business in which he is habitually engaged as an agent" (No. 2.),[31] or the acceptance could be inferred from his acts which carry out the agency (Art. 1870.) as when he begins to act under the authority conferred upon him.

It should be noted that under Article 1872, the principal *transmits* the power of attorney to the agent. In Article 1871, he personally *delivers* the power of attorney to the agent.

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.

[31]Under the Rules of Court, it is disputably presumed "that a letter duly directed and mailed was received in the regular course of the mail." (Sec. 3[v], Rule 131.)

The power shall continue to be in full force until the notice is rescinded in the same manner in which it was given. (n)

Communication of existence of agency.

There are two ways of giving notice of agency with different effects:

(1) If by special information (*e.g.*, by letter), the person appointed as agent is considered such with respect to the person to whom it was given.

(2) If by public advertisement, the agent is considered as such with regard to any person. Public advertisement may be made in any form — through the newspaper, radio, etc. and by posters or billboards.

In either case, the agency is deemed to exist whether there is actually an agency or not.

Manner of revocation of agency.

The power of attorney must be revoked in the same manner in which it was given. (par. 2.)

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. (Art. 1921.) 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. (Art. 1922.) Nevertheless, revocation made in any manner is effective where the person dealing with the agent has actual knowledge thereof; otherwise, bad faith and fraud would be committed.

EXAMPLE:

P especially informs X that he has given A a power of attorney. With respect to X, A thereby becomes a duly authorized agent of P. To rescind the power of attorney, P must give notice in the same manner in which he was given, namely, by special information to X.

Public advertisement is not sufficient unless X has actual knowledge of the revocation. But if P makes known the appointment of A by public advertisement, termination of the agency by special information to X or by public advertisement is effective against him.

ILLUSTRATIVE CASES:

1. *Principal terminated his relations with his agent without giving notice to one who was especially informed of agent's authority to act on his behalf.*

Facts: P sent a letter to B informing that he has opened in his steamship office "a shipping and commission department for buying and selling leaf tobacco and other native products" and that he had conferred upon A a public power of attorney "to perform in my name and on my behalf all acts necessary for carrying out my plans" with a request to "make due note of his (A's) signature hereto affixed." Accepting the invitation, B proceeded to do a considerable business with P through A, as his factor.

A converted to his own use part of the proceeds from the sale of tobacco leaf which were sent by B to A. Prior to the sending of said tobacco, P had severed his relations with A, which fact was not known to B and no notice of any kind was given to B of the termination of the relations between P and A.

Issue: Is P liable for A's conversion?

Held: Yes. Having advertised the fact that A was his agent and given B a special invitation to deal with A, it was the duty of P on the termination of the relationship of principal and agent to give due and timely notice thereof to B. Failing to do so, P is responsible to B for whatever the latter may have in good faith and without negligence sent to A without knowledge, actual or constructive, of the termination of such relationship. *(Rallos vs. Yangco, 20 Phil. 269 [1911].)*

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2. *A note was indorsed on behalf of a bank in favor of a person who did not know of the indorser's resignation as president of the bank.*

Facts: A resigned as president of P (bank). Subsequently, A indorsed in favor of T a note on behalf of P. T, who had dealt

with P while A was President, did not know of A's resignation. P denied A's authority to endorse.

The only evidence adduced to prove notice of the termination of such authority as A had was oral testimony to the publication of a notice of the resignation in a newspaper.

Issue: In the absence of proof that the notice was seen and read by T, who denied he ever saw it, is the notice sufficient?

Held: No. On the termination of an agency, persons who have dealt with the principal through the agent may continue to do so, in the absence of knowledge of the fact, and the principal will be bound by the acts of the former agent as fully as if his authority had not ceased.

The duty of the principal to notify third persons of the termination of the agency is of the same character and requires the same degree of certainty as that which the law imposes upon the members of a co-partnership in the case of a dissolution as a measure of protection from liability by reason of subsequent acts of the former members of the dissolved firm.[32] *(Union Bank & Trust Co. vs. Long Pole Lumber Co., 70 W. Va. 558, 74 S.G. 674 [1912].)*

Estoppel to deny agency.

(1) *Estoppel of agent.* — One professing to act as agent for another may be estopped to deny his agency both as against his asserted principal and the third persons interested in the transaction in which he engaged.

(2) *Estoppel of principal:*

(a) *As to agent.* — one who knows that another is acting as his agent and fails to repudiate his acts, or accepts the benefits of them, will be estopped to deny the agency as against such other.

(b) *As to sub-agent.* — to estop the principal from denying his liability to a third person, he must have known or be charged with knowledge of the fact of the transaction and the terms of the agreement between the agent and sub-agent.

[32]See Art. 1834, Chap. 3, Part 1.

(c) *As to third persons.* — one who knows that another is acting as his agent or permitted another to appear as his agent, to the injury of third persons who have dealt with the apparent agent as such in good faith and in the exercise of reasonable prudence, is estopped to deny the agency.

(3) *Estoppel of third persons.* — A third person, having dealt with one as an agent may be estopped to deny the agency as against the principal, agent, or third persons in interest. He will not, however, be estopped where he has withdrawn from the contract made with the unauthorized agent before receiving any benefits thereunder. (see 2 C.J.S. 1062-1067.)

(4) *Estoppel of the government.* — The government is neither estopped by the mistake or error on the part of its agents. (Pineda vs. CFI of Tayabas, 52 Phil. 803 [1959].) But it may be estopped through affirmative acts of its officers acting within the scope of their authority. (Bachrach vs. Unson, 50 Phil. 981 [1957].)

Agency by estoppel and implied agency distinguished.

Agency by estoppel (see Art. 1911.) should be distinguished from implied agency. (see Arts. 1881-1882.)

(1) *Existence of actual agency.* — In the latter, there is an actual agency, as much as if it were created by express words. The principal alone is liable. In an agency by estoppel, there is no agency at all, but the one assuming to act as agent has apparent or ostensible, although not real, authority to represent another. It is not a real agency as is one under express or implied authority.

(a) If the estoppel is caused by the principal, he is liable to any third person who relied on the misrepresentation. Our Supreme Court has said: "One who clothes another with apparent authority as his agent, and holds him out to the public as such, cannot be permitted to deny the authority of such person to act as his agent to the prejudice of innocent third parties dealing with such person in good faith and in the honest belief that he is what he appears to be." (Macke vs. Camps, 7 Phil. 553 [1907]; Naguiat vs. Court of Appeals, 412 SCRA 591 [2003].)

(b) If the estoppel is caused by the agent, then only the agent is liable.

(2) *Reliance by third persons.* — Agency by estoppel can be invoked only by a third person who in good faith relied on the conduct of the principal in holding agent out as being authorized, while such reliance is not necessary in an implied agency since in such case, the agent is a real agent. As to third persons, the principal is equally liable in the case of agency by estoppel and implied agency.

(3) *Nature of authority.* — As between the principal and the agent, the distinction between the two kinds of agency is vital.

(a) An agent by implied appointment is a real agent with all the rights and liabilities; he has actual authority to act on behalf of the principal. An apparent agent, an agent by estoppel, is no agent at all, and as against the principal, has none of the rights of an agent (2 C.J.S. 1050-1051.), except where the principal's conduct or representations are such that the agent reasonably believed that the principal intended him to act as agent in the matter.

(b) Implied agency, being an actual agency, is a fact to be proved by deductions or inferences from other facts, while in a strict sense, agency by estoppel should be restricted to cases in which the authority is not real but apparent. (2-A Words and Phrases 461.)

Agency by estoppel is well recognized in the law. If the estoppel is on the ground of negligence or fraud on the part of the principal, the agency is allowed upon the theory that, when one of two innocent persons must suffer loss, the loss should fall upon him whose conduct brought about the situation. (*Ibid.*, 459.)

EXAMPLES:

(1) Agency may be implied, when considered with all the attending circumstances from the fact that: legal title has been placed in the name of another; one is placed in charge of another's business to conduct it for him; one is placed in possession of personal property belonging to another; one is

given money to invest or pay over to another; one is given a note for collection or to receive payment thereon; an account against a third party is placed in the hands of a person for collection; etc.

But mere possession of a note is not enough to show an agency as where the note is left by the signer for his convenience. One is not made the agent of the purchaser simply by having been placed in possession of goods sold until such time as the agent of the purchaser should arrive. (*Ibid*., 1046-1047.)

(2) P tells T that A is authorized to sell certain merchandise. P privately instructs A not to consummate the sale but merely to find out the highest price T is willing to pay for the merchandise. If A makes a sale to T, the sale is binding on P who is in estoppel to deny A's authority.

In this case, there is no agency created but there is a *power* created in A to create contractual relations between P and T, without having *authority* to do so. The legal result, however, is the same as if A had authority to sell.

(3) P authorized A to sell the former's car. A sold the car to T who paid A the purchase price. However, A did not give the money to P.

T is not liable to P. A has implied authority to receive payment.

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)

Sale of land through agent.

As a general rule, the agent's authority may be oral or written. (Art. 1869.) An agency to sell on commission basis does not belong to any of the categories of contracts for which the law (see Arts. 1357, 1358, 1403.) requires certain formalities; hence, it is valid and enforceable in whatever form it may be entered into. (Lim vs. Court of Appeals, 254 SCRA 170 [1996].)

Under this article, the sale of a piece of *land* (not any other real estate) or any interest thereon, like usufruct, mortgage, etc., through an agent is void unless the authority of the agent to sell

is in writing. (Cosmic Lumber Corp. vs. Court of Appeals, 265 SCRA 168 [1996].) It should, however, be considered as merely voidable since the sale can be ratified by the principal (see Arts. 1901, 1910, par. 2.) such as by availing himself of the benefits derived from the contract.

(1) Article 1874 speaks only of an agency for "sale of a piece of land or any interest therein." It may be argued, therefore, that an agency to *purchase* need not be in writing. Such an agency, however, is covered by Article 1878(5) which provides that, "A special power of attorney is necessary to enter into any contract by which the ownership of an immovable is transmitted or acquired."

(2) Article 1874 refers to sales made by an agent for a principal and not to sales made by the owner personally to another, whether that other be acting personally or through a representative. (Rodriguez vs. Court of Appeals, 29 SCRA 419 [1969].)

(3) A real estate broker is not within Article 1874 where his authority (as is usual) is limited to finding prospective purchasers and does not extend to making a contract to pass title. (Babb & Martin, *op. cit*., p. 135.)

(4) A letter containing the specific authority to sell is held sufficient. (see Jimenez vs. Rabot, 38 Phil. 387 [1918].) But when there is any reasonable doubt that the language used conveys such power, no such construction shall be given the document. (Liñan vs. Puno, 31 Phil. 259 [1915]; Cosmic Lumber Corp. vs. Court of Appeals, *supra.*)

(5) The express mandate required by law to enable an appointee of an agency couched in general terms to sell must be one that expressly mentions a sale or that includes a sale as a necessary ingredient of the act mentioned. (Strong vs. Gutierrez Repide, 6 Phil. 680 [1906]; Cosmic Lumber Corp. vs. Court of Appeals, *supra.*)

The written authorization need not contain a particular description of the property which the agent is permitted to sell.

(a) Thus, the power giving to the agent the power to sell "any or all tracts, lots, or parcels" of land belonging to the principal is adequate. *(Ibid.)*

(b) Similarly, a power of attorney stating that "I hereby confer sufficient power x x x upon A, in order that in my name and representation he may administer the interest I possess within this Municipality of Tarlac, purchase, sell, collect and pay, etc." was held sufficient to cover the sale by the agent of land of the principal in Tarlac. (Liñan vs. Puno, 31 Phil. 259 [1915].)

(c) The authority to sell any kind of realty that "might belong" to the principal was held to include also such as the principal might afterwards have during the time it was in force. (Katigbak vs. Tai Hing Co., 52 Phil. 622 [1928].)

(6) To authorize a conveyance of real estate, a power of attorney must be plain in its terms.

(a) Where such power is specifically conferred, it does not authorize a conveyance by the agent to himself; unless such power is expressly granted, it will not be implied. (Mechem, Selected Cases on the Law of Agency [3rd ed.], pp. 142-143; see Art. 1491[2].)

(b) Where the power of attorney says that the agent can enter into any contract concerning a land, or can sell the land under any term or condition and covenant he may think fit, the power granted is so broad that it practically covers the celebration of any contract and the conclusion of any covenant or stipulation, and it undoubtedly means that the agent can act in the same manner and with same breadth and latitude as the principal could concerning the property. (P. Amigo and J. Amigo vs. S. Teves, 96 Phil. 252 [1954].)

(7) Where the co-owners of land affixed their signatures on the contract to sell, they were no longer selling their shares through an agent, but, rather, they were selling the same directly and in their own right, therefore, a written authority is no longer necessary in order to sell their shares in the subject land. (Oesmer vs. Paraiso Development Corporation, 514 SCRA 228 [2007].)

Under Article 1403 (No. 2, par. [e].) of the Civil Code, an oral agreement for the sale of real property or of an interest therein is unenforceable even if there is no agent.

ART. 1875. Agency is presumed to be for a compensation, unless there is proof to the contrary. (n)

Agency presumed to be with compensation.

This article changes the rule in the old Civil Code (Art. 1711.) under which an agency was presumed to be gratuitous. Hence, the agent does not have to prove that the agency is for compensation.

The *prima facie* presumption that the agency is for a compensation may be contradicted by contrary evidence.

ILLUSTRATIVE CASES:

1. *Non-members of a labor union which obtained benefits for all members and non-members, workers, refused to pay agency fee of the union.*

Facts: NB (labor union) is the bargaining representative of all regular workers paid on the daily basis of SMB (San Miguel Brewery, Inc.). Having obtained benefits for all workers of SMB, it signed a collective bargaining agreement with SMB which provided among others that SMB will deduct the NB agency fee from the wages of workers who are not members of NB provided the aforesaid workers authorized SMB to make such deduction in writing or if no such authorization is given, if directed by a competent court.

In view of the refusal of W (an independent worker's association in SMB) to pay the union agency fee and of SMB to deduct the said agency fee from the wages of workers who are not members of NB, NB brought action for the collection of the same under the bargaining contract.

Issue: May the collection of the union agency fee be justified on the principle of agency?

Held: (1) *Benefits of collective bargaining agreement accrue to all employees.* — No. It is true that whatever benefits the majority union obtains from the employer accrue to its members as well as to its non-members. But the above does not justify the collection of agency fee from non-members. For the benefits of a collective bargaining agreement are extended

to all employees regardless of their membership in the union because to withhold the same from the non-members would be to discriminate against them. The benefits that accrue to non-members by reason of the agreement can hardly be termed as "unjust enrichment" (see Art. 2142.) because the same are extended to them precisely to avoid discrimination.

(2) *Responsibility of bargaining agent to represent all employees.* — When a union acts as the bargaining agent, it assumes the responsibility imposed upon it by law to represent not only its members but all employees in the appropriate bargaining unit of which it is an agent. Article 1875 states that agency is presumed to be for compensation unless there is proof to the contrary. There can be no better proof that the agency created by law between the bargaining representative and the employees in the unit is without compensation than the fact that these employees in the minority voted against the NB union. *(National Brewery & Allied Industries Labor Union of the Phils. vs. San Miguel Brewery, Inc., 8 SCRA 805 [1963].)*

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2. *Agent seeks compensation for services rendered to a committee created by creditor banks to reorganize an insolvent company indebted to the banks to one of which he is counsel.*

Facts: Several creditor banks of an insolvent company appointed a committee to formulate and execute a plan for the reorganization of the insolvent company. A, counsel to P, one of the creditor banks, was a member of the committee. An action is brought by A against defendant creditor banks to recover compensation for his services rendered to the committee.

Issue: Is A entitled to receive compensation?

Held: No. The general rule is that where service is rendered by one person for another at the latter's request and under circumstances which negate the idea that it is gratuitous, the law implies a promise to pay reasonable compensation therefor. But where the service is rendered with the understanding that it is gratuitous, the law does not raise an implied promise to pay therefor, no matter how valuable the service may be.

Here, A was acting not so much for the defendant creditor banks but mainly for P for which he was counsel, and the defendants had a right to suppose that his offer of service was gratuitous as to them, A being prompted in doing so by reason

of his agency relation with P. *(Robinson vs. Lincoln Trust, 95 N.J.L. 445, cited in Teller, pp. 151-152.)*

Necessity of compensation.

The relation of principal and agent can be created although the agent receives no compensation.

A person who agrees to act as an agent without compensation is a *gratuitous agent.* Ordinarily, the promise of a gratuitous agent to perform is not enforceable. He is, however, bound by his acceptance to carry out the agency. (Art. 1884, par. 1.) The fact that he is acting without compensation has no effect upon his rights and duties with reference to the principal and to third parties. However, the circumstance that the agency was for compensation or not, shall be considered by the court in determining the extent of liability of an agent for fraud or for negligence. (Art. 1909.)

The principal is liable for the damage to third persons caused by the torts of the gratuitous agent whose services he accepted.

Liability of principal to pay compensation.

(1) *Amount.* — The principal must pay the agent the compensation agreed upon, or the reasonable value of the agent's services if no compensation was specified.[33]

[33]Sec. 24. *Compensation of attorneys; agreement as to fees.* — An attorney shall be entitled to have and recover from his client no more than a reasonable compensation for his services, with a view to the importance of the subject matter of the controversy, the extent of the services rendered, and the professional standing of the attorney. No court shall be bound by the opinion of attorneys as expert witnesses as to the proper compensation, but may disregard such testimony and base its conclusion on its own professional knowledge. A written contract for services shall control the amount to be paid therefor unless found by the court to be unconscionable or unreasonable. (Rule 138, Rules of Court.)

Sec. 31. *Attorneys for destitute litigants.* — A court may assign an attorney to render professional aid free of charge to any party in a case, if upon investigation it appears that the party is destitute and unable to employ an attorney, and that the services of counsel are necessary to secure the ends of justice and to protect the rights of the party. It shall be the duty of the attorney so assigned to render the required service, unless he is excused therefrom by the court for sufficient cause shown. (Rule 138, Rules of Court.)

Sec. 32. *Compensation for attorneys de oficio.* — Subject to availability of funds as may be provided by law the court may, in its discretion, order an attorney employed as counsel *de oficio* to be compensated in such sum as the court may fix in accordance with Section

(2) *Compliance by agent with his obligations.* — The liability of the principal to pay commission presupposes that the agent has complied with his obligation as such to the principal.

Accordingly, a broker is entitled to the usual commissions whenever he brings to his principal a party who is able and willing to take the property and enter into a valid contract upon the terms then named by the principal, although the particulars may be arranged and the matter negotiated and consummated between the principal and the purchaser directly. It would be the height of injustice to permit the principal then to withdraw the authority as against an express provision of the contract, and reap the benefits of the agent's labors, without being liable to him for his commission. This would be to make the contract an unconscionable one, and would offer a premium for fraud by enabling one of the parties to take advantage of his own wrong and secure the labor of the other without remuneration. (Macondray & Co. vs. Sellner, 33 Phil. 370 [1916]; Lim vs. Saban, 447 SCRA 232 [2004]; Perez de Tagle vs. Luzon Surety Co., [C.A.] 28 O.G. 1213.)

A broker is never entitled to commission for unsuccessful efforts.

(a) Thus, a broker whose job is to effect a transaction in behalf of the principal is not entitled to commission even if he finds or first contacts the buyer, shows him the property involved, interests him in it, negotiates with him or even indirectly influences him to come to terms, if he did not succeed in bringing about the sale subsequently made on those terms by the principal to the same person through another broker. (Quijano vs. Esguerra, [C.A.] 40 O.G. [Sup. 11] 166.)

(b) A broker or agent engaged in the sale of real estate is not limited to bring vendor and vendee together and arranging the terms and conditions of a sale of real estate. He

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24 of this rule. Whenever such compensation is allowed, it shall not be less than thirty pesos (P30) in any case, nor more than the following amounts: (1) Fifty pesos (P50) in light felonies; (2) One hundred pesos (P100) in less grave felonies; (3) Two hundred pesos (P200) in grave felonies other than capital offenses; (4) Five hundred pesos (P500) in capital offenses. *(Ibid.)*

must bring about the consummation of the contract of sale as to be entitled to collect a commission. He is not entitled to compensation for merely perfecting the contract, unless that right is clearly stipulated in the agreement with the owner.

As sales of real estate must be in writing, the preparation of the necessary documents for the transfer of the property sold in the absence of any contrary agreement, is part of the functions of the broker. If he abandons the transaction before the execution of such documents, he is not entitled to commission. (Quijano vs. Soriano, 10 C.A. Rep. 198; J.M. Tuason & Co. vs. Collector of Internal Revenue, 108 Phil. 700 [1960].)

(c) An agent employed to secure a purchaser may sue for commission upon showing that a purchaser whom he secured bought his principal's property, even though the principal did not know that the agent had referred the purchaser; but he is not entitled to commission where the principal made a sale at a reduced price to one whom he believed in good faith to be unconnected with the broker. (Teller, p. 153, citing 142 A.L.R. 270; Offutt & Oldham vs. Winters, 227 Ky. 56.) Common practice is for a buyer to inform the seller who referred him. Likewise, agents working on commission basis will not normally pass up a commission by not informing their principal of a referred buyer. (People vs. Castillo, 333 SCRA 506 [2000].)

(3) *Procurring cause of the transaction.* — In many cases, complex negotiations are involved in which it is difficult to determine whether the agent has been the one responsible for the sale or purchase or other transaction. The governing rule is that the agent must prove that he was the guiding cause for the transaction or, as has been said, the "procuring cause" thereof, depending upon the facts of the particular case (Teller, *op. cit*., p. 153, citing Note, 36 Harv. L. Rev. 875.); otherwise, he is not entitled to the stipulated broker's commission. (Inland Realty Investment Service, Inc. vs. Court of Appeals, 273 SCRA 70 [1997].)

The term "procuring cause" in describing a broker's activity, refers to a cause originating a series of events which, without

break in their continuity, result in the accomplishment of the prime objective of the employment of the broker — producing a purchaser ready, willing and able to buy on the owner's terms. The broker's efforts must have been the foundation on which the negotiations resulting in a sale began. In other words, the broker must be instrumental in the consummation of the sale to be entitled to a commission. (Philippine Health Care Providers, Inc. vs. Estrada, 542 SCRA 616 [2008].)

ILLUSTRATIVE CASE:

Property was sold by another broker at a higher price after the first broker found would-be purchaser.

Facts: P agreed to pay A a commission of 5% if A could sell P's factory for P1,200,000.00. No definite period of time was fixed within which A should effect the sale. A found a person who intended to purchase such a factory as B was selling, but before such would-be purchaser definitely decided to buy the factory in question at the fixed price of P1,200,000.00, P had effected the sale for P1,300,000.00 through another broker.

Issue: Is A entitled to recover the P60,000.00 (5% of P1,200,000.00) for services rendered, assuming that he could have effected the sale if P had not sold the factory to someone else?

Held: No. He is not entitled to recover anything. The broker must be the efficient agent or procuring cause of the sale. The means employed by him and his efforts must result in the sale. The duty assumed by the broker is to bring the minds of the buyer and seller to an agreement for a sale, and the price and terms on which it is to be made, and until that is done his right to commission does not accrue.

A broker is never entitled to commissions for unsuccessful efforts. The risk of failure is only his. The reward comes only with his success. (*Dañon vs. Brimo & Co., 42 Phil. 133 [1921];* see also Reyes vs. Mosqueda, 99 Phil. 241 [1956]; Coll. of Internal Revenue vs. Tan Eng Hong, 18 SCRA 531 [1966].)

(4) *Evasion of commission in bad faith.* — The principal cannot evade the payment of the commission agreed upon by inducing the agent to sign a deed of cancellation of the written authority

given him after the agent had found a buyer who was able, ready, and willing to close the deal under the terms prescribed by the principal on the ground that she was no longer interested in the deal which was a mere subterfuge, and later selling the property to said buyer. Such act is unfair as would amount to bad faith, and cannot be sanctioned without according to the agent the compensation which is due him. The seller's withdrawal in bad faith of the broker's authority cannot unjustly deprive the broker of his commission as the seller's duly constituted agent. (Infante vs. Cunanan, 93 Phil. 693 [1953]; Lim vs. Saban, 447 SCRA 232 [2004].)

(5) *Compensation contingent on profits.* — Where the compensation is contingent or dependent upon the realization of profit, the agent is not entitled to compensation until the principal realizes the profit, and there is no profit as yet, through the mere signing of the contract of sale. (Fiege & Brown vs. Smith, Bell & Co., 43 Phil. 118 [1922].)

(6) *Reduction by principal of overprice.* — In a case, the principal agreed to give the sales agent a commission equivalent to the overprice. The principal accepted a lower price with the result that the principal was reduced from 2% to 1/2%. It was held that the principal was liable for only 1/2% overprice as commission in the absence of bad faith, fraud or fault on his part, which was not imputed to him. He would be liable for the difference if he accepted the reduced price to prejudice the agent. (Ramos vs. Court of Appeals, 63 SCRA 331 [1975].)

(7) *Commission payable by owner of property sold.* — In a sale of real property where a commission is payable to the agent, it is the owner and not the buyer who must pay. (see Goduco vs. Court of Appeals and M.B. Castro, 10 SCRA 275 [1964].)

(8) *Grant of compensation on equitable ground.* — The general rule is that a broker or agent is not entitled to any commission until he has successfully done the job given to him (see Ramos vs. Court of Appeals, *supra*.), especially where his authority had already expired. Conversely, where his efforts are unsuccessful or where there was no effort on his part, he has no right to demand compensation. An exception to the general rule is enunciated:

(a) Where it appears that the offer of the owner to sell his lands was formally accepted by the buyer after the exclusive authority in favor of the real estate broker to negotiate the sale had expired and the broker was not the efficient procuring cause in bringing about the sale, for the buyer "never wanted to be in any way guided by, or otherwise subject to, the mediation or intervention of the [broker] relative to the negotiation" as manifested by the request of the buyer to the broker not to be present in the meeting between the buyer and the owner, the court, while it denied the right of the broker to the payment of P1,380,000.00 as his professional fee as computed under the agency agreement, noting that the broker "had diligently taken steps to bring back together" the owner and the buyer to whom the owner previously had offered the sale of the property, granted in *equity* to the broker the sum of P100,000.00 by way of compensation for his efforts and assistance in the transaction which was finalized and consummated after the expiration of his exclusive authority. (Pratts vs. Court of Appeals, 81 SCRA 360 [1978].)

(b) With more reason, the broker or agent should be paid his commission where he was the sufficient procuring cause in bringing the sale,[34] where said agent, notwithstanding the expiration of his authority, nonetheless, took diligent steps to bring back together the parties such that a sale was finalized and consummated between them. (Prats vs. Court of Appeals, 81 SCRA 360 [1978]; Manotok Brothers, Inc. vs. Court of Appeals, 221 SCRA 224 [1993]; see Sanchez vs. Medicard Philippines, Inc., 469 SCRA 347 [2005].)

(9) *Right of agent's companion to compensation.* — Where there was no understanding, express or implied, between the principal and his agent that no part of the compensation to which the latter

[34]In *Dañon vs. Brimo (supra.),* claimant-agent fully comprehended the possibility that he may not realize the agent's commission as he was informed that another agent was also negotiating the sale and thus, compensation will pertain to the one who finds a purchaser and eventually effects the sale. Such is not the case herein. In *Manotok,* the private respondent [broker] pursued with his goal of seeing that the parties reach an agreement on the belief that he alone was transacting the business with the [buyer] as this was what the petitioner [owner] made it to appear.

is entitled to receive can be paid to any companion or helper of his — and as there is no prohibition in law against the employment of a companion to look for a buyer of the principal's land nor is it against public policy — such companion or helper is entitled to compensation and may, therefore be joined with the agent as party to a case against the principal for recovery of compensation, even if the principal never dealt, directly or indirectly with such companion or helper.[35] (L.G. Marquez & Gutierrez Lora vs. Varela, 92 Phil. 373 [1952]; see Arts. 1892-1893.)

(10) *Termination of agency contract.* — Where no time for the continuance of the contract is fixed by its terms, either party is at liberty to terminate it at will, subject only to the ordinary requirements of good faith. (Danon vs. Brimo & Co., 42 Phil. 133 [1921]; Ramos vs. Court of Appeals, 63 SCRA 331 [1975].)

(11) *Validity of exclusive sales agency agreement.* — An exclusive sales agency agreement providing that during the continuance of the agreement, the broker is entitled to the commission irrespective as to whether the property is sold by the broker, the seller, or a third party without the aid of the broker and that for a period of three (3) months following its expiration, the broker may still be entitled to the commission if the property were sold by the seller "to a purchaser to whom it was submitted by you (broker) during the continuance of such agency with notice to me" (seller) has been upheld as not contrary to law, good customs, or public policy. (see Art. 1306.)

Such agreement aims to pin down the seller to his obligation to give what is due to his broker for his efforts during the life of the agency. It seeks to prevent bad faith among calculating customers to the prejudice of the broker particularly when the negotiations have reached that stage where it would be unfair

[35]Sec. 6. *Permissive joinder of parties.* — All persons in whom or against whom any right to relief in respect to or arising out of the same transaction or series of transactions is alleged to exist, whether jointly, severally, or in the alternative, may, except as otherwise provided in these Rules, join as plaintiffs or be joined as defendants in one complaint, where any question of law or fact common to all such plaintiffs or to all such defendants may arise in the action; but the court may make such orders as may be just to prevent any plaintiff or defendant from being embarrassed or put to expense in connection with any proceedings in which he may have no interest. (Rule 3, Rules of Court.)

to deny the broker his commission just because the sale was effected after the expiration of the broker's contract. (F. Calero & Co. vs. Navarette, [C.A.] 540 O.G. 705, Nov. 14, 1957.)

(12) *Sale through another agent.* — Where, however, no definite period was fixed by the principal within which the broker might effect the sale of principal's property nor was he given by the principal the exclusive agency on such sale, it was held that the broker cannot complain of the principal's conduct in selling the property through another agent before the broker's efforts were crowned with success for "one who has employed a broker can himself sell the property to a purchaser whom he has procured, without any aid from the broker." (Subido vs. Iglesia ni Cristo, [C.A.] No. 9910-R, June 27, 1955.)

Right of agent to compensation in case of double agency.

An agent acting at once for both contracting parties (*e.g.*, vendor and vendee) assumes a double agency.

(1) *With knowledge of both principals.* — Such agency is disapproved of by law unless the agent acted with full knowledge and free consent of both principals, or unless his employment was merely to bring the parties together. In this case, recovery may be had by the agent. (see Domingo vs. Domingo, 42 SCRA 131 [1971], cited under Art. 1891.) No public policy or principle of sound morality is violated by contracts of double agency where all the principals were fully advised and consented to the double employment. Undoubtedly, if two persons desire, for example, to negotiate a sale of property, they may agree to delegate to a third person the power to fix the terms. It may be said that such third person is an arbitrator chosen to settle differences between his employers, an agency or office greatly favored in the law.

Of course, to relieve such double agent from suspicion, it is necessary that it should appear that knowledge of every circumstance connected with his employment by either party should be communicated to the other, insofar as the same would naturally affect his action, and when it is done, the right of such agent to compensation cannot be denied on any just principle of morals or of law.

The key here is in fully informing both parties.

(2) *Without knowledge of both principals.* — In case of such double employment the agent can recover from neither, where his employment by either is concealed from or not assented to by the other.

Several reasons may be given for this rule. In law, as in morals, it may be stated that as a principle, no servant can serve two masters for either he will hate the one and love the other, or else he will hold to the one and despise the other. Unless the principal contracts for less, the agent is bound to serve him with all his skill, judgment and discretion. Therefore, by engaging with the second, he forfeits his right to compensation from the one who first employed him. By the second engagement, the agent, if he does not in fact disable himself from rendering to the first employer the full quantum of service contracted for, at least tempts himself not to do so. And for the same reason he cannot recover from the second employer, who is ignorant of the first engagement.

(3) *With knowledge of one principal.* — If the second employer has knowledge of the first engagement, then both he and the agent are guilty of the wrong committed against the first employer, and the law will not enforce an executory contract entered into in fraud of the rights of the first employer. It is no answer to say that the second employer having knowledge of the first employment should be liable on his promise, because he could not be defrauded in the transaction. The contract itself is void as against public policy and good morals, and both parties thereto being *in pari delicto*, the law will leave them as it finds them. (Bell vs. McConnel, 37 Ohio St. 396 [1881]; see also "Nature of relation between principal and agent," No. [3], under Art. 1868.)

Factors in fixing the amount of attorney's fees.

In fixing fees, lawyers should avoid charges which overestimate their advice and services, as well as those which undervalue them. A client's ability to pay cannot justify a charge in excess of the value of the service, though his poverty may

require a less charge, or even none at all. The reasonable requests of brother lawyers, and of their widows and orphans without ample means, should receive special and kindly consideration.

In determining the amount of the fee, it is proper to consider:

(1) The time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to conduct properly the cause;

(2) Whether the acceptance of employment in the particular case will preclude the lawyer's appearance for others in cases likely to arise out of the transaction, and in which there is a reasonable expectation that otherwise he would be employed, or will involve the loss of other business while employed in the particular case or antagonisms with other clients;

(3) The customary charges of the bar for similar services;

(4) The amount involved in the controversy and the benefits resulting to the client from the services;

(5) The contingency or the certainty of the compensation; and

(6) The character of the employment, whether casual or for an established and constant client. No one of these consideration in itself is controlling. They are mere guides in ascertaining the real value of the service.

In fixing fees, it should never be forgotten that the profession is a branch of the administration of justice and not a mere money-getting trade.[36] (Sec. 12, Canons of Professional Ethics.)

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[36]Canon 20. — A LAWYER SHALL CHARGE ONLY FAIR AND REASONABLE FEES.

Rule 20.01. — A lawyer shall be guided by the following factors in determining his fees:

x x x x x x

(c) The importance of the subject matter;

x x x x x x

(f) The customary charges for similar services and the schedule of fees of the IBP chapter to which he belongs;

x x x x x x

(j) The professional standing of the lawyer.

Rule 20.02. — A lawyer shall, in cases of referral with the consent of the client, be entitled to a division of fees in proportion to the work performed and responsibility assumed.

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)

General and special agencies.

The distinction here is based on the scope of the business covered. A general agency must not be confused with one couched in general terms (Art. 1877.) which is a special agency when it involves only one or more specific transactions. (Art. 1876.)

Classes and kinds of agents.

Agents may be classified as express or implied, according to the manner in which the agency is created; or as actual or ostensible, with reference to their authority in fact. (2 C.J.S. 1035.)

According to the nature and extent of their authority agents have been classified into universal, general, and special or particular.

(1) A *universal agent* is one employed to do all acts that the principal may personally do, and which he can lawfully delegate to another the power of doing. (*Ibid*., 1037.) A contract creating a universal agency normally includes the following delegation: "full power and authority to do and perform any and every act that I may legally do and every power necessary to carry out the purposes for which it is granted."

(2) A *general agent* is one employed to transact all the business of his principal, or all business of a particular kind or in a particular place, or in other words, to do all acts, connected with a particular trade, business, or employment. (*Ibid*., 1036.) He has authority to do all acts connected with or necessary to accomplish a certain job. A manager of a store is an example of a general agent.

Rule 20.03. — A lawyer shall not, without the full knowledge and consent of the client, accept any fee, reward, costs, commissions, interest, rebate or forwarding allowance or other compensation whatsoever related to his professional employment from anyone other than the client.

Rule 20.04. — A lawyer shall avoid controversies with clients concerning his compensation and shall resort to judicial action only to prevent imposition of injustice or fraud. (Code of Professional Responsibility.)

(3) A *special* or *particular agent* is one authorized to act in one or more specific transactions, or to do one or more specific acts, or to act upon a particular occasion. *(Ibid.)* An agent with authority to sell a house is an illustration of a special agent. He has no authority to act in matters other than that for which he has been employed. His authority is to do only a particular act or a series of acts of very limited scope. He has less power than a general agent.

A universal agent may be viewed as an unlimited general agent. Cases of universal agencies are rare since they can be created only by clear and unequivocal language; and while a principal may have as many special agents as occasions may require and may have a general agent in each line of his business and each of several places, he can only have one universal agent. (3 Am. Jur. 2d 422-425.)

Special types of agents.

The more common special types of agents are the following:

(1) *Attorney at law,* or one whose business is to represent clients in legal proceedings;

(2) *Auctioneer,* or one whose business is to sell property for others to the highest bidder at a public sale;

(3) *Broker,* or one whose business is to act as intermediary between two other parties such as insurance broker and real estate broker;

(4) *Factor* (synonymous with commission merchant), or one whose business is to receive and sell goods for a commission, being entrusted with the possession of the goods involved in the transaction. (see Art. 1903.);

(5) *Cashier in bank,* or one whose business is to represent a banking institution in its financial transactions; and;

(6) *Attorney-in-fact, infra.*

Attorney-in-fact defined.

An *attorney-in-fact* is one who is given authority by his principal to do a particular act not of a legal character. The term is, in loose language, used to include agents of all kinds, but in

its strict legal sense, it means an agent having a special authority created by deed. (3 C.J.S. 1037.)

Distinctions between a general agent and a special agent.

(1) *Scope of authority.* — A general agent is usually authorized to do all acts connected with the business or employment in which the principal is engaged (*e.g.*, manager of a shop), while a special agent is authorized to do only one or more specific acts (*e.g.*, delivering of goods sold to a customer) in pursuance of particular instructions or with restrictions necessarily implied from the act to be done. (3 Am. Jur. 2d 422.)

ILLUSTRATIVE CASE:

Agent sold flags for principal without specific authorization.

Facts: P drew up a document addressed to A that said: "This is to formalize our agreement for you to represent United Flag Industry to deal with any entity or organization, private or government, in connection with the marketing of our products — flags and all its accessories. For your service, you will be entitled to a commission of 30%."

A sold 15,666 Philippine flags to the Department of Education and Culture. P refused to pay A commission.

Issue: Could A represent P in the transaction in the absence of a specific authorization for the sale?

Held: Yes. "One does not have to undertake a close scrutiny of the document embodying the agreement between P and A to deduce that the latter was instituted as a general agent." Indeed, it can easily be seen that no restrictions were intended as to the manner the agency was to be carried out or in the place where it was to be executed. The power granted to A is so broad that it practically covers the negotiations leading to, and the execution of, a contract of sale of P's merchandise with any entity or organization. As general agent, A had authority to do all acts pertaining to the business of P.

A general agent usually has authority either expressly conferred in general terms or in effect made general by the usages, customs or nature of the business which he is authorized to transact x x x." *(Siasat vs. Intermediate Appellate Court, 139 SCRA 238 [1985].)*

(2) *Continuous nature of service authorized.* — A general agent is one who is authorized to conduct a series of transactions over time involving a continuity of service, while a special agent is one authorized to conduct a single transaction or a series of transactions not involving continuity of service *(Ibid.)* and covering a relatively limited period of time. Thus, one is a general agent if he is in continuous employment, although the employment consists of purchasing articles as the employer directs with no discretion as to the kinds, amounts or pieces to be paid, while one employed to purchase a single article would be a special agent although given the widest discretion as where one is directed to purchase any suitable article as a wedding gift. (Restatement of Law of Agency, Sec. 3[c].)

(3) *Extent to which agent may bind principal.* — A general agent may bind his principal by an act within the scope of his authority although it may be contrary to his special instructions, while a special agent cannot bind his principal in a manner beyond or outside the specific acts which he is authorized to perform on behalf of the principal. (3 Am. Jur. 2d 422.)

(4) *Knowledge/disclosure of limitations of power.* — A special agency is in its nature temporary and naturally suggests limitations of power of which third persons must inform themselves. A general agency is in its general nature, continuing and unrestricted by limitations other than those which confine the authority within the bounds of what is usual, proper, and necessary under like circumstances. If there are other limitations, the principal must disclose them. (Mechem on Agency, Sec. 739.)

The expertise of the agent or the amount of discretion given to him is not relevant in making a distinction between general and special agents.

ILLUSTRATIVE CASE:

Insurance agent agreed to insure a risk from date of application in violation of principal's instructions.

Facts: T made an application for fire insurance to A, agent of P, insurance company. A agreed to insure from the date of application. It appeared that the risk involved was of a special kind, and P had forbidden A from taking that kind of risk.

The court found, however, that the risk entered into by A was a general one.

Issue: Is P bound by the contract?

Held: Yes. "A restriction upon the power of an agent, not known to persons dealing with him, limiting usual powers possessed by agents of the same character, would not exempt the principal from responsibility for his acts and contracts which were within the ordinary scope of the business entrusted to him, although he acted in violation of special instructions." *(Ruggles vs. American Ins. Co., 144 N.Y. 415, cited in Teller, p. 19.)*

(5) *Termination of authority.* — The apparent authority created in a general agent does not terminate by the mere revocation of his authority without notice to the third party. (see Art. 1922.) In the case of special agent, the duty imposed upon the third party to inquire makes termination of the relationship as between the principal and agent effective as to such third party unless the agency has been entrusted for the purpose of contracting with such third party. (see Art. 1921.)

(6) *Construction of instructions of principal.* — It is a general rule that the authority of a special agent must be strictly pursued. Persons dealing with such an agent must at their peril inquire into the nature and extent of his authority. (2 C.J. Sec. 223.) Where the agent is general, statement by the principal with respect to former's authority would ordinarily be regarded as advisory in nature only. Where the agent is special, they would be regarded as words limiting the authority of the agent. This is but natural for it should not be presumed in the absence of countervailing circumstances that a general agency, with its consequent broad powers and reposing of confidence is, without more, intended to be limited in the extent of its authority by the principal's statements. (Teller, *op. cit.*, pp. 19-20.)

Be that as it may, a general agency does not import unqualified authority, and the implied power of any agent, however general, must be limited to such acts as are proper for an agent to do, and cannot extend to acts clearly adverse to the interests of the principal, or for the benefit of the agent personally; and an agent has no implied authority to do acts not usually done by agents

in that sort of business. The most general authority is limited to the business or purpose for which the agency was created. (2 C.J. Sec. 222.)

> **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)**

Agency couched in general terms.

As to the extent of the power conferred, agency may be couched in general terms (Art. 1877.) or couched in specific terms. (Art. 1878.)

An agency couched in general terms may be a general agency (Art. 1876, par. 1.) or a special agency. (*Ibid.*, par. 2.) It includes only acts of administration and an express power is necessary to perform any act of strict ownership (Art. 1878.), even if the principal states that (1) he withholds no power, or that (2) the agent may execute such acts as he may consider appropriate, or that (3) he authorizes a general or unlimited management. (Art. 1877.)

Whether the instrument be denominated as "general power of attorney" or "special power of attorney," what matters is the extent of the power or powers conferred upon the agent or attorney-in-fact. If the power is couched in general terms, then only acts of administration may be deemed granted although the instrument may be captioned as "special power of attorney"; but where the power, for example, to sell or mortgage, is specified, there can be no doubt that the agent may execute the act, although the instrument is denominated as a general power of attorney. (Veloso vs. Court of Appeals, 260 SCRA 593 [1996].)

Meaning of acts of administration.

It seems easy to answer that acts of administration are those which do not imply the authority to alienate for the exercise

of which an express power is necessary. Yet what are acts of administration will always be a question of fact, rather than of law, because there can be no doubt that sound management will sometimes require the performance of an act of ownership. (12 Manresa 468.) But, unless the contrary appears, the authority of an agent is presumed to include all the necessary and usual means to carry out the agency into effect. (Macke vs. Camps, 7 Phil. 553 [1907].)

(1) A person employed to sell goods in a retail store can sell without special power of attorney because selling itself is an act of administration.

(2) It has been held that the right to sue for the collection of debts owing to the principal is not an incident of strict ownership, which must be conferred in express terms. (German & Co. vs. Donaldson, Sim & Co., 1 Phil. 63 [1901].)

(3) An attorney-in-fact empowered to pay the debts of the principal and to employ attorneys to defend the latter's interests is impliedly empowered to pay attorney's fees for services rendered in the interests of the principal. (Municipal Council of Iloilo vs. Evangelista, 55 Phil. 290 [1930].)

(4) A person who is made an attorney-in-fact with the same power and authority to deal with property which the principal might or could have done if personally present, may engage the services of a lawyer to preserve the ownership and possession of the principal's property.

(5) Except where the authority for employing agents and employees is expressly vested in the board of directors or trustees of a corporation, an officer or agent who has control and management of the corporation's business, or a specific part thereof, may bind the corporation by the employment of such agents and employees as are usual and necessary in the conduct of such business. But the contracts of employment must be reasonable. (Yu Chuck vs. "Kong Li Po," 46 Phil. 608 [1924].)

(6) The authority to take charge of certain properties includes, unless it is otherwise agreed, the implied authority to take reasonable measures appropriate to the subject matter, to protect it against loss or destruction, to keep it in reasonable

repair, to recover it if lost or stolen, and, if the subject matter is ordinarily insured by the owners, to insure it. (2 Am. Jur. 122.) The authority to manage or administer a land does not include the authority to sell the same. (Cañeda vs. Puentespina, CA-G.R. No. 52855-R, May 29, 1978.)

(7) An agent to manage, supervise, or oversee the business or property of his principal has powers co-extensive in scope with the business instructed to him, that is to say, implied authority to do in that business or with the property whatever is usually and customarily done in business or property of the same kind in the same locality. (2 C.J.S. 1241-1242.)

(8) When the agent is entrusted with the custody of goods which he delivers himself to the purchaser, there is implied authority to collect and receive payment therefor. (Boice-Perrine Co. vs. Kelley, 243 Mass. 327, 137 N.E. 731.)

(9) The pertinent portion of the special power of attorney executed by the client expressly authorized its counsel "to appear for and in its behalf in the above entitled case in all circumstances where its appearance is required and to bind it in all said instances." Although the power of attorney does not specifically mention the authority of counsel to appear and bind the client at the pre-trial conference, the terms of the said power of attorney are comprehensive enough as to include said authority. (Tropical Homes, Inc. vs. Villaluz, 170 SCRA 577 [1989].)

(10) The authority to sell includes authority to make customary warranties and representations, but to sell only for cash unless a course of dealing justifies the inference that the agent had authority to sell on credit. Authority to buy is interpreted to mean only for money if the principal has supplied the agent with funds; otherwise, the agent can pledge the principal's credit on reasonable terms. (Babb & Martin, *op. cit*., p. 138.)

(11) The right of an agent to indorse commercial papers is a responsible power and will not be lightly inferred. A salesman with authority to collect money belonging to his principal does not have the implied authority to indorse checks received in payment. Any person taking checks made payable to a corporation, which can only act by agents, does so at his peril,

and must abide by the consequences if the agent who indorses the same is without authority. (Insular Drug Co. vs. National Bank, 58 Phil. 683 [1933].)

But the principal is liable on checks issued by an agent with a general power of attorney to issue checks, where such checks were issued for the agent's own benefit. The rule is that the principal is liable on contracts entered into by his general agent from improper motives or on contracts which represent violation of his fiduciary duty to the principal. (Empire Trust Co. vs. Cahan, 274 U.S. 474, cited in Teller, p. 228.)

(12) It is the general rule that an agent who solicits orders and transmits them to his principal to be filled has no implied authority to collect or to receive payment for the goods sold. The purchaser will not be discharged by payment to him without proof of further authority in the agent than the making of sales. (Boice-Perrine Co. vs. Kelley, 243 Mass. 327, 137 N.E. 731.)

Under this principle, brokers and travelling salesmen who do not have the possession of goods, and who sell for future delivery to be paid for on delivery or a future time, are without authority to collect payment for the goods. If the payment is made to a person occupying that relation, the purchaser makes him his agent to pay the seller, and, if he fails, it is the purchaser's loss and not the seller's. (Fairbanks Morse & Co. vs. Dole & Co., 159 So 859 [Miss.] 1925.)

(13) In a case where an agent with a power of attorney was authorized to take, sue for, recover, collect, and receive any and all sums of money and other things of value due his principal (lessor) from the lessee, it was held that said power of attorney did not authorize the agent to take articles belonging to the lessee, hiding them in his house and denying to the owner of the articles and the police authorities that he had them in his possession, these being illegal acts not covered by his power of attorney, and the agent, in the absence of satisfactory explanation as to his possession, was liable for the crime of theft of such properties. (Soriano vs. People, 88 Phil. 368 [1951].)

(14) The powers of the managing partner are not defined under the provisions of the Civil Code on partnership. (see Arts.

1800-1803, 1818.) Since according to well-known authorities, the relationship between a managing partner and the partnership is substantially the same as that of agent and the principal, the extent of the power of the managing partner must, therefore, be determined under the general principles of agency. And, on this point, the law says that an agency created in general terms includes only acts of administration, but with regard to the power to compromise, sell, mortgage, and other acts of strict ownership, an express power of attorney is required.

Of course, there is authority to the effect that a managing partner, even without express power of attorney, may perform acts affecting ownership if the same are necessary to promote or accomplish a declared object of the partnership. But a sale by a managing partner of real properties of the partnership to pay its obligation without first obtaining the consent of the other partners is invalid being in excess of his authority, as the transaction is not for the purpose of promoting the object of the partnership. (Goquiolay vs. Sycip, 108 Phil. 984 [1960] and 9 SCRA 603 [1963].)

(15) The authority to make a contract does not include authority to alter, rescind, waive conditions, render or receive performance, assign or sue upon it, for none of these acts is necessary or incidental to the making of the contract. (Babb & Martin, *op. cit*., p. 138.)

(16) See Article 1878, Nos. 6, 7, and 8.

Construction of contracts of agency.

(1) Contracts of agency as well as general powers of attorney must be interpreted in accordance with the language used by the parties. (see Art. 1370.)

(2) The real intention of the parties is primarily to be determined from the language used and gathered from the whole instrument. (see Art. 1374.)

(3) In case of doubt, resort must be had to the situation, surroundings, and relations of the parties. (see Art. 1371.)

(4) The intention of the parties must be sustained rather than be defeated. (see Art. 1370.) So, if the contract be open to

two constructions, one of which would uphold while the other would overthrow it, the former is to be chosen. (see Art. 1373.)

(5) The acts of the parties in carrying out the contract will be presumed to have been done in good faith and in conformity with and not contrary to the intent of the contract. (Liñan vs. Puno, 31 Phil. 259 [1951].)

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 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)

When special powers are necessary.

(1) *Acts of strict dominion.* — In the fifteen cases enumerated are general acts of strict dominion or ownership as distinguished from acts of administration. Hence, a special power of attorney is necessary for their execution through an agent.

(2) *Construction of powers of attorney.* — Powers of attorney are generally construed strictly and courts will not infer or presume broad powers from deeds which do not sufficiently include property or subject under which the agent is to deal. The act done must be legally identical with that authorized to be done. (Woodchild Holdings, Inc. vs. Roxas Electric & Construction Co., Inc., 436 SCRA 235 [2004].) However, the rule is not absolute and should not be applied to the extent of destroying the very purpose of the power. Furthermore, the instrument should always be deemed to give such powers as are essential or usual in effectuating the express powers. (Olaguer vs. Purugganan, Jr., 575 SCRA 460 [2007].)

Authority in the cases enumerated in Article 1878 must be couched in clear and unmistakable language.[37] In other cases, the authority need not be with special power, but may arise by implication if it is reasonably necessary to the exercise of other powers which are bestowed.

(3) *Nature, not form of authorization.* — Article 1878 refers to the *nature* of the authorization, not its form. (Lim Pin vs. Liao

[37]See, however Pelayo vs. Perez, 459 SCRA 475 (2005), under No. (5).

Tan, 115 SCRA 290 [1982]; Bravo-Guerrero vs. Bravo, 465 SCRA 244 [2005]; Gozun vs. Mercado, 511 SCRA 305 [2006].)

(a) A power of attorney is valid although no notary public intervened in its execution. (Barretto vs. Tuason, 59 Phil. 845 [1934].) Article 1878 does not state that the special authority be in writing. Be that as it may, the same must be duly established by evidence other than the self-serving assertion of the party claiming that such authority was verbally given him. (see Home Insurance Co. vs. United States Lines Co., 21 SCRA 863 [1967].) A notarized power of attorney, however, carries the evidentiary weight conferred upon it with respect to its due execution. (Veloso vs. Court of Appeals, 260 SCRA 593 [1996].)

(b) The special power of attorney can be included in a general power of attorney (hence, there is no need to execute a separate and special power) when it specifies therein the act or transaction (*e.g.*, special power to sell) for which the special power is required. The requirement of a special power of attorney is met if there is a clear mandate from the principal specifically authorizing the performance of act (*Ibid*.; Bravo-Guerrero vs. Bravo, *supra*; Estate of Lino Olaguer vs. Ongjico, 563 SCRA 373 [2009].)

To make payment.

Payment is the delivery of money or the performance in any other manner of an obligation. (Art. 1232.) It is an act of ownership because it involves the conveyance of ownership of money or property.

But when payment is made in the ordinary course of management, it is considered a mere act of administration. It is included in an agency couched in general terms (Art. 1877.) and hence, no special power of attorney is needed. Thus, a special power to make payment is implied from the authority to buy a designated piece of land at a certain price. The authority to execute or to indorse negotiable paper is ordinarily inferred only when indispensable to the accomplishment of the acts the agent is authorized to perform. Particularly rare is the situation in

which the agent could bind the principal by an accommodation signature. (Babb & Martin, *op. cit*., p. 139.)

To effect novation.

Novation is the extinction of an obligation through the creation of a new one which substitutes it by changing the object or principal conditions thereof, substituting a debtor, or subrogating another in the right of the creditor. (Art. 1291.) Note that the obligations must already be in existence at the time the agency was constituted.

To compromise, etc.

A compromise must, be strictly construed. The grant of special power regarding one of the acts mentioned in No. 3 of Article 1878 is not enough to authorize the others. A judgment based on a compromise entered into by an attorney without specific authority from the client is null and void. Such judgment may be impugned and its execution restrained in any proceeding by the party against whom it is sought to be enforced. (Cosmic Lumber Corp. vs. Court of Appeals, 265 SCRA 168 [1996]; see Philippine Aluminum Wheels, Inc. vs. FASGI Enterprises, Inc., 342 SCRA 722 [2000]; Rivero vs. Court of Appeals, 458 SCRA 714 [2005].)

(1) *Compromise* is a contract whereby the parties, by making reciprocal concessions, avoid a litigation or put an end to one already commenced. (Art. 2028.) *Arbitration* is where the parties submit their controversies to one or more arbitrators for decision. (Art. 2024; see Art. 1880.) These are acts of ownership since they involve the possibility of disposing of the thing or right subject of the compromise[38] (see Vicente vs. Geraldez, 52 SCRA 210 [1973]; Caballero vs. Deiparine, 60 SCRA 136 [1974].) or arbitration. *Confession of judgment* stands on the same footing as compromise

[38]Sec. 23. *Authority of attorneys to bind clients.* — Attorneys have authority to bind their clients in any case by any agreement in relation thereto made in writing, and in taking appeals, and in all matters of ordinary judicial procedure. But they cannot, without special authority, compromise their client's litigation, or receive anything in discharge of a client's claim but the full amount in cash. (Rule 138, Rules of Court.)

of causes; so a counsel may not confess judgment except with the knowledge and at the instance of the client. (Acener vs. Sison, 8 SCRA 711 [1963].)

But although the law expressly requires a special power of attorney in order that one may compromise an interest of another, it is neither accurate nor correct to conclude that its absence renders the compromise agreement void. In such a case, the compromise is merely unenforceable. This results from its nature as a contract. It must be governed by the rules and the law on contracts. (Dungo vs. Lopena, 6 SCRA 1007 [1962].)

(2) A special power of attorney is also necessary with respect to the authority of the agent to waive: the right to appeal from a judgment; objections to the venue of an action; and a prescription already acquired. By prescription, one acquires ownership and other real rights through the lapse of time. In the same way, rights and actions are lost by prescription. (Art. 1106.)

To waive an obligation gratuitously.

This is condonation or remission. (Art. 1270.) The agent cannot waive a right belonging to the principal without valuable consideration or even for a nominal consideration. He cannot bind the principal who is the obligee unless especially authorized to do so.

A waiver may not be inferred when the terms thereof do not explicitly and clearly prove an intent to abandon the right.

To convey or acquire immovable.

Note that No. (5) applies whether the contract is gratuitous or onerous. (see Art. 1874.) Note also that it refers only to immovables. (see No. 15.) Nos. (5) and (12) *(infra.)* refer to sales made by an agent for a principal and not to sales made by the owner personally to another, whether that other be acting personally or through a representative. (Rodriguez vs. Court of Appeals, 29 SCRA 419 [1969].)

It has been held that a wife, by affixing her signature to a deed of sale on the space provided for witnesses, is deemed to

have given her implied consent to the contract of sale. A wife's consent to the husband's disposition of conjugal property does not always have to be explicit or set forth in any particular document so long as it is shown by acts of the wife that such consent or approval was given. (Pelayo vs. Perez, 459 SCRA 475 [2005].)

A buyer has every reason to rely on a person's authority to sell a particular property owned by a corporation on the basis of a notarized board resolution. The notarial acknowledgment in a document is a *prima facie* evidence of the fact of its due execution. (St. Mary's Farm, Inc. vs. Prima Real Properties, Inc., 560 SCRA 704 [2008].)

To make gifts.

Gift or *donation* is an act of liberality whereby a person disposes gratuitously of a thing or right in favor of another who accepts it. (Art. 725.) An agent without special power from the principal cannot make gifts.[39] But the making of customary gifts for charity, or those made to employees in the business managed by the agent, are considered acts of administration.

To loan or borrow money.

In a *loan of money,* the borrower "is bound to pay to the creditor an equal amount of the same kind and quality." (Art. 1953.) The power to lend or borrow money is one with much great possibility of abuse and is not ordinarily incident to a general managerial agency. (2 C.J.S. 1294.)

(1) The power to borrow any amount of money which the agent deems necessary cannot be interpreted as also authorizing him to use the money as he pleases. (Hodges vs. Salas, 63 Phil. 567 [1936].)

(2) The exception in No. (7) refers to "borrow" and not to "loan." The agent, however, may be empowered to borrow

[39] Art. 745. The donee must accept the donation personally, or through an authorized person with a special power for the purpose, or with a general and sufficient power; otherwise, the donation shall be void. (630)

money. (Art. 1890.) But the authority to borrow money for the principal is not to be implied from the special power of attorney to mortgage real estate. (Phil. National Bank vs. Maximo Sta. Maria, 29 SCRA 303 [1969].)

(3) The creditor should require the execution of a power of attorney in order that one may be understood to have granted another the authority to borrow on behalf of the former. (Rural Bank of Caloocan, Inc. vs. Court of Appeals, 104 SCRA 151 [1981].)

(4) Authority to borrow money is rarely inferred unless such borrowing is usually incident to the performance of acts which the agent is authorized to perform for the principal (Restatement of Agency, Sec. 74.), or unless it is impossible for the agent to communicate with his principal and borrowing is indispensable to the continuance of the business or to prevent a very considerable loss. (Babb & Martin, *op. cit*., p. 139.)

Where the loans were contracted by the agent and the purchases on credit were made to pay the wages of the laborers and supply them with their needs, otherwise a stoppage of the mining operations without having completed the extraction of the ore therefrom would certainly have meant considerable losses to the principal, the loans contracted by the agent were held urgent and indispensable and a special power of attorney was not imperative under the circumstances to bind the principal, pursuant to Article 1878, par. 7. (Sta. Catalina vs. Espitero, 15 C.A. Rep. 1202, April 28, 1964.)

Note that No. 7 refers only to money and not to other fungible things. (see Art. 1253.)

ILLUSTRATIVE CASE:

Owner of property mortgaged is sought to be made liable for loan secured by debtor given authority to mortgage.

Facts: P granted to A a special power to mortgage the former's real estate. By virtue of said power, A secured a loan from C (PNB) secured by a mortgage on said real estate.

Issue: Is P personally liable for said loan?

Held: No. A special power to mortgage property is limited to such authority to mortgage and does not bind the grantor personally to other obligations contracted by the grantee in the absence of any ratification or other similar act that would estop the grantor from questioning or disowning such other obligations contracted by the grantee.

Consequently, A alone must answer for said loan, and P's only liability is that the real estate authorized by him to be mortgaged would be subject to foreclosure and sale to respond for the obligations contracted by A. But he cannot be held personally liable for the payment of such obligations.

It is not unusual in family and business circles that one would allow his property or an undivided share in real estate to be mortgaged to another as security either as an accommodation or for valuable consideration, but the grant of such authority does not extend to assuming personal liability, much less solidary liability, for any loan secured by the grantee in the absence of express authority given by the grantor. The outcome would be different if the authority given were "to borrow money and mortgage." (*Phil. National Bank vs. Sta. Maria, 29 SCRA 303 [1969];* see De Villa vs. Fabricante, 105 Phil. 672.)

To lease realty for more than one year.

In the *lease of things*, the lessor gives to the lessee the enjoyment or use of a thing for a price certain, and for a period which may be definite or indefinite. (Art. 1643.)

(1) An unrecorded lease of real estate is not binding upon third persons. (Art. 1648.) By implication, the lease of realty to another person for one year or less is an act of mere administration provided the lease is not registered.

(2) The requirement of special power of attorney extends to renewal or extension of lease of real property to another.

(3) An agreement for the leasing of real property for a longer period than one year is unenforceable unless made in writing. (Art. 1403[2, e].) It follows that even if the agent is especially authorized, the lease is not enforceable against the principal if it is not in writing.

Note that No. 8 does not refer to lease of real property *from* another person and to lease of personal property.

To bind the principal to render service gratuitously.

The agent may, by contract, bind himself to render service without compensation. (Art. 1875.) However, to bind the principal to that effect, a special power is necessary.

If the service is for compensation, the power may be implied.

To bind the principal in a contract of partnership.

By the *contract of partnership,* the partners bind themselves to contribute money, property, or industry to a common fund with the intention of dividing the profits among themselves. (Art. 1767.) The contract of partnership thus creates obligations the fulfillment of which requires an act of strict ownership.

Furthermore, the principal must personally have trust and confidence in the proposed partners.

To obligate principal as guarantor or surety.

By the *contract of guaranty,* the guarantor binds himself to fulfill the obligation of the principal debtor in case the latter should fail to do so. If the person binds himself solidarily, he is a surety and the contract is called a suretyship. (Art. 2047.)

It has been held that a contract of guaranty or surety cannot be inferred from the use of vague or general words. Thus, the phrase "contingent commitment" set forth in the power of attorney cannot be interpreted to mean "guaranty." (BA Finance Corp. vs. Court of Appeals, 211 SCRA 112 [1992].) A power of attorney given to sell or to lease the property of the principal and generally "to perform and execute all and every lawful and reasonable act as fully and effectively as I might or could do if personally present" does not operate to authorize the agent to sign in behalf of the principal a surety bond in favor of the government in connection with the purchase of certain materials dredged from a fish pond. The power to create a contract of suretyship cannot be inferred; it must be expressed. (Director of Public Works vs. Sing Juco, 53 Phil. 205 [1929].)

A power of attorney to loan money does not authorize the agent to make the principal liable as a surety for the payment of the debt of a third person. (Bank of the Phil. Islands vs. Coster, 47 Phil. 594 [1925].) Similarly, the authority given by a corporation to approve loans up to P350,000 without any security requirement does not include the authority to issue guarantees even for an amount much less than P350,000. (BA Finance Corp. vs. Court of Appeals, *supra*.)

A contract of guaranty is unenforceable unless it is made in writing. (Art. 1403[2, b].)

To create or convey real rights over immovable property.

An agent cannot create or convey real rights like mortgage, usufruct, easement, etc., over immovable property belonging to his principal without special power. That is an act of strict ownership. (see No. 5.) There is no principle of law by which a person can become liable on a real estate mortgage which he never executed either in person or by attorney-in-fact. (Philippine Sugar Estates Development Co. vs. Poizat, 48 Phil. 536 [1926]; Rural Bank of Bombon, Inc. vs. Court of Appeals, 212 SCRA 25 [1992].)

To accept or repudiate an inheritance.

Any person having the free disposal of his property may accept or repudiate an inheritance.[40] (Art. 1044.) This act is one of strict dominion; hence, the necessity of a special authority.

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[40]Art. 1045. The lawful representatives of corporations, associations, institutions and entities qualified to acquire property may accept any inheritance left to the latter, but in order to repudiate it, the approval of the court shall be necessary. (993a)

Art. 1046. Public official establishments can neither accept nor repudiate an inheritance without the approval of the government. (994)

Art. 1047. A married woman of age may repudiate an inheritance without the consent of her husband. (995a)

Art. 1048. Deaf-mutes who can read and write may accept or repudiate the inheritance personally or through an agent. Should they not be able to read and write, the inheritance shall be accepted by their guardians. These guardians may repudiate the same with judicial approval. (996a)

To ratify obligations contracted before the agency.

An agent cannot effect novation *(supra.)* of obligations existing at the time of the constitution of the agency unless he be specially authorized to do so. On the same principle, he cannot ratify or recognize obligations contracted before the agency without special power from the principal.

Any other act of strict dominion.

Generally, a sale or purchase of personal property is an act of strict dominion. Hence, a special power is necessary in order that the act shall be binding on the principal.

Thus, an agent appointed to manage a printing establishment of his principal cannot sell a printing machine in said establishment. (Yu Eng Yu vs. Ranson Phil. Corp., [C.A.] 40 O.G. No. 8, Supp. 65.) But a sale or purchase made in the ordinary course of management is merely an act of administration and, therefore, included in an agency couched in general terms. (Art. 1877.)

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)

Scope of authority to sell/ to mortgage.

(1) The agent cannot sell (Art. 1878, Nos. 5, 15.) or mortgage (No. 12.) the property belonging to the principal without special power. An authority to sell the principal's property does not carry with it or imply the authority to mortgage. And *vice versa,* the power to sell is not to be implied from the special power to mortgage (see Rodriguez vs. Pamintuan and De Jesus, 37 Phil. 876 [1918].), much less can it be construed to include an authority to represent the principal in any litigation. (Valmonte vs. Court of Appeals, 252 SCRA 92 [1996].) Sale (see Art. 1458.) and mortgage (see Art. 2085.) are distinct from each other. In the absence of special authority, the sale or mortgage will be unenforceable against the principal as the agent "has acted beyond his powers." (Art. 1403[1]; Art. 1881.)

(2) The sale proscribed by a special power to mortgage under Article 1879 is a voluntary and independent contract, and not an auction sale resulting from extrajudicial foreclosure of a real estate mortgage, which is precipitated by the default of the mortgagor. Absent such default, no foreclosure can take place. It matters not that the authority to extrajudicial foreclosure was granted by an attorney-in-fact and not by the mortgagor personally. The stipulation in that regard, although ancillary, forms an essential part of the mortgage contract and is inseparable therefrom. No creditor will agree to enter into a mortgage contract without that stipulation intended for his protection. (Bicol Savings & Loan Ass'n. vs. Court of Appeals, 171 SCRA 630 [1989].)

(3) The power of attorney to sell any kind of realty belonging and "might belong" to the principal covers not only the property belonging to him at the time of the execution of the power, but also such as he might afterwards have during the time it is in force. (Katigbak vs. Tai Hing Co., 52 Phil. 622 [1928].)

(4) A mere authority to a real estate agent "to sell" property at a certain price and for a certain commission does not carry with it the implied power to make a contract of sale at such price in behalf of the principal but as merely authorizing the agent to find a purchaser and submit his offer to the principal for acceptance.

ILLUSTRATIVE CASE:

The authority given is merely to sell.

Facts: P told A, a real estate agent, that he (P) would sell at a certain price his property and that he would give A a certain commission.

Issue: Does A have authority to enter into a contract of sale at such price?

Held: No. A mere authority of a real estate agent "to sell" does not carry with it the implied power to make a contract of sale in behalf of the principal. Courts have generally construed contracts for the employment of agents for the sale of land as merely authorizing the agent to find a purchaser and submit his offer to the principal for acceptance, and consequently, as not empowering the agent to execute a contract of sale in behalf of his principal. *(Raquiza vs. Lilles, 13 C.A. Rep. 343.)*

(5) In the absence of express authorization, authority to sell contemplates the sale for cash and not for credit. (Teller, *op. cit*., citing Paul vs. Stores, 4 Wis. 253.)

(6) Unless otherwise agreed, authority to buy or sell does not include authority to rescind or modify the terms of the sale after its completion, nor to act further with reference to the subject matter except to undo fraud or to correct mistakes. Thus, it has been held that a salesman of cash registers who made an accord and satisfaction under the terms of which he accepted the return of machines in satisfaction of the unpaid balance of the purchase price acted beyond the scope of his authority. (*Ibid*., citing Wichita Frozen Food Lockers vs. National Cash Register, 176 S.W. [2d] 161 [Tex.]; see Art. 1878[3].)

Contract giving agent exclusive authority to sell.

The appointment of a person as exclusive agent t*o sell* specified property is not equivalent to giving the agent an exclusive power *of sale*. In the former case, the principal may endeavor to sell through his own efforts; in the latter, he may not so compete with the agent. But if the principal appoints a person as exclusive agent to sell the principal's products in a specified territory, the principal may not compete with the agent in that territory (Babb & Martin, *op. cit*., p. 141.), either personally or by other agents, or appoint another selling agent to sell his products.

An exclusive agency will not be created by implication where the words of the contract do not naturally import such a meaning. An agency contract, to have the effect of giving the agent an exclusive territory which the principal may not invade to make sales, must sufficiently designate the territory within which the agent is to have exclusive rights. (3 C.J.S. 64-65.)

Contract giving agent exclusive authority of sale.

It is often desirable for the protection of the agent that he should be the exclusive agent and should be protected against the chance of other agents reaping the benefit of his labor in

securing purchasers — hence, arise contracts for exclusive agencies. The idea, however, that the owner shall be excluded from the right to sell his own property under such a contract is so inconsistent with the notion of ownership and the *jus disponendi* thereto appertaining that clear and unequivocal language must be employed to negate such right.

The reason is that, as is usual in such contracts, the broker does not bind himself to do anything. He has incurred no obligation to act, and the owner cannot even censure him for his inactivity. The words "exclusive sale" may well mean exclusive agency to sell — the idea being the owner shall employ no other agent and that the broker shall have the only grant of power to sell that the owner will execute. Hence, the words may be construed to be an inhibition upon the owner to grant to any one else the power to sell, rather than an inhibition upon his right to sell. (Roberts vs. Harrington, 168 Wis. 217, 169 N.W. 603 [1918].)

Power to revoke and right to revoke broker's authority distinguished.

In dealing with cases of contract for the exclusive sale, the distinction between the *power* to revoke and the *right* to revoke must be carefully observed.

The principal always has the power to revoke but not having the right to do so in those cases wherein he has agreed not to exercise his power during a certain period. If in the latter case, he does exercise his power, he must respond in damages. The same conclusion may also be reached in other cases by distinguishing between the authority and the *contract of employment.* The authority may be withdrawn at any moment but the contract cannot be terminated in violation of its terms, without making the principal liable in damages. (1 Mechem [2d ed.], Sec. 619.)

ILLUSTRATIVE CASE:

Agent who was given exclusive sale of principal's property seeks to recover commission from principal who sold the property of his own procuring.

Facts: P gave A the exclusive sale of P's land promising to pay A as commission 5% of the purchase price. A accepted the

employment under the contract, advertised the property at his own cost, and incurred other expenses but did not produce a customer willing to buy the property.

A few weeks later, P sold the property to a purchaser of his own procuring. Thereupon, P notified A of such sale.

Issue: Is A entitled to claim his commission as damages for breach of the contract?

Held: It depends. (1) *Where life of exclusive agency sale contract not specified.* — Yes. Where the contract gives the broker the exclusive sale of the property, a sale by the owner to a purchaser of his own procuring is a breach of contract if made while the contract is in force. Ordinarily, in this class of contracts, the exclusive sale is given to a broker for a definite time. Where the life of the contract is not specified, what is the life of the contract?

The rule of law is that where the contract is one of general agency employment, as that of a salesman, with no provision as to its duration, the employment is at will and may be terminated at any time without violating the contract. "Where the agency for the accomplishment of a particular transaction or specific purpose [*e.g.*, to procure a purchaser for one specific piece of property as in this case] the law implies its continuance for at least a reasonable time." (2 C.J. 525.) In this case, the court found that the reasonable time which the contract was to endure had not expired at the time of the sale by P.

(2) *Where exclusive sale is not given.* — No. From the above, it necessarily follows that A has no right of action against P in case the reasonable time involved had expired at the time of the sale by P.

Under the ordinary so-called listing contract of employment of a broker to procure a purchaser where the exclusive sale is not given, it is generally held that the employment may be terminated by the owner at will, and that a sale of the property by the owner terminates the employment without notice to the broker. Such a listing contract does not give the broker a reasonable time to procure a purchaser, but that he could be dismissed at any time. *(Harris vs. McPherson, 97 Com 164, 115 A 723 [1921].)*

ART. 1880. A special power to compromise does not authorize submission to arbitration. (1713a)

Scope of special power to compromise/ to submit to arbitration.

(1) The authority of the agent to compromise or make settlements of claims or accounts for the principal includes by implication the power to do whatever things are usual and necessary which the principal himself can do to effectuate such compromise or settlement. (see 2 C.J.S. 1340.) But he is not thereby authorized to submit to arbitration because while the principal may have confidence in the agent's judgment, the arbitrator designated may not possess the trust of the principal.

(2) It would seem that the authority to submit to arbitration does not include the power to compromise. The principal may not have trust in the agent's judgment in making a settlement. (see Art. 1878[No. 3].)

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)

Authority of an agent defined.

Authority is the power of the agent to affect the legal relations of the principal by acts done in accordance with the principal's manifestation of consent to him. The authority of the agent is the very essence — the *sine qua non* — of the principal and agent relationship. This authority, unless it is otherwise agreed, includes only authority to act for the benefit of the principal, and the source of the authority is always the principal and never the agent. (3 Am. Jur. 2d 469.)

Authority distinguished from power.

(1) A*s to existence.* — While "authority" and "power" are often used synonymously, the former may be considered the

source or cause, while the latter, the effect. Thus, an agent granted authority by the principal has thereby the "power" to act for him, which is taken to mean "an ability on the part of the agent to produce a change in a given legal relation, by doing and not doing a given act."

The power of the agent is also the limitation upon his ability to bind the principal, for it is well-settled that an agent binds his principal only as to acts within his actual or apparent authority. (*Ibid*., 470.)

(2) *As to scope.* — Generally speaking, the extent of the agent's authority depends upon the purpose of the agency. As between an agent and a principal, an act is within the authority of the agent if it is not a violation of his duty to the principal, and it is within his power if he has the legal ability to bind the principal to a third person although the act constitutes a violation of his duty to the principal. In fine, an agent with authority to do an act has also the power to bind the principal, but the latter may exist without the former.

So far as third persons are concerned, no distinction exists. An act within the power of the agent is deemed within the scope of his authority even if the agent has, in fact, exceeded the limits of his authority (See examples under Arts. 1900 and 1911.), or he has no authority whatever to do so as in the following cases:

(a) The ambit of the principal's liability for the agent's torts are, under circumstances to be discussed later (see Art. 1910.), not limited to acts performed by the agent within his authority, but to tortious acts done by the agent within the scope of his employment, even though beyond the scope of his authority;

(b) An agent may bind his principal in contract with a third party, although the agent was unauthorized to do so, where he has apparent or ostensible authority upon which the third party relied. Apparent or ostensible authority is proclaimed authority; and

(c) An agent, provided he be a general agent and not a special agent (see Art. 1876.), possesses the power to subject

his principal to third party liability in respect to matters incidental to that type of general agency, although the agent's contract was in point of fact unauthorized or forbidden if usually within the authority of such a general agent. This is true even though the principal is undisclosed. (see Teller, *op. cit*., p. 7.)

(d) Case law has it that wherever the doing of a certain act, or the transaction of a given affair, or the performance of certain business is confided to an agent, the authority to so act will generally carry with it by implication the authority to do all the collateral acts which are the natural and ordinary incidents of the main act or business authorized. (Guinnawa vs. People, 468 SCRA 278 [2005], citing Park vs. Moorman Manufacturing Co., 40 A.L.R. 2d 273 [1952].)

It will be seen that the power of the agent to subject his principal to liability at the instance of third persons is much wider than his authority. Of course, it is to authority that we must look in determining (a) the nature of the relationship, *i.e*., whether it be that of master and servant, principal and agent, or principal and independent contractor, and (b) the agent's ability normally to subject his principal to liability in contract. (Teller, *op. cit.*, p. 6.)

Kinds of authority.

An agent cannot act in behalf of the principal in any way he sees fit. He can make the principal legally responsible only when he is authorized by the principal to act the way he did. The authority of the agent may be:

(1) *Actual.* — when it is actually granted, and it may be express or implied. It is the authority that the agent does, in fact, have. It results from what the principal indicates to the agent;

(2) *Express.* — when it is directly conferred by words (Art. 1869.);

(3) *Implied.* — when it is incidental to the transaction or reasonably necessary to accomplish the main purpose of the agency (Art. 1881.), and, therefore, the principal is deemed to have

actually intended the agent to possess although the principal has said nothing about the particular aspect of the agent's authority;

(4) *Apparent or ostensible.* — when it is conferred by words, conduct or even by silence of the principal (see Art. 1869.) which causes a third person reasonably to believe that a particular person, who may or may not be the principal's agent, has actual authority to act for the principal. This specific type of authority is another name for *authority by estoppel* or a species of the doctrine of estoppel.[41] It is also an implied authority but only in the sense that it is not expressly conferred.

Apparent authority relied on by a third party to be possessed by an agent may be created by the principal intentionally or by negligence. It is something of a contradiction because it implies absence of actual authority. The apparent authority of an agent can only arise by the acts or conduct of the principal giving rise to an *appearance of authority* and making the principal responsible for certain agent's action that were not really authorized at all. Note that for apparent authority, an agent has authority if it appeared reasonable from the viewpoint of the third party, while in the case of implied authority, the concern is in what appeared responsible to the agent. Apparent authority is the term used where no express or implied authority is present.

Both actual and apparent authority are embraced in the agent's "power" *(supra.);*

(5) *General.* — when it refers to all the business of the principal (see Art. 1876.);

(6) *Special.* — when it is limited only to one or more specific transactions *(Ibid.)*; and

[41]Art. 1431. Through estoppel an admission or representation is rendered conclusive upon the person making it, and cannot be denied or disproved as against the person relying thereon. (Civil Code)

Sec. 2. *Conclusive presumptions*. — The following are instances of conclusive presumptions: (a) Whenever a party has, by his own declaration, act, or omission, intentionally and deliberately led another to believe a particular thing is true, and to act upon such belief, he cannot, in any litigation arising out of such declaration, act or omission, be permitted to falsify it. xxx. (Rule 131, Rules of Court.)

(7) *Authority by necessity or by operation of law.* — when it is demanded by necessity[42] or by virtue of the existence of an emergency. The agency terminates when the emergency has passed.

EXAMPLE:

P gave a power of attorney to A authorizing him to sell P's car for at least P500,000.00 payable in cash. Here, the authority of A to sell the car is *express.* If A sells the car for P600,000.00, P is bound by the transaction as it is within the scope of A's authority. Conversely, P is not required to honor the transaction if A sells the car for P400,000.00.

The authority of A includes the *implied* authority to receive payment and to give a receipt as they are acts necessary to accomplish the purpose of the agency. This type of authority is what a person in a similar position customarily has unless the principal has given indication to the contrary.

A does not have the implied authority to grant credit or because it is simply not customarily for an agent to do so unless expressly given by the principal.

Express authority and implied authority are both *actual* authority.

If P privately instructed A not to consummate the sale, the sale by A is binding upon P as A had *apparent* or *ostensible* authority to sell. The effect is as if A has actual authority to sell.

The same is true if P had not authorized A to sell the car but having knowledge that A was acting for him, kept silent and after the consummation of the sale, received the proceeds thereof from A. Here, A's authority rests on *estoppel* on the part of P to deny such authority. (see Art. 1911.) Thus, if there is estoppel based upon the conduct of the principal, it is unnecessary to distinguish between actual and apparent authority since in both cases the principal is liable.

The authority given to A to sell the car is *special* because it involves a particular transaction. A has no authority to use the car for purposes of his own but he can use it in an emergency

[42]For example, suppose the wife purchases certain basic necessaries and charges them to the husband's charge account. The husband cannot deny liability for payment for the necessaries on the assumption that the purchase is demanded by the needs of the family and the husband has the legal duty to provide such necessaries.

as, for example, to take a member of his family who is seriously hurt to a hospital. In this case, the authority of A arises by necessity or by the occurrence of an emergency.

If there is no opportunity to consult with the principal or it is impracticable for the agent to communicate with the principal and wait for instructions in emergency situations, an agent has implied authority to take actions reasonable under the circumstances including those that may be contrary to the prior instructions of the principal.

When principal bound by act of agent.

The principal is, of course, liable to the agent if he breaches his contractual or any other duty to the agent. However, the more important questions arising from the relationship relate to the principal's liability to third persons with whom the agent has dealt.

(1) *Requisites.* — In order that the principal may be bound by the act of the agent as to third persons and as to the agent himself, there are two requisites:

(a) The agent must act within the scope of his authority; and

(b) The agent must act in behalf of the principal.

(2) *Authority possessed by agent.* — The principal is bound by either actual or apparent authority of the agent.

(a) So long as the agent has actual authority, express or implied, the principal is bound by the acts of the agent on his behalf, whether or not the third person dealing with the agent believes that the agent has actual authority.

(b) Under the doctrine of apparent authority (estoppel), the principal is liable only as to third persons who have been led reasonably to believe by the conduct of the principal that such actual authority exists, although none has been given. The principal may or may not be liable to the apparent agent.[43]

[43]See "Distinctions between agency by estoppel and implied agency," under Article 1874.

(3) *Authority ratified by another (principal).* — On occasion, a person, who is in fact not an agent, may make a contract on behalf of another, or he is an agent but he has exceeded his powers. If the principal subsequently approves or affirms the contract, an agency relationship is created by ratification, and neither the principal nor the third person can set up the fact that the agent had no authority or exceeded his powers. (see Art. 1901.)

When a person not bound by act of another.

A person, therefore, is not bound by the act of another in the following instances:

(1) The latter acts without or beyond the scope of his authority in the former's name; and

(2) The latter acts within the scope of his authority but in his own name, except when the transaction involves things belonging to the principal. (Art. 1883, par. 2.)

One who acts in his own behalf without authority from another, or in the name of a non-existent principal, naturally binds himself alone. He cannot be considered an agent for any purpose, since there must be a principal in order to have an agent.

Unauthorized acts in the name of another unenforceable.

An agent acting for a principal ordinarily incurs no personal liability if he acts in a proper fashion. If the "agent" acts without authority or in excess or beyond the scope of his authority, there is no representation.

Such act is unauthorized and, therefore, unenforceable, whether or not the party with whom the agent contracted was aware of the limits of the agent's power, unless the "principal" ratifies the transaction before it is revoked by the other contracting party (Arts. 1317, 1403[1].) or is in estoppel to deny the agent's authority. (*supra*; see Art. 1911.)

Where acts in excess of authority more advantageous to principal.

The agent is not deemed to have exceeded the limits of his authority should he perform the agency in a manner more advantageous to the principal than that indicated by him (Art. 1882.) since he is authorized to do such acts as may be conducive to the accomplishment of the purpose of the agency. (Art. 1881.) This rule is of evident equity.

EXAMPLES:

(1) In the preceding example, if A sells the car to B in P's name for P500,000.00 cash, the transaction is valid. P and B are the only parties. A assumes no personal liability.

(2) If A sells the car, without authority, or being authorized, he sells the car to B for P400,000.00 cash, or for P500,000.00 payable in five (5) monthly installments, the transaction insofar as P is concerned is an unauthorized act which renders it unenforceable. Hence, P is not bound unless he ratifies the sale and provided it has not already been revoked by B.

(3) Suppose A sold the car for P550,000.00 cash, did he exceed his power? No, because the price is more advantageous to P. What is prohibited is for A to sell the car at a price less than P500,000.00 but there is no prohibition against selling it at a better price if said price can be obtained. (see Tan Tiong Teck vs. Securities and Exchange Commission, 69 Phil. 425.)

Since an agent may do such acts as may be conducive to the accomplishment of the purpose of the agency, admissions secured by the agent within the scope of the agency favors the principal. This ought to be the rule for the acts or declarations of an agent of a party within the scope of the agency and during its existence are considered and treated in turn as the declarations, acts and representations of his principal (see Sec. 26, Rule 130, Rules of Court.) and may be given in evidence against such party. (Bay View Hotel, Inc. vs. Ker & Co., Ltd., 116 SCRA 327 [1982].)

Liability of principal/agent for acts of agent beyond his authority or power.

(1) *Principal.* — As a general rule, the principal is not bound by the acts of an agent beyond his limited powers. In other words, third persons dealing with an agent do so at their risk and are bound to inquire as to the scope of his powers.

There are, however, four qualifications whereby the principal is held liable:

(a) Where his (principal's) acts have contributed to deceive a third person in good faith;

(b) Where the limitations upon the power created by him could not have been known by the third person;

(c) Where the principal has placed in the hands of the agent instruments signed by him in blank (Strong vs. Gutierrez Repide, 6 Phil. 680 [1906]; see Art. 1887.); and

(d) Where the principal has ratified the acts of the agent. (see Art. 1901.)

(2) *Agent.* — The agent who exceeds his authority is personally liable either to the principal or to the third party, in the absence of ratification by the principal.

(a) If the principal is liable to the third party on the ground of apparent authority, the agent's liability is to the principal.

(b) If the principal is not liable to the third person because the facts are such no apparent authority is present, then the agent's liability is to the third party.

(c) If the agent personally assumes responsibility for the particular transaction, if the principal defaults he, in effect, also becomes obligated as a co-principal.

Action must be brought by and against principal.

(1) An action is not properly instituted when brought in the name of an attorney-in-fact *("aporado")* and not in the name of the principal, the real party-in-interest, and in such case the

complaint must be dismissed not upon the merits, but on the ground that is has been improperly instituted. (Esperanza and Bullo vs. Catindig, 27 Phil. 397 [1914].)

(2) When the principal is bound by the act of the agent, the action must be brought against the principal, not against the agent. The bringing of the action against the agent cannot have any legal effect except that of notifying the agent of the claim. Beyond such notification, the filing of the action can serve no other purpose. There is no law giving any effect to such action upon the principal. (Ang vs. Fulton Fire Insurance Co., 2 SCRA 945 [1961].)

> **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)**

Kinds of principal.

The principal may be disclosed, partially disclosed, or undisclosed.

(1) *Disclosed principal.* — if at the time of the transaction contracted by the agent, the other party thereto has known that the agent is acting for a principal and of the principal's identity. (see Macias & Co. vs. Warner Barnes & Co., 43 Phil. 155 [1922]; Commercial Bank & Trust Co. of the Phil. vs. Republic Armored Car Service Corp., 9 SCRA 142 [1963]; Resolution on motion for new trial.) This is the usual type of agency.

(2) *Partially disclosed principal.* — if the other party knows or has reason to know that the agent is or may be acting for a principal but is unaware of the principal's identity. The partially

disclosed principal may enforce against the third person the contract of the agent like any disclosed principal. Similarly, the third person has a right of action against the principal. In sum, the liability of the third party and the principal is the same as in the case of a disclosed principal, except that the agent is also liable to the third party, unless they agree otherwise.

(3) *Undisclosed principal.* — if the party has no notice of the fact that the agent is acting as such for a principal. (see 3 Am. Jur. 2d 665.)

If a person purports to act for a non-existent principal, obviously he is liable to the party with whom he contracted. Since there is no principal, there is no agent at all; the person merely claims to be one.

Agency with undisclosed principal.

In order that an agent may bind his principal (whether identified by name or not), he must act on behalf of the latter (see Art. 1868.) and within the scope of his authority. (Art. 1881.)

(1) *General rule.* — Article 1883 speaks of a case where the agent (a) being authorized to act on behalf of the principal, (b) acts instead in his own name. In such case, the general rule is that the agent is the one directly liable to the person with whom he had contracted as if the transaction were his own.

The reason for the rule is that there is no representation of the principal when the agent acts in his own name. In effect, the resulting contractual relation is only between the agent and the third person. Therefore, the principal cannot have a right of action against the third person nor the third person against him.[44]

[44]Under the Negotiable Instruments Law (Act No. 2031.), parol evidence is inadmissible to charge a party not appearing on the face of the instrument. The pertinent provisions are the following:

"Sec. 18. *Liability of person signing in trade or assumed name.* — No person is liable on the instrument whose signature does not appear thereon, except as herein otherwise expressly provided.

But one who signs in a trade or assumed name will be liable to the same extent as if he had signed in his own name.

Sec. 19. *Signature by agent; authority; how shown.* — The signature of any party may be made by a duly authorized agent. No particular form of appointment is necessary for this purpose; and the authority of the agent may be established as in other cases of agency.

(see Lim vs. Ruiz y Rementeria, 15 Phil. 367 [1910]; Herranz & Garriz vs. Ker & Co., 8 Phil. 162 [1907]; Smith Bell & Co. vs. Sotelo Matti, 44 Phil. 874 [1923]; Behn, Meyer & Co. vs. Banco Español-Filipino, 51 Phil. 253 [1927]; Ortega vs. Bauang Farmers Cooperative Marketing Association, 106 Phil. 867 [1959]; Lim Tek Goan vs. Azores, 70 Phil. 363 [1940].) The third person cannot very well allege that he was misled by any representation of the agent since he did not know of the existence of the undisclosed principal.

An agent who enters into a contract in his own name without disclosing the identity of his principal renders himself personally liable even though the third person knows that he is acting as agent, unless it affirmatively appears that it was the mutual intention of the parties to the contract that the agent should not be bound. (2 C.J. Sec. 488.) It is a well-settled principle that the agent shall be liable for the act or omission of the principal only if the latter is undisclosed. (Maritime Agencies & Securities, Inc. vs. Court of Appeals, 187 SCRA 346 [1990].) Note that the exception in Article 1883 does not include knowledge by the third party that the agent who is acting in his own name is acting for another.

(2) *Exception.* — The exception to the rule that an agent acting in his own name does not bind the principal is when the contract involves things belonging to the principal. (Art. 1883, par. 2; see Gold Star Mining Co., Inc. vs. Lim-Jimena, 25 SCRA 597 [1968].) In such case, the contract is considered as entered into between the principal and the third person.

This exception is necessary for the protection of third persons against possible collusion between the agent and the principal. It applies only when the agent has, in fact, been authorized by the principal to enter into the particular transaction, but the agent, instead of contracting for and in behalf of the principal, acts in

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Sec. 20. *Liability of person signing as agent, etc.* — Where the instrument contains or a person adds to his signature words indicating that he signs for or on behalf of a principal or in a representative capacity, he is not liable on the instrument if he was duly authorized; but the mere addition of words describing him as an agent, or as filling a representative character, without disclosing his principal, does not exempt him from personal liability.''

his own name. (Phil. National Bank vs. Agudelo y Gonzaga, 58 Phil. 635 [1933]; Manubay vs. Picache, 2 C.A. Rep. 1034.)

According to this exception (when things belonging to the principal are dealt with), the agent is bound to the principal although he does not assume the character of such agent and appears acting in his own name. This means that in the case of this exception, the agent's apparent representation yields to the principal's true representation and that, in reality and in effect, the contract must be considered as entered into between the principal and the third person. Consequently, if the obligations belong to the former, to him alone must also belong the rights arising from the contract. Thus:

(a) The fact that the money with which the property was bought by the agent belonged to the principal, the exception established in Article 1883 is applicable. (Sy-Juco and Viardo vs. Sy-Juco, 40 Phil. 634 [1920].)

(b) The fact that the agent sold as owner thereof the property of the principal and that he personally executed the deed of sale may be only a violation of the agency on his part, without, however, affecting his authority to sell it. The question is not what representation he made and/or what he did to sell it, but whose property he sold. If the property he sold belonged to the principal and he was authorized to sell the same, whatever the agent said or did to effect the sale is beside the point. (Nicolas vs. Bormacheco, Inc., [C.A.] 70 O.G. 3971 [1973].)

(c) Where the commission agent of the plaintiff-shipowner personally obligated himself to transport the goods of the defendant, the latter is liable to the plaintiff for freightage and other charges due under the contract and paid to the agent after the defendant had been informed of the ownership of the vessel, although the agent did not assume the character of such agent and appeared to have acted in his own name. The agent and the defendant are solidarily liable to the plaintiff. If the principal can be obliged to perform his duties under the contract, then it can also demand the enforcement of its rights under the contract. (National Food

Authority vs. Intermediate Appellate Court, 184 SCRA 166 [1990].)

(3) *Remedy of principal.* — The foregoing is without prejudice to the principal's right to demand from the agent damages for his failure to comply with the agency. (*Ibid*., par. 3; Art. 1884, par. 1.) The rule in this jurisdiction is that where merchandise is purchased from an agent with undisclosed principal and without knowledge on the part of the purchaser that the vendor is merely an agent, the purchaser takes title to the merchandise and the principal cannot maintain an action against him for the recovery of the merchandise or for damages, but can only proceed against the agent. (Aivad vs. Filma Mercantile Co., 49 Phil. 816 [1926].)

(4) *Remedy of third person.* — Although according to Article 1883, when the agent acts in his own name he is not personally liable to the person with whom he enters into a contract when things belonging to the principal are the subject thereof, yet such third person has a right of action not only against the principal but also against the agent, when the rights and obligations which are the subject-matter of the litigation cannot be legally and juridically determined without hearing both of them. (Beaumont vs. Prieto, 41 Phil. 670 [1921].)

Section 13, Rule 3 of the Rules of Court specifically permits the plaintiff to sue several defendants in the alternative, when he is uncertain against which of them he is entitled to relief, with a view to ascertaining who among them is liable. Thus, where the alleged principal denies the authority of the agent to act in his name, the latter must be given a chance to prove that he really had such authority. And if the former succeeds in establishing such lack of authority on the part of the supposed agent, only the latter would be liable.

EXAMPLES:

(1) P authorized A to bid for him in the construction of a certain building. A acted in his own name, that is, without disclosing that his bid was on behalf of P.

If the bid of A was the lowest, only A and the owner of the building would be bound to each other. But A is liable to P under the contract of agency.

(2) P authorized A to borrow money and to mortgage P's real property. A negotiated a loan to himself and signed the mortgage in his own behalf and not in behalf of P.

The mortgage is not binding upon P. In order to bind the principal by a mortgage on real property executed by an agent, it must upon its face purport to be made and signed in the name of the principal. It is not enough merely that the agent was, in fact, authorized to mortgage, if he has not acted in the name of the principal. (see Phil. Sugar Estates Dev. Co. vs. Poiza, 48 Phil. 536 [1926].)

(3) P authorized A to sell the former's car. A sold the car to B. A acted in his own name. Here, the contract involves a thing belonging to the principal. The sale is completely valid. The contract is deemed entered into between P and B. So B can sue P in case the car has hidden defects.

(4) P told A to buy a car. A bought a car from B with money belonging to P. A acted in his own name. B and P have a right of action against each other. Thus, P can sue B in case the car has hidden defects.

(5) P authorized A to buy certain merchandise. A bought from B the merchandise in his own name, but really for the account of P. B has an option to look to either P or A for payment unless:

(a) B trusted A exclusively; or

(b) by the usage and understanding of business the agent (A) only is held; or

(c) unless the special circumstances of the case reveal that only the agent was intended to be bound and the seller (B) knew it, or was chargeable with knowledge of it. (Wing Lee Compradoring Co. vs. Bark "Manonggahela," 44 Phil. 464 [1923].)

(6) B purchased certain goods from A who was P's agent. Neither P nor A notified B that A was acting as agent of P. B believes that A was the owner of the goods and paid for the goods in full to A who acted in his own name.

P has no right of action against B for the price of the goods. "It is well-settled that the rights of an undisclosed principal are subject to claims acquired in good faith against the agent. In other words, a third person who contracts in ignorance of the existence of a principal can set up against the principal

who sues upon the contract any defenses and equities which he could have set up against the agent had the latter been in reality the principal suing in his behalf." (Lovelace vs. Reliable Garage, 125 S.E. 877.)

(7) A purchased merchandise from T upon credit authorized by P, but without disclosing P's name. Before the agency is disclosed to T, payment is subsequently made by P in good faith to A for T. A did not pay T. In this case, P would not be liable to T.

ILLUSTRATIVE CASES:

1. *Third person brings action against agent of undisclosed principal.*

Facts: A, agent, signed under a trade name used by P, his principal, in conducting the latter's business. T did not know that A was acting as agent of P. He sought to hold A liable partly because the principal was undisclosed.

Issue: Is the defense of A that he was acting as agent of P good?

Held: No. Personal liability may be visited on A since the use of the trade name was not sufficient disclosure of P's identity to give A an agency status as a matter of law. (*Saco Dairy Co. vs. Thompson Norden, 35 Atl. [2d], 857 [Mol],* cited in Teller, p. 223.)

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2. *Undisclosed principal brings action against seller for breach of warranty.*

Facts: A bought a horse from T for P but in A's name and without disclosure of the agency.

Issue: Is an action for breach of warranty of soundness of the horse maintainable in the name of P, though before unknown as the principal?

Held: Yes. The principal may claim all his rights, though not at first known, just as if he had been known, with the single limitation that the other party shall not lose any right which he would have against the agent if the agent were principal as he had first been supposed to be. The reason for the doctrine is that it is but just that every man should have what really,

though secretly, belongs to him, so far as he can obtain it without injuring another by appearing in his true character as owner. *(Wooddruff vs. McGeKee, 30 Ga. 159 [1960].)*

_____ _____ _____

3. *Seller refused to sign contract of sale after discovering the identity of the buyer (undisclosed principal) who acted through an agent.*

Facts: P had been in T's employ but had been discharged for misconduct. Wishing to buy a parcel of land from T, and knowing that T would not entertain any offer he might make, P procured A, a friend, to buy the property for him without disclosing the agency. T refused to sign the agreement when he discovered that P was the real buyer.

Issue: Is P entitled to specific performance?

Held: Yes. The agreement which P seeks to enforce is not one in which any personal qualifications possessed by A formed a material ingredient, but is a simple agreement for sale of land in consideration of a lump sum to be paid. It is an agreement which T would have entered into with any other person. It is well-settled that the benefits of such agreement is assignable and that the assignee can enforce specific performance of it. *(Syster vs. Randall & Sons, 1 Ch. 939 [1926].)*

_____ _____ _____

4. *Charterer's agent is sued for loss/damage to cargo which took place during the voyage.*

Facts: TFC, a non-resident foreign corporation, chartered from H shipping a vessel for the shipment of goods to the Philippines with Atlas as consignee. The goods were insured by Atlas with X Company. MAS was appointed as the charterer's (TFC's) agent and MC as the shipowner's (H's) agent. The charterer assumed responsibility for loading, storage and discharging at the ports visited, while the owner, for the care of the cargo during the voyage.

Atlas filed a claim for losses/damages to the cargo during the voyage. As subrogee of the consignee, X brought suit for reimbursement of the amount paid to Atlas, against H, MAS, and MC. TFC was not impleaded and so beyond the jurisdiction of the court.

Issue: Are the defendants liable?

Held: (1) Both H and MC are liable. However, since X's complaint against MC was filed beyond the one-year prescriptive period provided under the Carriage of Goods by Sea Act (C.A. No. 65.), only H is liable.

(2) As regards the goods damaged or lost during unloading, the charterer is liable therefor, having assumed this activity under the charter party "free of expense to the vessel." The difficulty is that TFC has not been impleaded in these cases and so is beyond the court's jurisdiction. The liability imposable upon it cannot be borne by MAS which, as a mere agent, is not answerable for injury caused by its principal. It is a well-settled principle that the agent shall be liable for the act or omission of the principal only if the latter is undisclosed.

MAS did not represent itself as a carrier and indeed assumed responsibility only for the unloading of the cargo, *i.e.*, after the goods were already outside the custody of the vessel. In supervising the unloading of the cargo and issuing Daily Operations Report and Statement of Facts indicating and describing the day-to-day discharge of the cargo, MAS acted in representation of the charterer and not of the vessel. It, thus, cannot be considered a ship agent. *(Maritime Agencies & Services, Inc. vs. Court of Appeals, 187 SCRA 346 [1990].)*

The question is whether the consideration of the contracting party enters as an element of the contract. If it does and the defendant was induced by a deception as to the real party, the contract may not be enforced against the one deceived. Thus, a contract to lend money is not enforceable by the borrower's undisclosed principal, whether or not security is to be given. (Shields vs. Cayne, 148 Iowa 313, 127 N.W. 63 [1910].)

ILLUSTRATIVE CASE:

Buyer returned the thing bought upon discovering the identity of seller (undisclosed principal) who acted through an agent.

Facts: P, knowing that T would not deal with him, employed A to act as his agent, though ostensibly as principal in selling oxen to T. The transaction was consummated in this manner, but when T learned of the facts, he returned the oxen.

Issue: In an action by P, based on the allegation that title passed to T, has P the right to recover the purchase price?

Held: No. "There may be good reason why one should be unwilling to buy a pair of oxen that had been owned or used or were claimed by a particular person, or why he should be unwilling to have dealings with that person; and as a man's right to refuse to enter into contract is absolute, he is not obliged to submit the validity of the reasons to a court or jury." (Winchester vs. Howard, 97 Mass. 303, cited in Teller, p. 123.)

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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)

Obligations, in general, of agent to principal.

(1) *Good faith and loyalty to his trust, agent's first duty.* — As has been pointed out (see discussions under Art. 1868.), the relationship existing between principal and agent is a fiduciary one, demanding conditions of trust and confidence.[1] Accordingly,

[1](15) *How Far a Lawyer May Go in Supporting a Client's Cause.* — The lawyer owes "entire devotion to the interest of the client, warm zeal in the maintenance and defense of his right and the exertion of his utmost learning and ability," to the end that nothing be taken or be withheld from him, save by the rules of law, legally applied. No fear of judicial disfavor or public unpopularity should restrain him from the full discharge of his duty. In the judicial forum, the client is entitled to the benefit of any and every remedy and defense that is authorized by the law of the land, and he may expect his lawyer to assert every such remedy or defense. But it is steadfastly to be borne in mind that the great trust of the lawyer is to be performed within and not without the bounds of the law. The office of attorney does not permit, much less does it demand of him for any client, violation of law or any manner of fraud or chicanery. He must obey his own conscience and not that of his client. (Canons of Professional Ethics.)

Canon 19. — A LAWYER SHALL REPRESENT HIS CLIENT WITH ZEAL WITHIN THE BOUNDS OF THE LAW.

Rule 19.01. — A lawyer shall employ only fair and honest means to attain the lawful objectives of his client and shall not present, participate in presenting or threaten

in all transactions concerning or affecting the subject matter of the agency, it is the duty of the agent to act with the utmost good faith and loyalty for the furtherance and advancement of the interests of the principal. The duty of good faith is also called the fiduciary duly which imposes upon the agent the obligation of faithful service. The duty to be loyal to the principal demands that the agent look out for the best interests of the principal as against his own or those of the third party.

It is immaterial in the application of this rule that the agency is one coupled with interest (see Art. 1927.), or that the compensation given the agency is small or nominal, or that it is a gratuitous agency. (3 C.J.S. 6-7.)

(a) *Presumption.* — An agent's acts which tend to violate his fiduciary duty are not only invalid as to the principal, but are also against public policy. In the absence of proof to the contrary, however, the presumption arises that an agent has performed his duty in good faith, and the principal, until notice is received of a breach of relational duties, may rely upon his agent's faithfulness. (*Ibid*., 7.)

(b) *General rule as to loyalty when not applicable.* — The general rule as to loyalty does not apply to cases where no relation of trust or confidence exists between the parties, as where the agent is bound merely as an instrument, more properly as a servant, to perform a service, or where there is no showing of an agency relationship. *(Ibid.)*

(2) *Obedience to principal's instruction.* — An agent must obey all lawful orders and instructions of the principal within the scope of the agency. If he fails to do so, he becomes liable for any loss the principal incurs even though he can show that he acted in good faith or exercised reasonableness. Even a gratuitous

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to present unfounded criminal charges to obtain an improper advantage in any case or proceeding.

Rule 19.02. — A lawyer who has received information that his client has, in the course of the representation, perpetrated a fraud upon a person or tribunal, shall promptly call upon the client to rectify the same, and failing which he shall terminate the relationship with such client in accordance with the Rules of Court.

Rule 19.03. — A lawyer shall not allow his client to dictate the procedure in handling the case. (Code of Professional Responsibility.)

agent must follow instructions or become responsible for any loss resulting from failure to do so. But an agent is not liable if he violates the principal's instructions for a good reason. Related to the agent's duty to obey instructions is the duty to keep within the limits of his authority when acting for the principal. An agent must know the extent of his authority. If he is in doubt, he should ask the principal for clarification.

(3) *Exercise of reasonable care.* — By accepting an employment whose requirements he knows, without stipulating otherwise, the agent impliedly undertakes that he possesses a degree of skill reasonably or ordinarily competent for the performance of the service, and that in performing his undertaking, he will exercise reasonable care, skill and diligence. He does not agree that he will make no mistake whatsoever, or that he will exercise the highest skill or diligence, but he does agree that he will exercise reasonable skill, and that he will take the usual precautions (Mechem, Sec. 524, p. 360; see Art. 1909; British Airways vs. Court of Appeals, 285 SCRA 450 [1998].) as a reasonably careful agent would under similar circumstances. Failure to do so constitutes a breach of his duty.

ILLUSTRATIVE CASES:

1. *In attempting a settlement of a controversy, a lawyer lost sight of a statute of limitations which had run against his client.*

Facts: P's wagon suffered from a collision with a traincar operated by T Corporation, the collision being caused by the negligence of the driver of T. A (lawyer), on taking charge of the case, attempted a settlement, and the controversy extended until a six (6) months' statute of limitations had run against P.

A claimed that he was misled by the conduct of the corporation and he was satisfied that it would pay.

Issue: Is A guilty of negligence?

Held: Yes. The duty of A was not discharged when he communicated the offer of T to P who made no reply. It was his duty to know the provisions of the law and to apply his knowledge. To lose sight of the statute was to fail in that degree of care and skill to which the client is entitled. If he had written a warning to P that the period of limitation was running out

and that if P were meditating legal proceedings he should have given instructions at once, that might have satisfied his (A's) obligation to P. *(Fletcher & Sons vs. Lubb Booth & Helliwell, 1 K.B. 275 [1919].)*

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2. *Agent, in violation of instruction of principal, delivered a note entrusted to him by principal, to a person who misappropriated the note.*

Facts: P delivered a note to A to get discounted, instructing him "not to let the note get out of his reach without receiving the money." A delivered the note to T, who promised to get it discounted and bring back the money, but instead misappropriated the note.

Issue: Is A liable for the conversion[2] of the note?

Held: Yes. The delivery to T was unauthorized and wrongful because it was contrary to the express directions of P. It was an unlawful interference with P's property which resulted in loss and that interference and disposition constituted a conversion. A had no more right to deliver the note to T to take away, any more than he had to pay his own debt with it. Morally, there might be a difference, but in law, both acts would be a conversion, each consisting in exercising an unauthorized dominion over P's property. *(Laverty vs. Snerthen, 68 N.Y. 522 [1877].)*

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3. *Agent violated instructions as to price.*

Facts: A (broker) sold property of P at a price below P's instructions.

Issue: Is A liable for conversion of the property?

Held: No. In this case A did nothing with the property but what he was authorized to do. He had a right to sell and deliver the property. He disobeyed instructions as to price only and was liable for misconduct, but not for conversion of the property, a distinction which, in a practical sense, may seem technical, but it is founded probably upon the distinction

[2]Conversion is the unauthorized exercise of the right of ownership over goods or property of another person.

between an unauthorized interference with the property itself and the avails or terms of sale. (*Dufresne vs. Hutchinson, 3 Taunt. 117, and Sarjeant vs. Blunt, 16 Johns. 74,* cited in the *Laverty* case.)

Specific obligations of agent to principal.

They are the following:

(1) To carry out the agency which he has accepted;

(2) To answer for damages which through his performance the principal may suffer *(Ibid.);*

(3) To finish the business already begun on the death of the principal should delay entail any danger *(Ibid.);*

(4) 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 in case he declines an agency, until an agent is appointed (Art. 1885.);

(5) To advance the necessary funds should there be a stipulation to do so (Art. 1886.);

(6) To act in accordance with the instructions of the principal, and in default thereof, to do all that a good father of a family would do (Art. 1887.);

(7) Not to carry out the agency if its execution would manifestly result in loss or damage to the principal (Art. 1888.);

(8) To answer for damages if there being a conflict between his interests and those of the principal, he should prefer his own (Art. 1889.);

(9) Not to loan to himself if he has been authorized to lend money at interest (Art. 1890.);

(10) To render an account of his transactions and to deliver to the principal whatever he may have received by virtue of the agency (Art. 1891.);

(11) To distinguish goods by countermarks and designate the merchandise respectively belonging to each principal, in the case of a commission agent who handles goods of the same kind and mark, which belong to different owners (Art. 1904.);

(12) To be responsible in certain cases for the acts of the substitute appointed by him (Art. 1892.);

(13) To pay interest on funds he has applied to his own use (Art. 1896.);

(14) To inform the principal, where an authorized sale of credit has been made, of such sale (Art. 1906.);

(15) To bear the risk of collection, should he receive also on a sale, a guarantee commission (Art. 1907.);

(16) To indemnify the principal for damages for his failure to collect the credits of his principal at the time that they become due (Art. 1908.); and

(17) To be responsible for fraud or negligence. (Art. 1909.)

Obligation to carry out the agency.

A person is free to refuse to be an agent (Art. 1885.) but once he accepts the agency, he is bound to carry it out in accordance with its terms in good faith (Art. 1159.) and following the instructions, if any, of the principal. (Art. 1887.) He is normally expected to exercise the degree of care and skill that is reasonable under the circumstances. By contract, the parties may make the agent's duty of diligence in carrying out the agency either stricter or more linient.

If the agent fulfills his duty, he is not personally liable unless he expressly binds himself. (Art. 1897.)

Obligation to answer for damages.

On the other hand, upon his failure to do so, he is liable for the damage which the principal may suffer. This rule is an application to agency of the general rule in contracts that any person guilty of fraud, negligence, or delay in the fulfillment of his obligation, or who in any other manner fails to comply with the terms thereof, shall be liable for damages. (Art. 1170; see Art. 1909.) Having accepted the agency when he was free to refuse it, the agent betrays the confidence reposed on him if he does not fulfill the mandate.

The damages to which the principal is entitled are those which result from the agent's non-performance. As there can be no indemnity when there has been no damage, the principal must prove his damages and the amount thereof. (11 Manresa 504.)

ILLUSTRATIVE CASE:

Creditor-assignee neglected in its duty to collect the sums due the debtor-assignor from the latter's debtors, thereby allowing such funds to be exhausted by other creditors.

Facts: A (PNB) had opened a letter of credit and advanced thereon $120,000.00 for 8,000 tons of hot asphalt in favor of P. Of this amount, 2,000 tons worth P280,000.00 were released and delivered to P under a trust receipt guaranteed by a surety. To pay for the asphalt, P constituted A, its assignee and attorney-in-fact, to receive and collect from D (Bureau of Public Works) the amount aforesaid out of funds payable to A. The assignment stipulated that the power of attorney shall remain irrevocable until P's total indebtedness to A has been fully liquidated.

A regularly collected from D for about 8 months. Thereafter, for unexplained reasons, A stopped collecting from D the money falling due in favor of P before the debt was fully collected, thereby allowing such funds to be taken and exhausted by other creditors.

Issue: Is A answerable for negligence in failing to collect the sums due its debtor (P) from the latter's debtor (D)?

Held: Yes. A is guilty of neglect in collecting from D (not from P, the principal debtor), contrary to its duty as holder of an exclusive and irrevocable power of attorney to make such collections since an agent is required to act with the care of a good father of a family (Art. 1887.) and becomes liable for the damages which the principal may suffer through his non-performance. It must not be forgotten that A's power to collect was expressly made *irrevocable*, so that D could very well refuse to make payments to P, the principal debtor himself, and *a fortiori*, reject any demands by the surety. A's negligence exonerated the surety. *(Phil. National Bank vs. Manila Surety & Fidelity Co., Inc., 14 SCRA 776 [1965].)*

Obligation to finish business upon principal's death.

Although the death of the principal extinguishes the agency (Art. 1919[3].), the agent has an obligation to conclude the business already begun on the death of the principal. The rule is in accord with the principles of equity. But the duty exists only should delay entail any danger.

The agency shall also remain in full force 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.) Where an agent makes use of the power of attorney after the death of his principal, the agent has the obligation to deliver the amount collected by him by virtue of said power to the administrator of the estate of the principal. (Ramos vs. Cavives, 94 Phil. 440 [1954].)

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)

Obligation of person who declines an agency.

In the event a person declines an agency, he is still bound to observe the diligence of a good father of a family (see Art. 1163.) in the custody and preservation of the goods forwarded to him by the owner. This rule is based on equity. The owner, however, must act as soon as practicable either (1) by appointing an agent or (2) by taking charge of the goods.

The obligation of an agent who withdraws from an agency is provided in Article 1929.

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)

Obligation to advance necessary funds.

As a rule, the principal must advance to the agent, should the latter so request, the sums necessary for the execution of the agency. (Art. 1912.) The contract of agency, however, may stipulate that the agent shall advance the necessary funds. (see Art. 1159.) In such case, the agent is bound to furnish such funds except when the principal is insolvent. The exception is based on the principal's obligation to reimburse the agent. Incidentally, the insolvency of the principal is a ground for extinguishment of agency. (Art. 1912[3].)

In certain cases, the principal is not liable for the expenses incurred by the agent. (see Art. 1918.)

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)

Instructions (of principal) defined.

Instructions are private directions which the principal may give the agent in regard to the manner of performing his duties as such agent but of which a third party is ignorant. They are said to be *secret* if the principal intended them not to be made known to such party.

Instructions distinguished from authority.

The distinctions are:

(1) Authority (see Arts. 1881, 1882.), the sum total of the powers committed or permitted to the agent by the principal, may be limited in scope and such limitations are themselves a part of the authority, but instructions direct the manner of transacting the authorized business and contemplates only a

private rule of guidance to the agent and are independent and distinct in character;

(2) Authority relates to the subject with which the agent is empowered to deal or the kind of business or transactions upon which he is empowered to act, while instructions refer to the manner or mode of his action with respect to matters which in their substance are within the scope of permitted action;

(3) Limitations of authority are operative as against those who have or are charged with knowledge of them (see Art. 1900.), while instructions limiting the agent's authority are without significance as against those dealing with the agent with neither knowledge nor notice of them; (see Art. 1902.) and

(4) Authority is contemplated to be made known to the third person dealing with the agent, while instructions are not expected to be made known to those with whom the agent deals. (see 2 C.J.S. 1200-1202.)

Effect of violation of principal's instructions.

(1) *Liability of principal to third person.* — If an act done by an agent is within the apparent scope of the authority with which he has been clothed, it matters not that it is directly contrary to the instructions of the principal. The principal will, nevertheless, be liable unless the third person with whom the agent dealt knew that he was exceeding his authority or violating his instructions. (3 Am. Jur. 2d 628.)

Third persons dealing with an agent do so at their peril and are bound to inquire as to the extent of his authority but they are not required to investigate the instructions of the principal. In other words, the principal after clothing an agent with apparent powers, cannot, by means of private communications with the agent, limit the authority which he allows the agent to assume. (*Ibid*., 486-487; see Art. 1902.) The principal will be liable to third persons, under the doctrine of estoppel (see Art. 1911.), for any unauthorized acts of the agent who exceeds the instructions given to him.

(2) *Liability of agent to principal. — infra.*

EXAMPLES:

(1) P writes to B that A is authorized to buy certain merchandise. P privately instructs A not to buy but merely to obtain B's lowest price. In violation of said instruction, A buys the merchandise.

In this case, the sale is binding upon P under the doctrine of estoppel because A has apparent authority to make the purchase although it is not in accordance with the instruction given.

(2) P employed A to sell P's horse at the best possible price, with private direction that A may receive P10,000.00, but no less. A sold the horse as agent of P for only P8,000.00 to T.

In this case, P is bound by the sale. The permission to sell for P10,000.00 and the direction not to sell for less, are not ordinarily to be communicated to T, although intended to control the action of A, and are not to be regarded as limitations upon A's authority. P trusts A, who has discretion on the matter, and "it would be most mischievous to hold such direction as a condition, upon a compliance with which depended the validity of the [sale]." (Hatch vs. Taylor, 10 N.H. 538 [1840].) A's violation of the instruction makes him liable to P.

Note: If there is no evidence showing that P gave A authority to sell the horse, P is not bound unless he is in estoppel. Agency cannot be proved by the mere declaration of the agent that he had been given the authority.[3]

Obligation to act in accordance with principal's instructions.

(1) *Duty to obey reasonable and lawful instructions*. — It is the fundamental duty of the agent to obey all the reasonable and lawful instructions given to him by his principal. That the agent shall, for the time being, put his own will under the direction of another, is one of the primary elements in the relation. (Mechem,

[3]Sec. 29. *Admission by co-partner or agent.* — The act or declaration of a partner or agent of the party within the scope of his authority and during the existence of the partnership or agency, may be given in evidence against such party after the partnership or agency is shown by evidence other than such act or declaration. x x x. (Rule 130, Rules of Court.)

Sec. 1244.) He must follow instructions even if he thinks they are capricious or unwise. He violates his duty of obedience whenever he disregards or deviates from such instructions. But an agent need not follow instructions that are outside the scope of the agency relationship agreed upon or that may subject him to unreasonable risk of injury to himself.

(2) *Liability for loss or damage.* — If the agent exceeds, violates, or fails to act upon such instructions, he will be liable to the principal for any loss or damage resulting therefrom. Thus, if an agent fails to effect an insurance as instructed, or sells on credit or for a less price where he has been given instruction to sell for cash, or for a certain price, or sells to irresponsible persons when instructed to sell only to those of undoubted solvency, or fails to take security for a loan as instructed, he is liable for the consequent loss. (see 3 C.J.S. 29-30.)

(3) *Duty to act in good faith and with due care.* — In the absence of specific instructions of the principal, the agent shall do all that a good father of a family taking care of the business as if it were his own would do as required by the nature of the business. (Art. 1887, par. 2.) If he acts in good faith and with due care, the agent is not liable for losses due to errors or mistakes of judgment as regards to matters with which he is vested with discretionary powers. It will be presumed that the agent acted in good faith and in accordance with his power as he understood it. (Liñan vs. Puno, 31 Phil. 529 [1915].)

EXAMPLE:

P ordered A, his broker, to sell 10,000 shares at a minimum price of P1.00 per share. All the transactions in the market showed that the said shares were being traded at P1.10 per share.

Now, if A sold the shares at only P1.00 per share, P is entitled to recover the difference of P0.10 for each of the 10,000 shares. Good faith and ordinary prudence demand that A should sell the shares at the price most profitable to P.

(4) *Exemption from liability for failure of undertaking.* — The agent has the power (not the right) in many cases to bind his

principal even when he acts beyond his authority. Accordingly, the law imposes upon him the duty not to exceed the authority given him by his principal. However, when an agent, in executing the orders and commissions of his principal, carries out the instructions he has received from his principal, and does not appear to have exceeded his authority or to have acted with negligence, deceit, or fraud, he cannot be held responsible for the failure of his principal to accomplish the object of the agency. (Gutierrez Hermanos vs. Oria Hermanos, 30 Phil. 491 [1915]; G. Puyat & Sons, Inc. vs. Arco Amusement Company, 72 Phil. 402 [1941].)

Since an agent is required to exercise only ordinary care, skill, and diligence, he is not, in the absence of an agreement, an insurer of the success of his undertaking, and does not guarantee the principal against incidental losses. (3 C.J.S. 36.)

EXAMPLE:

Suppose in the preceding example, A was given the discretion to sell the shares if he believes it would be profitable to P or not to sell them if he believes their price would still go up. A sold the shares at P1.10 per share. The next day the price rose to P1.30 a share.

In this case, A is not liable to P if he acted in good faith for losses suffered by P due to A's error of judgment.

(5) *Right to disobey principal's instructions.* — The agent may disobey the principal's instruction where it calls for the performance of illegal acts, or where he is privileged to do so to protect his security interest in the subject matter of the agency.

EXAMPLE:

A has lien on P's goods (see Art. 1914.) in A's possession to the extent of all moneys advanced by A to P. (see Art. 1912.) P directs A to return the goods or sell them on credit.

A is not bound to comply with P's orders until P has repaid all advances made by A. Unless privileged, A's disobedience subjects him to liability in damages and, if material, justifies P in terminating the agency. (Babb & Martin, *op. cit.*, p. 142.)

When departure from principal's instructions justified.

(1) A departure from instructions may be justified by a *sudden emergency*. Where some unexpected emergency or unforeseen event occurs which will admit no delay for communication with the principal, the agent is justified in adopting the course which seems best to him under the circumstances. A company foreman may be instructed to call a certain physician in case of accident. Surely, the foreman is justified in calling another physician if a serious accident occurs and he is unable to communicate with either the named physician or his principal.

The rule is applicable only where the principal cannot be consulted and where the circumstances cannot admit delay. (Wyatt & Wyatt, *op. cit*., p. 276.)

(2) *Ambiguous instructions* are another instance which may justify an agent in not following instructions. The agent will not be liable if he chooses reasonably one of two possible interpretations. Customs and usage may aid in the interpretation of ambiguous instructions but not to the extent of overruling positive instructions to the contrary. Nor will the agent be justified in following ideas of his own which are not within any interpretation of the instructions. *(Ibid.)*

Where instructions are ambiguous, the agent is not chargeable with disobedience or its consequences in case he makes an honest mistake and adopts a construction different from that intended by the principal. (2 C.J. Sec. 374.) If the instructions are ambiguous, the agent cannot disregard them altogether. He fulfills his duty, when acting in good faith, he interprets them in a manner that is reasonable under the circumstances. It is the duty of the principal to couch his instructions in clear terms.

(3) An agent may not be said to have breached the agency contract by reason of an *insubstantial departure* from the principal's instructions, which does not affect the result. However, a departure cannot usually be termed "insubstantial" in the face of the principal's countervailing instruction, for the principal has a right to determine what he will consider important.

But it has been said that a trivial mistake will not be held a bar to the agent's claim for compensation. Thus, if A is instructed to execute a deed on July 1st but it is mistakenly executed on July 2nd without damage to principal, it would seem that the principal should not be able to treat the departure so seriously as to constitute it a breach of the agency contract. (Teller, *op. cit.*, pp. 133-134.)

ART. 1888. An agent shall not carry out an agency if its execution would manifestly result in loss or damage to the principal. (n)

When agent shall not carry out agency.

The agent, upon acceptance of the agency, is not bound in all cases to carry out the agency (Art. 1884.) in accordance with the instructions of the principal. (Art. 1887.) Thus, the agent must not carry out the agency if its execution would *manifestly* result in loss or damage to the principal.

The reason for Article 1888 is obvious. The duty of the agent who is merely an extension of the personality of the principal is to render service for the benefit of the principal and not to act to his detriment. Furthermore, an agent must exercise due diligence in carrying out the agency. (Arts. 1884, 1887, par. 2.)

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)

Obligation not to prefer his own interests to those of principal.

(1) *Reason for the rule.* — Agency being a fiduciary relation, the agent is required to observe utmost good faith and loyalty towards his principal. He must look after the principal's interests as if they were his own. He is not permitted without the knowledge and consent of the principal, to assume two distinct and opposite characters in the same transaction — acting for himself and

pretending to act for his principal. (3 Am. Jur. 2d 595.) He is prohibited from dealing in the agency matter on his own account and for his own behalf without the consent of his principal, freely given with full knowledge of all the circumstances which might affect the transaction. An agent, therefore, is liable for damages if, there being a conflict between his interests and those of the principal, he should prefer his own. (Art. 1889.)

As the law does not distinguish, the rule is the same whether the agency is onerous or gratuitous.

(2) *Basis of the rule.* — The underlying basis of the rule precluding an agent from engaging in self-dealing is to shut the door against temptation and keep the agent's eye single to the rights and welfare of his principal. The rule is one of preventive, not remedial justice, which operates however fair the transaction may have been — however free from every taint of moral wrong. (3 Am. Jur. 2d 595.)

The principal, however, may waive the benefit of the rule so far as he is concerned, if he does so with full knowledge of the facts; but in the absence of such waiver, the rule is absolute. (Mechem, *op. cit.*, p. 346.) It has been held that an agent who has been authorized to sell some merchandise cannot bind the principal by selling to himself (agent) directly or indirectly. It results that the principal is not required to fill orders taken by the agent from his own sub-agent unless the principal ratifies such sale after he has full knowledge of the facts. (Barton vs. Leyte Asphalt, 46 Phil. 938 [1924].)

EXAMPLES:

(1) P authorized A to buy specified goods. A must not sell P goods belonging to him (A) without the full knowledge and assent of P. Such sale is voidable although the price may have been just. The reason is that A's obligation to P requires him to buy at the lowest possible price while his self-interest prompts him to sell at the highest price obtainable. P, however, may elect to ratify the sale.

(2) Similarly, if P authorized A to sell goods, A must not sell to himself either directly or indirectly. The reason is that his

duty to sell at the highest price for the principal conflicts with his interest to buy at the lowest price possible.

(3) P authorized A to sell specified goods for a certain price. If A instead sells goods of the same kind and quality belonging to him for the same price to B, A, is liable for damages. He should not prefer his own interests to those of P.

(3) *Where agent's interests are superior.* — Normally, where there is a conflict between the agent's own interests and those of the principal, the agent has the duty to prefer the principal's interest over his own. However, where the agent's interests are superior, such as where he has a security interest in goods of the principal in his possession, he may protect this interest even if in so doing he disobeys the principal's orders or injures his interest.

An agent, to be sure, is not required to expose himself to great physical risks not within the contemplation of the parties, or to perform services when he is ill. On the other hand, if the conflict resulted from his breach of a duty owed to the principal, the agent cannot prefer his own interest. (see Sell on Agency, p. 134; Seavy on Agency, p. 262.)

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)

Obligation not to loan to himself.

The agent cannot, without a special power of attorney, loan or borrow money. (see Art. 1878[7].)

(1) If he has been expressly empowered to borrow money, he may himself be the lender at the current rate of interest for there is no danger of the principal suffering any damage since the current rate of interest would have to be paid in any case if the loan were obtained from a third person.

(2) If the agent has been authorized to lend money at interest, he cannot be the borrower without the consent of the principal because the agent may prove to be a bad debtor. There is here a

possible conflict of interest. (see Art. 1890.) The transaction may thus be prejudicial to the principal.

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)

Obligation to render accounts.

It is the duty of the agent to account for and to deliver to the principal (or an authorized third party) all money and property which may have come into his hands or of a sub-agent appointed by him by virtue of or as a result of the agency.[4] This includes gifts from the third party in connection with the agency.

(1) *Source of profits.* — It is immaterial whether such money or property is the result of the performance or violation of the agent's duty, if it be the fruit of the agency. If his duty be strictly

[4](11) *Dealing with Trust Property.* — The lawyer should refrain from any action whereby for his personal benefit or gain, he abuses or takes advantage of the confidence reposed in him by his client. Money of the client or collected for the client or other trust property coming into the possession of the lawyer should be reported and accounted for promptly, and should not under any circumstances be commingled with his own or be used by him. (Canons of Professional Ethics.)

Canon 16. — A LAWYER SHALL HOLD IN TRUST ALL MONEYS AND PROPERTIES OF HIS CLIENT THAT MAY COME INTO HIS POSSESSION.

Rule 16.01. — A lawyer shall account for all money or property collected or received for or from the client.

Rule 16.02. — A lawyer shall keep the funds of each client separate and apart from his own and those of others kept by him.

Rule 16.03. — A lawyer shall deliver the funds and property of his client when due or upon demand. However, he shall have a lien over the funds and may apply so much thereof as may be necessary to satisfy his lawful fees and disbursements, giving notice promptly thereafter to his client. He shall also have a lien to the same extent on all judgments and executions he has secured for his client as provided for in the Rules of Court.

Rule 16.04. — A lawyer shall not borrow money from his client unless the client's interests are fully protected by the nature of the case or by independent advice. Neither shall a lawyer lend money to a client except, when in the interest of justice, he has to advance necessary expenses in a legal matter he is handling for the client. (Code of Professional Responsibility.)

performed, the resulting profit accrues to the principal as the legitimate consequence of the relation; if profit accrues from his violation of duty while executing the agency, that likewise belongs to the principal, not only because the principal has to assume the responsibility of the transaction, but also because the agent cannot be permitted to derive advantage from his own default. (Dumaguin vs. Reynolds, 92 Phil. 66 [1952].)

It matters not how fair the conduct of the agent may have been in a particular case, nor that the principal would have been no better off if the agent had strictly pursued his power, nor that the principal was not, in fact, injured by the intervention of the agent for his own profit. The result in both cases is the same. (Ojinaga vs. Estate of Perez, 9 Phil. 185 [1907].)

EXAMPLES:

(1) P employs A as a *full-time* salesman. A must turn over to P any overprice received by him for goods he is to sell at a certain price. He may not make any profit out of the agency beyond his stipulated compensation.

(2) In the same example, A also sold goods for B without the knowledge of P. In this case, P is also entitled to all commissions or compensation earned by A on sales of B's goods in violation of the contract of agency.

ILLUSTRATIVE CASES:

1. *Real estate broker appropriated money deposited by a customer and forfeited under a forfeiture clause inserted by the broker without authority for his own profit.*

Facts: P listed his land with A, a real estate broker. A found a customer, T, and made a contract with him in the name of P by which T, depositing P10,000.00 with A, agreed to forfeit this to A if he should not complete the contract. T defaulted.

Issue: Is P entitled to recover the P10,000.00 from A?

Held: Yes. From the facts, it appeared that A inserted without authority the forfeiture clause for his own profit.

No principle in the law of agency is better settled than that the agent may not deal in the business of his agency for his

own benefit. All profits and every advantage beyond lawful compensation made by an agent in the business, or by dealing or speculating with the effects of the principal though in violation of his duty as an agent, and though the loss, if one had occurred, would have fallen on the agent, will, wherever they can be regarded as the fruit or outgrowth of the agency, be deemed to have been acquired for the benefit of the principal.

The doctrine is not based on the idea that the transaction is necessarily an injury to or a fraud upon the principal, but on the idea of closing the door to temptation to fraud, and keeping the agent's eye single to the rights and welfare of his principal. *(Pederson vs. Johnson, 169 Wis. 320, 72 N.W. 723 [1919].)*

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2. *Agent bought for himself mining claims which were necessary to the operation of other mining claims which were subject to an option and which principal asked him to investigate.*

Facts: A was sent by P to a place to investigate mining claims which were the subject of an option. He found certain other claims which were not included in the option, but which he believed to be essential to the successful operation of those that were included. In conjunction with T, A purchased right in the new claims.

A and T were partners in the venture.

Issue: Has P the right to the profits of the transaction and to the transfer of the claims to him at cost?

Held: Yes. There was a diversion of profits here. A constructive trust is the formula through which the conscience of equity finds expression. It would be against good conscience for A to retain these profits unless his employer (P) has consented. When property has been acquired in such circumstances that the holder of the legal title may not in good conscience retain the beneficial interest, equity converts him into a (constructive) trustee.

A different situation would be presented if the claims had no relation to those which A was under the duty to investigate. But they had an intimate relation. One could not profitably be operated without the other. *(Beatty vs. Guggenheim Exploration Co., 225 N.Y. 380, 122 N.E. 378 [1919].)*

(2) *Secret profit.* — It has been held that an agent who takes a secret profit in the nature of a bonus, gratuity or personal benefit from the vendee, without revealing the same to his principal, the vendor, is guilty of breach of his loyalty to the principal and forfeits his right to collect the commission from his principal, even if the principal does not suffer any injury by reason of such breach of fidelity, or that he obtained better results, or that the agency is a gratuitous one, or that usage or custom allows it; because the rule is to prevent the possibility of any wrong, not to remedy or repair an actual damage.

By taking such profit or bonus or gift or *propina* from the vendee, the agent thereby assumes a position wholly inconsistent with that of being an agent for his principal, who has a right to treat him, insofar as his commission is concerned, as if no agency existed. The fact that the principal may have been benefited by the valuable services of the said agent does not exculpate the agent who has only himself to blame for such a result by reason of his treachery or perfidy. (Domingo vs. Domingo, 42 SCRA 131 [1971].)

ILLUSTRATIVE CASES:

1. *Principal seeks to recover commission paid by him to agent for receiving secret profit from purchaser.*

Facts: P paid A P10,000.00 as the latter's remuneration for his services in negotiating the sale of the former's house. While acting as P's agent, A received from B, the purchaser, P2,000.00 as a secret profit. When that was discovered by P, A paid over that P2,000.00 to P.

Issue: Is P entitled to recover back from A the P10,000.00 retained by him by way of commission?

Held: Yes. (1) *Immaterial that principal benefited from services of agent.* — It is claimed by A that he ought not be called upon to hand over the P10,000.00 to P because P had the benefit of his services.

The principle of *Salomons vs. Pender* (3 H. & C. 639 [1885]) is amply sufficient to govern the case. In that case, it was held that an agent who was himself interested in a contract to purchase property of his principal was not entitled to any commission

from the principal. The principle there laid down is that when a person who purports to act as an agent is not in a position to say to his principal, "I have been acting as your agent, and I have done my duty by you," he is not entitled to recover any commission from the principal. It is true that the principal has had the benefit (if it be one) of the agent's services. But the principal is in a position to say, "What you have done has been done as a volunteer and does not come within the line of your duties as agent."

(2) *Interest of agent adverse to principal.* — In matters touching the agency, agents cannot act so as to bind their principals, where they have an adverse interest in themselves. The interest of A here was adverse to that of P. A principal is entitled to have an honest agent, and it is only the honest agent who is entitled to any commission. If an agent directly or indirectly colludes with the other side, and so acts in opposition to the interest of his principal, he is not entitled to any commission.

(3) *Rule same whether commission had been paid or not.* — P allowed A to retain the P10,000.00 in the belief that A had earned that sum as commission. If the P10,000.00 had not been received by A, and A had to sue P for the commission, it is perfectly clear that A could not recover it. A ought not stand in any better position because P, believing that A had acted properly, had allowed him to retain the P10,000.00. The case ought to be the same whether the commission had already been paid or whether A has to sue for it. *(Andrews vs. Ramsay & Co., 2 K.B. 635 [1903].)*

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2. *Agent bought a house of certain specifications and then sold it at a profit to principal who asked him to look for such house.*

Facts: P asked A, a real estate agent, to look for a house, of certain specifications. A located such a house, bought it himself for P500,000.00 and sold it to P for P600,000.00 representing that he had paid P550,000.00 for it.

Issue: Is P entitled to A's profits?

Held: Yes. When the relationship of principal and agent exists, the agent may terminate that relationship by himself selling to his principal property which belongs to him so long

as the principal knows that the property does in fact belong to the agent and that the agent is intending to sell his own property. But that must be limited to this extent, that it is the duty of every agent to act honestly and faithfully towards his principal, and, if he conceals most material facts from his principal and by means of fraud obtains an advantage for himself by purporting to sell or by selling property which is his own, then the duty which lies upon him is not put to an end by such a contract, and he remains liable to account for any secret profit which he has made as the result of the transactions between himself and the principal. *(Regier vs. Campbell-Stuart, Ch. 766 [1939].)*

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3. *Principal seeks to recover secret commission and overprice received by agent from seller.*

Facts: A's duty as manager of P's gas works was to examine tenders of sale of coal and report to P. To induce A to recommend the acceptance of his tenders, T, a coal merchant, secretly agreed to pay A a commission. It was also agreed that the selling price should be raised to P100.00 per ton.

Issue: Is P entitled to recover the commission paid to A and the extra price received by T?

Held: Yes. (1) *Agent committed fraud.* — The foundation of the claim of P against A is that there is a separate and distinct fraud by A upon him, and, therefore, he is entitled to recover from A the sum which he has received. Suppose, that T thought that A was entitled to a commission, T would not be fraudulent, but A would be, and it is because of his separate and distinct fraud that he must give up the commission to his principal.

(2) *Seller bound to pay extra price received by him.* — But this does not prevent P from suing T also, if he has been fraudulent, because of the fraud. A has been guilty of two distinct and independent frauds — the one in his character of agent, the other by reason of his conspiracy with T with whom he has dealt. Whether P sues T or A first must be wholly immaterial. T is bound to pay back the extra price which he had received and he could not absolve himself or diminish the damages by reason of P having recovered from A the bribe which he received. *(Mayor, etc. of Salford vs. Lever, 1 Q.B. 168 [1811].)*

Stipulation exempting agent from obligation to account void.

The stipulation in paragraph 2 of Article 1891 is contrary to public policy as it would encourage fraud. It is in the nature of a waiver of an action for future fraud which is void. (Art. 1171.)

Paragraph 2 of Article 1891 is designed to stress the highest loyalty that is required of an agent. Article 1891 (and Art. 1909.) imposes upon the agent the absolute obligation to make a full disclosure or complete account to his principal of all his transactions and other material facts relevant to the agency, so much so that the law does not countenance any stipulation exempting the agent from such obligation and condemns as void such stipulation. The duty of an agent is likened to that of a trustee. This is not a technical or arbitrary rule but a rule founded on the highest and truest principle of morality as well as of the strictest justice. (Domingo vs. Domingo, *supra*.)

Liability for conversion.

If the agent fails to deliver and instead converts or appropriates for his own use the money or property belonging to the principal, the agent is liable for estafa. (Art. 315, par. 1[b], Revised Penal Code.) He cannot retain the commission pertaining to him by subtracting the same from his collections. (U.S. vs. Reyes, 36 Phil. 791 [1917]; see U.S. vs. Kiene, 7 Phil. 736 [1907]; Ojinaga vs. Estate of Perez, 9 Phil. 185 [1907]; *In re* Bamberger, 49 Phil. 962 [1927]; Duhart Freres y Cie vs. Macias, 54 Phil. 513 [1930].)

The duty of an agent to account for money or property in his hands belonging to his principal is similar to that of a trustee in possession of money or property belonging to the beneficiary of a trust.

When obligation to account not applicable.

(1) The duty embodied in Article 1891 will not apply if the agent or broker acted only as a middleman with the task of merely bringing together the vendor and the vendee, who themselves

thereafter will negotiate on the terms and conditions of the transaction. (Domingo vs. Domingo, 42 SCRA 131 [1971].)

(2) Neither would the rule apply if the agent or broker had informed the principal of the gift or bonus or profit he received from the purchaser and his principal did not object thereto. *(Ibid.)*

(3) Where a right of lien exists in favor of the agent, the rule is not also applicable.

(a) The agent may, under Article 1914, retain in pledge the things which are the object of the agency until the principal effects the reimbursement and pays the indemnity provided in Articles 1912 and 1913.

(b) A lawyer shall have a lien upon the funds, documents and papers of his client and may retain the same until his lawful fees and disbursements have been paid. (Sec. 37, Rule 138, Rules of Court.)

Obligation to turn over proceeds of agency.

The obligation imposed upon the agent to render an accounting and report of his collections, presupposes the duty of simultaneously turning over his collections.

"Report" imports a statement of collections. "Accounting" means settling of accounts of administration or agency; delivery or payment of property funds or money coming into the hands of the agent; submission of a statement of receipts and disbursements with the trust funds coming into his hands and tender or turning over to the one to which he is liable, moneys and property in respect thereto. The payment is part of the accounting. (1 Words and Phrases 543.)

The agent must account for the very property or funds he has received for his principal. (2 C.J. 735-736; Gen. Shipping Co., Inc. vs. Phil. Surety & Ins. Co., Inc., [C.A.] No. 13294-R, Sept. 30, 1955; see also U.S. vs. Kiene, 7 Phil. 736 [1907]; Duhart Freres y Cie vs. Macias, *supra*.) All profits made and any advantage gained by an agent in the execution of his agency should belong to the principal. (Murao vs. People, 462 SCRA 366 [2005].)

Nature of agent's possession of goods or proceeds received in agency.

(1) *Distinguished from possession of servant or messenger.* — An agent, unlike a servant or messenger, has both the physical and juridical possession[5] of the goods received in agency, or the proceeds thereof, which take the place of the goods after their sale by the agent. His duty to turn over the proceeds of the agency depends upon his discharge as well as the result of the accounting between him and the principal, and he may not set up his right of possession as against that of the principal until the agency is terminated. (Guzman vs. Court of Appeals, 99 Phil. 703 [1956].)

(2) *Distinguished from possession of teller of bank.* — There is an essential distinction between the possession by a receiving teller of funds received from third persons paid to the bank and an agent who receives the proceeds of sales of merchandise delivered to him in agency by his principal.

(a) In the former case, payment by third persons to the teller is payment to the bank itself; the teller is a mere custodian or keeper of the funds received, and has no independent right or title to retain or possess the same as against the bank. An agent, on the other hand, can even assert, as against his own principal, an independent, autonomous right to retain the money or goods received in consequence of the agency, as when the principal fails to reimburse him for advances he has made, and indemnify for damages suffered without his fault. (Art. 1914.)

(b) Where a sales agent misappropriates or fails to turn over to his principal proceeds of things or goods he was commissioned or authorized to sell for the latter, he is guilty of estafa. (Art. 315, par. 1[c], Revised Penal Code.) A receiving

[5]When money, goods or any other personal property is received by a person from another in trust, or on commission, or for administration, the former acquires both material or physical possession and juridical possession of the thing received. Juridical possession means a possession which gives the transferee a right over the thing which the transferee may set up even against the owner. (Chua-Burce vs. Court of Appeals, 331 SCRA 1 [2000]; see Art. 315[1, b], Revised Penal Code.)

teller of a bank who misappropriates money received by him for the bank is guilty of qualified theft (Arts. 308, 309[3], 310, *Ibid*.) on the theory that the possession of the latter is the possession of the bank he being a mere bank employee. (Guzman vs. Court of Appeals, 99 Phil. 703 [1956]; Chua-Burce vs. Court of Appeals, 331 SCRA 1 [2000].)

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)

Sub-agent defined.

A *sub-agent* is a person employed or appointed by an agent *as his agent*, to assist him in the performance of an act for the principal which the agent has been empowered to perform.

Power of agent to appoint sub-agent or substitute.

Unless prohibited by the principal, the agent may appoint a sub-agent or substitute. The agent in this situation is a principal with respect to the substitute. The law allows such substitution for reasons of convenience and practical utility. (11 Manresa 518-519.) An agent may not delegate to a subagent where the work entrusted to him by the principal to carry out requires special

knowledge, skill, or competence unless he has been authorized to do so by the principal.

While ordinarily the selection of an agent is determined largely by the trust and confidence that the principal has in the agent, the principal need not fear prejudice as he has a right of action not only against the agent but also against the substitute with respect to the obligations which the latter has contracted under the substitution. (Art. 1893.) This right of action against the substitute is an exception to the general rule that contracts are binding only between the contracting parties, their assigns and heirs.[6]

Relation among the principal, agent, and sub-agent.

(1) *Sub-agent appointed by agent on latter's sole account.* — In reality, the sub-agent is a stranger to the principal who originally gave life to the agency. This is particularly true where the sub-agent has been employed by the agent on the latter's own account to assist him in what he has undertaken to do for the principal. The principal will not be liable to third parties for the sub-agent's acts but the agent will be liable to the principal or third parties if the sub-agent acts wrongfully.

(2) *Sub-agent appointed by agent with authority from principal.* — Where, however, the agent is authorized to appoint a sub-agent, a fiduciary relationship exists between the principal and the agent, the agent and sub-agent, and the principal and the sub-agent. Any act done by the substitute or sub-agent in behalf of the principal is deemed an act of the principal. (11 Manresa 442.) Consequently, neither the agent nor the substitute can be held personally liable so long as they act within the scope of their authority. (Macias & Co. vs. Warner, Barnes & Co., 43 Phil. 155 [1922]; Lorca vs. Dineros, 103 Phil. 122 [1958]; Universal Glass Co., Inc. vs. Barcelona, 3 C.A. Rep. 355; see Art. 1897.)

[6]Art. 1311. Contracts take effect only between the parties, their assigns and heirs, except in case where the rights and obligations arising from the contract are not transmissible by their nature, or by stipulation or by provision of law. The heir is not liable beyond the value of the property he received from the decedent. x x x.

The sub-agent may also be the agent of the principal if he is in actual control of the business and the principal knows of his appointment, or knows that his appointment is necessary, and the agent was not prohibited from employing a sub-agent.

(3) *Effect of death of principal/agent.* — If the authority of the sub-agent proceeds from the principal, the death of the agent who appointed him does not affect his authority. But where the sub-agent is a substitute for the agent and acts under authority from him and to whom he is accountable, the death of the agent terminates his authority even though the power of substitution is given in the original power. (2 C.J. Sec. 187.)

ILLUSTRATIVE CASE:

Right of a companion or helper of a broker to recover from property owner his share in the broker's commission.

Facts: A was authorized by P to negotiate the sale of a parcel of land. A and S agreed to work together for the sale of P's property and were able to find a buyer which accepted P's price and terms. P refused to carry out the sale.

As A and S failed to receive their commission, they filed an action against P, who presented a motion to dismiss the complaint as to S on the ground that S has no cause of action against P.

Issue: Has S a sufficient interest in the subject of the action to justify the joinder of S as a party plaintiff?

Held: Yes. S clearly falls under Section 6, Rule 3 of the Rules of Court.[7] He is entitled to be paid his commission out of the very contract of agency between A and P, and he acted jointly in rendering services to P under A's contract and the same questions of law and fact govern their claims.

[7]Sec. 6. *Permissive joinder of parties.* — All persons in whom or against whom any right to relief in respect to or arising out of same transaction or series of transactions is alleged to exist, whether jointly, severally, or in the alternative, may, except as otherwise provided in these Rules, join as plaintiffs or be joined as defendants in one complaint, where any question of law or fact common to all such plaintiffs or to all such defendants may arise in the action; but the court may make such orders as may be just to prevent any plaintiff or defendant from being embarrassed or put to expense in connection with any proceedings in which he may have no interest.

> The rules do not require the existence of a privity of contract between S and P; all that they demand is that S has a material interest in the subject of the action, the right to share in the broker's commission to be paid A under the latter's contract, which right P does not deny. This is sufficient to justify the joinder of S as a party plaintiff, even in the absence of privity of contract between him and P. In this case, A acted as a broker, and as such was entitled to a commission for his services. There is no law prohibiting A from employing a companion to look for a buyer; neither is it against public policy. *(Marquez vs. Varela, 92 Phil. 373 [1952].)*

Effects of substitution.

(1) *Substitution prohibited.* — When the substitute is appointed by the agent against the express prohibition of the principal, the agent exceeds the limits of his authority. (Art. 1881.) The law says that all acts of the substitute in such a case shall be void. (Art. 1892, par. 2.) Thus, if the agent is authorized to sell goods of the principal, the sale made by a substitute designated by the agent against the prohibition of the principal is void.

If the principal has not prohibited the agent from appointing a substitute, he will be liable to third persons for the acts of the sub-agent within the scope of his authority, whether or not such sub-agent is known to the principal.

(2) *Substitution authorized.* — If in the contract of agency, the agent is given the power to appoint a substitute and the principal did not designate any particular person to be appointed, the substitution has the effect of releasing the agent from his responsibility unless the person appointed is notoriously incompetent or insolvent (Art. 1892[2].), because this would be an abuse by the agent of the principal's confidence. The principal may proceed against both the agent and the substitute for damages he may have suffered. But if the substitute is the person designated by the principal, the consequence is the absolute exemption of the agent.

(3) *Substitution not authorized, but not prohibited.* — If the agent appoints a substitute when he was not given the power to appoint one (*Ibid.*, No. 1.), the law recognizes the validity of the

substitution if the same is beneficial to the principal because the agency has thus been executed in fulfillment of its object.

If the substitution has occasioned damage to the principal, the agent shall be primarily responsible for the acts of the substitute (*Ibid.*, par. 1; see Serona vs. Court of Appeals, 392 SCRA 35 [2002]; Escueta vs. Lim, 512 SCRA 411 [2006].) as if he himself executed them. The principal has also a right of action against the substitute. (Art. 1893.) It has been held that an attorney who takes a claim "for collection" without qualification as to his liability is liable for the defaults of his own clerks and agents, and if he sends the claim to another attorney for collection, he is generally held liable for the latter's defaults. (Mechem, Outlines of Agency [3rd ed.], Sec. 330, cited in Mechem, Cases on the Law of Agency, p. 414.) A substitute appointed to collect the deferred installments from the sale of property made by an attorney-in-fact has no authority to enter into a new contract with the transferee by modifying the terms of the sale and releasing the solidary sureties in the original contract. (Villa vs. Garcia Bosque, 49 Phil. 126 [1920].)

EXAMPLE:

P authorized A to manage P's business affairs during the time that P was in the province. A allowed T to manage the store for him.

(1) Is A responsible for damages caused by the acts of T? Yes, if T was appointed by A against the prohibition of P that he shall not entrust the management of the store to another person; or he was not given the power to appoint one; or he was given the power, but T is "notoriously incompetent or insolvent."

No, if A was given the power and T was not "notoriously incompetent or insolvent," or T is the person designated by P to be appointed as substitute.

(2) Is the substitution valid? No, if A was prohibited by P from appointing a substitute. Yes, if A was given the power, or even if he was not given the power, there was no prohibition imposed by P.

(3) Are the acts of T in the name of P valid? No, if T was appointed by A against the prohibition of P or T acted beyond the scope of his authority. (see Art. 1910.)

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)

Necessity of concurrence where there are two or more agents.

In American Law, the term *joint agents* is used in a restricted sense to mean agents appointed by one or more principals under such circumstances as to induce the inference that it was the principal's intent that all should act in conjunction in consummating the transaction for which they were appointed. A distinction is made between a private "joint agency" and a public "joint agency" (created by law, or essentially public in character). In the former, the agency cannot be exercised except by the concurrence of all the agents while in the latter, it may be exercised by a majority. (Teller, *op. cit*., citing Caldwell vs. Harrison, 11 Ala. 755.)

Generally, it is presumed in American law that when a principal employs more than one agent to represent him in the same matter of business, they are joint agents as used above. Our law does not make the same presumption except as to the separate liability of the agents. A principal, however, may appoint more than one agent, each one to act separately in a particular branch of his principal's business or in a particular locality. Such agents are called *several agents* in American law, and are to act separately and when more than one agent is appointed with reference to the same business, they are still several agents if it appears that it was the intention of the principal that they should act separately, and an execution of the power by one of them is valid and binding on the principal. (2 C.J. Sec. 317.)

It is, of course, advisable that when a principal hires several agents to act for him, that he defines their powers — whether they may act only as a unit or whether they may act separately.

Nature of liability of two or more agents to their principal.

(1) In a joint obligation, each debtor is liable only for a proportionate part of the debt. If it is solidary, each debtor is liable for the entire obligation. (Art. 1216.[8]) The presumption is that an obligation is joint. (Arts. 1207, 1208.[9]) The rule in Article 1894 follows the general principle respecting solidarity.

(2) If solidarity has been agreed upon, each of the agents becomes solidarily liable:

(a) for the non-fulfillment of the agency even though in this case, the fellow agents acted beyond the scope of their authority; and

(b) for the fault or negligence of his fellow agents provided the latter acted within the scope of their authority. (Art. 1895.)

The innocent agent has a right later on to recover from the guilty or negligent agent. (Art. 1217, par. 2.)

(3) An agent who exceeds his powers does not act as such agent, and, therefore, the principal assumes no liability to third persons. Since this is so, solidary liability cannot be demanded by the principal.

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[8]Art. 1216. The creditor may proceed against any one of the solidary debtors or some or all of them simultaneously. The demand made against one of them shall not be an obstacle to those which may subsequently be directed against the others, so long as the debt has not been fully collected. (1144a)

[9]Art. 1207. The concurrence of two or more creditors or of two or more debtors in one and the same obligation does not imply that each one of the former has a right to demand, or that each one of the latter is bound to render, entire compliance with the prestations. There is a solidary liability only when the obligation expressly so states, or when the law or the nature or the obligation requires solidarity. (1137a)

Art. 1208. If from the law, or the nature or the wording of the obligations to which the preceding article refers the contrary does not appear, the credit or debt shall be presumed to be divided into as many equal shares as there are creditors or debtors, the credits or debts being considered distinct from one another, subject to the Rules of Court governing the multiplicity of suits. (1138a)

EXAMPLE:

A and B were appointed by P to manage the latter's business. Is A liable to P for damages in the amount of P10,000.00 caused by the fault or negligence of B?

(1) The presumption is that their responsibility is joint. Hence, A is not liable. But if both A and B were at fault, they shall be liable for P5,000.00 each.

(2) If solidarity has been agreed upon, P may recover P110,000.00 either from A or B. If A pays P5,000.00, P can still go against A and B for the balance as long as the entire amount has not been paid. (see Art. 1216.)

Incidentally, "joint" liability in the common law system is the equivalent of "solidary" or "several" liability in our jurisdiction. (see Art. 1915.)

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)

Liability of agent for interest.

Article 1896 contemplates two distinct cases. The first refers to sums belonging to the principal which the agent applied to his own use and the second, to sums which the agent still owes the principal after the expiration of the agency. (Mendezona vs. C. Viuda de Goitia, 54 Phil. 557 [1930]; A.L. Ammen Transportation Co. vs. De Margallo, 54 Phil. 570 [1930]; Ojinaga vs. Estate of Perez, 9 Phil. 185 [1907].)

(1) The agent who converted to his personal use the funds of the principal is liable for interest by way of compensation or indemnity (not to be confused with interest for delay) which shall be computed from the day on which he did so. Of course, the agent's liability is without prejudice to a criminal action that may be brought against him because of the conversion. (Art. 315, par. 1[b], Revised Penal Code.)

(2) While there is no liability for interest on sums which have not been converted for the agent's own use (De Borja vs. De Borja,

58 Phil. 811 [1933].), the agent who is found to owe the principal sums after the extinguishment of the agency is liable for interest from the date the agency is extinguished.

Demand not essential for delay to exist.

Is it always necessary that a demand for payment be made by the principal in order that delay shall exist? A negative answer seems evident in view of the clear provisions of the article. (see Art. 1169[1].) It is clear that if by provision of law the agent is bound to deliver to the principal whatever he may have received by virtue of the agency (Art. 1891.), demand is no longer necessary. (11 Manresa 532.)

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)

Duties and liabilities of agent to third persons.

The rule is that the principal is responsible for the acts of the agent done within the scope of his authority and should bear any damage caused to third persons. (see Art. 1910.) The agent acquires no rights whatsoever, nor does he incur any liabilities arising from the contract entered into by him on behalf of his principal.

(1) *In general.* — The duties of an agent to third persons and his corresponding liabilities must be considered with reference to the character of his act as to whether it is authorized or unauthorized, and also with reference to the nature of liability which it sought to assert as being in contract or in tort. The agent is liable to third persons for his torts which result in an injury to the third person.

(2) *Unauthorized assumption of agency.* — One who unauthorizedly assumes to act for another is guilty of a wrong, and is li-

able for the damage to those dealing with him in reliance on his assumed authority in that they are deprived of the benefit of the responsibility of the principal. Indeed, the assumed agent, by his act, impliedly warrants or represents that he has authority, thereby predicating liability for the damage sustained. This implied warranty and its accompanying liability is not confined merely to the making of contracts but extends to all unauthorized acts perpetrated in his assumed agency.

Of course, if no damages have been sustained, no liability for the agent's false assumption of authority exists.

(3) *Nature of liability.* — A purported agent will be held personally liable as principal on a contract executed without authority if the contract contains apt words to bind him personally, or if such was the intention of the parties. However, in the absence of an apt expression or intention, the nature of his liability is the subject of some divergence in judicial opinion.

(a) In some jurisdictions, in the absence of statute, the purported agent is held liable as principal on the contract itself, based, it has been said, on the theory that since the contract was intended to bind someone, it must necessarily bind the purported agent even if the principal is unaffected.

(b) According to the weight of authority, the purported agent is not liable on the contract itself, for the reason that there has been no intention to bind the agent, and to hold that he is bound would, in effect, create a new contract for the parties. Under the majority rule, liability of the purported agent, dependent on the facts of the particular case, is predicated on a breach of an implied warranty or promise of authority, or in tort for deceit or misrepresentation. Of course, when governed by statute, the purported agent, according to its provisions, will be held liable on the contract itself, or for breach of the implied warranty of authority. (see 3 C.J.S. 115-116.)

It has been held that one who signed receipt as a witness with the word "agent" typed below his signature, but never received the alleged amount or anything on account of the

subject transaction, is not liable. (Caoile vs. Court of Appeals, 226 SCRA 658 [1993].)

(4) *Tort cases.* — Agency is no defense to action against an agent based upon commission of tort, his liability being neither increased nor decreased by the fact of his agency. If the tort is committed by the agent within the scope of his authority (see discussion on this matter under Art. 1910.), both the principal and the agent are liable. It is no defense by the agent that the benefit obtained by the tort has been turned over to the principal. (Teller, *op. cit*., p. 204, citing Boshino vs. Cook, 67 N.J.L. 467.)

(5) *Where duty violated owed solely to principal.* — An agent is liable to third persons for injury resulting from his misfeasance or malfeasance, meaning by these terms, the breach of a duty owed to third persons generally independent of the particular duties imposed by his agency. But an agent is generally not responsible to third persons for injury resulting from nonfeasance, meaning by that term, the omission of the agent to perform a duty owed solely to his principal by reason of his agency. (2 C.J.S. 499-500.)

So, if the wrong done by the agent in the performance of his duties devolves upon him purely from his agency, he is not responsible for the resulting injury to third persons. Thus, it has been held that an agent is not liable to a third person for failure to give his principal notice of facts communicated to him by the third person. (Reid vs. Humber, 49 Ga. 207.) An agent cannot, as such, "be subject to any obligations toward third persons other than those of his principal. Those duties are not imposed upon him by law. He has agreed with no one except his principal to perform them. In failing to do so, he wrongs no one but the principal, who alone can hold him responsible." (Delaney vs. Rochereau, 34 La. Ann. 1123, cited in Teller, p. 205.)

When agent may incur personal liability.

An agent who acts as such within the scope of his authority represents the principal so that his contract is really the principal's. Hence, the agent is not personally liable to the party with whom he contracts unless he expressly binds himself or he exceeds

the limits of his authority without giving such party sufficient notice of his powers (see Zialcita-Yuseco vs. Simmons, 97 Phil. 487 [1955]; Banque Generale Belge vs. Walter, Bull & Co., Inc., 84 Phil. 164 [1949]; Salmon & Pacific Commercial Co. vs. Tan Cueco, 36 Phil. 556 [1917]; Salonga vs. Warner, Barnes & Co., Ltd., 88 Phil. 125 [1951]; E. Macias & Co. vs. Warner, Barnes & Co., Ltd., 43 Phil. 155 [1922].) or by his acts he incurs the liabilities of a principal under the contract.

A suit against an agent cannot, without compelling reasons, be considered a suit against the principal. (Philippine National Bank vs. Ritratto Groups, Inc., 362 SCRA 216 [2001].)

(1) *When the agent expressly binds himself,* he thereby obligates himself personally and by his own act. Thus, the agent may be bound with the third person when the latter, not having faith in the financial ability of the principal, enters into the contract on condition that the agent's financial ability is "back of it." It has been held that if the agent, aside from acting on behalf of the principal, also bound himself to pay the debt, this fact does not relieve the principal for whose benefit the debt was incurred. The individual liability of the agent (who mortgaged his property) can be considered a further security in favor of the creditor and does not affect or preclude the liability of the principal. Both are liable. (Tuazon vs. Orosco, 5 Phil. 596 [1905].)

(2) *When the agent exceeds his authority,* he really acts without authority and, therefore, the contract is unenforceable against the principal unless the latter ratifies the act. (Art. 1910, par. 2.)

(a) The agent becomes personally liable because by his wrong or omission, he deprives the third person with whom he contracts of any remedy against the principal. The third person would be defrauded if he would not be allowed to recover from the agent. (National Power Corp. vs. National Merchandising Corp., 117 SCRA 789 [1982].) But if the agent has sufficient notice of his powers to third persons dealing with him and such persons nevertheless contract with the agent, neither the principal nor the agent is bound (Art. 1898.), the former, because the contract is unauthorized and the latter, because he acted in good faith in disclosing the limits of his powers. (11 Manresa 537.)

(b) The rule that the agent is liable when he acts without authority is founded upon the supposition that there has been some wrong or omission on his part either in misrepresenting, or in affirming, or concealing the authority under which he assumes to act. Inasmuch as the non-disclosure of the limits of the agency carries with it the implication that a deception was perpetuated on the unsuspecting client, the provisions of Articles 19, 20, and 21 of the Civil Code[10] come into play. (Development Bank of the Phils. vs. Court of Appeals, 231 SCRA 370 [1994].)

(c) That the agent exceeded his authority must be proved by the principal if he denies liability, or by the third person if he wants to hold the agent personally liable, on that ground. Note that in case of excess of authority by the agent, the law does not say that a third person can recover from both the principal and the agent. (Eurotech Industrial Technologies, Inc. vs. Cruzon, 521 SCRA 584 [2007], citing De Leon & De Leon, Jr., Comments and Cases on Partnership, Agency and Trusts [1999 edition], p. 512.)

EXAMPLE:

A was given a written power of attorney by P to sell the latter's car for P150,000.00. He sold it to B for P130,000.00. The sale is unenforceable against P but A becomes personally liable to B.

However, if B was shown the power of attorney by A, neither P nor A will be liable.

ILLUSTRATIVE CASES:

1. *Third person seeks to recover from both principal and agent.*

Facts: P (a foreign juridical entity), through A, entered into an agreement with B, a domestic company, whereby the latter

[10]Art. 19. Every person must, in the exercise of his rights and in the performance of his duties, act with justice, give everyone his due, and observe honesty and good faith.

Art. 20. Every person who, contrary to law, wilfully or negligently causes damage to another, shall indemnify the latter for the same.

Art. 21. Any person who wilfully 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.

undertook to buy copra in the Philippines for P. On account of the various shipments of copra to foreign countries made by B, judgment was rendered by the lower court holding P liable to B for the same. A, as the duly authorized agent of P, was absolved from any and all liability.

B alleges that A, as agent of P, is liable to it under Article 1897.

Issue: May A (agent) be held personally liable on contracts made in the name of P (foreign entity) with third persons in the Philippines?

Held: No. In the case at bar, B cannot recover from both the principal and its agent. B has been given judgment against P for the whole amount. It asked for such judgment, and did not appeal from it.

There is no proof that A, *as agent, exceeded* the limits of his authority. In fact, P, who should be the one to raise the point, never raised it, denied its liability on the ground of excess of authority. At any rate, Article 1897 does not hold that in case of excess of authority, both the agent and the principal are liable to the other contracting party. *(Phil. Products Co. vs. Primateria Societe Anonyme Pour Le Commerce Exterieur: Primateria [Phil.], Inc., 15 SCRA 301 [1965].)*

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2. *A newly certified collective bargaining agent is being made liable for damages by company for staging a strike notwithstanding a no-strike stipulation assumed by a deposed union.*

Facts: BB (a workers' union), for and in behalf of all employees of BCI (company), entered into a collective bargaining contract. Three years later, BW was certified by the court as the sole and exclusive bargaining agent of all BCI employees. As a result of the strike staged by BW and its members, BCI sued BW and its President for damages on the sole premise that the defendants breached their undertaking in the existing contract with BB not to strike during the effectivity thereof.

Issue: Is BW contractually bound by the collective bargaining contract between BB and BCI?

Held: (1) *Agent not bound by acts of principal.* — No, in the light of Article 1704 of the Civil Code providing that: "In the collective bargaining, *the labor union or members of the board or*

committee signing the contract shall be liable for non-fulfillment thereof." (Stressed for emphasis.) In this case, BW was not a signatory nor participant in the contract. BCI contends that since all the employees, as principals, continue being bound by the no-strike stipulation until the contract's expiration, BW, as their agent, must necessarily be bound also pursuant to the law on agency. This is untenable. Everything binding on a duly authorized agent acting as such is binding on the principal; not *vice versa*, unless there is a mutual agency, or unless the agent "expressly binds himself" (Art. 1897.) to the party with whom he contracts.

(2) *Previous agent, not new agent, who bound himself to company.* — Here, it was the previous agent (BB) who expressly bound itself to the other (BCI). BW, the new agent, did not assume this undertaking of BB, because when the latter bound itself and its officers not to strike, it could not bind all the other rival unions because it was the agent only of the employees, not of the other unions which possess distinct personalities. (*Benguet Consolidated, Inc. vs. BCI Employees & Workers Union — PAFLU, 23 SCRA 465 [1968];* see Ortigas vs. Lufthansa German Airlines, 64 SCRA 610 [1975].)

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3. *Agent of seller guaranteed to purchaser availability of vessel to ship quantity of sulfur purchased contrary to seller's instruction that sale be subject to availability of vessel.*

Facts: NPC and NMC, the latter as representative of P, a New York firm, executed in Manila a contract for the purchase by NPC from P of crude sulfur for NPC's Maria Cristina Fertilizer Plant in Iligan City. A performance bond was executed by DIC, an insurance company, in favor of NPC to guarantee P's obligations. P was not able to deliver the sulfur due to its inability to secure shipping space. Under the contract, the non-availability of a steamer to transport the sulfur was not a ground for non-payment of the liquidated damages in case of non-performance by the seller, and NMC even guaranteed and made itself "responsible for the availability of bottom or vessel."

It appeared that before the contract was signed, P advised NMC that the sale was subject to the availability of a steamer, and that NMC should not sign the contract unless it wished to assume full responsibility for the shipment. NMC did not

disclose the cable to NPC when it finalized the contract. P disclaimed responsibility for the contract.

NPC sued P, NMC, and DIC for the recovery of liquidated damages. The case against P was dismissed by the trial court for lack of jurisdiction because it was not doing business in the Philippines. DIC contended that it was not liable to NDC because its bond was posted, not for NMC, but for P, which was not liable on the contract of sale.

Issue: Are NMC and DIC liable to NPC for the recovery of the stipulated liquidated damages?

Held: (1) *Agent who exceeded his authority personally liable.* — Yes. NMC is liable for damages because under Article 1897, the agent who exceeds the limits of his authority without giving the party with whom he contracts sufficient notice of his powers is personally liable to such party. The rule that every person dealing with an agent is put upon an inquiry and must discover upon his peril the authority of the agent, applies if the principal is sought to be held liable on the contract entered into by the agent, but not in this case where it is the agent that is "sought to be held liable on a contract of sale which was expressly repudiated by the principal because the agent took chances, it exceeded its authority, and, in effect, it acted in its own name."

(2) *Surety liable on its performance bond.* — The contention of DIC cannot be sustained. The rule is that "want of authority of the person who executes an obligation as the agent or representative of the principal will not, as a general rule, affect the surety's liability thereon, especially in the absence of fraud, even though the obligation is not binding on the principal." (72 C.J.S. 525.) In this case, it was NMC that actually solicited the bond from DIC and NMC is being held liable under the contract of sale because it virtually acted in its own name. It became the principal in the performance bond. In the last analysis, DIC acted as surety for NMC. *(National Power Corp. vs. National Merchandising Corp., 117 SCRA 789 [1982].)*

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4. *A parking lot attendant contracted for the safekeeping of personal property left in a parked car by a customer.*

Facts: A, a parking lot attendant employed by P, contracted for the safekeeping of a travelling bag left in a parked car by T.

There is no fact or circumstance tending to limit A's authority other than the nature of the business which he was conducting in the name of P.

Issue: Is it reasonable to infer that A was at least authorized to make known to a customer whether a bag of this kind might be left in the automobile?

Held: Yes. The evidence disclosed that A was in charge of the business on the premises. His authority would seem to be necessarily inferred from the fact that he was left in charge of this business. *(Mulhern vs. Public Auto Parks, Inc., 16 N.E. [2d] 157 [1938].)*

(3) *When an agent by his act prevents performance on the part of the principal,* he can be held liable to third persons. It is true that an agent who acts for a revealed principal in the making of a contract does not become personally bound to the other party in the sense than an action can ordinarily be maintained upon such contract directly against the agent. Yet it is manifest upon the simplest principles of jurisprudence that one who has intervened in the making of a contract in the character of agent cannot be permitted to intercept and appropriate the thing which the principal is bound to deliver, and thereby make performance by the principal impossible.

The agent in any event must be precluded from doing any positive act that could prevent performance on the part of his principal. This much, ordinary good faith towards the other contracting party requires. (National Bank vs. Welch, Fairchild & Co., 48 Phil. 780 [1926].)

(4) *When a person acts as an agent without authority or without a principal,* he is himself regarded as a principal, possessed of all the rights and subject to all the liabilities of a principal. (Vda. de Salvatierra vs. Garlitos, 103 Phil. 757 [1958]; Bay View Hotel, Inc. vs. Lynn Romero Productions, [Phils.], Inc., 7 C.A. Rep. 38.) Contracts are binding only between the parties thereto, and it is the consent manifested to the other that binds, not one's undisclosed, and in that sense, secret intention (to act in the name of the principal). (Connell Bros. Company [Phils.] vs. Hart, 1 C.A. Rep. 529.)

A person who contracts as the representative of a non-existent principal (*e.g.,* a proposed corporation or an unincorporated association) is the real party to the contract. (Albert vs. University Publishing Co., 13 SCRA 84 [1965].)

(5) *A person who purports to act as agent of an incapacitated principal* also incurs personal liability unless the third party was aware of the incapacity at the time of making the contract.

Third party's liabilities toward agent.

A third party's liability on agent's contracts is to the principal, not to the agent, because such contracts are not his own but his principal's. There are few instances in which a third party subjects himself to liability at the hands of an agent. The four main instances are these:

(1) Where the agent contracts in his own name for an undisclosed principal (see Art. 1883.), in which case, the agent may sue the third party to enforce the contract;

(2) Where the agent possesses a beneficial interest in the subject matter of the agency. A factor selling under a *del credere* commission (see Art. 1907.) would illustrate such an agent, as would also an auctioneer by virtue of his lien (see Art. 1914.);

(3) Where the agent pays money of his principal to a third party by mistake or under a contract which proves subsequently to be illegal, the agent being ignorant with respect to its illegal nature; and

(4) Where the third party commits a tort against the agent. We have seen that an agent may not utilize his agency as a defense to an action based on a tort committed by him. The converse is also true: an agent may sue for a tort committed against him, even though the alleged tortious act is also a wrong against the principal. (Teller, *op. cit*., pp. 206-207.)

ART. 1898. If the agent contracts in the name of the principal, exceeding the scope of his authority, and the principal does not ratify the contract, it shall be void

if the party with whom the agent contracted is aware of the limits of the powers granted by the principal. In this case, however, the agent is liable if he undertook to secure the principal's ratification. (n)

Effect where third person aware of limits of agent's powers.

(1) If the agent acts in the name of the principal (Art. 1883, par. 1.) and within the scope of his authority (Art. 1881.), the agent assumes no liability. The effect of the representation is to bind the principal as though he personally entered into the contract.

(2) If the agent acts in excess of his authority, even if he contracts in the name of the principal, the agent is the one personally liable unless there is subsequent ratification by the principal. (Art. 1910, par. 2.) The rule that a contract entered into by one who has acted beyond his powers shall be unenforceable (see Arts. 1317, par. 2; 1403[1].) refers to the unenforceability of the contract against the principal, and does not apply where the action is against the agent himself for contracting in excess of the limits of his authority. (National Power Corp. vs. National Merchandising Corp., 117 SCRA 789 [1982].)

(3) The liability of an agent who exceeds the scope of his authority depends upon whether the third person is aware of the limits of the agent's power. (Development Bank of the Phils. vs. Court of Appeals, 231 SCRA 370 [1994].) The agent is not bound nor liable for damages in case he gave notice of his powers to the person with whom he has contracted (Art. 1897.) nor in case such person is aware of the limits of the powers granted by the principal. (Art. 1898.) The effect is to make the contract, which is unenforceable as against the principal, void even as between the agent and the third person, and consequently, not legally binding as between them. However, if the agent promised or undertook to secure the principal's ratification and failed, he is personally liable. If the ratification is obtained, then the principal becomes liable. (Cervantes vs. Court of Appeals, 304 SCRA 25 [1999]; Safic Alcan & Cie vs. Imperial Vegetable Oil Co., Inc., 355 SCRA 559 [2001].)

EXAMPLE:

If B, in the preceding example, knew that A was not authorized to sell P's car for P130,000.00, the sale is void even as between A and B. However, if B bought the car on the assurance of A that he would obtain the consent of P, A would be liable in case of failure to obtain such ratification.

If P's consent is subsequently given, then there is ratification and the sale will be binding on P. (see Art. 1901.)

ILLUSTRATIVE CASE:

Consignee seeks to recover damages for loss of goods against agent of insurance company.

Facts: A contract of marine insurance was made and executed by and between WF Insurance Company of New York and A, the sender of goods consigned to B. The contract was entered into in New York. According to the contract, WF undertook to pay to A or B, the consignee, the damages that may be caused to the goods shipped.

B instituted an action against WBC, the agent of WF in the Philippines, for the loss or damage to the goods shipped.

Issue: Is WBC, as agent of WF, responsible upon the insurance claim subject of the suit?

Held: No. WBC has not taken part, directly or indirectly, in the contract in question. It did not enter into any contract either with A or B. There is nothing in the contract which may affect WBC favorably or adversely, the fulfillment of which may be demanded by or against it. (see Art. 1311.) That contract is purely bilateral, binding only upon A, the consignor, and WF, the insurance company.

The scope and extent of the functions of an adjustment and settlement agent, as in the case of WBC, do not include personal liability. His functions are merely to settle and adjust claims in behalf of his principal. If those claims are disapproved by the principal, the agent does not assume any personal liability. The recourse of the insured is to press his claim against the principal. (*Salonga vs. Warner, Barnes & Co., Ltd., 88 Phil. 127 [1951];* see E. Macias & Co. vs. Warner, Barnes & Co., 43 Phil. 155 [1922].)

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)

Effect of ignorance of agent.

This article refers to the liability of the principal towards third persons.

It is enough that the agent acts within the scope of his authority (Art. 1881.) and in accordance with the instructions of the principal. (Art. 1887.) If the principal appoints an agent who is ignorant, the fault is his alone. Equity demands that the principal should be bound by the acts of his agent.

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)

Scope of agent's authority as to third persons.

Scope of agent's authority includes not only the actual authorization conferred upon the agent by his principal, but also that which has apparently or impliedly been delegated to him. (Angerosa vs. The White Company, 210 N.Y.S. 204 [1936].)

(1) *Where authority not in writing.* — Every person dealing with an assumed agent *is put upon an inquiry* and must discover upon his peril, if he would hold the principal liable, not only the fact of the agency but the nature and extent of authority of the agent. (Veloso vs. La Urbana, 58 Phil. 681 [1933]; Strong vs. Gutierrez Repide, 6 Phil. 680 [1906]; Deen vs. Pacific Commercial Co., 42 Phil. 738 [1922]; Toyota Shaw, Inc. vs. Court of Appeals, 244 SCRA 320 [1995].) If he does not make such an inquiry, he is chargeable with knowledge of the agent's authority, and his

ignorance of that authority will not be an excuse. (Bacaltos Coal Mines vs. Court of Appeals, 245 SCRA 460 [1995].)

(a) He must act with ordinary prudence and reasonable diligence to ascertain whether the agent is acting and dealing with him within the scope of his powers. Obviously, if he knows or has good reason to believe that the agent is exceeding his authority, he cannot claim protection. So, if the character assumed by the agent is of such a suspicious or unreasonable nature, or if the authority which he seeks is of such an unusual or improbable character, as would suffice to put an ordinarily prudent man upon his guard, the party dealing with him may not shut his eyes to the real state of the case but should withal refuse to deal with the agent at all, or should ascertain from the principal the true condition of affairs. (Harry E. Keeler Electric Co. vs. Rodriguez, 44 Phil. 19 [1922].)

(b) The fact that one is dealing with an agent, whether the agency be general or special, should be a danger signal. The mere representation or declaration of one that he is authorized to act on behalf of another cannot of itself serve as proof of his authority to act as agent or of the extent of his authority as agent. (Roman Catholic Archbishop of Manila vs. Hallare, C.A.-G.R. No. 29035-R, Dec. 10, 1963; Yu Eng Cho vs. Pan American World Airways, Inc., 328 SCRA 717 [2000].)

(c) The mere opinion of an agent as to the extent of his powers will not bind the principal who may act on the presumption that third persons dealing with his agent will not be negligent to ascertain the extent of his authority as well as the existence of the agency. (3 Am. Jur. 2d 482-483.) The authority or extent of authority of an agent cannot be established by his own representations out of court but upon the basis of the manifestations of the principal himself. In case the fact of agency or the extent of the authority of the agent is controverted, the *burden of proof is upon the third person* to establish it. (*Ibid*., BA-Finance Corp. vs. Court of Appeals, 211 SCRA 112 [1992]; Velasco vs. La Urbana, 58 Phil. 681 [1933]; Bacaltos Coal Mines vs. Court of Appeals, *supra;* Safic Alcan & Cie vs. Imperial Vegetable Oil Co., Inc., 355 SCRA 559

[2001].) In the absence of proof, he cannot seek relief on the basis of a supposed agency. The law makes no presumption with respect to an agent's authority.

ILLUSTRATIVE CASE:

Purchaser paid purchase price to agent who was given mere authority to sell property.

Facts: P, engaged in the sale of electric plants, agreed to give A 10% commission for his services for any plant A could sell. Through the efforts of A, P sold a plant to B. Without the knowledge of P, B paid the purchase price to A.

Issue: Is the payment to A binding upon P?

Held: No. In approaching the consideration of the inquiry whether an assumed authority exists in a given case, there are certain fundamental principles which must not be overlooked. Among them are:

(1) that the law indulges in no bare presumptions that an agency exists; it must be proved and presumed from facts;

(2) that the agent cannot establish his own authority, either by his representations or by assuming to exercise it;

(3) that an authority cannot be established by a mere rumor or general reputation;

(4) that even a general authority is not an unlimited one; and

(5) that every authority must find its ultimate source in some act or omission of the principal. An assumption of authority to act as agent for another of itself challenges inquiry.

Like a railroad crossing, it should be in itself a sign of danger and suggest the duty to stop, look, and listen! (citing Mechem, Vol. 1, Sec. 746.)

In the case at bar, P never authorized A to receive or receipt for money in his behalf. Applying the above rules, B had no right to assume by any act or deed of P that A was authorized to receive payment. A made the payment at his own risk and on the sole representation of A that he was authorized to accept the payment. *(Harry E. Keeler Electric Co. vs. Rodriguez, 44 Phil. 19 [1922].)*

(2) *Where authority in writing.* — Nevertheless, if the authority of the agent is in writing, such person is not required to inquire further than the terms of the written power of attorney. As far as he is concerned, an act of the agent within the terms of the power of attorney as written is within the scope of the agent's authority, although the agent has in fact exceeded the limits of his actual authority according to the *secret understanding between him and the principal.* (see Arts. 1887, 1902.) In such a case, the principal is estopped from claiming that the agent exceeded his authority. The rule is necessary to protect the interests of third persons.

EXAMPLE:

P gave A a written power of attorney wherein A is authorized to sell P's factory for such price and upon such terms and conditions as A may deem reasonable. However, P and A had an understanding to the effect that A should sell the factory for not less than P5 million and for cash. A sold the factory to B on credit for P4,500,000.00.

Under Article 1900, P is bound. As far as B is concerned, A acted within the scope of his authority. Here, A has the *power* to make the sale binding on P even though as between them, A has no authority to make such sale.[11]

ILLUSTRATIVE CASES:

1. *Husband, with authority to mortgage from wife, mortgaged her property to secure his pre-existing debt.*

Facts: W (wife) gave H (husband) a written power of attorney "to loan and borrow money and to mortgage her property." H signed W's name to a promissory note which would make her liable for the payment of the pre-existing debt of H or that of his firm, for which W was not previously liable, mortgaging her property to secure said debt.

Issue: Is the mortgage binding upon W?

Held: No. H acted outside the scope of his authority. (See Art. 1881.) The powers and duties of H as agent of W are confined and limited to those which are specified and defined his written power of attorney, which limitation is a notice to,

[11]See Distinctions between "authority" and "power" under Articles 1881 and 1882.

and is binding upon, the person dealing with such agent. *(Bank of the P.I. vs. De Coster, 47 Phil. 594 [1925].)*

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2. *Payments evidenced by provisional receipts, made by a customer to the manufacturer's sales representative, were not turned over to the manufacturer.*

Facts: On several occasions, T, a dealer of soft drinks, purchased and received on credit various products from P, a manufacturer of soft drinks and beverages. T paid A, P's route manager, on four (4) occasions, sums of money for which T received four (4) trade provisional receipts (TPRs) issued by A. These receipts are given by P to its sales representatives who, in turn, gave a copy thereof to customers when a collection is made.

P claimed that it never received the amounts reflected in the provisional receipts but it failed to prove that A, who is its duly authorized agent with respect to T, did not receive these amounts from the latter.

Issue: Should the amounts in the said receipts be credited in favor of T?

Held: Yes. Under Article 1900, insofar as P's customers are concerned, for as long as they paid their obligations to the sales representative of P using the latter's official receipts, said payment extinguishes their obligations; otherwise, it would unreasonably cast the burden of supervision over P's employees from P to its customers. The substantive law is that payment shall be made to the person in whose favor the obligation has been constituted or his successor-in-interest or any person authorized to receive it. (Art. 1240.) It was the responsibility of T to turn over the collection to P. *(Eugenio vs. Court of Appeals, 239 SCRA 207 [1994].)*

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3. *Agent given authority "to use the coal operating contract" of his principal, entered into a trip charter party contract in behalf of the latter.*

Facts: Petitioner GAB signed an authorization in favor of RRS the pertinent portions of which read as follows:

> "I, German A. Bacaltos, of legal age, Filipino, widower, and residing at second street, Espina Village, Cebu City,

province of Cebu, Philippines, do hereby authorize Rene R. Savellon, of legal age, Filipino and residing at 376-R Osmeña Blvd., Cebu City, Province of Cebu, Philippines, to use the coal operating contract of Bacaltos Coal Mines of which I am the proprietor, for any legitimate purpose that it may serve. Namely, but not by way of limitation, as follows:

(1) To acquire purchase orders for and in behalf of Bacaltos Coal Mines;

(2) To engage in trading under the style of Bacaltos Coal Mines/Rene Savellon;

(3) To collect all receivables due or in arrears from people or companies having dealings under Bacaltos Coal Mines/Rene Savellon;

(4) To extend to any person or company by substitution the same extent of authority that is granted to Rene Savellon;

(5) In connection with the preceding paragraphs to execute and sign documents, contracts, and other pertinent papers.

Further, I hereby give and grant to Rene Savellon full authority to do and perform all and every lawful act requisite or necessary to carry into effect the foregoing stipulations as fully to all intents and purposes as I might or would lawfully do if personally present, with full power of substitution and revocation.''

A trip charter party was executed by and between Bacaltos Coal Mines (BMC) represented by RRS and private respondent SM Corporation (SMC) whereby for a consideration "lets, demises'' BMC's vessel to charterer SMC "for three round trips to Davao.'' SMC filed a complaint against BMC, GAB, and RRS for specific performance and damages.

Issue: The paramount issue raised is whether RRS was duly authorized by petitioners BMC and GAB to enter into the trip charter party under and by virtue of the authorization.

Held: No such authority was given to RRS.

(1) *Duty of every person dealing with an agent.* — "Every person dealing with an agent is put upon inquiry and must

discover upon his peril the authority of the agent. If he does not make such inquiry, he is chargeable with knowledge of the agent's authority, and his ignorance of that authority will not be an excuse. Persons dealing with an assumed agent, whether the assumed agency be a general or special one, are bound at their peril, if they would hold the principal, to ascertain not only the fact of the agency but also the nature and extent of the authority, and in case either is controverted, the burden of proof is upon them to establish it."

(2) *Extent and scope of RRS's powers.* — "Since the agency of Savellon is based on a written document, the Authorization of 1 March 1988, the extent and scope of his powers must be determined on the basis thereof. The language of the Authorization is clear. x x x There is only *one* express power granted to Savellon, *viz., to use the coal operating contract for any legitimate purpose it may serve.* The enumerated "five prerogatives" — to employ the term used by the Court of Appeals — are nothing but the specific prerogative subsumed under or classified as part of or as examples of the power to use the coal operating contract. The clause *"but not by way of limitation"* which precedes the enumeration could only refer to or contemplate other prerogatives which must exclusively pertain or relate or be germane to the power to use the coal operating contract.

The conclusion then of the Court of Appeals that the Authorization includes the power to enter into the Trip Charter Party because the "five prerogatives" are prefaced by such clause, is seriously flawed. It fails to note that the broadest scope of Savellon's authority is limited to *the use of the coal operating contract* and the clause cannot contemplate any other power not included in the enumeration or which are unrelated either to the power to use the coal operating contract or to those already enumerated. In short, while the clause allows some room for flexibility, it can comprehend only additional prerogatives falling within the primary power and within the same class as those enumerated.

The trial court, however, went further by hastily making a sweeping conclusion that "a company such as a coal mining company is not prohibited to engage in entering into a Trip Charter Party contract." But what the trial court failed to consider was that there is no evidence at all that Bacaltos Coal

Mines as a coal mining company owns and operates vessels, and even if it owned any such vessels, that it was allowed to charter or lease them."

(3) *Authorization, a special power of attorney.* — "The trial court also failed to note that the Authorization is *not a general power of attorney*. It is a *special power of attorney* for it refers to a clear mandate specifically authorizing the performance of a specific power and of express acts subsumed therein. In short, both courts below unreasonably expanded the express terms of or otherwise gave unrestricted meaning to a clause which was precisely intended to prevent unwarranted and unlimited expansion of the powers entrusted to Savellon."

(4) *SMC failed to exercise due diligence and prudence.* — "The suggestion of the Court of Appeals that there is obscurity in the Authorization which must be construed against German Bacaltos because he prepared the Authorization has no leg to stand on inasmuch as there is no obscurity or ambiguity in the instrument. If any obscurity or ambiguity indeed existed, then there will be more reason to place SMC on guard and for it to exercise due diligence in seeking clarification or enlightenment thereon, for that was part of its duty to discover upon its peril the nature and extent of Savellon's written agency. Unfortunately, it did not.

Howsoever viewed, the foregoing conclusions of the Court of Appeals and the trial court are tenuous and farfetched, bringing to unreasonable limits the clear parameters of the powers granted in the Authorization.

Furthermore, had SMC exercised due diligence and prudence, it should have known in no time that there is absolutely nothing on the face of the Authorization that confers upon Savellon the authority to enter into any Trip Charter Party. Its conclusion to the contrary is based solely on the *second* prerogative under the Authorization, to wit:

To engage in trading under the style of Bacaltos Coal Mines/Rene Savellon; unmindful that such is but a part of the primary authority to use the coal operating contract which it did not even require Savellon to produce. x x x Since the principal subject of the Authorization is the coal operating contract, SMC should have required its presentation to determine what it is and how it may be used by Savellon. Such a determination

is indispensable to an inquiry into the extent or scope of his authority. x x x SMC's negligence was further compounded by its failure to verify if Bacaltos Coal Mines owned a vessel. A party desiring to charter a vessel must satisfy itself that the other party is the owner of the vessel or is at least entitled to its possession with power to lease or charter the vessel. In the instant case, SMC made no such attempt. It merely satisfied itself with the claim of Savellon that the vessel it was leasing is owned by Bacaltos Coal Mines and relied on the presentation of the Authorization as well as its test on the seaworthiness of the vessel. x x x.

The Authorization itself does not state that Bacaltos Coal Mines owns any vessel, and since it is clear therefrom that it is not engaged in shipping but in coal mining or in coal business, SMC should have required the presentation of pertinent documentary proof of ownership of the vessel to be chartered."

(5) *SMC made possible the wrong to be done.* — "There is likewise no proof that the petitioners received the consideration of the Trip Charter Party. The petitioners denied having received it. The evidence for SMC established beyond doubt that it was Savellon who requested in writing on 19 October 1988 that the check in payment therefor be drawn in favor of Bacaltos Coal Mines/Rene Savellon and that SMC drew the check in favor of Rene Savellon in Trust for Bacaltos Coal Mines and delivered it to Savellon who thereupon issued a receipt. We agree with the petitioners that SMC committed negligence in drawing the check in the manner aforestated. It even disregarded the request of Savellon that it be drawn in favor of Bacaltos Coal Mines/Rene Savellon.

Furthermore, assuming that the transaction was permitted in the Authorization, the check should still have been drawn in favor of the principal. SMC then made possible the wrong done. There is an equitable maxim that between two innocent parties, the one who made it possible for the wrong to be done should be the one to bear the resulting loss. For this rule to apply, the condition precedent is that both parties must be innocent. In the present case, however, SMC is guilty of not ascertaining the extent and limits of the authority of Savellon. In not doing so, SMC dealt with Savellon at its own peril." *(Bacaltos Coal Mines vs. Court of Appeals, 245 SCRA 460 [1995].)*

Methods of broadening and restricting agent's authority.

A principal may assume rights and incur liabilities in respect of his agent's acts or transactions other than those for which express authorization has been given and an agent's authority may be enlarged or restricted in a number of ways:

(1) *By implication.* — This means that the agent's authority extends not only to the express requests, but also to those acts and transactions incidental thereto. It embraces all the necessary and appropriate means to accomplish the desired end.

This principle is founded on the manifest intention of the party creating such authority and is in furtherance of such intention. Thus, the employment of a general manager of a business constitutes an implied authorization to him to hire employees; the authorization to drive a motor vehicle incidentally empowers the agent to purchase gas and all necessary things to make a trip; the authority to receive payment empowers the agent, upon receiving payment, to surrender to the payee the evidence of the debt; etc.

(2) *By usage and custom.* — They may enlarge as well as restrict the scope of the agent's authority.

(a) An agent's authorization may not, however, be enlarged through usage and custom in the following four classes of cases:

1) Where it is sought to vary the terms of an express authorization, as where the agent appointed to sell for cash only, seeks to allege a custom to sell for credit;

2) Where it is sought thereby to dispense with a legal requirement enacted for the principal's benefit (as, for example, the legal provision [Art. 2112.] that the pledgee may appropriate the thing pledged only if after the first and second public auctions, the thing is not sold);

3) Where it is sought thereby to change a rule of law (as, for example, a law makes illegal certain contracts) or to dispense with a formality required by law (as, for example, the Statute of Frauds [Art. 1403[2].); and

4) Where it is sought to vary an essential quality of the agency relationship, as where a broker acting under an authority to sell stock, purchased principal's stock for himself, and then introduces a custom in the market, empowering him to do so;

(b) The general rule requires that the principal must have notice of the alleged custom before the agent's acts, in accordance therewith, may bind the principal. But in two main types of cases, a principal is deemed to have notice of a given usage, even though he did not in fact have such notice:

1) Where the principal and the agent reside in the same community, the usage is definite and well-known, and the agent has no notice that he is to act to the contrary; and

2) Where the agent is authorized to deal in a particular place or in a particular market or exchange. This is upon the ground that the principal, as a reasonable man, must have anticipated that such usages were likely to prevail and, therefore, in the absence of any contrary intention, must have authorized the dealing in contemplation of them.

(3) *By necessity.* — Actually, an agency can never be created by necessity; what is created is additional authority in an agent appointed and authorized before the emergency arose. The existence of an emergency or other unusual conditions may operate to invest in an agent authority to meet the emergency, provided:

(a) the emergency really exists;

(b) the agent is unable to communicate with the principal;

(c) the agent's enlarged authority is exercised for the principal's protection; and

(d) the means adopted are reasonable under the circumstances. Thus, a conductor may employ a physician upon the railroad's credit to care for a brakeman injured in an accident. In an ordinary case, the person employed in an emergency is an agent (not a sub-agent) because the appointing agent

is not employed to do that for which the appointed agent is responsible.

(4) *By certain doctrines.* — The doctrines (a) of apparent authority (see Art. 1911.), (b) of liability by estoppel (*Ibid*.; see Art. 1873.), and (c) of ratification (Art. 1910.) are additional methods by which authorization may be created.

(5) *By the rule of ejusdem generis.* — An outstanding maxim of construction which operates to restrict the agent's authority is the rule which is usually expressed in the Latin words *ejusdem generis* (literally, "of the same kind or species"). The term is a method for stating the rule that where, in an instrument of any kind, an enumeration of specific matters is followed by a general phrase, the general phrase is held to be limited in scope by the specific matters. (see Teller, *op. cit*., pp. 60-80.)

Responsibility of principal where agent acted with improper motives.

(1) *General rule.* — The motive of the agent in entering into a contract with a third person is immaterial. Where a written authority given to an agent covers the thing done by him on behalf of the principal, it is not competent to the court to look into the mind of the agent, and if he had applied his authority for his own ends, to hold that the principal is not bound.

It would be impossible for the business of a mercantile community to be carried on, if a person dealing with an agent was bound to go behind the authority of the agent in each case, and inquire whether his motives did or did not involve the application of the authority for his own private purposes. Furthermore, any inquiry of that kind would be regarded by an agent as an affront. (Hambro vs. Burmand, 2 K.B. 10, 17 Harvard L.R. 56.)

(2) *Exceptions.* — The rule does not apply:

(a) where the third person knew that the agent was acting for his private benefit. In other words, the principal is not liable to the third person.

ILLUSTRATIVE CASE:

Agent, in payment of his debt, gave a check drawn on principal's account and as principal's agent.

Facts: A, who had authority to draw checks on P's account on P's affairs, bought a car for his own use from T, giving in payment a check drawn on P's account and signed by himself as agent.

Issue: Is P entitled to recover from T the money paid?

Held: Yes. To sign and deliver checks in payment of his debts was not within the authority of A as agent acting in the affairs of P, and T had notice by the check itself that A was dealing for his own private benefit with the money of his principal. *(Reckitt vs. Barnett, Pembroke & Slatter, Ltd., 77 Pa. L.R. 271.)*

(b) where the owner is seeking recovery of personal property of which he has been unlawfully deprived. (Art. 559;[12] see Dizon vs. Suntay, 47 SCRA 160 [1972].) Thus, where an agent entrusted with a diamond ring for sale to a named party, had in fact a preconceived design to steal it and convert the proceeds, and did in fact pledge it for his own debt, the principal is entitled to recover the ring.

It is not sufficient to work an estoppel that the person to whose possession the owner entrusts his chattel is a dealer in similar merchandise. If the doctrine were otherwise, "no man could safely leave his watch with a watch maker who sells watches" or "his car in a garage, where the business of selling cars is conducted," for the purpose of having the same repaired. Neither is it sufficient, to make out an estoppel, that the possessor of the chattel is authorized to exhibit the same for the purpose of obtaining offers of purchase provided he can show that while authority was given to exhibit the chattel

[12]Art. 559. The possession of movable property acquired in good faith is equivalent to a title. Nevertheless, one who has lost any movable or has been unlawfully deprived thereof, may recover it from the person in possession of the same.

If the possessor of a movable lost or of which the owner has been unlawfully deprived, has acquired it in good faith at a public sale, the owner cannot obtain its return without reimbursing the price paid therefor. (464a)

for sale, no authority to sell, without first reporting to the owner, was conferred. (Utica Trust & Deposit Co. vs. Decker, 244 N.Y. 340, 155 N.E. 665.)

Contra:[13] "Where a mortgagor is a retail merchant engaged in selling articles or merchandise of the same kind as the mortgaged property and the mortgagee permits the mortgagor to keep the mortgaged property in his salesroom, among such other articles constituting his stock in trade, which he is selling in the regular course of trade, in such case, even though the permission is coupled with the proviso that the mortgaged property may be used for purposes of demonstration only, one who purchases the mortgaged property in the regular course of trade in good faith obtains good title unencumbered by the mortgage.

If the law were otherwise, no one would dare purchase at the merchant's retail store a fur coat, a suit of clothes, a piano, a radio set, or any other article of merchandise, without first searching the records in the office of the country clerk and recorder. x x x Where one of two innocent persons must suffer loss because of the fraudulent act of a third person, the law places the loss upon the one who put it in the power of the third person to commit the fraud." (Moore vs. Ellison, 82 Colo. 478, 261 P. 461 [1927].)

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[13]Art. 1505. Subject to the provisions of this Title [Title VI, Sales.], where goods are sold by a person who is not the owner thereof, and who does not sell them under authority or with the consent of the owner, the buyer acquires no better title to the goods than the seller had, unless the owner of the goods is by his conduct precluded from denying the seller's authority to sell.

Nothing in this Title, however, shall affect:

(1) The provisions of any factors' acts, recording laws, or any other provision of law enabling the apparent owner of goods to dispose of them as if he were the true owner thereof;

(2) The validity of any contract of sale under statutory power of sale or under the order of a court of competent jurisdiction;

(3) Purchases made in a merchant's store, or in fairs, or markets, in accordance with the Code of Commerce and special laws. (n)

Art. 1506. Where the seller of goods has a voidable title thereto, but his title has not been avoided at the time of the sale, the buyer acquires a good title to the goods, provided he buys them in good faith, for value, and without notice of the seller's defect of title. (n)

Principal's responsibility for agent's misrepresentation.

(1) *Within the scope of agent's authority.* — A principal is subject to liability for loss caused to another by the other's reliance upon a deceitful representation of an agent in the course of his employment if the representation is authorized, or within the implied authority of the agent to make for the principal, or apparently authorized, whether the agent was authorized by him or not to make the representation. (see Mechem, Cases on the Law of Agency, p. 230.) Thus, an agent empowered to sell property is presumed to possess the right to make representations regarding the condition and quality of the subject of the sale as usually accompany such transactions. (Angerosa vs. The White Company, 209 N.J.S. 204 [1936].) A principal who has cloaked his agent with apparent authority is estopped to deny said authority. Innocent third persons should not be prejudiced if the principal failed to adopt the needed measures to prevent misrepresentation, much more so if the principal ratified the agent's acts beyond the latter's authority. (Filipinas Life Assurance Company vs. Pedroso, 543 SCRA 542 [2008].)

Liability is based upon the fact that the agent's position facilitates the consummation of the fraud in that from the point of view of the third person, the transaction seems regular on its face and the agent appears to be acting in the ordinary course of the business confided to him. (Restatement of the Law of Agency, Sec. 262.)

ILLUSTRATIVE CASES:

1. *Misrepresentation made by agent authorized to sell property.*

Facts: An agent authorized to bind a purchaser misrepresented that a small building was wholly on the property, and that the Standard Oil Company was trying to lease part of the property.

Issue: Is the principal liable for the misrepresentation?

Held: The principal is liable for the former but not for the latter misrepresentation. "Authority to exhibit property to a prospective purchaser is implied authority to identify the

property with reasonable certainty; but not implied authority to make representations as to a prospective lease of the property." *(Lemarb vs. Power, 275 P. 561 [1929].)*

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2. *Misrepresentation made by agent authorized to receive subscriptions for stock.*

Facts: P (company) employed A to solicit and receive subscriptions for stock. T brought an action for tort for misrepresentation made by A in the sale of stock. P claims that there was no proof that it had authorized A to make the alleged misrepresentation and had no knowledge that they had been made.

Issue: Is P liable in the action for deceit or fraud of A?

Held: Yes. The natural inquiry of a proposed purchaser would be directed to the condition and situation of the company, its officers, and promoters. To give such facts was necessarily incumbent on A and was strictly in line of his duties, and, therefore, P is responsible for any misrepresentation in an action for fraud and deceit. *(Jacobson vs. Skinner Packing Co., 118 Neb. 711, 226 N.W. 321 [1929].)*

(2) *Beyond the scope of agent's authority.* — The principal is not bound by the misrepresentation of his agent committed beyond the scope of his authority. It does not follow, however, that he can take advantage of a contract made under the false representation of an agent. The theory is that the one who accepts the benefit of a contract must also accept responsibility for the means by which such contract was procured.

EXAMPLE:

P employed A to sell a horse but expressly forbade A to warrant the horse sound. T, induced by the warranty of A, paid twice the price he would have paid for an unsound horse. Having discovered the horse to be unsound, T sought rescission of the sale.

In this case, while P might defend himself upon the ground of want of authority in A, it by no means follow that he could at the same time, insist upon enforcing the contract obtained by means of a false representation made by A, because A had no authority.

(3) *For the agent's own benefit.* — Is a principal responsible for his agent's fraudulent acts committed within the scope of his agency, where the agent's fraud was perpetrated for his own benefit? The weight of authority holds the principal liable. Given the agent's fraudulent act within the scope of the authority, the principal is subjected to liability though done by the agent solely to effect a fraudulent design for his own benefit. (Teller, *op. cit*., pp. 193-194, citing Gleason vs. Seeboard Air Line Ry Co., 278 U.S. 349; Bank of Batevia vs. N.Y.R.R. Co., 106 N.Y. 195; see rule with respect to principal's liability for agent's tort under Art. 1910.)

Similarly, a principal has often been held liable on contracts entered into by his agent from improper motives, or violations by the agent of his fiduciary duty, as where an agent with a general power of attorney to issue checks, issues checks for his own benefit. (*Ibid*., p. 194, citing Empire Trust Co. vs. Cahan, 274 U.S. 474; Reinstatement of the Law of Agency, Sec. 165.)

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)

Ratification by the principal.

(1) *Binding effect of ratification.* — The principal is not bound by the contract of his agent should the latter exceed his power. The contract is unenforceable but only as regards him. Hence, he may ratify the contract giving it the same effect as if he had originally authorized it. (see Art. 1910, par. 2.) Under the above article, the third person cannot set up the fact that the agent exceeded his authority to disaffirm his contract not only after the principal has ratified the agent's acts but even before such ratification where he has signified his willingness to ratify. In such a case, the third person can be compelled to abide by his contract.

The ratification shall have retroactive effect. It relates back to the time of the act or contract ratified and is equivalent to original authority. (see Board of Liquidators vs. Kalaw, 20 SCRA 987 [1967].)

(2) *Only principal can ratify.* — It is fundamental in the law of agency that only the principal and not the agent can stamp the imprimatur of ratification. There must be knowledge on the part of the principal of the things he is going to ratify. It can hardly be said that there was ratification on his part in the absence of proof that he had knowledge of what was to be ratified. (Brownell vs. Parreno, [C.A.] No. 16714-R, May 27, 1958, 54 O.G. 7412.) Before ratification by the principal or expression of willingness on his part to ratify, the third person may repudiate the act of the agent. (see Art. 1317.)

In a case, the Supreme Court held that the State cannot impugn the validity of the compromise agreement executed by the Solicitor General on behalf of the State (in an expropriation proceeding) on the ground that it was executed by the counsel of the owner of the property, without any showing of having been especially authorized to bind the property thereby, because such alleged lack of authority may be questioned only by the principal or client, and the principal has on the contrary confirmed and ratified the compromise agreement. (Commissioner of Public Highways vs. San Diego, 31 SCRA 616 [1970].)

(3) *Receipt by principal of benefits of transaction.* — It is an established principle of law that where a person acts for another who accepts or retains the benefits or proceeds of his effort with knowledge of the material facts surrounding the transaction, the latter must be deemed to have ratified the methods employed, as he may not, even though innocent, receive or retain the benefits and at the same time disclaim responsibility for the measures by which they were acquired. This is in accord with the principle to the effect that a principal may not accept the benefits of a transaction and repudiate its burdens. (2 Am. Jur. 181-182.)

(a) A principal is deemed to have received the benefits of the unauthorized sale of his property and thereby ratified the transaction where the checks issued by the buyer in favor of the principal were credited to the latter's account with a bank or endorsed and negotiated by him. (see Rafferty vs. Province of Cebu, 52 Phil. 548 [1928]; Pamdico [Manila], Inc. vs. Alto Electronics Corp., [C.A.] No. 14904-R, June 8, 1956.)

(b) A principal who seeks to enforce a sale made by his agent cannot ordinarily allege that the agent exceeded his instructions in warranting the goods, because he must accept the contract as a whole if he means to rely on any portion. For the same reason, he cannot treat the sale good for the agreed price, but bad as to the agreed mode of payment. (Shominger vs. Peofody, 57 Com. 42, 17 A. 278 [1889], cited in Mechem, Cases on the Law of Agency, pp. 323-324.)

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)

Presentation of power of attorney or instructions as regards agency.

As a rule, a third person deals with an agent at his peril. Hence, he is bound to inquire as to the extent of the agent's authority, and this is especially true where the act of the agent is of an unusual nature.

Ignorance of the agent's authority is no excuse. So, it is his duty to require the agent to produce his power of attorney to ascertain the scope of his authority. He may also ask for the instructions of the principal. (Art. 1887.)

Third person not bound by principal's private instructions.

While the third person is chargeable with knowledge of the terms of the power of attorney as written and the instructions disclosed to him, he is not bound and cannot be affected by the private or secret orders and instructions of the principal in the same way that he cannot be prejudiced by any understanding between the principal and the agent. (Art. 1900.) Such secret orders or instructions cannot be invoked as against third parties if the agent has apparent authority.

EXAMPLES:

(1) P employed A under a power of attorney to sell a parcel of land for not less than P200,000.00. In this case, A has no power to bind P by selling the property for less than the specified amount to T. His statement to T that he is authorized to sell at a lower price is not admissible against P.

(2) Suppose, in the same example, the authority given to A is to sell at any reasonable price, with a secret instruction to keep the minimum price (P200,000.00) secret. A sold the property to T at P180,000.00. T is not bound by the secret instruction of P who is bound by the contract, his liability being based upon the apparent authority of A. (see Art. 1900.)

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)

Factor or commission agent defined.

A *factor* or *commission agent* is one whose business is to receive and sell goods for a commission (also called *factorage*) and who is entrusted by the principal with the possession of goods to be sold, and usually selling in his own name. (See Art. 1868, *re* distinctions between commission agent and broker.) He may act in his own name or in that of the principal.

An ordinary agent need not have possession of the goods of his principal, while the commission agent must be in possession.

Liability of commission agent as to goods received.

If the commission agent received goods consigned to him, he is responsible for any damage or deterioration suffered by the same in the terms and conditions and as described in the consignment. The phrase "in the terms and conditions and as described in the consignment" refers to the quantity, quality, and physical condition of the goods.

To avoid liability, the commission agent should make a written statement of the damage or deterioration if the goods received by him do not agree with the description in the consignment.

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)

Obligation of commission agent handling goods of same kind and mark.

This provision explains itself. The evident purpose is to prevent any possible confusion or deception. He may not commingle the goods without authority.[14]

An agent is also under a duty not to mingle his principal's property with his own or to deal with his principal's property in a way which would make it appear to be his own property. Ordinarily, the agent must hold the property only in the name of the principal. Where he violates that duty by mingling the property with his own, he becomes a debtor of the principal and liable to him for any losses suffered as a result of the mingling.

Two exceptions exist to these general rules. *First*, by custom, some agents, such as auctioneers, normally are permitted to mingle their principal's property with their own. *Second*, some agents, such as collecting banks, are permitted to mingle the funds of their principal (depositor) with their own and the property of other principals. (Sell on Agency, p. 124.)

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[14]Art. 472. If by the will of the owners two things of the same or different kinds are mixed, or if the mixture occurs by chance, and in the latter case the things are not separable without injury, each owner shall acquire a right proportional to the part belonging to him, bearing in mind the value of the things mixed or confused. (381)

Art. 473. If by the will of only one owner, but in good faith, two things of the same or different kinds are mixed or confused, the right of the owners shall be determined by the provisions of the preceding article.

If the one who caused the mixture or confusion acted in bad faith, he shall lose the thing belonging to him thus mixed or confused, besides being obliged to pay indemnity for the damages caused to the owner of the other thing with which his own was mixed. (382)

ILLUSTRATIVE CASE:

A co-owner made withdrawals of sugar owned in common.

Facts: The sugar of A and B were stored together in one single mass without separation or identification in a warehouse. A made withdrawals of sugar without express statement as to whose sugar was being withdrawn, whether his or B's.

Issue: Is there legal basis for B's contention that as the taking of the sugar was without his consent, and that of A with A's consent, all that remained is B's?

Held: No. As the mass of sugar in the warehouse was owned in common, and as it is not possible to determine whose sugar was withdrawn and whose was not, the mass remaining must pertain to the original owners in the proportion of the original amounts owned by each of them. *(Montelibano vs. Bacolod Murcia Milling Co., 95 Phil. 407 [1954].)*

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)

Right of principal where sale on credit made without authority.

A commission agent can sell on credit only with the express or implied consent of the principal. If such sale is made without authority, the principal is given two alternatives:

(1) He may require payment in cash, in which case, any interest or benefit from the sale on credit shall belong to the agent since the principal cannot be allowed to enrich himself at the agent's expense; or

(2) He may ratify the sale on credit in which case it will have all the risks and advantages to him. (see Green Valley Poultry & Allied Products, Inc. vs. Intermediate Appellate Court, 133 SCRA 697 [1984].)

EXAMPLE:

P authorized A, his commission agent, to sell certain merchandise for P20,000.00 cash. A sold the merchandise to B on credit for P21,000.00.

P may demand the payment of P20,000.00 in cash. Should A eventually collect P21,000.00 from B, A need not turn over the overprice of P1,000.00 as he is entitled to it. (see Art. 1891.)

If P ratified the sale on credit and B could pay only up to P19,000.00, A is not liable for the difference of P2,000.00.

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)

Obligation of commission agent where sale on credit authorized.

Under this article, an authorized sale on credit shall be deemed to have been on a cash basis (Art. 1905.) insofar as the principal (not third parties) is concerned, upon failure of the agent to inform the principal of such sale on credit with a statement of the names of the buyers. The purpose of the provision is to prevent the agent from stating that the sale was on credit when in fact it was made for cash.

Again, the agent shall be entitled to the benefits arising from the credit sale. The principal may also choose to ratify the sale on credit with all its resulting benefits and risks. (See Art. 1905.)

EXAMPLE:

Suppose, in the preceding example, A was authorized by P to sell on credit but he failed to so inform P with a statement of the name of the buyer.

In this case, P may demand from A the payment of the P20,000.00 in cash. As far as the buyer is concerned, the sale is on credit and he is not liable to pay before the arrival of the period agreed upon.

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)

Meaning and purpose of guarantee commission.

(1) *Guarantee commission* (also called *del credere commission*) is one where, in consideration of an increased commission, the factor or commission agent guarantees to the principal the payment of debts arising through his agency. (Mechem on Agency, Sec. 2534.) An agent who guarantees payment of the customer's account in consideration of the higher commission is called a *del credere* agent.

(2) The purpose of the guarantee commission is to compensate the agent for the risks he will have to bear in the collection of the credit due the principal.

Article 1907 applies to both cash and credit sales because it makes no distinction.

Nature of liability of a del credere agent.

An agent with a *del credere* commission is liable to the principal if the buyer fails to pay or is incapable of paying. But he is not primarily the debtor. On the contrary, the principal may sue the buyer in his own name notwithstanding the *del credere* commission, so that the latter amounts to no more than a guaranty.[15]

In other words, the liability of the *del credere* agent is a contingent pecuniary liability — to make good in the event the buyer fails to pay the sum due. It does not extend to other

[15]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)

obligations of the contract (Thomas Gabriel & Sons vs. Churchill & Sim, K.B. 1272 [1914].), such as damages for failure of the buyer to accept and pay for the goods.

A *del credere* agent may sue in his name for the purchase price in the event of non-performance by the buyer.

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)

Obligation of commission agent to collect credits of principal.

A commission agent who has made an authorized sale on credit (Art. 1906.) must collect the credits due the principal at the time they become due and demandable. If he fails to do so, he shall be liable for damages unless he can show that the credit could not be collected notwithstanding the exercise of due diligence on his part. (see Arts. 1173, 1174.) Where the agent is not liable, the principal's remedy is to proceed against the debtor.

This article does not apply to a case where there is a guarantee commission. (Art. 1907.)

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)

Liability of agent for fraud and negligence/ intentional wrong.

(1) In the fulfillment of his obligation, the agent is responsible to the principal not only for fraud (Art. 1171.) committed by him but also for negligence. (Art. 1172.) It is his duly to notify the principal of all relevant and material facts or any information having a bearing on the interests of the principal (*e.g.*, a debtor

who owes the principal a substantial amount of money is about to sell his property) as soon as reasonably possible after learning them. The circumstance that the agency is or is not gratuitous will be considered by the courts in fixing the liability of the agent for *negligence* (not fraud). Agency is presumed to be for compensation. (Art. 1875.)

It has been held that the failure of a sub-agent with whom film has been left for safekeeping to insure against loss by fire does not constitute negligence or fraud on its part when it has received no instruction to that effect from its principal, the insurance of the film not forming part of the obligation imposed upon it by law. (International Films vs. Lyric Film Exchange, 63 Phil. 778 [1936].) But the agent is liable when he does not discharge the agency with due promptness, or according to the instructions of his principal, or within the limits of his authority, or when he does not make use of the powers conferred on him. (11 Manresa 541-542.)

(2) Quasi-delict or tort may be committed by act or omission. If it causes damage to another, there being fault or negligence, the guilty party is liable for the damage done. (Art. 2176.) Article 1909 speaks of negligence (simple carelessness). The agent, to be sure, is also liable for torts committed willfully. As a general, rule, the principal is not responsible if the agent's tort was intentional rather than merely negligent. The reason is that an intentional wrong committed by one employed is more likely motivated by personal reasons than by a desire to serve or benefit his employer. The principal is solidarily liable if the tort was committed by the agent while performing his duties in furtherance of the principal's business.[16]

ILLUSTRATIVE CASES:

1. *Principal relied on the gratuitous promise of agent to insure former's goods.*

Facts: A, agent, promised without consideration to insure P's goods against loss. A failed to keep his promise to insure the goods which were destroyed by fire.

[16]See "Liability of principal for tort of agent," under Article 1910.

Issue: May P hold A liable for the loss of the goods?

Held: Yes. An agent who gratuitously assumes the agency obligation and neglects to carry it out is generally not liable for his nonfeasance. But where the agent knows or should know that the principal, in reliance upon his promise to do the given act, will refrain from doing the act himself, liability for nonfeasance attaches. (*see Merselman vs. Wicker, 30 S.E. [2d] 317 [Tenn.],* cited in Teller, p. 225.)

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2. *Broker sold shares at minimum price fixed by principal but below prevailing market price.*

Facts: P ordered his broker A, to sell his gold shares at a minimum price of P0.15 which A did. On the day of the sale, gold shares were sold at prices ranging from P0.16 to P0.195, or at an average of P0.175. P brought suit to recover from A the difference between the value of his shares at P0.175 and the price of P0.15 at which they were sold.

Issue: Is P entitled to recover the said difference?

Held: Yes. A should have sold the shares at the highest possible price. He failed to exercise the prudence and tact of a good father of a family which the law required of him. *(Tan Tiong Teck vs. Securities and Exchange Commission, 69 Phil. 425 [1940].)*

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3. *Action is brought by bank to recover unauthorized loans both against its manager and the borrowers.*

Facts: A, a manager of PNB, violated standing regulations regarding the granting of loans; and what is more, thru his carelessness, laxity, and negligence, he allowed loans to be granted to persons who were not entitled to receive loans. PNB brought action against both A and the borrower to recover the loans granted.

Issue: Is it necessary for PNB to first go against the borrower, exhaust all remedies against him and then hold A liable only for the balance?

Held: No. PNB could proceed against A for losses it had sustained in consequence of the unauthorized loans released by him. The cause of action of PNB accrued and the injury

to it was complete on the very day that the amounts of the unauthorized loans were released by A.

Ordinarily, if the principal collects either judicially or extra-judicially a loan made by an agent without authority, he thereby ratifies the said act of the agent. However, in the case at bar, PNB is merely trying to diminish as much as possible the loss to itself and automatically decrease the financial liability of A. *(Phil. National Bank vs. Bagamaspad and Ferrer, 89 Phil. 365 [1951].)*

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4. *Bank allowed a depositor to withdraw from the proceeds of the treasury warrants deposited with the former, even before the said warrants had been declared cleared.*

Facts: G opened an account with GSAL (a savings and loan association) and deposited over a period of two months 38 treasury warrants drawn by a government agency with a total value of more than P1.7 million. Six of these were directly payable to G while the others appear to have been indorsed by their respective payees followed by G as second indorser. The warrants were subsequently indorsed by C, Cashier of GSAL, and deposited to GSAL's savings account with a branch of MBTC (bank) which forwarded them to the Bureau of Treasury for special clearing. In the meantime, G was not allowed to withdraw from his account.

After more than two weeks, "exasperated" over C's repeated inquiries as to whether the warrants had been cleared, and also as an accommodation for a "valued client," MBTC finally decided to allow GSAL to withdraw from the proceeds of the warrants. In turn, GSAL subsequently allowed G to make withdrawals from his own account. Later, MBTC informed GSAL that 32 of the warrants had been dishonored by the Bureau of Treasury and demanded the refund of the amount GSAL had previously withdrawn, to make up for the deficit in its account.

Issue: Was MBTC negligent in giving GSAL the impression that the treasury warrants had been cleared and that consequently, it was safe to allow G to withdraw the proceeds thereof from his account with it?

Held: Yes. (1) *MBTC not entitled to refund of amounts withdrawn by GSAL.* — The argument of MBTC that GSAL would have exercised more care in checking the personal

circumstances of G before accepting his deposit does not hold water. It was G who was entrusting the warrants, not GSAL that was extending him a loan. And moreover, the treasury warrants were subject to clearing pending which the depositor could not withdraw its proceeds. x x x In stressing that it was acting only as a collecting agent for GSAL, MBTC seems to be suggesting that as mere agent it cannot be held liable to the principal. This is not exactly true. On the contrary, Article 1909 clearly provides that x x x.

(2) *MBTC exhibited extraordinary carelessness.* — The amount involved was not trifling (and this was in 1979). Despite the lack of clearance — and notwithstanding that it had not received a single centavo from the proceeds of the treasury warrants — it allowed GSAL to withdraw — not once, not twice, but thrice — from the uncleared treasury warrants in the total amount of P968,000.00. It "presumed" that the warrants had been cleared. For a bank with its long experience, this explanation is unbelievably naive.

MBTC *misled* GSAL. There may have been no clearance but that clearance could be implied from MBTC allowing GSAL to withdraw from its account three times. The total withdrawal was in excess of its original balance before the treasury warrants were deposited, which only added to its beliefs that they had indeed been cleared. *(Metropolitan Bank Trust Co. vs. Court of Appeals, 194 SCRA 169 [1991].)*

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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)

Obligations, in general, of principal to agent.

Since an agency is essentially a contractual and consensual relationship between the principal and the agent, the duties and liabilities of the principal are primarily based upon the contract and the validity of the contract between them. In addition to his contractual duties, the principal is under an obligation to deal fairly and in good faith with his agent (3 C.J.S. 63-64.) who owes the same duty to his principal. The agency relationship is a fiduciary one. The specific obligations of the parties to each other enumerated in the law are merely specific applications of the general fiduciary obligation.

The primary obligation of the principal to the agent is simply that of complying with the terms of their employment contract, if one exists. The principal may be justified in refusing to perform his part of the contract when the agent has already breached the contract.

Specific obligations of principal to agent.

The contract creating the agency normally defines the specific obligations or duties of the principal to an agent. In the absence

of express agreement, the law imposes upon the principal certain obligations to his agent, among which are the following:

(1) To comply with all the obligations which the agent may have contracted within the scope of his authority (Arts. 1910, 1881, 1897.) and in the name of the principal (Arts. 1868, 1883.);

(2) To advance to the agent, should the latter so request, the sums necessary for the execution of the agency (Art. 1912.);

(3) To reimburse the agent for all advances made by him, provided the agent is free from fault *(Ibid.)*;

(4) To 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.); and

(5) To pay the agent the compensation agreed upon, or if no compensation was specified, the reasonable value of the agent's services. (Arts. 1875, 1306.)

Liability of principal to third persons.

(1) *General rule.* — It may be stated as a general rule that where the relation of agency legally exists, the principal will be liable to third persons for all acts committed by the agent and obligations contracted by him in the principal's behalf in the course and within the actual (express or implied) or apparent scope of his authority, and should bear the damage caused to third persons. This responsibility is not altered by the fact that the agent also may be liable, nor by the fact that some of the acts are to the principal's advantage while others are to his disadvantage.

The principal becomes liable to the third party when he ratifies an authorized act of his agent.

(2) *Reason for liability.* — A principal is liable for the acts of his agent within his express authority because the act of such agent is the act of the principal. Where the agent acts within the scope of the authority which the principal holds himself out as possessing, or knowingly permits him to assume, the principal is made responsible, because to permit him to dispute the authority

of the agent in such a case would be to enable him to commit a fraud upon innocent third parties.

(3) *Estoppel to deny.* — The principal is bound by the act of his agent when he has placed the agent in such position that persons of ordinary prudence are thereby led to believe and assume that the agent is possessed of certain authority, and to deal with him in reliance on such assumption. The rule that the principal is responsible for the acts of his agent within the apparent scope of his authority applies only where the principal is responsible for such appearance of authority. (3 C.J.S. 138-142.) A registered owner who places in the hands of another an executed document of transfer of registered land effectively represents to a third party that the holder of such document is authorized to deal with the property. (Blondeau vs. Nano, 61 Phil. 625 [1935]; Domingo vs. Robles, 453 SCRA 812 [2005].)

An agency by estoppel may involve the expansion of the authority given to a designated agent or create authority in the alleged agent though not actually granted. (see Art. 1911.) The principal is bound by either the actual (express or implied) or apparent authority of the agent. Thus, it has been held that if a bank could give the authority to sell to a licensed broker, there is no reason to doubt the authority to sell of two of the bank's vice-presidents (with whom the broker finalized the details of the contract to sell) whose precise job in the bank was to manage and administer its real estate property. (Limketkai Sons Milling, Inc. vs. Court of Appeals, 250 SCRA 523 [1995].) A bank is liable to innocent third persons where representation is made in the course of its normal business by an agent even though such agent abused his authority. (Rural Bank of Milaor vs. Ocfemia, 325 SCRA 99 [2000].)

ILLUSTRATIVE CASES:

1. *Telegram accepting an arrangement proposed by a debtor did not include a condition imposed by creditor due to error of creditor's minor employees.*

Facts: P (GSIS) extrajudicially foreclosed the mortgage on the property of X who was in arrears on her monthly installments

in the amount of P32,000.00. Y, X's father, by means of a letter, sent to Z, general manager of P, offered to pay P30,000.00 and as regards the balance proposed an arrangement. On the same date, X, received a telegram, which reads: "P board approved your request *re* redemption of foreclosed property of your daughter." In accordance with the letter and the reply, remittances of payment were subsequently made by Z which remittances were accepted by P.

It appears that the telegram was sent by P's board secretary, in Z's name and without his knowledge, and that it did not express the contents of the board resolution due to the error of P's minor employees in failing to include the following phrase: "subject to the condition that Y shall pay all expenses incurred by P in the foreclosure of the mortgage."

Issue: Is P bound by the telegram?

Held: Yes. (1) *Debtor not bound by condition.* — The telegram generated a contract. There was nothing in it that hinted at any anomaly and, therefore, Y could not be blamed for relying upon it. Corporate transactions would speedily come to a standstill if every person dealing with a corporation were held duty bound to disbelieve every act of its responsible officers, no matter how regular they should appear on their face.

(2) *Creditor in estoppel.* — If a private corporation intentionally or negligently clothes its officers or agents with apparent power to perform acts for it, the corporation will be estopped to deny that such apparent authority is real as to innocent third persons dealing in good faith with such officers or agents.[1]

(3) *Original agreement ratified.* — The unconditional acceptance of remittances from Y constituted in itself a binding ratification of the original agreement.

(4) *Equitable maxim applicable.* — The equitable maxim that between two innocent parties, the one who made it possible for

[1]Same ruling in *Phil. National Bank vs. Court of Appeals* (94 SCRA 357 [1979].), where the Supreme Court held the PNB bound by the acts of its branch manager who assured the plaintiff (heir of the debtors) that he would be allowed to pay the obligation to the bank of his deceased parents and redeem the mortgaged property although the period for redemption had long expired and the plaintiff acted on that assurance but the bank reneged on its commitment when it sold the property to another.

the wrong to be done should be the one to bear the resulting loss is applicable. *(Francisco vs. Government Service Insurance System, 7 SCRA 577 [1963].)*

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2. *Airline passenger sued for damages both the ticket-issuing airline and the airline that performed the actual carriage although the breach of the contract of air transportation occurred on the flight of the latter airline.*

Facts: Respondent Chiok purchased from petitioner China Airlines, Ltd. (CAL) airline passenger ticket for air transportation covering Manila-Taipei-Hongkong-Manila. Said ticket was exclusively endorseable to Philippine Airlines, Ltd. (PAL).

In a complaint for damages against CAL and PAL, Chiok alleged that despite several confirmations of his flight PAL refused to accommodate him in Flight No. 307 for which reason he failed to arrive in Manila on his scheduled date and he lost a business option which he had to execute on said date; that a PAL's personnel ridiculed and humiliated him in the presence of so many people; and that CAL and PAL are solidarily liable for the damages he suffered including personal belongings he lost.

Affirming the Regional Trial Court, the Court of Appeals ruled that under the contract of transportation, CAL, as the ticket-issuing carrier was liable regardless of the fact that PAL was to perform or had performed the actual carriage.

Issue: Is CAL liable for damages:

(1) *Contract of carriage treated as single operation.* — The contract of air transportation was between petitioner and respondent, with the former endorsing to PAL the Hongkong-Manila segment of the journey. Such contract of carriage has always been treated in this jurisdiction as a single operation. This jurisprudence rule is supported by the Warsaw Convention, to which the Philippines is a party, and by the existing practices of the International Air Transport Association (IATA).

(2) *PAL acted as carrying agent of CAL.* — Under a general pool partnership agreement, the ticket-issuing airline is the principal in a contract of carriage, while the indorsee-airline is the agent.

Members of the IATA are under a general pool partnership agreement wherein they act as agent of each other in the issuance of tickets to contracted passengers to boost ticket sales worldwide and at the same time provide passengers easy access to airlines which are otherwise inaccessible in some parts of the world. Booking and reservation among airline members are allowed even by telephone and it has become an accepted practice among them. A member airline which enters into a contract of carriage consisting of a series of trips to be performed by different carriers is authorized to receive the fare for the whole trip and through the required process of interline settlement of accounts by way of the IATA clearing house an airline is duly compensated for the segment of the trip serviced.

In the instant case, following cited jurisprudence, PAL acted as carrying agent of CAL and CAL cannot evade liability to Chiok even though it may have been only a ticket issuer for the Hongkong-Manila sector.

(3) *PAL's gross and reckless negligence amounted to bad faith.* — Due to the nature of their business, airline companies must not merely give cursory instructions to their personnel to be more accommodating towards customers, passengers and the general public; they must *require* them to be so.

In the present case, respondent had repeatedly secured confirmations of his PR 311 flight on November 24, 1981 — initially from CAL and subsequently from the PAL office in Hong Kong. The status of this flight was marked "OK" on a validating sticker placed on his ticket. That sticker also contained the entry "RMN6V." Ms Chan explicitly acknowledged that such entry was a computer reference that meant that respondent's name had been entered in PAL's computer.

Since the status of respondent on Flight PR 311 was "OK," as a matter of right testified to by PAL's witness, he should have been automatically transferred to and allowed to board Flight 307 the following day. Clearly resulting from negligence on the part of PAL was its claim that his name was not included in its list of passengers for the November 24, 1981 PR 311 flight and, consequently, in the list of the replacement flight PR 307. Since he had secured confirmation of his flight — not only once, but twice — by personally going to the carrier's offices where he was consistently assured of a seat thereon — PAL's negligence was so gross and reckless that it amounted to bad faith.

In view of the foregoing, moral and exemplary damages were properly awarded by the lower courts. *(China Airlines vs. Chiok, 407 SCRA 432 [2003].)*

(4) *Waiver of claim against principal.* — Since it is the principal who should be answerable for the obligation arising from the agency, it is obvious that if a third person waives his claims against the principal, he cannot assert them against the agent. (Bedia vs. White, 204 SCRA 273 [1991].)

(5) *Agency from necessity or by operation of law.* — An agency from necessity is created, or the ordinary powers of an agent may be enlarged, when an emergency occurs and an employee or an agent is unable to get in touch with his employer. The "agency-from-necessity" doctrine has been most frequently applied, although it in no wise so limited, to accidents. It is generally held that the highest ranking agent or employee on the scene is authorized to employ physicians or surgeons for immediate medical services in behalf of the company.

The authority is limited to the necessity and ceases to exist when the emergency has passed. (Wyatt & Wyatt, p. 237, citing Vandalia vs. Ryan, 110 N.E. 218 [Ind., 1915].)

Liability of third persons to principal.

An agent is the instrumentality of the principal whose primary design is to obtain rights against third parties. The principal's rights are the third parties' liabilities.

(1) *In contract.* — A third person is liable to the principal upon contracts entered into by his agent, in the same manner as though the contract were entered into by the principal himself. This proposition results from the representative nature of agency. The relationship of the third party to the principal is the same as that in a contract in which there is no agent.

(a) It follows that the third party may not set-off or allege any defense against the agent, in an action by the principal to enforce the contract other than one which arises out of the particular contract upon which the action is brought. (see Teller, *op. cit*., p. 197.)

(b) Since notice by a third party to the agent is notice to the principal, the third party is not liable for damages for failure of the agent to give notice to his principal. Thus, in a case where A, who handled travel arrangements of P, was duly informed by B, P's travel agent, of the advice of the office manager of T (air carrier) of the rejection of the request for extension beyond the period of their validity of plane tickets of P without paying the fare differentials and additional travel taxes brought about by increased fare rate and travel taxes, the court ruled that, to all legal intents and purposes, A was the agent of P and notice to her was notice to P. (Air France vs. Court of Appeals, 126 SCRA 448 [1983].)

(2) *In tort.* — The third person's tort liability to the principal, insofar as the agent is involved in the tort, arises in three main factual situations:

(a) Where the third person damages or injures property or interest of the principal in the possession of the agent;

(b) Where the third person colludes with the agent to injure or defraud the principal; and

(c) Where the third person induces the agent to violate his contract with the principal to betray the trust reposed upon him by the principal.

(3) *In respect of property received.* — An agent does not have legal title to property entrusted to his possession by the principal, but in some cases he possesses a power to effect a transfer thereof, valid as against the principal. In the absence of a law or the possession by the agent of apparent authority or circumstances working an estoppel against the principal, the latter may recover property from the agent's transferee.

In respect of negotiable instruments, however, the law protects third parties who are *bona fide* holders thereof or holders in due course. (Teller, *op. cit*., pp. 197-199.) The principal cannot recover money and negotiable instruments wrongfully transferred by his agent to innocent holders for value who have no knowledge or notice of the agent's wrongful acts.

Liability of principal for mismanagement of business by his agent.

Under general rules and principles of law, the mismanagement of the business of a party by his agents does not relieve said party from the responsibility that he had contracted to third persons. (Commercial Bank & Trust Co. vs. Republic Armored Car Service Corp., 8 SCRA 425 [1963].) Thus, the fact that the agent defrauded the principal in not turning over the proceeds of the transactions to the latter cannot in any way relieve nor exonerate him from liability to the third person who relied on his agent's authority. It is an equitable maxim that as between two innocent parties, the one who made it possible for the wrong to be done should be the one to bear the resulting loss. (Cuison vs. Court of Appeals, 227 SCRA 391 [1993].)

Where the agent's acts bind the principal, the latter may seek recourse against the agent.

ILLUSTRATIVE CASES:

1. *Debtor raises as defense against liability the fraud of its former officers.*

Facts: P Corporation was granted by B (bank) credit accommodations in the form of an overdraft line not exceeding P80,000.00. P admits having drawn upon the credit line but claims that it has instituted actions against its former officers who had defrauded it and misapplied the amounts drawn.

Issue: Is the mismanagement and fraud of the former officers of P a defense against its liability to B?

Held: No. Said alleged mismanagement and the action pending in court regarding the same are merely internal affairs of P which cannot affect or diminish its liability to B. Having admitted the indebtedness, P's liability is beyond question. This is especially so in the case at bar where the written agreement for credit in current account between P and B contains no limitation about the liability of P, nor an express agreement that the responsibility of P should be conditioned upon the lawful management of the business of P. *(Ibid.)*

2. *Agent applied portion of amounts given to him by principal in payment of the latter's taxes, to tax obligations of other taxpayers.*

Facts: P made payments of his taxes through A, his business agent. The originals of the official receipts issued by the City Treasurer show that the full amount of the taxes due from P had been paid. Investigations disclose, however, that the amounts of the taxes allegedly paid by him as appearing in the original of every official receipt were bigger than the amounts appearing in the corresponding copies thereof kept in the office of the City Treasurer. As a result, P was assessed for the deficiencies.

It appeared that A applied a portion of the amounts given to him by P to pay tax obligations of other taxpayers, also A's clients.

Issue: Since the checks issued by P covered in full the taxes due, should the anomaly in the application of the amounts be held against him?

Held: Yes. When a contract of agency exists, the agent's acts bind his principal, without prejudice to the latter seeking recourse against the agent in an appropriate civil or criminal action. *(Dy Peh vs. Collector of Internal Revenue, 28 SCRA 216 [1969].)*

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3. *Insurance company cancelled personal accident policy for non-payment by insured of premiums which were misappropriated by the company's branch manager.*

Facts: Seven months after the issuance of petitioner-insured I's Personal Accident Insurance Policy, P, respondent insurance company, unilaterally cancelled the same since company records revealed that I failed to pay his premiums. Later, P offered to reinstate same policy it had previously cancelled and even proposed to extend its lifetime upon a finding that the cancellation was erroneous and that the premiums were paid in full by I but were not remitted by M, respondent's Baguio office branch manager.

It is I's submission that the fraudulent act of M, in misappropriating his premium payments, is the proximate cause of the cancellation of the insurance policy. He theorized that M's act of signing and even sending the notice of cancellation himself, notwithstanding his personal knowledge

of petitioner-insured's full payment of premiums, further reinforces the allegation of bad faith. Such fraudulent act committed by M, argued I, is attributable to respondent insurance company, an artificial corporate being which can act only through its officers or employees. It must, therefore, bear the consequences of the erroneous cancellation of subject insurance policy caused by the non-remittance by its own employee of the premiums paid. Subsequent reinstatement, according to I, could not possibly absolve respondent from liability, there being an obvious breach of contract. After all, I reasoned out, damage had already been inflicted on him and no amount of rectification could remedy the same.

Respondent insurance company, on the other hand, argues that where reinstatement, the equitable relief sought by petitioner-insured, was granted at an opportune moment, *i.e.*, prior to the filing of the complaint, petitioner-insured is left without a cause of action on which to predicate his claim for damages. Reinstatement, it further explained, effectively restored petitioner-insured to all his rights under the policy. Hence, whatever cause of action there might have been against it, no longer exists, and the consequent award of damages ordered by the lower court was unsustainable.

Issue: Is respondent liable to I for the cancellation of the insurance contract which was admittedly caused by the fraudulent acts and bad faith of its own officer?

Held: (1) *M's fraudulent act imputable to respondent.* — "We uphold petitioner-insured's submission. Malapit's fraudulent act of misappropriating the premiums paid by petitioner-insured is beyond doubt directly imputable to respondent insurance company. A corporation, such as respondent insurance company, acts solely thru its employees. The latter's acts are considered as its own for which it can be held to account.

The facts are clear as to the relationship between private respondent insurance company and Malapit. As admitted by private respondent insurance company in its answer, Malapit was the manager of its Baguio branch. It is beyond doubt that he represented its interests and acted in its behalf. His act of receiving the premiums collected is well within the province of his authority. Thus, his receipt of said premiums is receipt by private respondent insurance company who, by provision of

law, particularly under Article 1910 of the Civil Code, is bound by the acts of its agent."

(2) *Fact that respondent was also defrauded not a defense.* — "Malapit's failure to remit the premiums he received cannot constitute a defense for private respondent insurance company; no exoneration from liability could result therefrom. The fact that private respondent insurance company was itself defrauded due to the anomalies that took place in its Baguio branch office, such as the non-accrual of said premiums to its account, does not free the same from its obligation to petitioner Areola [I]. As held in Prudential Bank vs. Court of Appeals (223 SCRA 350 [1993]), citing the rule in Macintosh vs. Dakota Trust Co. (52 ND 752, 204 NW 818, 40 ALR 1021.):

'A bank is liable for wrongful acts of its officers done in the interests of the bank or in the course of dealings of the officers in their representative capacity but not for acts outside the scope of their authority. A bank holding out its officers and agent as worthy of confidence will not be permitted to profit by the frauds they may thus be enabled to perpetrate in the apparent scope of their employment; nor will it be permitted to shirk its responsibility for such frauds, even though no benefit may accrue to the bank therefrom. Accordingly, a banking corporation is liable to innocent third persons where the representation is made in the course of its business by an agent acting within the general scope of his authority even though, in the particular case, the agent is secretly abusing his authority and attempting to perpetrate a fraud upon his principal or some other person, for his own ultimate benefit.' "

(3) *Insurance contract creates reciprocal obligations.* — "Consequently, respondent insurance company is liable by way of damages for the fraudulent acts committed by Malapit that gave occasion to the erroneous cancellation of subject insurance policy. Its earlier act of reinstating the insurance policy cannot obliterate the injury inflicted on petitioner-insured. Respondent company should be reminded that a contract of insurance creates reciprocal obligations for both insurer and insured. Reciprocal obligations are those which arise from the same cause and in which each party is both a debtor and a creditor of the other, such that the obligation of one is dependent upon the obligation of the other."

(4) *I, as injured party, is entitled to damages.* — "Under the circumstances of the instant case, the relationship as creditor and debtor between the parties arose from a common cause: *i.e.*, by reason of their agreement to enter into a contract of insurance under whose terms, respondent insurance company promised to extend protection to petitioner-insured against risk insured for a consideration in the form of premiums to be paid by the latter.

Under the law governing reciprocal obligations, particularly the second paragraph of Article 1191 [of the Civil Code], the injured party, petitioner-insured in this case, is given a choice between fulfillment or rescission of the obligation in case one of the obligors, such as respondent insurance company, fails to comply with what is incumbent upon him. However, said article entitles the injured party to payment of damages, regardless of whether he demands fulfillment or rescission of the obligation. Untenable then is respondent insurance company's argument, namely, that reinstatement being equivalent to fulfillment of its obligation, divests petitioner-insured of a rightful claim for payment of damages. Such a claim finds no support in our laws on obligations and contracts."

(5) *Nature of damages to be awarded.* — "The nature of damages to be awarded, however, would be in the form of nominal damages contrary to that granted by the court below. Although the erroneous cancellation of the insurance policy constituted a breach of contract, private respondent insurance company within a reasonable time, took steps to rectify the wrong committed by reinstating the insurance policy of petitioner. Moreover, no actual or substantial damage or injury was inflicted on petitioner Areola at the time the insurance policy was cancelled.

Nominal damages are recoverable where a legal right is technically violated and must be vindicated against an invasion that has produced no actual present loss of any kind, or where there has been a breach of contract and no substantial injury or actual damages whatsoever have been or can be shown."

Respondent is ordered to pay nominal damages amounting to P30,000.00 plus legal rate of interest computed from the date of filing of complaint until final payment thereof. *(Areola vs. Court of Appeals, 236 SCRA 643 [1994].)*

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4. *Employee of an airline company committed an error in validating reservation of plaintiff who could only be waitlisted.*

Facts: L (an international airline company) was ordered by the lower court to pay damages for the former's failure to "comply with its obligation to give first class accommodation to O, a (Filipino) passenger holding a first class ticket," aggravated by the giving of the space instead to a Belgian and the improper conduct of its agents in dealing with him during the occasion of such discriminatory violation of its contract of carriage.

L claimed that the employee of Alitalia (another international airline company) who validated and confirmed O's reservation must have made a mistake because he was allegedly informed by L Rome office that O could only be waitlisted.

Issue: Assuming there was error, is L bound by the mistake?

Held: Yes. It has been indisputably proven under the so-called pool arrangement among different airline companies pursuant to the International Air Transport Association (IATA) agreement of which Alitalia and L are signatories, both companies are constituted thereby as agents of each other in the issuing of tickets and other matters pertaining to their relations with those who would need their services.

Besides, it appears that when O checked in at the airport, a lady employee thereat of L told him, after making the proper verification, that the reservation was correct. *(Ortigas, Jr. vs. Lufthansa German Airlines, 64 SCRA 610 [1975].)*

Liability of principal for tort of agent.

(1) *General rule.* — As a general rule, the principal is civilly liable to third persons for torts of an agent committed at the principal's direction or in the course and within the *scope of the agent's employment.*

The principal cannot escape liability so long as the tort was committed by the agent while performing his duties in furtherance of the principal's business or at his direction although outside the scope of his employment or authority. Nor is it a defense in an action for damages against the principal that the act which caused the tort was unknown to him or even that it was in disobedience to his instructions.

Whether the tort is committed willfully or negligently has no effect on the extent or degree of the principal's liability.

2) *Reason for liability.* — This rule is based upon the principle that he who does an act through another does it himself. If the principal has the power of control over an agent, he should take responsibility for the latter's action, and since the agent's acts are for the principal's benefit, the principal should also be responsible for the consequences of the agent's improper behavior.

The agent, to be sure, is also liable with the principal and their liability shall be solidary, *i.e.*, the third person may sue both the principal and the agent or choose whom he will hold.

(3) *Business hazard theory.* — In the common law, several theories have been offered to explain the rule. The "business hazard theory" advances the argument that "it is thought that the hazards of business should be borne by the business directly. It is reasoned that if the cost then is added to the expense of doing business, it will ultimately be borne by the consumer of the product; that the consumer should pay the costs which the hazards of the business have incurred." (Note, 30 Yale L.J. 584, cited in Teller, p. 167.)

(4) *Motivation-deviation test.* — The bounds of the agent's authority are not the limits of the principal's tort liability, but rather the "scope of the employment" which may or may not be within the bounds of authority. Scope of employment is much wider than scope of authority. But an act is not necessarily done within the scope of employment by reason merely of the fact that it is done during the employment.

An examination of a large number of cases discussing vicarious liability for tort shows that where two factors are present, such liability is imposed, but that where either of the two factors is missing, such liability is not imposed.

These factors are:

(a) satisfactory evidence that the employee in doing the act, in the doing of which the tort was committed, was motivated in part, at least, by a desire to serve his employer; and

(b) satisfactory evidence that the act, in the doing of which the tort was committed, was not an extreme deviation from the normal conduct of such employee. (see Tiffany on Agency, 2nd ed., by Powell, pp. 106-107, cited in Teller, pp. 168-169.)

For brevity, the above has been referred to as the "motivation-deviation test."

EXAMPLES:

(1) P empowered A to sell the former's parcel of land. Because of the misrepresentation of A that a big company was trying to lease the land, T bought the property. P permitted A to make the false statement.

There is no doubt that P would be responsible for the tort of A.

(2) While A, a driver of P, was delivering goods to the store of T, he destroyed a portion of the store because of his negligence in the operation of the delivery truck he was then driving.

In this case, P would be liable as the damage caused was the direct consequence of the performance by A of the duty delegated to him. P cannot escape liability merely because the tort was done by A willfully, unless A acted entirely out of personal reason against T. Neither is P liable where A was employed to do some other work (*e.g.*, as a mechanic) and the delivery of the goods by A was not authorized by P unless it is subsequently ratified.

(3) T was shot by A who was in charge of the gasoline station owned by P in the erroneous belief that T was a thief stealing gasoline.

P is liable. A's act was within the general scope of his employment, while he was engaged in P's business, and was done with a view to the furtherance of that business. But P is not liable if A's act was solely to effect some independent purpose of his own. (Teller, *op. cit.*, p. 170, citing Buck vs. Standard Oil Co., 249 N.Y. 595.)

(4) A travelling salesman used his own car, but the principal paid for its upkeep. May the principal be held liable

for the torts committed by the salesman in the course of the use of the car?

Yes, the rule of *respondeat superior* applies in general only where the relationship is that of master and servant, but this is not to say that the rule can never apply to the principal-agent relationship. When the principal's control over the agent's particular activity can be spelled out, vicarious liability may result. By paying for the upkeep of the automobile, the principal may become liable for the salesman's tort where the salesman was engaged at the time of the commission of the tort in furthering the principal's business. (Sinclair vs. Perma-Maid Co., 26 Atl. [2d] 921, cited in Teller, p. 226.)

(5) A, a private detective employed by P at its retail store, arrested a customer knowing that she had not stolen anything, but for the purpose of extorting money from her. May P be held liable for A's act?

No. A master is liable for the servant's act only where the act can reasonably be regarded as an incident or in furtherance of employment. Here, however, A took advantage of his employment in an effort to secure a private gain. (Cobb vs. Simon, 124 Wis. 467, cited in Teller, pp. 226-227.)

ILLUSTRATIVE CASES:

1. *Damage to car of customer resulted from negligence of employee in failing to make a thorough check-up of gasoline service station equipment.*

Facts: A car was brought by a customer to S gasoline service station operated by A for washing, greasing, and spraying. The car fell when it was placed on the hydraulic lifter under the direction of the personnel of the station.

It appeared that the service station belonged to P (Shell Co.) and bore P's trade name and A sold only the products of P which fixed their price; that the equipment used by A were just loaned by P which took charge of their repair and maintenance; that A (as operator) owed his position to P which could remove him or terminate his services at will; that an employee of P supervised the operator and conducted periodic inspection of the station and that P's mechanic failed to make a thorough check up of the hydraulic lifter and the check-up made by him

was "merely routine" by raising "the lifter once or twice and after observing that the operation was satisfactory," he left the place.

Issue: Is P liable for the damages to the car?

Held: Yes. A is an agent of P and not an independent contractor. As the act of the agent or his employees within the scope of his authority is the act of the principal, the breach of the undertaking by the agent is one for which the principal is answerable. The mechanic of P was negligent and P must answer for the negligent act of the mechanic which was the cause of the fall of the car from the hydraulic lifter. (*The Shell Co. of the Phils., Ltd. vs. Firemen's Ins. Co. of Newark, N.J., 100 Phil. 757 [1957]*; for distinctions between an agent and an independent contractor, see comments under Art. 1868.)

_____ _____ _____

2. *Agent used force on buyer who suffered damages, in complying with instruction of principal to collect price for goods delivered.*

Facts: A, a truck driver of P, a manufacturer of ice cream, delivered ice cream to T, a store owner. P's instruction to A was to collect the price on delivery. T claimed that the ice cream was not properly iced and refused to receive it and pay for it. A then undertook to take the payment out of T's cash register. A struggle ensued in the course of which T was kicked and severely beaten by A.

P claimed that his instructions to A, as well as to other drivers, were to use no force in making collections but to call P's office in case of dispute.

Issue: Is P liable for the act of A in assaulting and beating T?

Held: Yes. When the agent is doing or attempting to do the very thing which he was directed to do, the principal is liable though the agent's method of doing it, it be wholly unauthorized or forbidden. Here, A was instructed by P to collect for goods delivered, and the assault complained of grew out of his attempt to enforce payment by helping himself out of T's cash register, which attempt precipitated a series of acts constituting one continuous transaction, and the beating

occurred in the course of A's attempt to perform the business of P. *(Son vs. Hartford, 129 Atl. 778 [Conn. 1925].)*

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3. *Tort was committed while agent was driving from his home to place where he was assigned.*

Facts: A, a senior engineering technician working for P, was assigned by P to a reservoir project about 80 miles from his residence in Buffalo (USA). Because of the distance, A boarded near the project during the week and drove home for weekends with his family. While driving back to the project from Buffalo, A negligently struck and killed B whose widow sought wrongful death damages from P.

Issue: Was A acting within the scope of his employment at the time of the accident?

Held: No. A was not driving to satisfy an obligation he owed to P, but solely to satisfy his personal desire to visit his home in Buffalo. Moreover, P clearly did not have the power to control A's activities between the close of work on Friday and the commencement of work on Monday. During these hours, A was free to do as he pleased. The mere fact that P had agreed to pay his travel expenses did not give it any right of control. *(Lundberg vs. New York, 306 N.Y.S. 2d 947.)*

Representation, essence of agency.

(1) *Agent acts in a representative capacity.* — Representation being the essence of agency, it is evident that the obligations contracted by the agent are for and in behalf of the principal to bind him as if he personally contracted. (11 Manresa 647.) It is not enough, however, that the agent should act within the scope of his authority under Article 1910. (par. 1.) The agent must also act in a representative capacity (Art. 1868.), in the principal's name; otherwise, the principal assumes no liability. (Art. 1883.)

(2) *Agent acts within limits of his authority.* — Under the second paragraph of Article 1910, the agent who exceeds his authority is not deemed a representative of the principal. In effect, he acts without authority and becomes personally liable for any damage caused. Hence, the principal is not bound unless he ratifies the act expressly or impliedly. Without such ratification, the agent

is the one personally liable.[2] (Art. 1897.) Of course, the principal must have capacity to ratify the unauthorized act. *(Infra.)*

Meaning of ratification.

As applied to the law of agency, *ratification* is the adoption or affirmance by a person of a prior act which did not bind him, but which was done or professed to be done on his account thus giving effect to the acts as if originally authorized.[3] The doctrine applies to the ratification of the act of an agent in excess of his authority or the act of one who purports to be an agent but is really not. (3 Am. Jur. 2d 548.) It may be implied from the principal's conduct, *e.g.*, acceptance of benefits by the principal under a contract entered in his name.

ILLUSTRATIVE CASE:

Action was instituted by principal to recover from insolvent buyer where instruction was to sell to a person of undoubted credit.

Facts: A, agent, disobeyed P's instruction to sell only to people of undoubted credit. Instead, A made a sale to an insolvent person and took promissory notes in payment for the goods. P brought action on the notes to realize something on the notes and thereby to avoid a total loss on the transaction.

Issue: Does P's action constitute a ratification of X's unauthorized sale?

Held: No. Speaking generally, ratification is spelled out when the principal brings legal proceedings to enforce the contract or transaction entered into by the unauthorized agent.

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[2]Art. 1317. No one may contract in the name of another without being authorized by the latter, or unless he has by law a right to represent him.

A contract entered into the name of another by one who has no authority or legal representation, or who has acted beyond his powers, shall be unenforceable, unless it is ratified, expressly or impliedly, by the person on whose behalf it has been executed, before it is revoked by the other contracting party. (1259a)

Art. 1403. The following contracts are unenforceable, unless they are ratified:

(1) Those entered into the name of another person by one who has been given no authority or legal representation, or who has acted beyond his powers; x x x.

[3]Art. 1393. Ratification may be effected expressly or tacitly. It is understood that there is a tacit ratification if, with knowledge of the reason which renders the contract voidable and such reason having ceased, the person who has a right to invoke it should execute an act which necessarily implies an intention to waive his right. (1311a)

This is subject to the qualification, however, that the bringing of the legal proceedings is not deemed a ratification, even though based on the validity of the agent's unauthorized act, where the principal's action is undertaken to avert a greater loss rather than to assert a gain. (*Robinson Machine Works vs. Borse, 52 Ia. 207*, cited in Teller, p. 221.)

Act of ratification purely voluntary.

The very idea of ratification implies that the principal has an option to ratify or not, and that he has this advantage over the other party, to wit: that he may hold the other party whether the other party wishes it or not (see Art. 1901.) whereas the other party cannot hold him if he is not willing to be held.

It may appear unfair that one may ratify an unauthorized contract after he knows that it is to his own advantage to do so, and so bind the other party to his apparent disadvantage. Further reflection, however, causes this apparent unfairness to disappear. The other party, having agreed to be bound by his contract and not having withdrawn from it, has no ground to complain if compelled to perform, the original lack of authority having been cured. (Marqusee vs. Hartford Fire Ins. Co., 198 F. 475, 1023 [1912].)

The failure or refusal of the principal to ratify the unauthorized acts of his agent makes the latter personally in damages to the third party.

Conditions for ratification.

In addition to an intent to ratify, the following conditions must be fulfilled for ratification to be effective:

(1) The principal must have the capacity and power to ratify;

(2) He must have had knowledge or had reason to know of material or essential facts about the transaction;

(3) He must ratify the acts in its entirety;

(4) The act must be capable of ratification; and

(5) The act must be done in behalf of the principal.

Forms of ratification.

An unathorized act may be ratified (or affirmed) expressly or impliedly. There is express ratification where, for example, the principal simply informs the agent, the third party, or someone else of his intention to honor the agent's unathorized dealings. The principal can nevertheless be deemed to have impliedly communicated his intent to ratify by words or conduct that had amounted to ratification or even by silence or inaction where under the circumstances a reasonable person would have expressed objections to what the agent's had done.

For an act of the principal to be considered as an implied ratification of an unauthorized act of an agent, such act must be inconsistent with any other hypothesis than that he approved and intended to adopt what had been done in his name. Ratification is based on waiver — the intentional relinquishment of a known right. It cannot be inferred from acts that a principal has a right to do independently of the authorized act of the agent. Moreover, if a writing is required to grant an authority to do a particular act, ratification of the act must also be in writing. (Woodchild Holdings, Inc. vs. Roxas Electric & Construction Co., Inc., 436 SCRA 235 [2004].) Of course, the agent cannot ratify his own unauthorized acts.

Persons entitled to ratify.

(1) In order that one may be entitled to ratify the unauthorized act of an agent, it is necessary that the ratifier has the power or authority to do, on his account, the original act which is sought to be ratified. (2 C.J.S. 1072.)

(2) A principal is incapable of ratifying an act if his own position has, in the interval between the time the agent performed the act and the time when the ratification is supposed to have occurred, so altered that he is no longer capable of doing the original act. *(Ibid.)*

(3) A voidable act or transaction by reason of incapacity to give consent may be ratified but the defect must first be removed

before a valid ratification can take place. Thus, an infant is not bound by ratification of a contract entered by an agent.[4]

(4) The third party has a right to withdraw from the transaction prior to ratification. The principal will not be permitted to ratify after the third party has already indicated a desire to withdraw from the transaction. Obviously, there can be no ratification of an illegal transaction.

ILLUSTRATIVE CASES:

1. *Principal collected part of a loan made without authority by its agents to unqualified borrowers merely to diminish its loss and the financial responsibility of its agents.*

Facts: The evidence showed that in violation of regulations and instructions of the Phil. National Bank, BB and BF, its agent and assistant agent, respectively, in its Cotabato Agency, released large crop loans to manifestly insolvent and unqualified borrowers.

Phil. National Bank filed suits against the borrowers which suits resulted in the payment of part of the loans.

Issue: Should the filing of the suits be interpreted and considered as a ratification of the acts of BB and BF?

Held: No. Ordinarily, a principal who collects either judicially or extrajudicially a loan made by an agent without authority thereby ratifies the said act of the agent. In the present case, however, there was no intention on the part of the Phil. National Bank to ratify the acts of BB and BF. It was merely trying to diminish as much as possible the loss to itself and automatically decrease the financial liability of BB and BF who were not in position to pay the large amount for which they were found liable. The act of the Phil. National Bank was really beneficial to BB and BF. *(Phil. National Bank vs. Bagamaspad and Ferrer, 89 Phil. 365 [1951].)*

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[4]Art. 1391. The action for annulment shall be brought within four years.

This period shall begin:

In cases of intimidation, violence or undue influence, from the time the defect of the consent ceases.

In case of mistake or fraud, from the time of the discovery of the same.

And when the action refers to contracts entered into by minors or other incapacitated persons, from the time the guardianship ceases. (1301a)

2. *Owner testified in court that he consented to the sale of his property which he had not previously authorized.*

Facts: A sold to B a parcel of land belonging to P without being authorized by P. However, in a criminal prosecution for estafa against A, P testified that he consented to the sale. As a result of his testimony, A was acquitted of the criminal charge.

Issue: Was there ratification by P?

Held: Yes. Although P had not previously authorized the sale, he subsequently approved the action of A in selling the property to B and this produced the effect of an express agency. *(Gutierrez vs. Orense, 28 Phil. 571 [1914].)*

Knowledge by ratifier of material facts essential.

(1) *Meaning of material facts.* — Within the meaning of the requirement, they are those which reasonably ought to be known by the principal, having in mind the factors of time, place, and circumstance, and especially the situation of the parties. The problem is one which must be determined by reference to the facts of the particular case. In a case, where an agent authorized to enter into contracts for carriage of goods for the principal common carrier unauthorizedly entered into a contract binding the principal as insurer, and paid over to the principal and principal accepted, money advanced by the third party, it was held that the principal could not be made liable in the absence of showing that he had knowledge of the terms of the contract, since that was a material fact. (Teller, *op. cit*., p. 93, citing Pennsylvania Co. vs. Dandrige [Md.], 29 Am. Dec. 543.)

(2) *Full and complete knowledge.* — In order to bind a principal by ratification, he must have been in possession of all the facts and must have acted in the light of such facts. (3 Am. Jur. 2d 557.) It has been held that to ratify the unauthorized act of an agent and make it binding on a corporation, it must be shown that the governing body or officer authorized to ratify had full and complete knowledge of all the material facts connected with the transaction to which it relates. Ratification by a corporation cannot be made by the same person who wrongfully assumed

the power to make the contract. (Vicente vs. Geraldez, 52 SCRA 210 [1973].) If material facts were suppressed or unknown, there can be no valid ratification, regardless of the purpose or lack thereof in concealing such facts. This principle does not apply if the principal's ignorance of the material facts and circumstances was willful, or that the principal chooses to act in ignorance of the facts. However, the general rule is that ratification cannot be implied as against the principal who is ignorant of the facts. (Manila Park Cemetery, Inc. vs. Linsangan, 443 SCRA 377 [2004].)

(3) *Actual knowledge.* — The general rule requires actual knowledge on the part of the principal, as a condition to the imposition upon him of the obligation of his agent's unauthorized acts. This requirement springs from the fact that a principal has the election of repudiating or affirming an agent's unauthorized act, and he ought not to be made liable in spite of his ignorance. (Teller, p. 94, citing Combs vs. Scott, 12 Allen [Mass.] 493; see Air France vs. Court of Appeals, 126 SCRA 448 [1983].)

Burden to show such knowledge.

(1) *Party relying on the ratification.* — Whoever, therefore, seeks to rely on a ratification is bound to show that it was made under such circumstances as in law to be binding on the principal, especially to see that all material facts were made known to him.

The burden of making inquiries and of ascertaining the truth is not cast on him who is under no obligation to assume a responsibility, but rests on the party who is endeavoring to obtain a benefit or advantage for himself. This is not only just but it is practicable. The needful information or knowledge is always within the reach of him who is either party or privy to a transaction which he seeks to have ratified, rather on him who did not authorize it, and to the details of which he may be a stranger. (Combs vs. Scott, 12 Allen [Mass. 1] 493 [1866].)

(2) *When actual knowledge assumed.* — This does not mean that the principal can be willfully ignorant, or purposely shut his eyes to means of information within his own possession and control and thereby escape the consequence of a ratification of unauthorized acts into which he has deliberately entered. *(Ibid.)*

What this means is that the principal must have either actual knowledge of material facts or sufficient knowledge or notice of other facts so that it would have been easy to find out the material facts.

(a) Actual knowledge will be assumed where the principal's reckless disregard of the natural consequences of known facts induces an inference that he was willing to assume a risk in respect of the facts. Thus, where A, purporting to represent P but without authority, contracts to sell property to T, and then tells P of the contract, not including the terms, and P replies: "I am satisfied with anything you have done," there is ratification which P cannot avoid. (Teller, p. 94, citing Restatement of Agency, Sec. 9[e].)

(b) Similarly, actual knowledge will be assumed where the principal has actual knowledge of a fact or facts that a person of ordinary intelligence would thereby infer the existence of the fact or facts about which the dispute exists. Here, the law says: "You must have known that fact B was true, since B is a necessary consequence of fact of A, and you had knowledge of fact A." (*Ibid*., *op. cit*., pp. 94-95.)

ILLUSTRATIVE CASES:

1. *Horse sold without authority of owner who cashed indorsed check, believing it was in payment for another obligation.*

Facts: A, having possession of P's horse, but no authority to sell, sold the horse to T, taking a check payable to A which he indorsed and sent to P who cashed it on the assumption that it was in payment of money owed him by A from another transaction. Thereafter, P learned of the sale.

Issue: Is P entitled to recover the horse from T?

Held: Yes. If the only dealing between P and A related to the horse in question, and the money paid for the horse by T to A, who had no authority to sell, had been sent to P, the taking and keeping of it might be a ratification of the sale by P; or if P had wished to rescind it, he should return the money so received. *(Thacher vs. Pray, 113 Mass. 291 [1873].)*

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2. *Principal received benefits of an unauthorized contract without informing himself of its terms.*

Facts: A, who was authorized by P to lease the latter's premises for a period not to exceed two (2) years, leased them for four (4) years to T (company) which gave its old quarters and moved in. Two years later, discovering the mistake, P sought to force T to vacate.

It is asserted that P did not see the contract, was in ignorance of A's unauthorized act, and was under the impression that the agent had not exceeded his authority, and only became aware of the terms of the contract at the end of two (2) years when he notified T to vacate and was met with refusal.

Issue: Is this a valid excuse under the law?

Held: No. It was the duty of P to know under what kind of a contract he was receiving money, and by what terms T held its premises especially since the contract was in writing and was open to his inspection. It might have been different if the contract had been withheld or suppressed, and P was misinformed as to its terms.

The delivery of the contract to P was a notice to him of its contents, and after taking benefits thereunder, especially after the one-year term of the lease had expired, he ratified it, and is estopped from denying the validity of its provisions. There was no concealment, misrepresentation, or attempt to mislead on the part of T. *(Payne Realty Co. vs. Lindsey, 112 S.E. 306 [1922].)*

Ratification must be entire.

(1) The act must be ratified in its entirety or not at all. A person cannot ratify that portion which is beneficial or advantageous to him and repudiate that portion which is burdensome or disadvantageous. In other words, the principal cannot accept the benefits of a transaction and refuse to accept the obligations (*e.g.*, warranties in a contract of sale) that are part of it.

(2) The acceptance of the result of the act, moreover, ratifies the whole transaction including the means whereby that result was achieved. This rule is constantly applied to promises, misrepresentations, and even fraud upon which the contract was based. A principal, therefore, who ratifies with knowledge

is ordinarily liable for any wrong flowing from such promises, misrepresentations, or fraud.

(3) At the time of accepting the benefits of the act, the person may be ignorant of the practices resorted to. Even so, he is liable unless he attempts to undo the thing within a reasonable time after he is advised of it. The rule, however, is not broad enough to constitute ratification of another act which, though closely related to the ratified act, is not a part of it. (Wyatt & Wyatt, *op. cit*., p. 240.)

EXAMPLE:

Without authority to sell, A represented himself as the agent of P in selling P's horse to T who paid A. P accepted the payment from A after the latter informed him of all particulars relating to the sale.

In this case, P ratified the entire agreement through his act of accepting payment from A. In ratifying the sale, P is obligated on any warranties that accompany the contract.

Distinguish the situation in this example from that obtaining in the illustrative case below.

ILLUSTRATIVE CASE:

Judgment creditor cashed check given by judgment debtor to a collection agency which settled the claim without authority from the creditor.

Facts: P obtained a judgment of $1,000 against D. Sometime after, A, who was wholly unknown to P, called her on the telephone and informed her that he was in charge of a collection agency, his purpose being to obtain authority from her to collect the amount of the judgment. She advised him that she was not interested in his proposition. A, nevertheless, through the course of events, settled the judgment for $425.25. A check payable to the order of P for that amount was then given to A who cashed the check at the defendant-bank by indorsing thereon the name of P and his own as her attorney-in-fact.

About four months thereafter, P's attorney learned of the settlement and immediately wrote P so advising her. The information so obtained was the first that P had received, either

as to the settlement of the judgment or as to the act of A in indorsing her name upon the check and cashing it at the bank.

Action was brought out to recover the proceeds of the check which the defendant-bank paid upon the unauthorized indorsement.

Issue: In ratifying A's cashing of the check, did P also elect to adopt A's act in settling her claim with the judgment debt?

Held: No. (1) *Ratification of an unauthorized act includes its entirety.* — It is quite true that one who ratifies the act done in his name without previous authority must ratify it as done, and he cannot accept in part, and reject in part. In other words, he must take the bitter along with the sweet, and he cannot affirm that portion of the act done which suits his fancy, and reject the balance which serves to impose a burden upon him. Consequently, if he sees fit to adopt an unauthorized act at all, he must adopt it as a whole, and in its entirety.

(2) *Ratification not cover separate and independent act or transaction.* — This principle, however, does not apply to the case at bar. Here, the settlement of the judgment was one transaction and the cashing of the check at the bank was another. The parties were different, and the two transactions were wholly independent, separable, and dissociated; and while it is incidentally true that the check cashed was the one given in satisfaction of the judgment, yet so far as concern the rights and obligations of the parties, it might as well have been obtained by A from any other source. Whatever P did by ratifying A's settlement of the judgment could not extend to and cover further unauthorized act of A in an entirely separate and independent transaction. *(Fretsch vs. National City Bank, 24 S.W. 2d [Mo. 1930].)*

Acts that may be ratified.

(1) *Valid/void acts.* — Usually, those acts that may be authorized (*i.e.,* they are valid) may be ratified. Acts which are absolutely void cannot be authorized nor ratified.

(2) *Voidable acts.* — Acts which are merely voidable may be ratified.[5] The reason is that a voidable act is not inoperative but

[5]Art. 1327. The following cannot give consent to a contract:
(1) Unemancipated minors;

imperfectly inoperative. Ratification, indeed, is a method by which a voidable act may be ratified.[6] (Teller, *op. cit*., p. 83.)

(3) *Unrevoked acts.* — The act or transaction must remain capable of ratification. The general rule is that a principal must ratify his agent's unauthorized contract before it is revoked by the other contracting party.[7] In other words, the third party's contract with the unauthorized agent may be said to constitute an offer to the principal which can be revoked by the offeror before acceptance by the offeree. This aspect of the doctrine of ratification would appear to contradict a fundamental concept of the doctrine, that of relation back to the time when the contract was originally entered into. (Teller, *op. cit*., p. 93.)

The third party's offer to a principal arising out of a contract with his unauthorized agent, may be revoked in one of two ways: first, as indicated above, by express revocation, and second, by a change in the nature of the contract as originally entered into.

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(2) Insane or demented persons, and deaf-mutes who do not know how to write. (1263a)

Art. 1328. Contracts entered into during a lucid interval are valid. Contracts agreed to in a state of drunkenness or during a hypnotic spell are voidable. (n)

Art. 1329. The incapacity declared in Article 1327 is subject to the modifications determined by law, and is understood to be without prejudice to special disqualifications established in the laws. (1264)

Art. 1330. A contract where consent is given through mistake, violence, intimidation, undue influence, or fraud is voidable. (1265a)

Art. 1390. The following contracts are voidable or annullable, even though there may have been no damage to the contractings parties:

(1) Those where one of the parties is incapable of giving consent to a contract;

(2) Those where the consent is vitiated by mistake, violence, intimidation, undue influence or fraud.

These contracts are binding unless they are annulled by a proper action in court. They are susceptible of ratification. (n)

[6]Art. 1393. Ratification may be effected expressly or tacitly. It is understood that there is a tacit ratification if, with knowledge of the reason which renders the contract voidable and such reason having ceased, the person who has a right to invoke it should execute an act which necessarily implies an intention to waive his right. (1311a)

[7]Art. 1317. No one may contract in the name of another without being authorized by the latter, or unless he has by law a right to represent him.

A contract entered into in the name of another by one who has no authority or legal representation, or who has acted beyond his powers, shall be unenforceable, unless it is ratified, expressly or impliedly, by the person on whose behalf it has been executed, before it is revoked by the other contracting party. (1259a)

EXAMPLE:

A, as agent of P, unauthorizedly entered into a contract of fire insurance. Thereafter, a fire occurred. P then seeks to ratify A's unauthorized act.

May P validly ratify the contract of insurance?

No. When the fire occurred, the transaction A entered into ceased to exist. A entered into a contract for an insurance risk while P purported to enter into a contract for the payment of money involving no risk. (Kline Bros. vs. Royal Ins. Co., 192 Fed. 378, cited in Teller, p. 93.)

(4) *Criminal acts.* — The general rule is subject to qualification in one important particular. A substantial number of cases hold that one whose name has been forged can ratify the act. A slight majority of the cases, however, hold that since forgery involves a crime and a public wrong and is also opposed to public policy, it cannot be ratified. This is another instance where ratification should not be confused with estoppel. All would probably agree that a person who expressly or impliedly represents that his forged signature is genuine, would be estopped from denying its genuineness against one who has changed his position from the worse. (Wyatt & Wyatt, *op. cit*., p. 240.)

(5) *Tortious acts.* — An agency to commit a tort would generally be inoperative and, therefore, the ratification without more of a tort is inconceivable, and is, in fact, a rare phenomenon. The usual case, however, presents the ratification of a transaction in general, which includes, by circumstance, a tort. (Teller, *op. cit*., p. 83.)

ILLUSTRATIVE CASE:

Damage was caused by the negligence of one while doing an unauthorized act for the benefit of another who ratified the act.

Facts: The plate-glass window of T was broken by the negligence of A, while delivering some coal which had been ordered by T from P. It is found as a fact that A was not P's servant when he broke the window, but that the delivery of the coal by A was ratified by P.

Issue: Did P, by his ratification, become responsible for the negligence of A?

Held: Yes. The ratification was not directed especially to A's trespass, and that act was not for P's benefit if taken by itself, but it was so connected with A's employment that P would have been liable as master if A really had been his servant when delivering the coal. P's ratification of the employment established the relation of master and servant from the beginning, with all its incidents including the anomalous liability for A's negligent acts. *(Dempsey vs. Chambers, 154 Mass. 330, 28 N.E. 279 [1891].)*

Note: The doctrine applied in the above case is not to be applied to the case of a bare personal tort. A man cannot make himself a party to a bare tort merely by assenting to it after it had been committed. "If a man assaulted another in the street out of his own head, it would seem rather strong to say that, if he merely called himself my servant, and I afterwards assented without more, our mere words would make me a party to the assault." Perhaps the application of the doctrine would be avoided on the ground that the facts did not show an act done for the defendant's benefit. *(Ibid.)*

Acts must be done in behalf of principal.

An act, to be capable of ratification, must be done by one party as agent for someone else. Stated in another way, a principal cannot ratify the unauthorized act of another person unless that person purported to act as agent for, and in the name of, the principal, and not in his own behalf.

The rule operates to prevent one person from acquiring the right of another. One person may enter into a fruitful contract with another person; a stranger cannot acquire rights in the contract by attempting to ratify it. (Wyatt & Wyatt, *op. cit*., p. 240.)

EXAMPLE:

A, agent, entered into a contract in his own name without disclosing the fact that he was really acting as agent of P, undisclosed principal. A was not authorized to enter into the contract.

In this case, P cannot ratify A's unauthorized contract because A did not act as agent of P.

Effects of ratification by principal.

By ratification, the relation of principal and agency is created since ratification by a principal is equivalent to prior authority. Once made, ratification becomes irrevocable.

(1) *With respect to agent.* — Ratification relieves the agent from liability to the third party to the unauthorized transaction, and to his principal for acting without authority and he may recover compensation due for performing the act which has been ratified.

(2) *With respect to principal himself.* — The principal who ratifies thereby assumes responsibility for the unauthorized act, as fully as if the agent had acted under original authority but he is not liable for acts outside the authority approved by his ratification. Thus, ratification does not render the principal liable for fraudulent misrepresentations made by the agent without his knowledge.

(3) *With respect to third persons.* — Ordinarily, a third person is bound by a ratification to the same extent as he would have been bound if the ratified act had been authorized in the first instance, and he cannot raise the question of the agent's authority to do the ratified act. (see Art. 1901.) Where a third person is liable to a principal under an unauthorized act of his agent, the third person may not be relieved of his liability on the theory that the principal ratified the agent's acts merely because the principal made an unsuccessful effort to collect from the agent. (see 2 C.J.S. 1137-1142.)

To be effective, ratification need not be communicated or made known to the agent or the third party. The act or conduct of the principal rather than his communication is the key. But before ratification, the third party is free to revoke the unauthorized contract.

Retroactive effect of ratification.

Ratification so operates upon an unauthorized act to have retroactive effect. The authority created by ratification is subsequent but it is equivalent to initial approval or prior authority. The effect is the same as where the principal allowed the agent to act as though the latter had full authority from the beginning. But to the generally retroactive effect of ratification, there are four well-recognized exceptions.

(1) *Rights of third parties.* — Where to do so would be to defeat rights of third parties which have accrued between the time of the making of the unauthorized contract and the time of ratification.

EXAMPLE:

P sold his property to T. Thereafter, P ratified a sale which has been effected without authority by A before P had sold the property to T.

In this case, T's title cannot be impaired by P's subsequent ratification. A principal cannot ratify an unauthorized contract to sell by his agent, after he himself has disposed of the subject of such contract, for to do so would be to affect detrimentally intervening third party rights.

Where, however, the intervening act is inferior in importance to the retroactive effect of ratification, the ratification will be given full effect, even to the detriment of the intervening rights.

EXAMPLE:

Without authority, A turned over a sum of money to X, binding P to a partnership agreement with X. T, judgment creditor of P, sought to levy execution on property which was the result of the business carried on by X with the money A had advanced. Upon learning of T's action, P ratified A's act, binding him as partner of X. Now, partnership creditors seek to subordinate T's levy to their rights in partnership assets.

Under the law, creditors of individual partners can attach only the partners' interest in the firm after payment of firm

debts.[8] Therefore, the partnership creditors have preferential right over the property since it is partnership property.

(2) *Intervening act or omission otherwise rightful.* — Where to do so would be to render wrongful an otherwise rightful act or omission which has taken place between the making of the unauthorized contract and the time of its ratification.

EXAMPLE:

T, tenant, failed to comply with a notice to vacate as of the time when he received such notice from A. The act of A was unauthorized by P, landlord. Subsequently, P ratified the act of A. Surely, T cannot be held for his failure to comply with the notice.

(3) *Circumvention of legal rule or provision.* — Where to do so would be to allow the circumvention of a rule of law formulated in the interest of public policy.

EXAMPLE:

A, attorney, unauthorizedly filed an appeal from a judgment rendered against P within the period prescribed by law. Later, but after such period, P ratified the appeal.

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[8]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 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)

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)

The appeal must be dismissed "because the right of the judgment creditor to maintain the judgment had become fixed at the end of the prescribed period."

(4) *Withdrawal by third party from contract.* — If the third party has withdrawn from the contract *(supra.)*, the act or transaction is no longer capable of ratification. (see Teller, *op. cit*., pp. 97-99.) There is no ratification with retroactive effect to speak of.

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)

Meaning of estoppel.

Estoppel is a bar which precludes a person from denying or asserting anything contrary to that which has been established as the truth by his own deed or representation either express or implied. (19 Am. Jur. 601.)

Through estoppel, an admission or representation is thus rendered conclusive upon the person making it and cannot be denied or disproved as against the person relying thereon. (Art. 1431.)

Ratification and estoppel distinguished.

(1) Ratification differs from estoppel mainly in that the former *rests on intention,* express or implied, regardless of prejudice to another, whereas estoppel rests on prejudice rather than intention. (3 Am. Jur. 2d 549.) In other words, in the former, the party is bound because he intended to be, while in the latter, he is bound notwithstanding the absence of such intention because the other party will be prejudiced and defrauded by his conduct, unless the law treats him as legally bound. (Forsythe vs. Day, 46 Me. 175, cited in Teller, pp. 81-82.)

(2) While ratification is retroactive and makes the agent's unauthorized act good from the beginning, estoppel operates upon something which has been done but after the misleading

act and in reliance on it and may only extend to so much of such act as can be shown to be affected by the estopping conduct. (Woodworth vs. School Dist. No. 2, Stevens Country, 159 P. 757, 92 Washington 456; 2 C.J.S. 1070.) Stated otherwise, ratification *affects the entire transaction and from the beginning,* while estoppel affects only the relevant parts of the transaction and from that time only when estoppel may be said to be spelled out. (Federal Garage, Inc. vs. Prenner, 106 Vt. 222, cited in Teller, p. 82.)

(3) Ratification by a principal of an unauthorized act of his agent has occasionally been grounded upon the doctrine of an equitable estoppel. A clear distinction, however, exists between an estoppel *in pais*[9] (or by conduct) and ratification. The *substance of ratification is confirmation of the unauthorized act or contract after it has been done or made,* whereas, the substance of estoppel is the principal's inducement to another to act to his prejudice. Acts and conduct amounting to an estoppel *in pais* may in some instances amount to a ratification; but on the other hand, ratification may be complete without any elements of estoppel. (2 C.J. 469.)

So far as the rights of third persons are concerned, however, the distinctions are of little importance because the principal is bound by the acts of the agent whether the conduct of the principal constitutes ratification or whether it constitutes estoppel.

ILLUSTRATIVE CASES:

1. *Principal did not deny power of agent to consummate contract after being fully notified thereof.*

Facts: A, P's agent, authorized to secure saloon-keepers who would sell P's beer exclusively, guaranteed on P's behalf, the payment of rent by such a saloon-keeper. P, being informed of this, did nothing.

Issue: Is P answerable for A's act?

Held: Yes. "In the case at bar, it is possible that the extension of the term of the lease and the reduction of the monthly rent might be regarded as creating an equitable estoppel, but however that may be, we rest our decision upon an implied

[9]Art. 1433. Estoppel may be *in pais* or by deed.

ratification by the defendant [P] of its agent's unauthorized assumption of authority, by failing, when fully notified thereof, promptly to deny his power to consummate the agreement." *(Depot Realty Syndicate vs. Enterprise Brewing Co., 87 Ore. 560, 171, p. 223 [1918].)*

Note: "A distinction has been made between the acts of an agent who has gone beyond his authority and those of a mere stranger intermeddling in affairs with which he is in no way connected. In the case of a stranger, it has been said that the act will not be binding upon the principal unless expressly ratified by him. But the better opinion appears to be that, as in the case where an agency exists, the approval of the principal may be inferred from his silence and acquiescence when informed of what has been done in his name. But all agree that the relations of the parties are of great consequence in determining the question of ratification, the presumption arising from acquiescence being very much stronger where the agency exists than in the case of a mere stranger." *(Union Gold Mining Co. vs. Rocky Mountain Nat. Bank, 2 Colo. 248 [1873].)*

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2. *Purported maker of note asked for additional time within which to pay, and later claimed that it was made in his name without authority by a broker who had died.*

Facts: When T, holder of a note, proposed to enforce it, P (purported maker of the note) had sought and secured additional time from T. When T again took steps to enforce the note, P set up the claim that the note had been made in his name by his brother (now dead) without authority.

Issue: Is P estopped to set up his claim?

Held: Yes. He was fully aware of the facts surrounding the transaction when he accepted from T further indulgence and forbearance. His brother was then living and the note was not barred by the statute of limitations. P made no contention at that time that the note was not genuine. By remaining silent when it was his duty to speak, P has disadvantaged T. He ought not to be heard now in repudiation of his former conduct. *(McNelly vs. Walters, 211 N.C. 112, 189 S.E. 114 [1937].)*

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3. *Silence of depositor to forgery of his name was after the checks were already forged and paid.*

Facts: W told her husband P that there was no more money from his account in the bank, as it had all been drawn out to pay moneys to W's sister to enable her to fight a case about a house. W declined to say who had forged P's name, but she persuaded him not to go to the bank until her sister's case was finished. He consented not to do so. Nothing more happened after eight (8) months when P again raised the question.

Doubting the truth about W's sister, P told W he would go to the bank. W thereupon shot herself.

Issue: Did P, by his silence, ratify or adopt the forged checks as his own? Was he estopped by his silence from alleging that his signatures were forgeries?

Held: No. All the checks were forged and paid before the silence; no checks were forged after the silence. The silence could not be the proximate cause of the bank's mistake. The bank was in no worse position than it was at the time when it was within the power of P to give the information.

But if the silence of P has caused the bank to lose its right of action against the forger, P is estopped from alleging the fact which he ought to have disclosed — namely, that the checks were forged. In the present case, while the carelessness of the bank was the proximate cause of the bank's loss in paying the forged checks, it was not the proximate cause of the bank's losing its right of action against the forger. This was caused by the failure of P to inform the bank of the forgery till his wife was dead and the cause of action was lost. *(Greenwood vs. Martins Bank, Ltd., 1 K.B. 371 [1913].)*

When principal solidarily liable with the agent.

Under Article 1911, the agent must have acted in the name of a disclosed principal and the third person was not aware of the limits of the power granted by the principal. (See Art. 1898.)

Article 1911 is based on the principle of estoppel and it is necessary for the protection of innocent third persons. It is an instance when solidarity is imposed by law. (Arts. 1207, 1208.) Both the principal and the agent may be considered as joint

tortfeasors whose liability is solidary. (Verzosa vs. Lim, 45 Phil. 416 [1923]; see Cuison vs. Court of Appeals, 227 SCRA 391 [1993]; Lustan vs. Court of Appeals, 266 SCRA 663 [1997].)

The third person with whom the agent dealt may sue either the agent or the principal alone, or both. The agent should be exempt from liability if he acted in good faith.

Apparent authority distinguished from authority by estoppel.

(1) *Apparent authority* is that which though not actually granted, the principal knowingly permits the agent to exercise or holds him out as possessing. *Authority by estoppel* arises in those cases where the principal, by his culpable negligence, permits his agent to exercise powers not granted to him, even though the principal may have no notice or knowledge of the conduct of the agent.

(2) Apparent authority is not founded in negligence of the principal but in the conscious permission of acts beyond the powers granted, whereas the rule of estoppel has its basis in the negligence of the principal in failing properly to supervise the affairs of the agent, allowing him to exercise powers not granted to him, and so justifies others in believing he possesses the requisite authority. (Mechem on Agency, Sec. 720; 3 C.J.S. 139.)

The doctrine of powers by estoppel can apply only in those cases in which a third party acted to his detriment in reliance upon the appearance of authority the principal has held the agent out as having. (see Art. 1898.) The presence of such reliance is unnecessary to spell out an apparent authority.

EXAMPLE:

P authorized A to sell P's land, the purchase price payable to P in 12 monthly installments. A sold the land to T.

If P knowingly permits A to collect from T, A may be said to have apparent authority to receive payment. But if A collects from T without informing P but under such circumstances as to charge P with knowledge of such collection, as where T has not paid him even a single installment notwithstanding that

several months have already passed, there arises in this case authority by estoppel founded on the negligence of P.

ILLUSTRATIVE CASES:

1. *Impostor who appeared to be a hotel clerk absconded with the valuables of a lodger.*

Facts: T came to the hotel of P late at night; one A, who was in fact a lodger but who "appeared to be in charge," went behind the counter, had T register, showed him to a room, and received and signed a receipt for certain valuables on behalf of the hotel. A absconded with the valuables during the night.

Issue: Is P liable to T?

Held: Yes. An agency may be created by estoppel, and that estoppel may be allowed on the ground of negligence or fault on the part of the principal, upon the principle that when one of two innocent parties must suffer loss, the loss will fall on him whose conduct brought about the situation.

Here P, the proprietor of the hotel, left A in the office either designedly or negligently, clothed with apparent authority to do what hotel clerks usually do, and one (T) who came in for the purpose of becoming a guest, and did become a guest, must reasonably conclude that he (A) had apparent authority to do what clerks under similar circumstances would have a right to do. *(Kanelles vs. Locke, 31 O.C.A. 280 [1919].)*

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2. *After selling his business, seller held out buyer as his agent in the conduct of the business.*

Facts: After selling his business to A, P took out a license for the business in his own (P's) name, leaving A in charge of the business conducted under his license, leaving his (P's) name on the sign over the store, directing T to "deliver his goods to A," followed by the conduct of A in receiving the goods shipped and invoiced to P.

Issue: Upon the facts, is T justified in believing that A was acting as agent of P?

Held: Yes. P, by his conduct, put it in the power of A to hold himself out as his agent, thereby inducing T to sell and ship the goods on P's credit. The liability of P rests upon the familiar

principle that, when one of two innocent persons must sustain a loss, the law will place it upon the one whose conduct, either intentionally or negligently, misleads the other. *(Metzger vs. Whitehurst, 60 S.E. 907 [1908].)*

Implied agency distinguished from agency by estoppel.

Implied agency should be distinguished from agency by estoppel.

(1) In the former, there is an actual agency. The principal alone is liable.

(2) In an agency by estoppel, the authority of the agent is not real but only apparent:

(a) If the estoppel is caused by the principal, he is liable to any third person who relied on the misrepresentation.

(b) If the estoppel is caused by the agent, then only the agent is liable.

EXAMPLES:

(1) P tells X that A is authorized to sell certain merchandise. P privately instructs A not to consummate the sale but merely to find out the highest price X is willing to pay for the merchandise. If A makes a sale to X, the sale is binding on P who is in estoppel to deny A's authority.

In this case, there is no agency created but there is a *power* created in A to create contractual relations between P and X, without having *authority* to do so. The legal result is the same as if A had authority to sell.

(2) P authorized A to sell the former's car. A sold the car to X who paid A the purchase price. However, A did not give the money to P. X is not liable to P. A has implied authority to receive payment.

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)

Obligation to advance funds.

The agent is bound by his acceptance to carry out the agency. (Art. 1884.) On the other hand, the principal is under obligation to provide the means with which to execute the agency. In the absence of stipulation that the agent shall advance the necessary funds (Art. 1886.), the principal must advance to the agent upon his request the sums necessary for the execution of the agency. (Art. 1912, par. 1.)

If the principal fails to comply with his obligations, the agent will not be liable for the damage which, through his non-performance, the principal may suffer. (Art. 1884.)

Obligation to reimburse agent for funds advanced by latter.

An agency is for the principal's benefit. In case the agent advanced the sums necessary for the execution of the agency, whether on his own initiative or by virtue of stipulation, the said advances must be reimbursed by the principal with interest from the day the advance was made. (see Art. 1896.) Demand is not necessary in order that delay on the part of the principal shall exist. (Art. 1169[1].)

(1) *Obligation founded on implied promise to repay.* — The general rule is that, where one is employed or directed by another to do an act in his behalf, not manifestly wrong, the law implies a promise by the principal to reimburse the agent for expenditures incurred as a proximate consequence of the good faith execution of the agency, which includes interest thereon. This rule is based upon the principle that a request to undertake an agency, the proper execution of which involves the expenditure of money on the part of the agent, operates not only as an implied request on

the part of the principal to incur such expenditure but also as a promise to repay it. (3 C.J.S. 102.)

(2) *Obligation not affected even if undertaking not successful.* — The law adds that the obligation to reimburse the agent cannot be defeated by the fact that "the business or undertaking was not successful" provided the agent is free from all fault. (Art. 1912.) The reason for this rule is that the agent simply obligates himself to represent the principal and not that all the business entrusted to him shall be successful. If the mission was executed with the diligence of a good father of a family, then the agent has complied with his duty; and if nothing less is required of him, neither is he expected to do more. (11 Manresa 541.)

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)

Obligation to indemnify agent for damages.

The rule in the above article is based on equity. Since the principal receives the benefits of the agency and has a right to demand damages from the agent should the latter not perform the agency (Art. 1884.), he should answer for the damages resulting from the execution thereof without fault or negligence on the part of the agent. Article 1913 is also a logical corollary to the rule which makes the agent liable to the principal for damages or losses which the latter may suffer because of his non-performance (Art. 1884.), fraud, or negligence. (Art. 1909.)

(1) *Where damages caused by the execution of agency.* — The agent has the right to assume that the principal will not call upon him to perform any duty which would render him liable in damages to third persons. Having no personal interest in the act other than the performance of his duty, the agent should not be required to suffer loss from the doing of an act apparently lawful in itself, and which he has undertaken to do by the direction and for the benefit and advantage of his principal. If in the performance of such an act, therefore, the agent invades the rights of third

persons, and incurs liability to them, the loss should fall rather upon him for whose benefit and whose direction it was done, than upon him whose only intention was to do his duty to his principal.

Wherever then, the agent is called upon by his principal to do an act which is not manifestly legal, and which he does not know to be wrong, the law implies a promise on the part of the principal to indemnify the agent for such losses and damages as flowing directly and immediately from the execution of the agency. Thus, an agent is entitled to be indemnified when he is compelled to pay damages for taking personal property by direction of his principal which, though claimed adversely by another, he has reasonable ground to believe belongs to his principal. (Hoggan vs. Cahoon, 73 Pac 512 [Utah 1903].)

(2) *Where damages caused by wrongful acts of third persons.* — Be it noted, however, that the liability of the principal for damages is limited only to that which the execution of the agency has caused the agent. Thus, no promise to indemnify will be implied for losses or damages caused by the independent and unexpected wrongful acts of third persons for which the principal is in no way responsible. (see Mechem, Secs. 571-573, pp. 397-398; 3 Am. Jur. 2d 612-613.) "If, for example, a broker while going upon his principal's business should be waylaid by a robber, or should be injured by the negligence of a motor vehicle driver, the principal would not be liable more than he would be if the agent, during the existence of the agency, should contract a contagious disease or be struck by lightning." (Mechem on Agency, Sec. 1604, cited in Teller, p. 155.)

(3) *Where agent acted upon his own account.* — Similarly, there is no obligation to indemnify where no agency relation exists, as where it appears that the supposed agent acted upon its own account and not as an agent, in the legal sense. (See Albaladejo y Cia vs. Phil. Refining Co., 48 Phil. 556 [1925].)

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)

Right of agent to retain in pledge object of agency.

If the principal fails to reimburse or indemnify the agent as required in Articles 1912 and 1913, the agent has the right to retain in pledge the things which are the object of the agency. This is an instance of legal pledge or pledge which is created by operation of law.[10]

Unlike contractual pledges, however, the agent is not entitled to the excess in case the things are sold to satisfy his claim and the proceeds thereof are more than the amount due. (see Arts. 2115, 2121.)

Nature of agent's right of lien.

(1) *Right limited to subject matter of agency.* — The lien[11] of the agent is specific or particular in character, and not a general lien so as to give the agent a right to retain the principal's goods for claims disconnected with the business of the agency.

(2) *Right requires possession by agent of subject matter.* — An agent in order to have a lien, must have some possession, custody, control, or disposing power in and over the subject matter in which the lien is claimed. The lien does not arise where possession

[10]Sec. 37. *Attorney's liens.* — An attorney shall have a lien upon the funds, documents and papers of his client which have lawfully come into his possession and may retain the same until his lawful fees and disbursements have been paid, and may apply such funds to the satisfaction thereof. He shall also have a lien to the same extent upon all judgments for the payment of money, and executions issued in pursuance of such judgments, which he has secured in a litigation of his client, from and after the time when he shall have caused a statement of his claim of such lien to be entered upon the records of the court rendering such judgment, or issuing such execution, and shall have caused written notice thereof to be delivered to his client and to the adverse party; and he shall have the same right and power over such judgments and executions as his client would have to enforce his lien and secure the payment of his just fees and disbursements. (Rule 138, Rules of Court.)

[11]A lien is a right *in rem* against real or personal property, given by law to secure the performance of an obligation existing in favor of the lien holder. Liens are classified as (1) *general lien,* defined as a right to retain the property of another on account of a general balance due from that other. It can be asserted only by an agent where he has come into possession of the money or property in the course of employment and continues to possess the money or property; and (2) *special lien,* which is the right to retain the property of another on account of labor or money employed in that specific property. (Teller, *op. cit.,* pp. 155-156.)

of the property is acquired by the agent under a contract which expressly or impliedly shows a contrary intention, as where it is delivered to him for a particular purpose inconsistent with the existence of the lien thereon. (3 C.J.S. 109-110.) To entitle the agent to a lien, the funds or property against which it is asserted must be in his actual or constructive possession, and he must have acquired that possession lawfully and in his capacity as agent. (2 C.J. 457.)

(3) *Right generally only in favor of agent.* — In the absence of a ratification of a sub-agent's acts by the principal, the right of lien exists only in favor of the agent, and cannot be claimed by one to whom the agent delegates his authority where no privity exists between sub-agent and the principal. (*Ibid*., 111.)

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)

Nature of liability of two or more principals to their agents.

In American law, the term "joint principals" relates to a group with substantially identical interests, and contemplates the appointment of an agent or agents empowered to bind the members of the group jointly (solidarily). Generally speaking, all of the joint principals must unite in the appointment of an agent.

An example of an exception to the rule is partnership though it is usually cited as an example of joint (solidary) principalship. An agent appointed by the partnership or by a partner thereof acting within the scope of the partnership business binds all the partners by his valid acts or transactions. (see Arts. 1803[1], 1818.) Co-owners, on the other hand, do not possess authority to bind the others. The law does not imply a partnership among them because they develop or operate the common property, since they may rightfully do this by virtue of their respective titles. (Teller, *op. cit*., p. 48.)

It is to be noted that in the common law system, every debtor in a joint obligation is liable *in solidum* for the whole obligation. Under Article 1915, the so-called joint principals are solidarily liable to the agent for all the consequences of the agency. It would, therefore, be more appropriate to use the term "solidary principals." On the other hand, the responsibility of two or more agents, even though they have been appointed simultaneously, is joint, not solidary. (Art. 1894.)

Requisites for solidary liability.

There are three requisites for the application of the above article:

(1) There are two or more principals;

(2) The principals have all concurred in the appointment of the same agent; and

(3) The agent is appointed for a common transaction or undertaking.

The liability of the principals is solidary for all the consequences of the agency; that is, each principal may be sued by the agent for the entire amount due and not just for his proportionate share. Thus, if P and O engage the professional services of A, a lawyer, for the recovery of a parcel of land of which they are co-owners, they are liable solidarily for the attorney's fees. The principal who made the payment may claim from the other the share which corresponds to him. (Art. 1217, par. 2.)

A transaction or undertaking is common to all principals if it is one as to which their interests are in accord and in harmony. (11 Manresa 561.) The rule in Article 1915 applies even when the appointments were made by the principals in separate acts, provided that they are for the same transaction. The solidarity arises from the common interest of the principals and not from the act of constituting the agency. The parties, however, may, by express agreement negate this solidarity responsibility. (De Castro vs. Court of Appeals, 384 SCRA 607 [2002], citing Arturo M. Tolentino, Commentaries and Jurisprudence on the Civil Code of the Philippines, Vol. 5, pp. 428-429, 1992 ed.)

Where principals are members of a non-profit association.

A distinction has been made in respect of the liability of the principals of a profit association as compared to that of a non-profit or voluntary association. While the principals in the first are personally liable on all business contracts, the principals or members in the second are liable personally only under two circumstances:

(1) Where the member assented to the particular act or transaction in respect of which personal liability is sought to be fastened. Such assent is usually indicated by an affirmative vote at the meeting where the proposal is discussed. Thus, in a case (citing Wilcox vs. Arnold, 162 Mass. 577.), it was held that only the members of a college class who voted in favor of the publication of a classbook were liable to the printing firm for the non-payment of the contract price; and

(2) Where the member assented by his conduct, *e.g.*, at a meeting at which the contract was proposed, nobody dissented. (Teller, *op. cit*., p. 49.)

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)

Rule where two persons contract separately with agent and principal.

Two persons may contract separately with the agent and the principal with regard to the same thing. If the two contracts are incompatible with each other, the one of prior date shall be preferred. This is subject, however, to the rules under Article 1544 which provides as follows:

> "If the same thing should have been sold to different vendees, the ownership shall be transferred to the person who may have first taken possession thereof in good faith, if it should be movable property.

Should it be immovable property, the ownership shall belong to the person acquiring it who in good faith first recorded it in the Registry of Property.

Should there be no inscription, the ownership shall pertain to the person who, in good faith was first in the possession; and, in the absence thereof, to the person who presents the oldest title, provided there is good faith."

EXAMPLES:

(1) P authorized A to contract for the construction of his house for a price of not more than P100,000.00. Without the knowledge of A, P contracted with B for the construction of the house for P95,000.00. Later, A entered into a contract with C for the construction of the same house for P90,000.00.

Under Article 1916, the contract with B shall be preferred as it is of prior date.

(2) P gave authority to A to sell a cash register. Without the knowledge of A, P sold the cash register to B. It was agreed that P would deliver the register the following day. Before delivery, A sold the same register to C who bought it in good faith and took possession thereof.

Under the first paragraph of Article 1544, C should be considered the owner of the property.

(3) P gave to A a special power of attorney to sell a certain parcel of land. A sold the land to B who did not register the sale. Later, P sold the same land to C who in good faith, registered the sale.

The ownership belongs to C. If the sale to B was first recorded, his title would prevail. (see Sta. Romana vs. Imperio, 15 SCRA 625 [1965].)

If neither sale was registered and C took possession of the land in good faith, the ownership shall also belong to him.

In the absence of registration and possession by B and C, the ownership shall pertain to B, his title being older than that of C.

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)

Liability to third person of agent or principal who contracts separately.

Whether the principal or the agent will be the one liable for damages to the third person who has been prejudiced under Article 1916 depends on whether the agent acted in bad faith or not. If the agent acted in good faith and within the scope of his authority, the principal incurs liability. If the agent acted in bad faith, he alone shall be responsible to such third person.

Article 1916 governs the rights of third persons as between themselves.

EXAMPLE:

In the preceding example (No. 1.), if A acted in good faith, P shall be liable in damages to C whose contract must be rejected; if A acted in bad faith, he alone shall be responsible to C.

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)

When principal not liable for expenses incurred by agent.

In the four cases provided in this article, the principal is not liable for expenses incurred by the agent. (see Art. 1912.)

The reason under No. 1 is evidently to punish the agent; for the exception, the acceptance of benefits is implied ratification; under No. 2, it is self-evident (see Arts. 1909, 1912, par. 2.); under No. 3, the agent is guilty of bad faith and lack of diligence (see Art. 1888.); and under No. 4, an express stipulation which is not contrary to law, morals, good customs, public order, or public policy is binding between the parties. (see Art. 1306.)

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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)

Presumption of continuance of agency.

When once shown to have existed, an agency relation will be presumed to have continued, in the absence of anything to show its termination; and the burden of proving a revocation or other termination of an agency is on the party asserting it. (3 Am. Jur. 2d 440.)

Modes of extinguishing an agency.

An agency does not last forever. Like most consensual agreements, the relationship usually comes to an end at some point. Termination can take place because of something done by the parties themselves or of something beyond their control, *i.e.*, by operation of law. Under the law, agency may be terminated:

(1) by agreement (Nos. 5, 6.); or

(2) by the subsequent acts of the parties which may be either:

(a) by the act of both parties or by mutual consent; or

(b) by the unilateral act of one of them (Nos. 1, 2.); or

(3) by operation of law. (Nos. 3, 4.)

Presence, capacity, and solvency of parties essential for continuance of agency.

Agency requires the presence, capacity, and solvency of both the principal and agent. Consequently, the death, civil interdiction, insanity, or insolvency[1] of either party terminates the agency (see Arts. 39, 1327.) and this is true notwithstanding that the agency period has not yet expired.

(1) Whether the death of one of two or more principals or of one of two or more agents terminates the agency depends upon the intention of the parties. Generally, the death of one of several principals does not revoke the agent's authority nor does the death of one of several agents put an end to the agency of all, whether the responsibility of the several principals or agents is joint or solidary. (see Arts. 1844-1895, 1915.) The intention of the parties controls except as otherwise provided by law. *(infra.)*

(2) Civil interdiction deprives the offender during the period of his sentence of the right to manage his property and dispose of such property by any act or any conveyance *inter vivos*. (Art.

[1]Sec. 16. *Death of party; duty of counsel.* — Whenever a party to a pending action dies, and the claim is not thereby extinguished, it shall be the duty of his counsel to inform the court within thirty (30) days after such death of the fact thereof, and to give the name and address of his legal representative or representatives. Failure of counsel to comply with this duty shall be a ground for disciplinary action.

The heirs of the deceased may be allowed to be substituted for the deceased, without requiring the appointment of an executor or administrator and the court may appoint a guardian *ad litem* for the minor heirs.

The court shall forthwith order said legal representative or representatives to appear and be substituted within a period of thirty (30) days from notice.

If no legal representative is named by the counsel for the deceased party, or if the one so named shall fail to appear within the specified period, the court may order the opposing party, within a specified time, to procure the appointment of an executor or administrator for the estate of the deceased and the latter shall immediately appear for and on behalf of the deceased. The court charges in procuring such appointment, if defrayed by the opposing party, may be recovered as costs. (Rule 3, Rules of Court.)

34, Revised Penal Code.) A person under civil interdiction cannot validly give consent. (Art. 1327.)

(3) As by an act of insolvency the principal loses control of the subject matter of the agency, the authority of the agent to act for his principal generally ceases by operation of law upon an adjudication of the principal's insolvency. The insolvency of the agent will also ordinarily put an end to the agency, at least if it is in any way connected with the agent's business which has caused his failure. But the insolvency of the agent will not destroy any right he may have under a power coupled with interest. (2 C.J.S. 177-178.)

Death of the principal or agent.

(1) *General rule.* — By reason of the very nature of the relationship between the principal and agent, agency is extinguished *ipso jure* upon the death of either principal or agent.

(a) Although a revocation of a power of attorney to be effective must be communicated by the parties concerned (see Arts. 1921 and 1922.), yet a revocation by operation of law, such as by death of the principal is, as a rule, instantaneously effective inasmuch as "by legal fiction the agent's exercise of authority is regarded as an execution of the principal's *continuing will.*" (2 C.J.S. 1174.)

With death, the principal's will ceases or is terminated; the source of authority is extinguished. (Rallos vs. Felix Go Chan & Sons Realty Corp., 81 SCRA 251 [1978].) Thus, the death of a client divests his lawyer of authority to represent him as counsel. A dead client has no personality and cannot be represented by an attorney. (Laviña vs. Court of Appeals, 171 SCRA 691 [1989].)

(b) On the other hand, if the agent dies (see Art. 1932.), he can no longer act for the benefit and representation of the principal. It is obvious that there can be no principal where there is no agent.

(2) *Exceptions.* — The Civil Code expressly provides for two exceptions to the general rule that the death of the principal or the agent revokes or terminates *ipso jure* the agency, to wit:

(a) That the agency is coupled with an interest (Art. 1930.); and

(b) That the act of the agent was executed without knowledge of the death of the principal and the third person who contracted with the agent acted in good faith. (Art. 1931.)

Power to foreclose survives death of mortgagor.

(1) *Under Act No. 3135.* — The power of sale in a deed of mortgage is not revoked by the death of the principal (mortgagor) as it is not an ordinary agency that contemplates exclusively the representation of the principal by the agent but is primarily an authority conferred upon the mortgagee for the latter's own protection. It is an ancillary stipulation supported by the same cause or consideration for the mortgage and forms an essential and inseparable part of that bilateral agreement. That power survives the death of the mortgagor. (Perez vs. Phil. National Bank, 17 SCRA 833 [1966]; see Del Rosario vs. Abad and Abad, 104 Phil. 648 [1958], under Art. 1927.)

(2) *Under the Rules of Court.* — In fact, the right of the mortgagee to extrajudicially foreclose the mortgage after the death of the mortgagor does not depend on the authorization in the deed of mortgage executed by the latter. The right exists independently of said stipulation and is clearly recognized in Section 7, Rule 86 of the Rules of Court which grants to a mortgagee three remedies that can be alternatively pursued in case the mortgagor dies, to wit:

(a) to waive the mortgage and claim the entire debt from the estate of the mortgagor as an ordinary action;

(b) to foreclose the mortgage judicially and prove any deficiency as an ordinary claim; and

(c) to rely on the mortgage exclusively, foreclosing the same at any time before it is barred by prescription without right to file a claim for any deficiency. (Bicol Savings and Loan Ass'n. vs. Court of Appeals, 171 SCRA 630 [1989].)

Dissolution of firm or corporation.

Dissolution of a firm or corporation which entrusted (as principal) or accepted (as agent) the agency, extinguishes its juridical existence as far as the right to go on doing ordinary business is concerned, except for the purpose of winding up its affairs. It is equivalent to its death, being sometimes likened to the death of a natural person.

After winding up, the existence of the firm or corporation is terminated for all purposes.

Accomplishment of object or purpose.

(1) *Termination of agency ipso facto.* — At least as between the parties, principal and agent, the fulfillment of the purpose for which the agency is created *ipso facto* terminates the agency, even though expressed to be irrevocable.

(a) Accordingly, where the purpose of the agency was to effect a sale (or purchase), the agency terminated when the property was sold (or purchased);

(b) Likewise, a power of attorney to convey land for the payment of a debt is extinguished by the payment of the debt. (2 C.J.S. 1152.)

(2) *Continued existence of authority illogical.* — When the object or purpose of the agency is accomplished and nothing else remains to be done, there would be no sense in continuing the relationship beyond that point. It is illogical to assume the continued existence of authority to do something which can no longer be done.

An agency relationship between the parties may also be terminated by the non-accomplishment of the object or purpose within a reasonable time. *(infra.)*

Expiration of term.

(1) *Term specified.* — Where an agency, by the terms of the original agreement, is created for a fixed period or is to end at a certain time, the expiration of such period or the arrival of that

time, obviously results in the termination of the relationship, even though the purpose for which the agency was created has not been accomplished.

(2) *Term not specified.* — If no time is specified, it terminates at the end of a reasonable period of time. Either, party can terminate the relationship at will by giving notice to the other.

(3) *Period implied.* — The period may be implied from the terms of the agreement, the purpose of the agency, and the circumstances of the parties. Thus:

(a) An agreement that the agency shall continue for one year may be implied from a provision for payment of a salary in quarterly annual installments;

(b) Where the principal agrees to furnish the agent as many machines as he may be able to sell prior to a certain date, an agreement that the agency is to continue until that date is implied; and

(c) Where an agent has expended a substantial sum of money or has substantially rearranged his business preparatory to engaging upon the terms of an agreement for the benefit of the principal, he ought to have a reasonable time and notice of the cancellation of the contract in order that he might have a reasonable opportunity to put his house in order. (see 2 C.J.S., 1148-1149.)

(d) Where an agent was employed to sell the principal's car and after more than one (1) year the agent has not sold the car and there has been no communication between them, it is safe to assume that the agency has terminated;

(e) Where the agent was appointed to manage the business affairs while the principal is abroad, the agency automatically terminates when the principal return.

Modes provided not exclusive.

Article 1919 gives only those causes of extinction which are peculiar to agency. (see 11 Manresa 570-571.) The list is not exclusive. Thus:

(1) *Generally.* — An agency may also be extinguished by the modes of extinguishment of obligations in general when applicable, like loss of the thing and novation. (Art. 1231.) It is a basic rule of contract law that the parties can rescind or cancel their contract by mutual agreement. It makes no difference that the principal and agent originally agreed that the agency was irrevocable.

(2) *War.* — During the existence of a state of war, a contract of agency is inoperative if the agent or the principal is an enemy alien. Since it is generally conceded that war suspends all commercial intercourse between the residents of two belligerent states, the general rule is that agency is terminated, as a matter of law, upon outbreak of war. (Kershaw vs. Kelsey, 100 Mass. 561.)

(3) *Legal impossibility.* — Implied in every contract is the understanding that it shall be capable of being carried out legally at the time called for by the contract.[2] Thus, a lawyer who agreed to appear as counsel is released from his obligation if he is subsequently appointed a regional trial judge for under the law, judges are prohibited from engaging in the practice of law. An agency terminates if a change in the law makes the purpose of the agency unlawful.

(4) *Termination of agent's authority.* — A position which flows from a trust relationship, whether directly or indirectly, terminates as a matter of law with the destruction or loss of the trust. A sub-agent's authority terminates with the termination of the agent's authority. (Teller, citing Livermore on Agency, Sec. 307.)

(5) *Occurrence of a specified event.* — If the principal and agent have originally agreed that the agency, or some particular aspect of it, will continue until a specified event occurs (*e.g.*, authority of agent to continue until the principal returns from abroad), the happening of the event obviously terminates the agency. The event is in the nature of a resolutory condition.

[2]Art. 1266. The debtor in obligations to do shall also be released when the prestation becomes legally or physically impossible without the fault of the obligor. (1184a)

Loss or destruction of subject matter.

(1) *General rule.* — In the absence of any agreement by the parties to the contrary, the loss or destruction of the subject matter of the agency or the termination of the principal's interest therein terminates the agent's authority to deal with reference to it. Thus, the agency of a master of vessel terminates upon the absolute destruction of the vessel.

(2) *Exceptions.* — The contract will not always be terminated in every case where the subject matter of the agency is lost or destroyed.

(a) If it is possible to substitute other material for that which was destroyed without substantial detriment to either party or if the destroyed subject matter was not in fact essential to the contract, the agency may continue.

(b) A partial loss or destruction of the subject matter does not always result in a complete termination of the agency, and under such circumstances, while the agency may be ended insofar as the destroyed property is concerned, it may continue in existence as to other property not affected. Thus, it has been held that the contract of one engaged to act as agent to secure freight for the defendant's three boats cannot be cancelled merely because one boat was destroyed. (3 Am. Jur. 2d 459-460.)

(3) *Liability of principal.* — The termination of the agency does not necessarily free the principal from liability. If the principal, for example, sells personal property in reference to the sale of which he has appointed an agent, the agency is, of course, terminated, but the principal is liable in damages for his wrongful terminating act. On the other hand, should the subject matter be destroyed without the fault of the principal, no liability is assumed by him. (Teller, *op. cit*., p. 113.) However, if a third party has given money or a thing of value for the subject matter, he may sue the principal to recover the same.

Change of conditions.

(1) *General rule.* — Where there is a basic change in the circumstances surrounding the transaction, which was not con-

templated by the parties and which would reasonably lead the agent to believe that the principal would not desire him to act, the authority of the agent is terminated. Among those changes in the circumstances which will terminate the authority of the agent are changes in the value of the subject matter and changes in the general business climate which should indicate to him that the principal would not desire him to act.

The agent is under a duty to exercise due care in ascertaining the business conditions in the market in which he is to act. If they are not conducive to his acting, his authority may be terminated.

(2) *Exceptions.* — The above rule is subject to certain qualifications.

(a) If the original circumstances are restored within a reasonable period of time, the agent's authority may be revived.

(b) Where the agent has reasonable doubts as to whether the principal would desire him to act, his authority will not be terminated if he acts reasonably. Of course, when in doubt, the agent can always protect himself by contracting the principal for instructions if it is at all possible.

(c) Where the principal and agent are in close daily contact, the agent's authority to act will not terminate upon a change of circumstances if the agent knows the principal is aware of the change and does not give him new instructions. (Sell on Agency, pp. 192-193.)

Confidential information acquired by former agent in the course of his agency.

While the relation of principal and agent is confidential, not all knowledge acquired by the agent is of a confidential nature. Some clearly is of so general a nature that equity ought not to attempt to restrict its subsequent use. The court, therefore, must determine, *first*, whether the knowledge or information, the use of which the complainant seeks to enjoin, is confidential; and *second*, whether, if it be confidential, in whole or in part, its use ought to be prevented. Just where to draw the line between usable and non-usable knowledge is a matter of difficulty.

There is always the question whether encouragement of individual initiative and competition should outweigh whatever unfairness seems to be involved in the use of the information.

(1) Authorities generally agree that an employee lawfully entering upon a competing business may be enjoined from the use of trade secrets or processes, knowledge of the employer's business surreptitiously obtained, or copied lists of customers or information about them.

(2) If information be imparted privately, the character of the secret is immaterial, if it is one important to the business of the employer and one to which the employment relates. For an employee to quit the employment and then use in the service of a rival information of a confidential nature gained in the prior employment, is contrary to good faith and fair dealing. (Colonial Laundries, Inc. vs. Henry, 48 R.I. 332, 138 A. 47 [1927].)

(3) If one is employed to devise or perfect an instrument, or a means for accomplishing a prescribed result, he cannot, after successfully accomplishing the work for which he was employed, plead title thereto as against his employer. That which he has been employed and paid to accomplish becomes, when accomplished, the property of his employer. (Wireless Specialty Apparatus Co. vs. Mica Condenser Co., Ltd., 239 Mass. 158, 131 N.E. 30F [1921].)

(4) An employee, who learns in the course of or by reason of his employment that the premises where his employer's business is conducted are of peculiar value to his employer has no right without his employer's knowledge to take a lease of those premises and hold them as his own to the injury of his employer's property. (Horn Pond Ice Co. vs. Pearson, 267 Mass. 256, 166 N.E. 640 [1929].)

The real principle upon which the agent is restrained from making use of confidential information which he has gained in the employment of the principal is that there is in the contract of service subsisting between the principal and agent an implied contract on the part of the agent that he will not, after the service is terminated, use information which he has gained while the service has been subsisting to the detriment of his former employer. (Essex Trust Co. vs. Enwright, 214 Mass. 507.)

ILLUSTRATIVE CASES:

1. *Employee, after his discharge from employment, obtained a lease covering same premises leased under terms generally known by his former employer.*

Facts: A was employed for several years as manager of P's store and was discharged when the business became unprofitable. P rented the premises from T under a written lease which expired about two (2) years before the controversy.

After his discharge, A procured a lease covering the same premises and T ousted P through ejectment proceedings. The lease was obtained by A after the relation of employee had been terminated.

Issue: Did A procure the lease through any secret or confidential information obtained by him in the course of his employment?

Held: No. The fact that P had been operating on a month-to-month tenancy was generally known. It was not a "secret of the trade." Anyone in or out of the business could have ascertained whether a term lease was recorded and, upon inquiry could have learned the terms of the tenancy under which the premises were occupied. This information could be learned by anyone outside of the employment. *(Cohn vs. Clare, 6 Cal. App. [2d] 504, 44 P. [2d] 634 [1935].)*

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2. *Former employee put up a competitive business, soliciting the patronage of customers of his former employer, whose names and addresses were made known to the former only for the purpose of the latter's business.*

Facts: A was employed for several years by P as driver of laundry wagons. Upon entering employment, A was given the names of certain regular customers upon whom to make periodical calls for the solicitation and collection of laundry to be done by P. Such customers constituted what is called a route, and the number of customers on the routes increased during A's employment.

During the last week of A's employment, A notified P's customers that he was about to go into the laundry business for himself and received assurance from P's customers, and

did in fact receive, in the following week, 80% of the customers on their respective routes. A copied no list of customers but simply carved the names and addresses of said customers in his memory. A's contract with P did not forbid the former from engaging in a competitive business.

Issue: Is P entitled to injunction restraining A from soliciting laundry business from P's former customers from whom A as driver for P had collected laundry?

Held: Yes. (1) *Former employee's knowledge of the principal's customers confidential information.* — Knowledge of the names of P's customers furnished to A at the time the employment began, was confidential information. Without this knowledge, A's solicitation must have been of a general nature, such as might be addressed to anyone in the community. The time and expense spent by P in gathering these groups of customers was capitalized by A, to save making the otherwise required general canvass for customers. A misused the confidential information secured while the contractual relation existed.

There is no question that if A had taken a written list of customers when he quit, or had surreptitiously procured the names, the injunction would be proper. It is difficult to see why P is entitled to less protection when the names on the list are carried off in A's memory. So, too, may secret formulas be carried away.

(2) *Voluntary patronage of former employee's business permitted.* — That P could have protected himself by a special contract, operating after A's employment does not render the use of the knowledge less an abuse of confidence. The use by A of the specific list of laundry customers written or unwritten, made known to A only for the purpose of P's business exclusively, may not be made the basis for competitive solicitation of business from those specific customers.

Acceptance of patronage of all who voluntarily decide to employ A is not interfered with by the terms of the injunction. A may advertise or take any means of publicity to call attention to his business, so long as he does not specifically solicit the trade of those upon their former routes. *(Colonial Laundries, Inc. vs. Henry, supra.)*

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3. *Employee obtained lease, knowing by reason of his employment, that his employer, a tenant at will, would be prejudiced if made to transfer to another place.*

Facts: A, was a newspaper reporter who had "by reason of his employment" learned that the premises on which the paper was published were of "peculiar value" to P, his employer, because the printing press was situated in the basement upon a foundation of concrete, embedded in the earth underneath the building, and could not be removed from said basement and set up in some other place in less than two (2) weeks' time and at a very considerable expense.

While the press was being taken down and being set up in another place, the paper could not be published unless it made arrangements for its printing from some other press, and it appeared in evidence that no press could be used for that purpose.

A went to the owner, secured a lease, and asked P to quit. P was a tenant at will.

Issue: Is P entitled to an assignment of the lease?

Held: Yes. A has made use of information which has come to him in his employment to the detriment of P. This is enough to entitle P to equitable relief. (*Essex Trust Co. vs. Enwright, supra.*; see Horn Pond Ice Co. vs. Pearson, *supra*.)

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)

Revocation of agency by principal.

An agency may be terminated by the subsequent acts of the parties. When done by the principal, it is called "revocation" and when done by the agent, it is usually spoken of as "withdrawal" or "renunciation." (see Art. 1919[2].) Wrongful termination can subject the terminating party to a suit for damages.

(1) *Agency generally revocable at will by principal.* — Subject only to the exceptions provided in Article 1927, the principal may revoke the agency at will — at any time, at his mere option, with

or without reason — since an agency relationship is voluntary. This is true even though there was an agreement previous to the revocation that the agency should continue longer. Even a statement in the agreement that the agency cannot be terminated cannot affect the principal's ability or power to terminate it. This is an exception to the rule that the validity or compliance of a contract cannot be left to the will of one of the parties. (Art. 1308.)

As the law makes no distinction, revocation at will is proper whether the agency is gratuitous or with compensation.

(2) *Reason for the rule.* — The mere fact that the agency is to be irrevocable will not make it so; and the principal may still revoke the relationship at will. (Art. 1920.)

(a) Since the authority of the agent emanates from or depends on the will of the principal, it is enough that the principal should wish to withdraw the authority or terminate the agency.

(b) Moreover, confidence being the cardinal basis of the relation, it stands to reason that it should cease when such confidence disappears. If this were not so, the contract would become unnatural, converting the representation into a real alienation of personality something repugnant to the principles of modern law. (11 Manresa 571; see Barretto vs. Santa Marina, 20 Phil. 440 [1911].)

(c) The principal-agent relationship is consensual and personal in nature and no one can be forced to retain another as his agent against his will. (Sell on Agency, p. 191.) But a principal may not revoke an agent's authority for acts or transactions the agent has already performed or entered into, or an agency coupled with interest. (see Art. 1927.)

Liability of principal for damage caused by revocation.

While the principal may have absolute power to revoke the agency at any time, he must respond in damages for breach of contract where the termination is wrongful, although Article

1920 does not expressly so provide, in those cases wherein not having the legal right to do so, he should discharge the agent.[3]

It must be emphasized, that we are speaking of a *power* and not a *right*. As to whether the principal's revocation of authority constitutes an exercise of a "right to revoke" or a "power to revoke" will, of course, depend upon the facts of the particular case.

(1) *Where agency constituted for a fixed period.* — The principal shall be liable for damages occasioned by the wrongful discharge of the agent before the expiration of the period fixed. In such case, however, the action for indemnity would be derived not from the law, but from the contract of the parties. (11 Manresa 573.)

(a) In a case where the exclusive authority given "to dispose of, sell, cede, transfer and convey x x x until all the subject property as subdivided is fully disposed of" was revoked by the subdivision owner before all the lots have been disposed of, the owner was held liable for damages for breach of contract on the ground that the agency agreement could not be terminated "until all the lots have been disposed of." (Diolosa vs. Court of Appeals, 130 SCRA 350 [1984].)

(b) But where the principal has the absolute right to revoke the agency, even if the period fixed in the contract of agency has not yet expired, the agent cannot object thereto; neither may he claim damages for such revocation, unless it is shown that such was done in order to evade the payment of the agent's commission. (CMS Logging, Inc. vs. Court of Appeals, 211 SCRA 374 [1992].)

(2) *Where no time fixed for continuance of agency.* — Where no time for the continuance of the agency is fixed by its terms, the

[3]Sec. 26. *Change of attorneys.* — x x x A client may at any time dismiss his attorney or substitute another in his place, but if the contract between client and attorney has been reduced to writing and the dismissal of the attorney was without justifiable cause, he shall be entitled to recover from the client the full compensation stipulated in the contract. However, the attorney may, in the discretion of the court, intervene in the case to protect his rights. For the payment of his compensation, the attorney shall have a lien upon all judgments for the payment of money, and executions issued in pursuance of such judgment, rendered in the case wherein his services had been retained by the client. (Rule 138, Rules of Court.)

principal is at liberty to terminate it at will subject only to the requirements of good faith. (Dañon vs. Brimo & Co., 44 Phil. 133 [1922].)

(a) In a case, no definite period was fixed by the principal within which the agent might effect the sale of the former's factory. Nor was the agent given by the principal the exclusive agency of such sale. It was held that the agent cannot complain of the principal's conduct in selling the property through another agent before the first agent's efforts were crowned with success. "One who has employed a broker can himself sell the property to a purchaser whom he has procured, without any aid from the broker." (Subido vs. Iglesia ni Cristo, [C.A.] No. 9910-R, June 27, 1955

(b) But if the principal acted in bad faith, *i.e.*, with the view of concluding the bargain without the aid of the broker and avoiding the payment of commission about to be earned, it might be well said that the due performance of his obligation by the broker was purposely prevented by the principal.[4] (Wylie vs. Marine National Bank, 42 Phil. 133 [1921].)

(c) A principal is liable under Article 19[5] of the Civil Code in terminating an agency, at will — a legal act — when such termination would deprive the agent of his legitimate business. (Sevilla vs. Court of Appeals, 160 SCRA 171 [1988]; Valenzuela vs. Court of Appeals, 190 SCRA 1 [1990]; Florentino vs. Sandiganbayan, 202 SCRA 309 [1993].) He must give the agent at least sufficient notice to allow the agent to recoup his expenses and, in some cases, to make a normal profit.

Return of document evidencing agency.

If the authority of the agent is in writing, the principal can compel the agent to return the document evidencing the agency. (Art. 1920.) The purpose is to prevent the agent from making use of the power of attorney and thus avoid liability to third persons

[4]Art. 1186. The condition shall be deemed fulfilled when the obligor voluntarily prevents its fulfillment. (1119)

[5]Art. 19. Every person must, in the exercise of his rights and in the performance of his duties, act with justice, give everyone his due, and observe honesty and good faith.

who may subsequently deal with the agent on the faith of the instrument. (11 Manresa 573.)

Kinds of revocation.

Article 1920 adds that the revocation may be express or implied. An example of implied revocation is when the principal appoints a new agent for the same business or transaction (Art. 1923.) or when the principal directly manages the business entrusted to the agent. (Art. 1924.) When the principal after granting a general power of attorney to an agent, grants a special one to another agent, there is implied revocation of the former as regards the special matter involved in the latter. (Art. 1926.) The agent's authority may also be revoked impliedly in the same manner as in the case of appointment of an agent. (see Art. 1869.)

While Article 1358 of the Civil Code requires that contracts involving real property must appear in a proper document, a revocation of a special power of attorney to mortgage a parcel of land, embodied in a private writing, is valid and binding between the parties, such requirement being only for the convenience of the parties and to make the contracts effective as against third persons. (Philippine National Bank vs. Intermediate Appellate Court, 189 SCRA 680 [1990].)

Notice of revocation.

(1) *To agent.* — As between the principal and the agent, express notice to the agent that the agency is revoked is not always necessary. If the party to be notified actually knows, or has reason to know, facts indicating that his authority has been terminated or is suspended, there is sufficient notice. A revocation without notice to the agent will not render invalid an act done in pursuance of the authority. (3 Am. Jur. 2d 446.)

(2) *To third persons.* — In this connection, it has been held that actual notice must be brought home to former customers, while notice by publication is sufficient as to other persons. (*Ibid*., 448; see Art. 1873.)

(a) The general rule is that the acts of an agent within the apparent scope of his authority are binding on the principal

as regards one who had formerly dealt with him through the agent and who has no notice of the revocation, because such a person is justified in assuming the continuance of the agency relationship.

(b) In the absence of any notice of revocation, the principal may also be held liable even to third persons who never dealt with the agent previous to the revocation, if they, in common with the public at large, are justified in believing that such agency continues to exist. This is especially so where, after the revocation, the agent is permitted to deal with the principal's goods in his own name and in a manner indicating that he is the owner. (3 Am. Jur. 2d 447-448.)

(c) It is not always necessary that the notice of revocation be shown in a written oral communication from the principal or agent. Whether a third person has received such notice depends upon the facts of the particular case. One may be deemed to have knowledge or notice of the termination of the agency when, for example, he knows that the principal has ceased to do business, or is dealing with the subject matter of the agency, or the principal has appointed another agent for the purpose, etc. (*Ibid*., 448.)

Renunciation of agency by agent.

(1) *Agency terminable at will.* — Just as the principal has the power to revoke the agency at will, so too, the agent has the power to renounce the agency relationship, subject only to the contractual obligations owing to the principal.[6] Thus, if there is no contract existing between the parties or if the contract is for no fixed or definite period of time, it is terminable by the agent at will. Even in the face of an express contract, the agent has the power to renounce the agency, although under such circumstances, his

[6]Sec. 26. *Change of attorneys.* — An attorney may retire at any time from any action or special proceeding, by the written consent of his client filed in court. He may also retire at any time from an action or special proceeding, without the consent of his client, should the court, on notice to the client and attorney, and on hearing, determine that he ought to be allowed to retire. In case of substitution, the name of the attorney newly employed shall be entered on the docket of the court in place of the former one, and written notice of the change shall be given to the adverse party. x x x. (Rule 138, Rules of Court.)

breach may create a liability for wrongful termination. (*Ibid*., 445; see Art. 1928.)

An agent cannot legally terminate an agency in order to take advantage of the principal's condition or to profit by information resulting from his agency. (3 C.J.S. 28.)

(2) *Reason for the rule.* — Where the agent terminates the agency in violation of a contract, the principal has no right to affirmative specific performance of the agency for the essence of the relationship is consensual — the willingness of the agent to act for the principal. The same rule applies where the termination is done by the principal *(supra.)* except where the agency is coupled with interest. (see Art. 1927.)

A statement in a contract that the authority cannot be terminated by either party for a specified time adds nothing to the contract; it is effective only to create liability for breach thereof. The law will not compel the parties to continue an agency if they do not want to do so. Agency deals with personal services, and, therefore, specific performance is inappropriate. (see Constitution, Art. III, Sec. 18[2].)

(3) *Form of renunciation.* — It is not always necessary for the agent to renounce the agency expressly, as for example, where he has conducted himself in a manner clearly incompatible with his duties as agent.

(a) When an agent abandons the object of his agency and acts for himself in committing a fraud upon his principal, his capacity as agent ceases. (3 Am. Jur. 2d 446.)

(b) When an agent institutes an action against his principal for the recovery of the balance in his favor resulting from the liquidation of the accounts between them arising from the agency, and renders a final account of his operations, such actions are equivalent to an express renunciation of the agency, and terminates the juridical relation between them. Although the agent has not expressly told his principal that he renounced the agency, yet neither dignity nor decorum permits one to continue representing a person who has adopted an antagonistic attitude towards him. The act of filing a complaint against the principal is more expressive

than words renouncing the agency. (Valera vs. Velasco, 51 Phil. 695 [1928].)

On the other hand, the mere fact that the agent violates his instructions does not amount to a renunciation, and although he may thus render himself liable to the principal, he does not cease to be an agent. (3 Am. Jur. 2d 446.)

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)

Effect of revocation in relation to third persons.

(1) *Agent authorized to contract with specified persons.* — If the agency is created for the purpose of contracting with specific persons, its revocation will not prejudice such third persons until notice thereof is given them. (Art. 1921.) Thus, where the Special Power of Attorney particularly provides that the same is good not only for the principal loan but also for subsequent commercial, individual, agricultural loan or credit accommodation that the attorney-in-fact may obtain and until the power of attorney is revoked in a public instrument and a copy of which is furnished to the bank, in the absence of any proof that the bank had knowledge that the last three loans were without the express authority of the principal, the bank cannot be prejudiced thereby. (Lustan vs. Court of Appeals, 266 SCRA 683 [1997].)

The reason for the law is obvious. Since the third persons have been made to believe by the principal that the agent is authorized to deal with them, they have a right to presume that

the representation continues to exist in the absence of notification by the principal.

Of course, notice is not required if the third persons already know of the revocation.

EXAMPLE:

P authorized A to especially transact the purchase of a parcel of land belonging to B who was given a notice of the authorization given to A. Pending negotiations, P revoked the authority of A but P did not give notice of the revocation to B.

If the purchase is pushed through, P is still liable for the price assuming B acted in good faith and without knowledge of the revocation.

(2) *Agent authorized to contract with public in general.* — In case the agent has general powers (as when the agent has been appointed to manage a business), innocent third persons dealing with the agent will not be prejudiced by the revocation before they had knowledge thereof. In this case, however, the fact that the revocation was advertised in a newspaper of general circulation would be sufficient warning to third persons (Art. 1922; see Rammani vs. Court of Appeals, 196 SCRA 731 [1991].), for the publication constitutes notice upon everybody and this is true whether or not such third persons have read the newspaper concerned.

Under Article 1921, the notice of revocation must be personal; under Article 1922, it may be personal. (see Art. 1873.)

ILLUSTRATIVE CASE:

No notice was given to a regular customer of the revocation of a branch manager's authority to issue surety bonds, the company, furthermore, having honored surety bonds issued after such revocation.

Facts: It is not disputed that P (surety company) has not caused to be published any notice of revocation of A's authority to issue surety bonds on its behalf, notwithstanding the fact that the powers of A, as its branch manager in Iloilo City, were of a general nature, for she had exclusive authority,

in said place, to represent P, not with a particular person, but with the public in general, "in all negotiations, transactions, and business wherein the company may lawfully transact or engage in subject only to the restrictions specified in their agreement." When the surety bond in question was executed in favor of T, P had already withdrawn the authority of A to issue, *inter alia*, surety bonds.

It appeared that some surety bonds issued by A in favor of T after her authority had allegedly been curtailed, on March 15, 1952, were honored by P despite the fact that these were not reported to P's main office at the time of their issuance.

Issue: Is Article 1922 applicable?

Held: Yes. The opening of P's branch office amounted to a publication of the grant of powers to A, as manager of said office. Furthermore, by honoring several surety bonds issued in its behalf subsequently to March 15, 1952, P induced the public to believe that A had authority to issue such bonds. As a consequence, P is now estopped from pleading, particularly against a regular customer thereof, like T, the absence of said authority. *(Central Surety & Insurance Co. vs. C.N. Hodges, 38 SCRA 159 [1971].)*

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)

Revocation by appointment of new agent.

(1) *Implied revocation of previous agency.* — There is implied revocation of the previous agency when the principal appoints a new agent for the same business or transaction provided there is incompatibility. (Dy Buncio & Co. vs. Ong Guan Gan, 60 Phil. 696 [1934].) But the revocation does not become effective as between the principal and the agent until it is in some way communicated to the latter. Again, the rights of third persons who acted in good faith and without knowledge of the revocation will not be prejudiced thereby. (Arts. 1921, 1922.)

There is no implied revocation where the appointment of another agent is not incompatible with the continuation of a like authority in the first agent, or the first agent is not given notice of the appointment of the new agent. (see Garcia vs. De Manzano, 39 Phil. 577 [1919].)

EXAMPLE:

P authorized A to sell the former's land. Subsequently, P also gave authority to B to sell the same land. There is no implied revocation of the previous agency. The intention of P may be to authorize both A and B for the same transaction. If B was given an exclusive authority to sell, there is an implied revocation of the previous agency.

In either case, the knowledge by A (or B) of the sale or contract for sale of the land by B (or A), terminates the authority of A (or B).

(2) *Substitution of counsel of record.* — No substitution of counsel of record is allowed unless the following essential requisites of a valid substitution of counsel concur:

(a) There must be a written request for substitution;

(b) It must be filed with the written consent of the client;

(c) It must be with the written consent of the attorney to be substituted; and

(d) In case, the consent of the attorney to be substituted cannot be obtained, there must be at least a proof of notice, that the motion for substitution was served on him in the manner prescribed by the Rules of Court.

In a case, the authority of the attorney-in-fact was revoked by the principal, the real party-in-interest in a pending litigation. It was held that the revocation did not affect the authority of the counsel retained by said agent — he remained counsel of record of the principal absent a valid substitution of counsel. The first counsel may not be presumed substituted by a new counsel merely from the filing of a formal appearance by the latter. (Santana-Cruz vs. Court of Appeals, 361 SCRA 520 [2001].)

ART. 1924. The agency is revoked if the principal directly manages the business entrusted to the agent, dealing directly with third persons. (n)

Revocation by direct management of business by principal himself.

The above article provides for another case of implied revocation.

(1) Unless the only desire of the principal is for him and the agent to manage the business together, the effect of the direct management of the business by the principal himself is to revoke the agency for there would no longer be any basis for the representation previously conferred. (11 Manresa 574.)

(2) If the purpose of the principal in dealing directly with the purchaser and himself effecting the sale of the principal's property is to avoid payment of his agent's commission, the implied revocation is deemed made in bad faith and cannot be sanctioned without according to the agent the commission which is due him. (Infante vs. Cunanan, 93 Phil. 693 [1953].)

EXAMPLES:

(1) P authorized A to manage the former's printing press. Every now and then, P takes direct part in the management of the business. There is no implied revocation where the only purpose of P is to help A in the management of the business.

(2) P authorized A to collect whatever amounts may be due P from T. Subsequently, P demanded payment from T, telling the latter to remit to him (P) the amount the collection of which he entrusted to A. The agency to A is revoked. (New Manila Lumber Co., Inc. vs. Republic, 107 Phil. 824 [1960].)

(3) P appointed A as its agent for the sale of P's logs to Japanese firms. During the existence of the contract of agency, P sold its logs directly to several Japanese firms. This act of P constituted an implied revocation of the contract of agency with A. (CMS Logging, Inc. vs. Court of Appeals, 211 SCRA 374 [1992].)

(4) A, as agent P, principal-foreign employer, deployed T as a domestic helper to Taiwan under a 12-month contract.

After the termination of the employment contract, P directly negotiated with T and entered into a new and separate employment contract in Taiwan. There is an implied revocation of A's agency relationship with P. (Sunace International Management Services, Inc. vs. National Labor Relations Commission, 480 SCRA 146 [2006].)

Article 1924 should be distinguished from Article 1916 which governs the relations as between themselves of third persons who separately contract with the agent and the principal with regard to the same thing.

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)

Revocation by one of two or more principals.

As the appointment of an agent by two or more principals for a common transaction or undertaking makes them solidarily liable to the agent for all the consequences of the agency (Art. 1915.), any one of the principals is granted under this article the right to revoke the power of attorney without the consent of the others.

In a solidary obligation, the act of one is the act of all. (see Arts. 1212, 1214, 1221, 1222.)

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)

Partial revocation of general power by a special power.

In this article (like Art. 1923.), two agents are involved: one to whom a general power is previously granted and the other, to whom a special power is given. It may, however, also apply where the special power is subsequently granted to the same agent.

The general power is impliedly revoked as to matters covered by the special power. A special power naturally prevails over a general power.

It is indispensable that notice of the revocation be communicated in some way to the agent.

EXAMPLE:

P appoints A as manager of P's business. The authority of A to manage P's business includes the authority to enter into reasonable contracts of employment of such personnel as are usual and necessary in the conduct of the business.

If subsequently, P grants special power to B to hire personnel for his business, then as regards this matter of hiring employees, the general power granted to A is revoked. As to matters not covered by the special power, the general power remains valid.

ILLUSTRATIVE CASES:

1. *Property was sold under a special power of attorney not giving authority to sell, executed after a general power was previously granted.*

Facts: P gave a general power of attorney to his son, A. About eight (8) years later, P executed in favor of A a special power of attorney which did not give A the express power to alienate the properties of P. Thereafter, A sold certain properties of P to B.

C subsequently obtained attachment and execution against the same properties for a judgment debt against P.

Issue: Did the second power of attorney supplant the first?

Held: Yes. The making and accepting of a new power of attorney, whether it enlarges or decreases the power of the agent under a prior power of attorney, must be held to supplant and revoke the latter when the two are inconsistent. If the new appointment with limited powers did not revoke the general power of attorney, the execution of the second power of attorney would have been a mere futile gesture. The properties in question were subject to attachment and execution, the title of P not having been divested by the sale made by A. *(Dy Buncio vs. Ong Guan Gan, 60 Phil. 696 [1934].)*

2. *Property was sold under a general power of attorney by agent without notice of a second general power of attorney given later to another.*

Facts: P gave a general power of attorney to his son, A, and a month later, a second general power of attorney to his wife, B. A, acting under his general power of attorney, sold the half-interest of P in a steamer. There was no proof that A knew of the power of attorney to B.

Issue: Did the power of attorney to B revoke that given to A?

Held: No, and therefore, the sale made by A was valid. In the absence of proof that A had notice of the second power of attorney, it must be considered that A acted under a valid power of attorney from P which had not been legally revoked at the date of the sale. *(Garcia vs. De Manzano, 39 Phil. 577 [1919].)*

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)

Agency coupled with an interest.

The general rule is that the principal may revoke an agency at will. (Art. 1920.) The rationale for the rule is that the essence of agency is the agent's duty of obedience to the principal. This rule, however, has exceptions and they are:

(1) when the agency is created not only for the interest of the principal but also for the interest of third persons; and

(2) when the agency is created for the mutual interest of both the principal and the agent. (Art. 1930.)

In either case, the agency is deemed as one coupled with an interest. It becomes part of another obligation or agreement. It is evident that the agency cannot be revoked by the sole will of the principal as long as the interest of the agent or of a third person

subsists because it is not solely the rights of the principal which are affected.

However, an irrevocable power of attorney is obligatory only on the principal who executed the agency. It cannot affect one who is not a party thereto. (New Manila Lumber Co., Inc. vs. Republic, 107 Phil. 824 [1960]; Republic vs. Evangelista, 466 SCRA 544 [2005]; see Philex, Mining Corp. vs. Comm. of Internal Revenue, 551 SCRA 428 [2008].)

Article 1927 mentions three instances of irrevocability.

EXAMPLES:

(1) P sold to B a factory for P1,000,000.00. B paid only P800,000.00. It was stipulated that the ownership in the factory would be transferred to B only after the payment of the balance of P200,000.00 to be made within six (6) months. It was further agreed that P would appoint A to manage the factory and that any profits would be used to pay off the balance of the purchase price.

Here, P cannot revoke the agency at will for a bilateral contract depends upon it.

(2) P borrowed from B P50,000.00. As security for the debt, P gives A a power of attorney to collect rents due from tenants of P and authorizes A to apply the same to the debt of P50,000.00.

In this case, P cannot revoke the agency, without any justifiable cause, for it is a means of fulfilling his obligation to B.

(3) A, B, and C are partners in business. By common agreement, A was appointed a manager in the articles of partnership (written document embodying the contract of partnership).

The appointment of A is revocable only upon just and lawful cause and upon the vote of the partners representing the controlling interest. (Art. 1800.) The reason is that the appointment is in effect one of the conditions of the contract and it is only logical that such appointment should not be revoked without the consent of all the partners, including A.

Termination of the agency.

An agency coupled with an interest cannot be terminated by the sole will of the principal although it is so revocable after the interest ceases.

(1) *Interest in the subject matter of power conferred.* — In order that an agency may be irrevocable because coupled with an interest, it is essential that the interest of the agent shall be in the subject matter of the power conferred and not merely an interest in the exercise of the power because it entitles him to compensation therefor. Thus, an agency is coupled with an interest:

(a) where the agent has parted with value or incurred liability at the principal's request, looking to the exercise of the power as the means of reimbursement or indemnity; or

(b) where the interest in the thing concerning which the power is to be exercised arises from an assignment, pledge or lien created by the principal with the agent being given the power to deal with the thing in order to make the assignment, pledge or lien effectual. (see Mechem, *op. cit.*, pp. 406-407.)

The fiduciary relationship inherent in ordinary contracts of agency is replaced by material consideration in an agency coupled with an interest which bars the removal or dismissal of the agent as attorney-in-fact on the ground of loss of trust and confidence. (Bacaling vs. Muya, 380 SCRA 714 [2002]; see National Sugar Trading vs. Philippine National Bank, 396 SCRA 528 [2003].)

(2) *Sufficiency of interest.* — As to what constitutes a sufficient interest to take the holder out of the agency relation, it is sometimes said it must be a present interest in the subject matter itself and that an interest in the proceeds of the power's exercise as compensation is insufficient. (Sell on Agency, p. 23.) An agent is not considered to have an interest in the subject matter simply because he expects to make a commission or profit from his employment as agent.

An agent's interest in earning his agreed compensation is an ordinary incident of agency, and neither a contract that the

principal will not revoke nor a contract that the agent can protect his rights to earn commission in spite of the revocation will deprive the principal of control over acts to be done by the agent on his behalf. (1 Restatement of Agency, p. 340.) It is a usual by-product of agency which does not affect the essential nature of the relationship. (Teller, *op. cit.*, p. 108, citing Restatement of Agency, Sec. 138[b].) The agent's remedy is to sue for breach of contract if the principal terminates their contract.

EXAMPLES:

(1) P owes B P10,000.00. At the request of P, A consented to be P's surety but only after P delivered to A a certificate of stock as security with a power to transfer it in case A becomes liable to B.

It is clear that P cannot revoke the agency unless he first pays B.

(2) P borrows from A P10,000.00. P pledges or mortgages his property to A as security for the debt and gives A the power to dispose of it should P default.

There is also an agency coupled with an interest which is irrevocable.

(3) P appoints A as his agent to sell specific goods on commission and with power to retain such commission out of the proceeds of the sale.

The power given to A is not given as security nor is it coupled with interest because his interest is merely in the commission which will arise from the exercise of the power. Hence, P can revoke the agency at will.

(4) P (travel agency company) appoints A, travel agent, as its branch manager. A binds herself solidarily with P for the payment of monthly rentals agreed with the lessor. She gets 4% of the airline fares she brings in as commissions.

The agency is one coupled with an interest, having been created for the mutual interest of P and A. She had acquired on interest in the business entrusted to her by assuming a personal obligation for the operation thereof. Her interest is not limited to the commissions she earns as a result of her business transactions but one that extends to the very subject matter

of the power of management delegated to her. (see Sevilla vs. Court of Appeals, 160 SCRA 171 [1988].) The reason for the exception is that the agent is not really acting for the principal but also in his own behalf to assert a personal interest.

Terminology used by parties not controlling.

Whether an interest which will make an agency or power[7] irrevocable exists in a particular case is to be determined from the entire agreement between the parties and from the facts and circumstances.

The terminology used by the parties is not controlling. Even though an agency or power is made in terms irrevocable, that fact will not prevent its revocation by the principal where the agency or power is not, in fact, coupled with an interest. Nor will the fact of a stipulation in the instrument that the intention of the grantor of the power is that it shall "be construed as a power of attorney coupled in the interest of the subject matter thereof" prevent its revocation. (3 Am. Jur. 2d 464.)

ILLUSTRATIVE CASES:

1. *Mortgagor authorized mortgagee in a separate instrument termed "irrevocable power of attorney coupled with an interest" to sell mortgaged property.*

Facts: P obtained a loan from A. As security, P mortgaged the improvements of a parcel of land in favor of A. On the same day, P executed an irrevocable power of attorney coupled with an interest in the subject matter thereof in favor of A, authorizing A, among others, to sell and convey the parcel of land. P died, leaving the mortgage debt unpaid. Two years later, A, acting as attorney-in-fact of P, sold the land to his son for and in consideration of the token sum of P1.00 and the payment by the vendee of the mortgage debt of P to A.

The heirs of P sought to recover the possession and ownership of the land.

[7]Terms used to refer to this power are "power coupled with an interest," "irrevocable agency power," and "power given as security." See note 7.

Issue: Did the power of attorney create an agency coupled with an interest?

Held: No. A mere statement in the power of attorney that it is coupled with interest is not enough. In what does such interest consist must be stated in the power of attorney. The fact that P mortgaged the improvements of the parcel of land is not such interest as could render irrevocable the power of attorney in favor of A. In fact, no mention of it is made in the power of attorney. The mortgage has nothing to do with the power of attorney and may be foreclosed by A, as mortgagee, upon failure of P, as mortgagor, to comply with his obligation. As the agency was not coupled with an interest, it was terminated upon the death of P and, therefore, A could no longer validly convey the parcel of land to his son. *(Del Rosario vs. Abad and Abad, 104 Phil. 648 [1958].)*

Note: But the power to foreclose a mortgage if the mortgage debt is not paid survives the death of the mortgagor. (see Perez vs. Phil. National Bank, 17 SCRA 833 [1966], *supra.*, under Art. 1919.) In the Del Rosario case, the power of attorney was given independently of the mortgage, without prejudice to the right of foreclosure of the mortgagee who sold the land, however, not as mortgagee but as agent under the power of attorney after the death of the mortgagor. (see Art. 1913[3].)

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2. *Power of attorney to sell property for a fixed commission was revoked by principal before the expiration of period during which it is stated as "not revocable."*

Facts: In consideration of a stated commission, P gave to A the exclusive sale of P's property. The written power of attorney declares that it "is not revocable, and cannot be revoked by me (P) within (three [3] months) from this date." In one (1) month after executing the instrument, and without notice to A, P himself sold the property.

A, having taken steps to effect a sale, by advertising and personal solicitation of purchasers, sued P for the stipulated commission.

Issue: Is the authority given to A to sell the land coupled with an interest?

Held: No. Nothing is better settled than that the phrase "coupled with an interest" means an interest in the thing sold,

or than that a commission out of the proceeds of a sale to be made, is not such an interest and the sale by the principal of the property is a revocation. The revocation of such authority may be made by the principal at his pleasure, though the terms of the appointment declare that it shall be "exclusive" or "irrevocable."

These propositions are based on the ground of want of consideration. There is no mutuality of obligation. The agent does not obligate himself to do anything, and, therefore, the principal is not bound. The agent can recover nothing for what he did, even for expenses, unless there was a complete contract, in which case, of course, he may recover damages for its breach. (*Kolb vs. Bennet Land Co., 74 Miss. 567, 21 So. 233 [1896];* see Macondray & Co. vs. Seller, 33 Phil. 370 [1916], cited under Art. 1875.)

Revocability of agency coupled with an interest.

(1) *Where there is no just cause.* — A contract not to revoke an agency only abridges the right of the principal to revoke, and not his power to revoke. (see Art. 1920.) However, where the authority given to the agent is supplemented with an interest in the subject matter of the agency itself, the rule is that both the right and the power to revoke the agency without the agent's consent is taken away, and a purported revocation can have no effect unless by express provision the authority remains revocable. (2 C.J.S. 1159.)

(2) *Where there is a just cause.* — A power of attorney can be made irrevocable by contract only in the sense that the principal may not recall it at his pleasure; but coupled with interest or not, the authority certainly can be revoked for a just cause, such as when the agent betrays the interest of the principal. It is not open to serious doubt that the irrevocability of a power of attorney may not be used to shield the perpetration of acts in bad faith, breach of confidence, or betrayal of trust, by the agent for that would amount to holding that a power coupled with an interest authorizes the agent to commit frauds against the principal. (Coleongco vs. Claparols, 10 SCRA 577 [1964].)

Article 1800 of the Civil Code declares that the powers of a partner, appointed as manager, in the articles of partnership are "irrevocable without just or lawful cause." An agent with power coupled with an interest cannot stand on better grounds than such a partner insofar as irrevocability of the power is concerned. *(Ibid.)*

Nature of agent's interest in power given as security to him.

The agent's power may be given as security without transferring to the agent any interest in the subject matter of the agency, or he may be given, in addition, an interest in the subject matter of the agency.

(1) *Revocable by death of principal when without interest in subject matter.* — According to Mechem (Agency, Sec. 117.), in the first case, there is a power or authority given as security, which, though irrevocable during the principal's lifetime, is revoked by his death. In the second case, there is a power or authority coupled with interest, which is irrevocable by the principal, whether by any act during his lifetime or by his death.

EXAMPLE:

A borrows money from P. As security, P authorizes A, if P does not pay A, to take P's horse and sell it and satisfy the debt out of the proceeds. Here, P gives no present estate or property in the horse but only an authority, for a valuable consideration, to take it and apply it to the payment of the debt.

Now, if P delivers the horse to A to keep as security and authorizes him, as before, if the debt is not paid, to sell the horse and reimburse himself out of the proceeds, A has a present property interest in the horse as well as authority over it. He is a pledgee with express authority to sell.

In neither case may P revoke the authority without paying the debt, but in the first case, if P should die before A had acted under the authority by taking possession of the horse, the authority would be terminated by P's death, while in the second, A's present property in the horse would not be destroyed by P's death.

(2) *Contrary view.* — This distinction is not followed by the Restatement of Agency (Secs. 138, 139.) which holds that neither type of power is revocable by the principal, whether during his lifetime or by his death. The Restatement uses the term power given as a security "to cover both types of cases."

The position taken by the Restatement would seem to be a commendable one, for the relation of trust and confidence which is supposed to stand in the way of absolute irrevocability of an agent's appointment is affected adversely as much by one type of power as it is by the other. In both cases, the agent acts for himself (or for the benefit of a third person), and not on behalf of the principal. (see Teller, *op. cit*., p. 107.)

"Agency" coupled with an interest not a true agency.

Persons with a proprietary interest in the subject matter of their "agency" are not true agents at all. It is sometimes said that such an "agency" merely differs from other types in that it is irrevocable. However, that very fact negates the possibility that it could be an agency relation at all. This is the case, of course, since one of the hallmarks of the agency relation is that the principal must retain control over the agent concerning the object of his agency.

Plainly, if the principal cannot terminate the relation, he has surrendered that degree of control which an agency requires. If the power holder holds an interest for the benefit of a person other than the creator of the power, he is not the creator's agent. (Sell on Agency, p. 22.)

EXAMPLE:

Suppose A renders services to P and in return P authorizes A to sell P's land and pay himself with or out of the proceeds. Or suppose that P borrows money from A and as security authorizes A to sell P's land, if the loan is not repaid, and pay himself from the proceeds.

It is clear that in such a case there is no more reason why P should be allowed to revoke than if he had formally conveyed or mortgaged the land to A, and that it would be

most unwarranted and unfair to A to allow P to revoke. It is also clear that the reason that the case is not properly governed by the considerations normally making an agency is that it is not in reality a case of agency at all. In a genuine agency case, the power is given to the agent to enable him to do something for the principal.[8] (Mechem, *op. cit.,* p. 177.)

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)

Right of agent to withdraw.

Just as the principal may revoke generally the agency at will (Art. 1920.), the agent may likewise renounce or withdraw from the agency at any time, without the consent of the principal, even in violation of the latter's contractual rights; subject to liability for breach of contract or for tort. This rule which applies whether the agency is gratuitous or for compensation is based on the constitutional prohibition against involuntary servitude. (Constitution, Art. III, Sec. 18[2].) It is also consistent with the

[8]A power cast in agency terms may fit within the concept of what the Restatement calls a "power given as security" — a power which (1) is bestowed upon the holder for consideration or in connection with a transfer of title to property and (2) is to be exercised by the power holder for his own benefit or the benefit of a third party in securing the performance of a duty or to protect a title. The holder of such a power has what older terminology refers to as an "agency coupled with an interest," but the important point is that the agency is one only in form, most agency rules being inapplicable. The holder acts pursuant to the agreement, not the command of the creator of the power; and unless otherwise agreed, revocation by the creator or the death or incapacity of the creator or holder does not terminate the power. The Restatement cites an example of a power given as security an arrangement whereby three creditors of a corporation agree (in consideration of their mutual promises) to subscribe to additional shares to protect the corporation's position, supplying to a fourth person a power of attorney to carry out the agreement. (Restatement [Second] of Agency 138, Comment c, Illustration 5 [1958].)

In the corporation law, the issue whether the courts will exempt an arrangement from the normal agency rules on termination of authority and power arises most frequently when a proxy holder maintains his proxy is not revocable by the shareholder. (W.L. Cary, Materials and Cases on Corporations, 1969 ed., p. A-104.)

concept that agency is a voluntary relationship between the parties.

(1) *Without just cause.* — The law imposes upon the agent the duty to give due notice to the principal and if the withdrawal is without just cause, to indemnify the principal should the latter suffer damage by reason of such withdrawal. The reason for the indemnity imposed by law is that the agent fails in his obligation and as such, he answers for losses and damages occasioned by the non-fulfillment. (Arts. 1884, 1770.)

(2) *With just cause.* — If the agent withdraws from the agency for a valid reason (Art. 1929.) as when the withdrawal is based on the impossibility of continuing with the agency without grave detriment to himself (Art. 1928.), or is due to a fortuitous event (Art. 1174.), the agent cannot be held liable. (see De la Peña vs. Hidalgo, 16 Phil. 450 [1910].) While the agent is forbidden to prefer his interests to those of the principal (Art. 1889.), he is not required to sacrifice his own interests just to serve the principal.

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)

Obligation of agent to continue to act after withdrawal.

Even when the agent withdraws from the agency for a valid reason, he must continue to act until the principal has had reasonable opportunity to take the necessary steps like the appointment of a new agent to remedy the situation caused by the withdrawal. The purpose of the law is to prevent damage or prejudice to the principal.

The law reconciles the interests of the agent with those of the principal, and if it permits the withdrawal of the agent, it is on the condition that no damage results to the principal, and if the agent desires to be relieved of the obligation of making reparation when he withdraws for a just cause, he must continue to act so that no injury may be caused to the principal. (11 Manresa 583-584.)

The obligation imposed by Article 1929 is similar to that provided in Article 1885 in the case of a person who declines an agency.

> **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)**

When death of principal does not terminate agency.

Agency is terminated instantly by the death of the principal. (Art. 1919[3].) The reason is obvious. In agency, being based on representation, there is no one to be represented where the principal is already dead. However, there are exceptions to this rule. In the following cases, the agency remains in full force and effect even after the death of the principal:

(1) if the agency has been constituted in the common interest of the principal and the agent (see Art. 1927.); and

(2) if it has been constituted in the interest of a third person who has accepted the stipulation in his favor.[9]

EXAMPLES:

(1) A renders services to P who authorizes A to sell the latter's land for not less than a certain price and pay himself out of the proceeds. Before the land is sold, P dies. It is clear that the agency to sell is one coupled with an interest (see Art. 1927.) and is not extinguished by the death of P.

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[9]Art. 1311. Contracts take effect only between the parties, their assigns and heirs, except in case where the rights and obligations arising from the contract are not transmissible by their nature, or by stipulation or by provision of law. The heir is not liable beyond the value of the property he received from the decedent.

If a contract should contain some stipulation in favor of a third person, he may demand its fulfillment provided he communicated his acceptance to the obligor before its revocation. A mere incidental benefit or interest of a person is not sufficient. The contracting parties must have clearly and deliberately conferred a favor upon a third person. (1257a)

(2) P borrows from B P5,000.00 payable in one (1) year. Before the due date of the obligation, P sells his land to A and he authorizes A to pay P's debt out of the purchase price. B accepts the agency of A. Here, the right of B to receive payment from A cannot be defeated by the death of P.

ILLUSTRATIVE CASE:

Power of attorney authorizes agent to receive amounts due insured under a policy and apply the same to expenses incurred by the former for hospitalization of the latter.

Facts: Under the life policy issued to P, T was designated as beneficiary in case of P's death. P had tuberculosis and was cared for in a hospital at the expense of X county. Pursuant to county statutory duty, P constituted A, auditor of X county, as attorney-in-fact to receive any amounts due P under the policy and to apply so much of the sums received on his expense for hospitalization and medical care as might owe to X county. P died.

Issue: The question is whether the instrument, either as a power of attorney or as an assignment of benefits, survived the decease of P.

Held: The instrument constitutes a power coupled with an interest and survived P's death. It operated as an assignment of a present interest or right of benefit under the insurance policy. A power to create and then have an interest in the thing created, if not consummated, does not survive the death of the grantor of the power. On the other hand, a power, coupled with an interest in an accrued right, survives the death of the grantor of the power. *(Chrysler Corporation vs. Blozic, 267 Mech. 479, 255 N.W. 399 [1934].)*

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)

Nature of agent's authority after death of principal.

Normally, the death of the principal will terminate the agency. However, the agent is required to "finish the business

already begun on the death of the principal should delay entail any danger." (Art. 1884, par. 2.)

In the case where the principal's affairs must be wound up, or even in rare cases, carried on for a time by the agent after the death of the principal, the agent acts because of a prior and not a presently existing relation with the creator of the authority; but the agent's duty is no longer to the deceased but to a quasi-entity — the principal's estate. Hence, it is for the personal representative (executor or administrator) vested by law with the authority to administer the liquidation of the principal's affairs to say *what shall be done* about the business *originally delegated* by the principal to the agent. If the agent has to continue the business, it must be by the personal representative's authority and as his agent. (see Mechem, pp. 183-184.)

Validity of acts of agent after termination of agency.

The death of the principal extinguishes the agency; but in the same way that revocation of the agency does not prejudice third persons who have dealt with the agent in good faith without notice of the revocation (Arts. 1921, 1922.), such third persons are protected where it is not shown that the agent had knowledge of the termination of the agency because of the death of the principal or of any other cause which extinguishes the agency. (Herrera vs. Luy Kim Guan, 1 SCRA 406 [1961]; Buason and Reyes vs. Panuyas, 105 Phil. 795 [1959].) "This rule, it is argued, will best subserve the condition and wants of the people and enable them to transact the business of expanding commercial life with a proper sense of safety and security." (3 Am. Jur. 2d 456.)

A contrary rule would operate very unjustly and produce very great hardships. Thus: "A party dealing with an insolvent agent, upon the faith of his well-known authority from a wealthy and distant principal, is suddenly confronted with the fact that the authority had ceased by the death of the principal, a day or perhaps one hour before the transaction occurred." (Mechem on Agency, Sec. 665, cited in Teller, p. 111.)

The common law doctrine is that the acts of agency done after the death of the principal are void, even though the death

is unknown to the agent. Many of the cases and text writers have regarded the doctrine as harsh and unjust, and in view of the apparent hardship, the rule has been modified by statute in some jurisdictions in conformity to the civil law rule. (2 C.J. 598.)

Note that Article 1931 speaks of "knowledge of death of the principal or of any other cause" and requires not only the third persons to be in good faith but also the agent.

EXAMPLE:

P authorized A to sell the former's land. Subsequently, P died. Without the knowledge of P's death, A sold the land to T.

Can the heirs of P recover the land from T? No, if both A and T acted in good faith. Yes, if either A or T acted in bad faith.

ILLUSTRATIVE CASES:

1. *Agent, with authority to collect, received payment knowing at the time of the death of principal without disclosing the fact to payor.*

Facts: P executed in favor of A a power of attorney authorizing him, among other things, to collect and receive moneys becoming due from any person to P and to execute discharges therefor. Subsequently, P died. A received payment from T, a mortgagor, and although A knew at the time of the death of P, he did not disclose the fact to T.

A never accounted to X, administratrix of P, who brought action against T to foreclose the mortgage.

Issue: Is the payment made by T to A after the death of P binding upon the estate of P?

Held: No. The death of the principal puts an end to the agency, and, therefore, is an instantaneous and unqualified revocation of the authority of the agent. There can be no agent where there is no principal. There are, no doubt, exceptions to this rule, as where the agency is coupled with interest; or where the principal is a firm and only one of its members died. Those who deal with an agent are held to assume the risk that his authority may be terminated by the death of the principal without notice to them. *(Weber vs. Bridgman, 113 N.Y. 600, 21 N.E. 985 [1989].)*

Contra: "Now, upon what principle does the obligation imposed by the acts of the agent after his authority has terminated, really rest? The true answer is, public policy. The great and practical purposes and interests of trade and commerce, and the imperious necessity of confidence in the social and commercial relations of men require that an agency, when constituted, should continue to be duly accredited. To secure this confidence, and consequent facility and aid to the purposes and interests of commerce, it is admitted that an agency, in cases of *actual* revocation, is still to be regarded as continuing in such cases as the present, toward third persons, until actual or implied notice of revocation.

There is no reason why the rule should be held differently in cases of revocation by mere operation of law. In all such cases, the party who has, by his own conduct purposely invited confidence and credit to be reposed in another as his agent, and has thereby induced another to deal with him in good faith, as such agent, neither such party nor his representatives ought to be permitted, in law, to gainsay the commission of credit and confidence so given to him by the principal." *(Ish vs. Crane, 8 Ohio St. 521 [1858].)*

Note: Article 1931 follows the contrary view subject to the qualification that both the agent and the third person acted in good faith. In the *Weber* case, the ruling can be upheld under Article 1931 on the ground that the agent had knowledge of the death of the principal.

_____ _____ _____

2. *Agent with authority to sell sold property of principal knowing at the time of the latter's death.*

Facts: Pursuant to a power of attorney, A, as attorney-in-fact of P, sold after P's death, and with full knowledge of such death, the latter's share in a parcel of land to T who acted in good faith. X, as administrator of the estate of P, went to court to have the sale declared unenforceable and to recover the disposed share.

Issue: Is the sale to T valid?

Held: No. (1) *Exception in Article 1931 to be strictly construed.* — "Under Article 1931, an act done by the agent after the death of the principal is valid and effective only under two conditions, *viz.:* (1) that the agent acted without knowledge of the death

of the principal; and (2) that the third person who contracted with the agent himself acted in good faith. Good faith here means that the third person was not aware of the death of the principal at the time he contracted with said agent. These two requisites must concur: the absence of one will render the acts of the agent invalid and unenforceable.

It is argued that there is no provision in the Civil Code which provides that whatever is done by an agent having knowledge of the death of his principal is void with respect to third persons who may have contracted with him in good faith and without knowledge of the death of the principal.

This argument ignores the existence of the general rule enunciated in Article 1919 that the death of the principal extinguishes the agency. That being the general rule, it follows *a fortiori* that any act of an agent after the death of the principal is void *ab initio* unless the same falls under the exceptions provided for in Articles 1930 and 1931. Article 1931, being an exception to the general rule, is to be strictly construed.''

(2) *Revocation by death of principal generally instantaneously effective.* — "Another argument advanced is that the vendee (T) acting in good faith relied on the power of attorney which was duly registered on the original certificate of title recorded in the Register of Deeds, that no notice of death was ever annotated on said certificate of title by the heirs of the principal (P), and accordingly, they must suffer the consequences of such omission.

By reason of the very nature of the relationship between the principal and agent, agency is extinguished *ipso jure* upon the death of either principal or agent. Although a revocation of a power of attorney to be effective must be communicated by the parties concerned (see Arts. 1921 and 1922.), yet a revocation by operation of law, such as by death of the principal is, as a rule, instantaneously effective inasmuch as 'by legal fiction the agent's exercise of authority is regarded as an execution of the principal's *continuing will.*' (2 C.J.S. 1174.) With death, the principal's will ceases or is terminated; the source of authority is extinguished.''

(3) *Duty to notify agent of principal's death not imposed by law on latter's heir.* — "The Civil Code does not impose a duty on the heirs of the principal to notify the agent of the death of the principal. What the Code provides in Article 1932 is that if

the agent dies his heirs must notify the principal thereof x x x. Hence, the fact that no notice of the death of the principal was registered on the certificate of title of the property in the Office of the Register of Deeds is not fatal to the cause of the estate of P." *(Rallos vs. Felix Go Chan & Sons Realty Corp., 81 SCRA 251 [1978].)*

Note: In the case of *Blondeau vs. Nano* (61 Phil. 625 [1935]), cited by T in the Rallos case, one V, as co-owner of lands with N, delivered to the latter his (V's) land titles. A power of attorney supposedly executed by V but later denied by him, in favor of N was registered in the Office of the Register of Deeds. The Supreme Court sustained the vendee "for without those title papers handed over to N with the acquiescence of V, a fraud could not have been perpetrated."x x x As between two innocent persons, one of whom must suffer the consequence of a breach of trust, the one who made it possible by his act of confidence must bear the loss.

According to the Supreme Court, there is no "parallelism" between the Rallos case which is expressly covered by a provision of law on agency and the Blondeau decision which has as its basis Section 55 of the Land Registration Law.

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)

Duty of agent's heirs to protect interest of principal.

If the agent dies, the agency is also extinguished. (Art. 1919[3].) In such case, the law imposes upon the heirs of the deceased agent not only the obligation to notify the principal to enable the latter reasonable opportunity to take such steps as may be necessary to meet the situation (Art. 1929.) but also to adopt such measures as the circumstances may demand in the interest of the principal.

Article 1932 does not impose a duty on the heirs of the principal to notify the agent of the death of the principal. (Rallos vs. Felix Go Chan, *supra*.)

Continuation by agent's heirs of agency.

(1) *General rule.* — An agency calls for personal services. Ordinarily, therefore, the agent's duties cannot be performed by his personal representatives, and in case of his death, the agency is generally thereby terminated. (2 C.J.S. 185.)

Since the death of the agent ends his ability to perform the duties of the agency, the event of the agent's death terminates the agency relationship at least in those instances where personal services and skill are required or cannot be performed by the agent's representative and this is true, even though the agency is for a specified period which has not yet expired. (12 C.J.S. 1178.) The rights and obligations of the agent arising from the contract are not transmissible to his heirs. (see Art. 1311; Terrado vs. Court of Appeals, 131 SCRA 371 [1984].)

(2) *Exceptions.* — There are cases when the authority conferred may pass to the agent's heirs.

(a) The heirs' duty to continue the agency after the death of the agent arises from what may be termed as an *agency by operation of law* or a presumed or tacit agency. (see 11 Manresa 588; see also Arts. 1884, par. 2, 1885, 1929, and 1931.) Of course, the heirs can continue the agency only temporarily for, as we have seen, the essence of the contract is personal confidence. The principal has a right to an agent of his choice. There is nothing to suggest that he would or should expect the authority to pass to the agent's heirs or personal representatives.

(b) Where the agency is one coupled with an interest in the subject matter of the agency (like the power of sale in a mortgage), the death of the agent will not instantly end the relationship, and consequently, his heirs or representatives may subsequently exercise the power conferred at least insofar as may be necessary to protect the interests of the estate of the agent. (see 2 C.J.S. 1178.) An agency coupled with an interest survives the death of the agent. It is transmitted to his heirs or representatives.

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PART III

TITLE V

TRUSTS (n)

(Arts. 1440-1457)

Chapter 1

GENERAL PROVISIONS

ARTICLE 1440. A person who establishes a trust is called the trustor; one in whom confidence is reposed as regards property for the benefit of another person is known as the trustee; and the person for whose benefit the trust has been created is referred to as the beneficiary.

Concept of trust.

A *trust* is the fiduciary relationship between one person having an equitable ownership in property and another owning the legal title to such property, the equitable ownership of the former entitling him to the performance of certain duties and the exercise of certain powers by the latter (see 54 Am. Jur. 21.) for the benefit of the former.

It is a legal arrangement whereby a person transfers his legal title to property to another to be administered by the latter for the benefit of a third party. It is a right of property held by one party for the benefit of another.

(1) *Trust implies confidence in a relationship.* — The word "trust" is often employed in a broader or popular sense as denoting "confidence," "fiduciary relationship," etc. and is often used in

reference to the confidential aspect of any kind of a bailment or possession by one person of the property of another. (*Ibid*., 22.) It indicates duties, relations, and responsibilities which are not strictly technical trusts. (89 C.J.S. 712; Salao vs. Salao, 70 SCRA 65 [1976].)

In its more technical significance, the word still implies such confidence in a relationship intentionally created, involving a trustee, a beneficiary, and a trust property and not one involving merely personal duties, imposing equitable duties upon the trustee with respect to the property to deal with it for the benefit of the beneficiary.

(2) *Trust cannot be established in violation of law.* — A trust is the right, enforceable in equity, to the beneficial enjoyment of property the legal title to which is in another. Trust is founded in equity and can never result from acts violative of law. Thus, no trust can result from a contract of partnership formed for an illegal purpose. Since the contract is null and void, no rights and obligations can arise therefrom. (Deluao vs. Casteel, 26 SCRA 415 [1968] and 29 SCRA 350 [1969].)

Concept not new.

The Civil Code of 1889 contains no specific provisions on trusts as does the new Civil Code. Neither does the Code of Civil Procedure of 1901 for the same merely provides for the proceeding to be followed relative to trusts and trustees. (Chapter XVIII.) This silence, however, does not mean that the juridical institution of trust was unknown in our jurisdiction before the effectivity of the new Civil Code. (De Leon vs. Molo-Peckson, 6 SCRA 978 [1962].)

As the law of trust has been much more frequently applied in England and in the United States than it has in Spain, the Supreme Court has drawn upon American precedents in determining the effects of trust, especially so because the trusts known to American and English equity jurisprudence are derived from the *fidei commissa*[1] of the Roman Law and are based entirely upon

[1]The *fidei commissum* originated in a prayer, petition, or request of a testator upon his instituted heir to deliver the inheritance, or some portion of it, to a designated person. It

civil law principles.[2] (Government vs. Abadilla, 46 Phil. 642 [1924]; see Barretto vs. Tuazon, 50 Phil. 888 [1927]; Miguel vs. Court of Appeals, 29 SCRA 760 [1969]; Sumaoang vs. Judge, RTC, 215 SCRA 136 [1992]; Policarpio vs. Court of Appeals, 269 SCRA 344 [1997].)

Trust distinguished from other relations.

What distinguishes a trust from other legal relations is the separation of the legal title and the equitable ownership of the subject property between two or more people.

(1) *Bailment.* — A delivery of property in trust necessarily involves a transfer of legal title, or at least a separation of equitable interest and legal title, with the legal title in the trustee, whereas it is a characteristic of a bailment that the bailee has possession of, without legal title to, the property subject to the bailment. (54 Am. Jur. 23.)

(2) *Donation.* — A trust is an existing legal relationship and involves the separation of legal and equitable title, whereas a gift is a transfer of property and except in the case of a gift in trust, involves a disposition of both legal and equitable ownership. (*Ibid*., 24.)

A trust constituted between two contracting parties for the benefit of a third person is not subject to the rules governing donations of real property. The beneficiary of a trust may demand performance of the obligation without having formally accepted the benefit of the trust in a public document, upon mere acquiescence in the formation of the trust and acceptance under the second paragraph of Article 1311 of the Civil Code. (Cristobal vs. Gomez, 50 Phil. 810 [1927].)

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was originally precatory in character. (54 Am. Jur. 27.) Examples of precatory words are: "At their discretion and option," "desire," "recommend," "suggest," "with the hope and trust," etc. (*Ibid.*, 1019.)

[2]"Although we are not quite in accord with the opinion that the 'trusts known to American and English equity jurisprudence are derived from the *fidei commissa* of the Roman Law,' it is safe to state that their roots are firmly grounded on such civil law principles as expressed in the Latin maxim, *Nemo cum alterius detrimento locupletari potest* (No one should be allowed to enrich himself unjustly at the expense of another), particularly the concept of constructive trust." (Phil. National Bank vs. Court of Appeals, 217 SCRA 347 [1993].)

(3) *Contract.* — A trust always involves an ownership, embracing a set of rights and duties fiduciary in character which may be created by a declaration without a consideration, whereas a contract is a legal obligation based on an undertaking supported by a consideration, which obligation may or may not be fiduciary in character. (54 Am. Jur. 24.)

(4) *Debt.* — The beneficiary of a trust has a beneficial interest in the trust property, while a creditor has merely a personal claim against the debtor. In trust, there is a fiduciary relation between a trustee and a beneficiary, but there is no such relation between a debtor and creditor. While a debt implies merely an obligation to pay a certain sum of money, a trust refers to a duty to deal with a specific property for the benefit of another.

If a creditor-debtor relationship exists, but not a fiduciary relationship between the parties, there is no express trust. However, it is understood that when the purported trustee of funds is entitled to use them as his or her own (and commingle them with his or her own money), a debtor-creditor relationship exists, not a trust. (Thomson vs. Court of Appeals, 248 SCRA 280 [1998], citing 76 Am. Jur., 2d, Trusts, Sec. 16.)

Persons involved in the creation of an express trust.

Generally, at least three (3) people are needed for an express trust.

(1) The *trustor* (creator/settlor/grantor) or the person who intentionally creates or establishes the trust. He transfers legal ownership of property to a person for the benefit of a third party, who owns the equitable little;

(2) The *trustee* or the person who takes and holds the legal title to the property in trust solely for the benefit of another, with certain powers and subject to certain duties; and

(3) The *beneficiary* or *cestui que trust* or the person who has the equitable title or interest in the property and enjoys the benefit of the administration of the trust by the trustee. (see 65 C.J. 232; 54 Am. Jur. 99, 114.) He may be a natural person or a legal entity. The trust may provide for more than one beneficiary.

Trustor as trustee or beneficiary.

The trustor may establish a trust with him as the trustee or the beneficiary. He cannot, however, be the sole trustee and the sole beneficiary of a single trust. In such case, both the legal and equitable titles to the trust property would be merged in the trustee and he would hold the property free of any trust.

Trust property.

The juridical concept of a trust arises from or is the result of a fiduciary relation between the trustee who holds legal title and the *cestui que trust* who has the equitable title as regards certain property.

(1) The subject-matter of a trust may be any property of value — real, personal, funds or money, or choses in action.(see Pacheco vs. Arro, 85 Phil. 505 [1950]; Salao vs. Salao, 70 SCRA 65 [1976].). The property so held is referred to as the "trust property" or "trust *res*." *"Corpus"* and "principal" are names also used for the trust property.

(2) The trust *res* must consist of property actually in existence in which the trustor has a transferable interest or title although it may, as a rule, be any kind of transferable property either realty or personalty including undivided, future, or contingent interest therein. But a trust *res* cannot be a mere expectancy without right or interest or a mere interest in the performance of a contract although such interest is in the nature of a property right. (54 Am. Jur. 44.)

Nature of ownership of trustee and beneficiary.

A trust is a very important and curious instance of duplicate ownership.

(1) *Ownership by two persons at the same time.* — The trust property is owned by two persons at the same time, the relation between the two owners being such that one of them with legal title under an obligation to use his ownership for the benefit of the other. The former is called the trustee, and his ownership

is *trust-ownership;*[3] the other is called the beneficiary, and his is *beneficial ownership*.[4]

(2) *Ownership of trustee, a mere matter of form and nominal.* — The trustee is destitute of any right of enjoyment of the trust property. His ownership, therefore, is a mere matter of form rather than of substance, and nominal rather than real. If we have to regard the essence of the matter, a trustee is not an owner at all, but a sort of an agent, upon whom the law has conferred the power and imposed the duty of administering the property of another person.[5]

(3) *Trustee, not mere agent.* — In legal theory, however, the trustee is not a mere agent but an owner. He is a person to whom the property of someone else is *fictitiously* attributed by the law, to the extent that the rights and powers thus vested in a nominal owner shall be used by him on behalf of the *real owner.* (see Salmond, Jurisprudence, 10th ed., p. 275.)

(4) *Transfer of equitable title.* — The interests of the beneficiary in the trust can, in general, be reached by his creditors, and he can sell or otherwise dispose of them. The beneficiary can transfer only the interests he holds — the equitable title.

(5) *Rights of beneficiary.* — Depending on the terms of the trust instrument, the beneficiary may receive the income from the assets of the trust, the assets themselves, or both.

Character of office of trustee.

(1) *As principal*. — The trustee is not an agent of the trust estate or of the *cestui que trust,* but he acts for himself in the administration of the trust estate, although subject to the terms of the trust and the law of trusts. He cannot act as an agent of the trust estate for the reason that it lacks juristic personality. In other words, a trust and an agency are distinguishable on the basis of

[3]A trustee on behalf of his principal may apply for original registration of any land held in trust by him unless prohibited by the instrument creating the trust. (Sec. 14, last par., Pres. Decree No. 1529 [Property Registration Decree].)

[4]The interest of the beneficiary in trust property is also called "equitable ownership."

[5]The trustee may be accorded the right to prosecute a suit, but only on behalf of the beneficiary who must be included in the title of the case and shall be deemed to be the real party-in-interest. (Marcos-Araneta vs. Court of Appeals, 362 SCRA 41 [2008].)

the non-representative role of the trustee and the representative role of the agent.

(2) *As agent.* — In some cases, however, a trustee has been regarded as an agent of beneficiaries of the trust at least for certain purposes, such as for the purpose of imputing to the beneficiaries of the trust notice given to the trustee. (*Ibid*., 100.) By some statutes, it is provided that a trustee is a general agent for the trust property and that his acts within the scope of his authority bind the trust estate to the same extent as the acts of an agent bind his principal. (54 Am. Jur. 24; Tuttle vs. Union Bank and Trust Co., 119 P [2d] 884, 139 ACR 127.)

(3) *As fiduciary.* — A trustee, like an executor or administrator, holds an office of trust. The duties of the latter are, however, fixed and/or limited by law, whereas those of trustee of an express trust are, usually, governed by the intention of the trustor or of the parties, if established by contract. (Art. 1441.) Besides, the duties of trustees may cover a much wider range than those of executors or administrators of the estate of deceased persons. (Araneta vs. Perez, 5 SCRA 338 [1962]; see Estate of H.M. Ruiz vs. Court of Appeals, 252 SCRA 541 [1996].)

Necessity of existence of beneficiary.

A trust is not void for indefiniteness if by its terms the whole property will go to the beneficiary or beneficiaries who is/are undetermined but will be determined at the termination of the trust, at the latest.

It is not necessary to the creation of a trust that the *cestui que trust* be named or identified or even be in existence at the time of its creation; and this is especially so in regard to charitable trust. (54 Am. Jur. 117; Government vs. Abadilla, 46 Phil. 642 [1924].) The trustor can simply specify as the beneficaries a class of persons (*e.g.*, "my minor children," "my brothers and sisters") who are readily identifiable. Thus, a devise of a land to a father in trust for his children lawfully begotten at the time of his death is valid although the father had no children at the time of the creation of the trust.

ART. 1441. Trusts are either express or implied. Express trusts are created by the intention of the trustor or

of the parties. Implied trusts come into being by operation of law.

Classification of trusts.

(1) *Creation.* — From the viewpoint of the creative force bringing them into existence, they may be either:

(a) *express trust* (Arts. 1443-1446.) or one which can come into existence only by the execution of an intention to create it by the trustor or the parties; or

(b) *implied trust*, or one which comes into being by operation of law (Arts. 1447-1457.); this latter trust being either:

1) *resulting trust* or one in which the intention to create a trust is implied or presumed in law *(infra.);* or

2) *constructive trust* or one imposed by law irrespective of, and even contrary to, any such intention for the purpose of promoting justice, frustrating fraud, or preventing unjust enrichment. *(infra.)* It is otherwise known in American law as a trust *ex maleficio,* trust *ex delicto*, and *de son tort.* (see Sumaoang vs. Judge, RTC, 215 SCRA 136 [1992].)

In other words, a trust intentional in fact is an express trust; one intentional in law is a resulting trust; and one imposed irrespective of intention is a constructive trust.

The classification of "voluntary" and "involuntary" trusts is sometimes employed in referring to express trusts and implied trusts. (see 54 Am. Jur. 22-23.)

(2) *Effectivity.* — From the viewpoint of whether they become effective after the death of the trustor or during his life, they may be either:

(a) *testamentary trust* or one which is to take effect upon the trustor's death. It is usually included as part of the will and does not have a separate trust deed (see Tuazon vs. Caluag, [Unrep.] 96 Phil. 981 [1955]; Lorenzo vs. Posadas, 64 Phil. 353 [1937].); or

(b) *trust inter vivos* (sometimes called "living trust") or one established effective during the owner's life. The grantor

executes a "trust deed," and once the trust is created, legal title to the trust property passes to the named trustee with duty to administer the property for the benefit of the beneficiary.

(3) *Revocability*. — From the viewpoint of whether they may be revoked by the trustor, they may be either:

(a) *Revocable trust* or one which can be revoked or cancelled by the trustor or another individual given the power; or

(b) *Irreovocable trust* or one which may not be terminated during the specified term of the trust.

Whether a trust is revocable or irrevocable depends on the wordings or language used in the creation of the trust. It will be presumed revocable unless the creator has expressed a contrary intention in the trust deed.

Elements of express trust.

Basically, these elements include:

(1) A competent trustor and trustee;

(2) An ascertainable trust *res*; and

(3) Sufficiently certain beneficiaries.

The trustee must also have some power of administration other than a mere duty to perform a contract although the contract is for some third-party beneficiary. A declaration of terms is essential and these must be stated with reasonable certainty in order that the trustee may administer, and that the court, if called upon so to do, may enforce the trust. (Mindanao Development Authority vs. Court of Appeals, 113 SCRA 429 [1982].) Since the trustee takes title to property and administers it, it follows that he must be capable of owning property.

Consideration, is not required to establish a trust.

ILLUSTRATIVE CASE:

Seller bound himself to work for the titling at his own expense the portion of the land sold to buyer but title issued in name of seller.

Facts: In 1939, S, owner of an unregistered tract of land with an area of 29 hectares, sold to B a portion of said land, Lot

1846-C with an area of around 5 hectares. In the deed of sale, S made the following commitment: "I hereby agree to work for the titling of the entire area of my land under my own expenses and the expenses for the titling of the portion sold (by) me shall be under the expenses of B."

Ten months later, B sold to the Government Lot 1846-C. In 1941, S executed an affidavit wherein he confirmed the previous sale to B clarifying that the exact area of the lot sold is 61,107 square meters and certifying that he intended to cede and transfer the lot to B after the survey of S's land. The affidavit was registered. Subsequently, S obtained original certificate of title for the 29-hectare land.

By Presidential Proclamation, certain parcels of land forming part of the Government's private domain were transferred to MDA (Mindanao Development Authority, now Southern Philippines Development Administration), a government agency, subject to private rights, if any. Lot 1846-C was among the parcels of land transferred to MDA in said proclamation. In 1969, MDA filed suit against S for the reconveyance of the title over Lot 1846-C after the latter ignored repeated demands to the transfer of title to MDA.

Issue: Is S a trustee in an express trust covering Lot 1846-C, and, therefore, the lot should be adjudicated to MDA?

Held: No. The stipulation in the deed of sale does not categorically create an obligation on the part of S to hold the property in trust for B. Hence, there is no express trust. It is essential to the creation of an express trust that the settlor presently and unequivocably make a disposition of property and make himself the trustee of the property for the benefit of another. While S had agreed that he will work for the titling of "the entire area of my land under my own expenses," it is not clear therefrom whether said statement refers to the 29-hectare parcel of land or to that portion left to him after the sale. A failure on the part of the settlor definitely to describe the subject matter of the supposed trust or the beneficiaries or object thereof is strong evidence that he intended no trust.

And even assuming that an express trust was created, S had long repudiated it when he refused to deliver and convey the title to the property to MDA, the alleged beneficiary to the trust. MDA did not take any action until after the lapse of 23 years. *(Mindanao Development Authority vs. Court of Appeals, supra.)*

Aquino, J., dissenting:

S created an express trust by executing later an affidavit that he intended to transfer the disputed lot to B. Prescription in the case of express trusts can be invoked only from the time the trust is repudiated. And a trustee who takes a torrens title in his name for the land held in trust cannot repudiate the trust by relying on the registration. That is one of the limitations upon the finality of a decree of title. In any event, the real plaintiff in this case is the Republic of the Philippines and prescription does not run against the State. The maxim is *nullum tempus o occurrit reg* or *nullum tempus occurrit reipublicae* (lapse of time does not bar the right of the crown or lapse of time does not bar the commonwealth). The rule is now embodied in Article 1108(4) of the Civil Code.

The negligence of government officials concerned in not intervening in the land registration proceeding or in not promptly asking S to reconvey the disputed lot to the Government does not prejudice the State. The negligence or omissions of public officers as to their public duties will not work an estoppel against the State. *(Ibid.)*

ART. 1442. The principles of the general law of trusts, insofar as they are not in conflict with this Code, the Code of Commerce, the Rules of Court[6] and special laws are hereby adopted.

Principles of the general law of trusts adopted.

This provision is similar to Article 1432 which adopts the principle of estoppel as known in American jurisprudence. "This article incorporates a large part of the American law on trusts and thereby the Philippine legal system will be amplified and will be rendered more suited to a just and equitable solution of many questions." (Report of the Code Commission, p. 60; see 24 Roa, Jr. vs. Court of Appeals, 123 SCRA 3 [1983], under Art. 1456.)

[6]The Rules of Court establishes a disputable presumption relating to trust, to wit:

"That a trustee or other person whose duty it was to convey real property to a particular person has actually conveyed it to him when such presumption is necessary to perfect the title of such person or his successor-in-interest." (Sec. 3[ii], Rule 131, Rules of Court.)

Pursuant to Article 1442, it has been held that the question of whether the proceeds from the sale of property held in trust constitute profits or not within the purview of the internal revenue laws depends upon the provisions of the latter, regardless of the will of the trustor. (Perez vs. Araneta, 4 SCRA 430 [1962].)

A trust or a provision in the terms of a trust would be invalid if its enforcement is against the law even though its performance does not involve the commission of a criminal or tortious act. It likewise must follow that what the parties are not allowed to do expressly is one that they also may not do impliedly as, for instance, in the guise of a resulting trust. (Heirs of L. Yap vs. Court of Appeals, 312 SCRA 603 [1999].)

Termination of express trust

(1) *Expiration of period fixed.* — Ordinarily, a trust instrument states the termination of date of the trust or the event (*e.g.*, when the beneficiary reaches a certain age) on which the trustor wishes it to terminate.

(2) *Accomplishment of purpose.* — If the trust purpose (*e.g.*, education of a child) is fulfilled before the date, the trust will terminate; otherwise, on the date specified even when the purpose has not yet been fulfilled. Of course, whether or not a date is expressly stated, a trust will terminate when its purpose has been fulfilled, or has became unlawful or impossible.

(3) *Mutual agreement of beneficiaries.* — Under some circumstances, the trust may terminate by mutual agreement of all the beneficiaries.

(4) *Exercise of power to terminate.* — Under the terms of the trust deed, the trustor, trustee, or someone else may have the power to terminate the trust.

Upon termination of a trust, any balance of funds reverts to the trustor or is disposed of in accordance with the instructions contained in the trust. If the trust does not make any provision, they can be distributed to those entitled thereto under the law.

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Chapter 2

EXPRESS TRUSTS

ART. 1443. No express trusts concerning an immovable or any interest therein may be proved by parol evidence.

Evidence to prove express trust.

(1) *Burden of proof.* — The general rule is that the burden of proving the existence of a trust is on the party alleging its existence; and to discharge this burden, it is generally required that his proof be clear and satisfactory and convincing. (54 Am. Jur. 465; Ramos vs. Ramos, 61 SCRA 284 [1974].)

(2) *Trust concerns immovable therein.* — By virtue of Article 1443, a writing is necessary to prove an express trust concerning an immovable or any interest therein. The writing is required by said article not for validity but for purposes of proof. Hence, by analogy, this requirement may also be included under the Statute of Frauds. (Cuaycong vs. Cuaycong, 21 SCRA 1192 [1967].)

(3) *Failure to object to parol evidence.* — Like the defense of the Statute of Frauds, the defense that express trusts cannot be proved by parol evidence may be waived, either by failure to interpose timely objections against the presentation of oral evidence not admissible under the law or by cross-examining the adverse party and his witnesses along the prohibited lines. (Magtulis vs. Espartero, 9 C.A. Rep. 67; De Ramos vs. Velez, 12 C.A. Rep. 826; see Arts. 1403[2], 1405; see Sinaon vs. Sorongan, 136 SCRA 407 [1985].)

To affect third persons, a trust concerning an immovable or any interest therein must be embodied in a public instrument and registered in the Registry of Property.

(3) An express trust over personal property or any interest therein, and an implied trust, whether the property subject to the trust is real or personal, may be proved by oral evidence. (Art. 1457.)

ART. 1444. No particular words are required for the creation of an express trust, it being sufficient that a trust is clearly intended.

Creation of an express trust.

Express trusts are those trusts intentionally created by direct and positive act of the trustor, by some writing, deed, will, or oral declaration evincing an intention to create the trust.

They are distinguishable from implied trusts, resulting and constructive, in that the latter are respectively founded upon an intention of the parties to a transaction implied in law, or upon fraud or wrong irrespective of the intention of the parties concerned. (54 Am. Jur. 36.)

No particular words are required or essential for the creation of an express trust, it being sufficient that a trust is clearly intended. (Vda. de Esconde vs. Court of Appeals, 253 SCRA 66 [1996]; see Development Bank of the Phils. vs. Commission on Audit, 422 SCRA 459 [2004]; Canezo vs. Rojas, 538 SCRA 242 [2007].)

ILLUSTRATIVE CASE:

Vendee a retro, though the title to the property was still in his name, recognized the right to repurchase of vendor a retro by allowing the latter to exercise acts of ownership over the property.

Facts: The trial court declared in a decision that S had the right to redeem four (4) lots with a house of strong materials, and ordered B to make the resale of the property in favor of S. After the decision had become final and executory, B suggested that the tenants of the house pay his rentals to S instead of to him. Not only this but when the tenants left the house, S took possession of, and exercised acts of, ownership over the house and B all along showed conformity thereto.

Issue: Upon the facts, is there an express trust?

Held: Yes. The acts of B should be construed as a recognition of the fact that the property, though still in his name, is to be held in trust for S, to be conveyed to the latter upon payment of the repurchase price. Such trust is an express one, not subject to prescription. *(Geronimo and Isidro vs. Nava and Aquino, 105 Phil. 145 [1959].)*

Terminology used not controlling.

Technical or particular forms of words or phrases are not essential to the manifestation of an intention to create a trust. It is possible to create a trust without using the word "trust" or "trustee." Conversely, the mere fact that the word "trust" or "trustee" is employed does not necessarily prove an intention to create a trust.

What is important is whether the trustor or the party manifested an intention to create the kind of relationship which in law is known as a trust. It is immaterial whether or not he knows that the relationship which he intends to create is called a trust, and whether or not he knows the precise characteristic of the relationship which is called a trust (Julio vs. Dalandan, 21 SCRA 543 [1967]; Tamayo vs. Callejo, 46 SCRA 27 [1972]; Lorenzo vs. Posadas, 64 Phil. 353 [1937].), it being sufficient that a trust is clearly intended. (Ungab-Valeroso vs. Ungab-Grado, 524 SCRA 699 [2007].)

ILLUSTRATIVE CASES:

1. *Document imposes upon a person the duty to turn over the possession of property to another.*

Facts: A private document labelled "Statement" recites that the riceland owned by the deceased mother of A was posted as security for an obligation assumed by the deceased father of B, but was foreclosed due to the failure of B's father to fulfill his obligation. In said document, it was agreed between B's father and A that the former held himself liable to A's mother for such foreclosure and "promised" that he would replace such riceland with another of his own.

A brought action because of B's refusal to deliver the "promised" land.

Issue: Did the document create an express trust?

Held: Yes. The document itself imposes a duty upon B to turn over both the fruits and the possession of the property to A. An express trust is thereby created, imposed upon B by his predecessor and no evidence *aliunde* is necessary for its recognition, considering that no particular words are required for the creation of an express trust under Article 1444. *(Julio vs. Dalandan, supra.)*

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2. *Husband designated as sole heir with obligation to deliver properties to certain persons referred to as "beneficiaries."*

Facts: In her will, T, testatrix, designated her husband, H, as universal and sole heir with the obligation to deliver the properties in question to certain persons who were referred to as "beneficiaries." The word "trust" does not appear in the will.

Issue: Did T effectively create a trust in favor of the parties over the properties adverted to in the will?

Held: Yes. The designations, coupled with the other provisions for co-ownership and joint administration of the properties and other conditions imposed by T, clearly demonstrated the intent of T that the legal title to the properties should vest in H and the beneficial or equitable interest thereto should repose in said persons. *(Vda. de Mapa vs. Court of Appeals, 154 SCRA 294 [1987].)*

Kinds of express trusts.

Certain trusts are created for special purposes.[1] Among them are:

[1]Both wills and trusts are the most commonly used estate planning devices. Estate planning is applying the law of property, wills, trusts, future interests, life insurance, and taxation to the ordering of one's affairs, keeping in mind the possibility of retirement and the certainty of death. The aim is not merely to dispose of one's estate at death but to organize resources during life in order to provide for the present and future well-being of one's family.

Trusts are an excellent estate device, capable of accomplishing much more than other tools used in the construction of an estate plan. The use of trusts is usually motivated by tax benefits. For example, if property is transferred outright to the estate owner's children, and they transfer it to their children, there will be estate taxes and other expenses at the death of the children — a double bite, so to speak. However, if the property is transferred to the owner's children in trust for their lives, with the remainder to the grandchildren, no tax will be levied on the death of the children. A generation will be skipped

(1) *Charitable trust* or one designed for the benefit of a segment of the public or of the public in general. It is one created for charitable, educational, social, religious, or scientific purposes, or for the general benefit of humanity. A *private trust* is not for the good of the public in general or society as a whole;

(2) *Accumulation trust* or one that will accumulate income to be reinvested by the trustee in the trust for the period of time specified;

(3) *Spendthrift trust* or one established when the beneficiary need to be protected, because of his inexperience or immaturity from his imprudent spending habits or simply because the beneficiary is spendrift. Income will be paid to the beneficiary only when actually necessary. Under some circumstances, the trustee will pay directly the creditor for obligations of the beneficiary; and

(4) *Sprinkling trust* or one that gives the trustee the right to determine the income beneficiaries who should receive income each year and the amount thereof. Income that is not distributed in any given year is added to the *corpus*, as in an accumulation trust. It is a *discretionary trust* if it gives the trustee the discretion to pay or not to pay the income or principal.

When trustee may sue or be sued alone.

In order that a trustee may sue or be sued alone, it is essential that his trust be express, that is, a trust created by the direct and positive acts of the parties, by some writing, deed, or will or by proceedings in court. (Phil. Air Lines, Inc. vs. Heald Lumber Co., 101 Phil. 1031 [1957].)

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in the tax chain. And if the transfer is properly made, *inter vivos*, the estate tax may be substantially reduced for both generations.

There are several other reasons for using trusts. Those with "spendrift" provisions will protect beneficiaries from their own mismanagement. A trust can be set up so that a beneficiary cannot dispose of property the settlor wants to keep in the family. Insurance proceeds can be handled effectively by a trust because of its flexibility. A variety of beneficiaries can be provided for, with payments being increased or diminished depending on the individual needs of each. However, in using the trust and other devices, familiarity with tax laws, particularly the National Internal Revenue Code, is absolutely essential. (Business Law, by Howell-Allison & Henley, 1982, p. 652.)

If a property is insured and the owner received the indemnity from the insurer, it is provided in Article 2207[2] of the Civil Code that the insurer is deemed subrogated to the rights of the insured against the wrongdoer. It has been held that the payment of the indemnity does not make the insured a trustee of the insurer as in the American law, with the right to bring the action in the name of the latter and the duty to pay to him (insurer) so much of the recovery as corresponds to the amount he (insured) had received. This matter being statutory, the same is governed by our own law in this jurisdiction. *(Ibid.)*

ART. 1445. No trust shall fail because the trustee appointed declines the designation, unless the contrary should appear in the instrument constituting the trust.

Acceptance, declination, or renunciation by the trustee.

(1) In the case of an express trust, acceptance of trust by a trustee is necessary to charge him with the office of the trustee and the administration of the trust and to vest the legal title in him. However, his acceptance of the trust is not necessary to its existence and validity, since if he declines the trust, the courts will appoint a trustee to fill the office that he declines. (54 Am. Jur. 107; see Sec. 3, Rule 98, Rules of Court.)

(2) One designated or appointed as trustee may decline the responsibility and thereby be free from any legal or equitable duty or liability in the matter. Unless a contrary intention appears in the instrument constituting the trust (Art. 1145.), declination or refusal or disqualification of a trustee does not operate to defeat or void the trust; nor does it operate to vest legal as well as equitable title in the beneficiary. (54 Am. Jur. 108.)

[2]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.

(3) Furthermore, renunciation of a trust after its acceptance can only be by resignation or retirement with court approval or at least, with agreement of beneficiaries and on satisfaction of all legal liabilities growing out of the acceptance of the trust. A contract to renounce, for a pecuniary consideration, the right to act as a trustee has generally been recognized to be against public policy. *(Ibid.)* When a person administering property in the character of trustee inconsistently assumes to be holding in his own right, this operates as renunciation of the trust and the beneficiaries in the property are entitled to maintain an action to declare their right and remove the unfaithful trustee. (Martinez vs. Grano, 42 Phil. 35 [1921].)

ART. 1446. Acceptance by the beneficiary is necessary. Nevertheless, if the trust imposes no onerous condition upon the beneficiary, his acceptance shall be presumed, if there is no proof to the contrary.

Acceptance of trust by the beneficiary.

Acceptance of or assent to the trust by the beneficiary is essential to the creation and validity of a trust.

The trust being beneficial to the beneficiary, his acceptance is presumed if there is no proof to the contrary. However, if the trust imposes some onerous condition, acceptance must be shown. Such acceptance may be express or implied.

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Chapter 3

IMPLIED TRUSTS

ART. 1447. The enumeration of the following cases of implied trust does not exclude others established by the general law of trust, but the limitation laid down in Article 1442 shall be applicable.

Concept of implied trust.

Implied trusts are those which, without being express, are deducible from the nature of the transaction as matters of intent, or which are superinduced on the transaction by operation of law, as matters of equity, independently of the particular intention of the parties. (89 C.J.S. 724; Philippine National Bank vs. Court of Appeals, 217 SCRA 347 [1993].)

Implied trusts are not created voluntarily, but imposed by law or inferred from the conduct or dealings of the parties. The concept of implied trusts is that from the facts and circumstances of a given case, the existence of a trust relationship is inferred in order to effect the presumed intention of the parties. Thus, there is no implied trust where a contrary intention is proved. (Abellana vs. Ponce, 437 SCRA 531 [2004].)

Kinds of implied trust.

Implied trusts are ordinarily subdivided into:

(1) *Resulting trust.* — It is broadly defined as a trust which is raised or created by the act or construction of law. In its more restricted sense, it is a trust raised by *implication of law and presumed always to have been contemplated by the parties*, the intention as to which is to be found in the nature of their transaction, but not expressed in the deed or instrument of conveyance. (89 C.J.S. 725.)

This kind of trust is based on the equitable doctrine that valuable consideration and not legal title determines the equitable title or interest. (O'laco vs. Co Cho Chit, 220 SCRA 656 [1993].) The trust is said to result in law from the act of the parties. Examples of this kind of trust are found in Articles 1448, 1449, 1451, 1452, and 1453; and

(2) *Constructive trust.* — It is also a trust raised by construction of law or arising by operation by law. In a more restricted sense, and as contra-distinguished from a resulting trust, constructive trust is a trust not created by any words, either expressly or impliedly, evincing a direct intention to create a trust but by the *construction of equity in order to satisfy the demands of justice and prevent unjust enrichment*. It does not arise by agreement or intention but by operation of law against one who, by fraud, duress, or abuse of confidence obtains or holds the legal right to property which he ought not, in equity and good conscience, to hold. (*Ibid*.; Vda. de Esconde vs. Court of Appeals, 253 SCRA 66 [1996]; Vda. de Retuerto vs. Barz, 372 SCRA 712 [2001]; 89 C.J.S. 726-727.) "If a person obtains legal title to property by fraud or concealment, courts of equity will impress upon the title a so-called constructive trust in favor of the defrauded party." This kind of trust is illustrated in Articles 1450, 1454, 1455, and 1456.

However, a trust will not be created when for the purpose of evading the law prohibiting one from taking or holding real property he takes conveyance thereof in the name of a third person. (Kiel vs. Estate of P.S. Sabert, 46 Phil. 193 [1924].) For example, a homestead applicant is required by law to occupy and cultivate the land for his own benefit, and not for the benefit of someone else. Hence, a trust created in favor of one already disqualified from applying additional homestead under the Public Land Act (Sec. 112, CA No. 141.) is null and void considering that it is in direct violation of the Act as regards the acquisition of homestead patent. (Sollega de Romero vs. Court of Appeals, 319 SCRA 180 [1999].)

A constructive trust is not a trust in a technical sense. (see Art. 1456; Ramos vs. Ramos, 61 SCRA 284 [1974]; see Sinaon vs. Sorongon, 136 SCRA 407 [1985]; Salvatierra vs. Court of Appeals, 261 SCRA 45 [1996].) It is substantially an appropriate remedy

against unjust enrichment.[1] (see Sumaoang vs. Judge, RTC, 215 SCRA 136 [1992].)

While in an express trust, a beneficiary and a trustee are linked by a confidential or fiduciary relation, in a constructive trust, there is neither a promise nor any fiduciary relation to speak of and the so-called trustee neither accepts any trust nor intends holding the property for the beneficiary. (Phil. National Bank vs. Court of Appeals, 217 SCRA 347 [1993].)

Constructive trusts are illustrated in Articles 1450, 1454, 1455, and 1456.

Enumeration of cases of implied trust not exclusive.

The enumeration of cases of implied trust in Chapter 3 is not exclusive. (Art. 1447.) It is intended to be illustrative of situations in which implied trust is needed in order to correct a wrong or prevent an unjust enrichment.

(1) It has been held that the registration of a land under the Torrens System in the name of another does not bar evidence to show that the property is only being held in trust for the non-registered owner. (Special Services Corporation vs. Centro La Paz, 121 SCRA 748 [1983].)

(2) Similarly, although no specific provision can be cited to apply, an implied trust is created when the certificate of registration of a vehicle is placed in the name of a person although the price thereof was not paid by him but by another. (Chiao Liong Tan vs. Court of Appeals, 228 SCRA 75 [1993].)

(3) Even though a mortgagee who exercises the power of sale contained in a mortgage is not strictly considered a trustee

[1]An implied trust, whether resulting or constructive, is created by law. While the distinction is not always clear, constructive trust is usually imposed upon property by the courts to correct or rectify fraud or to prevent one party from being unjustly enriched at the expense of another. In reality, it is a fiction or remedy to which a court of equity will resort to prevent injustice. The resulting trust arises out of or is created by, the conduct of the parties. It is imposed in order to carry out the apparent intention of the parties at the time they entered into the transaction that gave rise to the trust. The most frequent use of the resulting trust occurs when one party purchases land but records the title in the name of another who subsequently refuses to convey the property in accordance with their understanding of the nature of the transaction. (Business Law by Howell, Allison, & Henley, 1982, pp. 649-650.)

in a purely equitable sense, he is deemed a custodian as far as concerns the surplus of the proceeds of the foreclosure sale and regarded a trustee thereof for the benefit of the mortgagor or owner of the equity of redemption. (Sulit vs. Court of Appeals, 268 SCRA 441 [1997].)

(4) An implied trust is created between the principal and the agent who willfully violated the trust reposed in him by the principal by buying for himself the property he was supposed to buy for the principal who designated and appointed him to negotiate with the owner. The agent is duty-bound to execute a deed of conveyance of the property upon payment by the principal of the purchase price without interest. (Policarpio vs. Court of Appeals, 269 SCRA 344 [1997].) So, a constructive trust may also arise by abuse of confidence, in order to satisfy the demands of justice. (Arlegui vs. Court of Appeals, 378 SCRA 322 [2002].)

(5) In consonance with the *trust fund doctrine* in corporation law, the assets of the corporation as represented by its capital stock are regarded as "trust funds" to be maintained unimpaired for the payment of corporate creditors in the sense that there can be no distribution of such assets among the stockholders without provision being first made for the payment of corporate debts.

(6) Included in the regulatory responsibilities of the Insurance Commissioner under Section 414 of the Insurance Code (Pres. Decree No. 1460, as amended.) is the duty to hold the security deposits under Sections 191 and 203 of the Code, for the benefit of all policy holders. Section 192 thereof specifically confers custody over the securities upon the Commissioner, with whom these investments are required to be deposited. An implied trust (Art. 1441.) is created by law for the benefit of all claimants under subsisting insurance contracts issued by the insurance company. (Republic vs. Del Monte Motors, Inc., 534 SCRA 53 [2006].)

Implied trust founded upon equity.

"The doctrine of implied trusts is founded upon equity. The principle is applied in the American legal system to numerous cases where an injustice would result if the legal estate or title

were to prevail over the equitable right of the beneficiary. A number of instances of implied trusts are enumerated in the [new] Civil Code, but this enumeration does not exclude other cases established by the general law of trusts" (Report of the Code Commission, p. 60.) insofar as they are not in conflict with the Civil Code, the Code of Commerce, the Rules of Court, and special laws.

The consequences of an implied trust are, principally, that the implied trustee shall deliver the possession and reconvey title to the property to the beneficiary of the trust, and to pay to the latter the fruits and other net profits received from such property during the period of wrongful holding and otherwise, to adjust the equities between the trustee holding the legal title and the beneficiary of the trust. (Sumaoang vs. Judge, RTC, *supra*.)

While the principle of undue enrichment or *quasi-contract* is not new, having been incorporated in the Spanish Civil Code, the provisions on trusts are fairly recent, having been introduced by the Code Commission in 1949. Although the concept of trusts is nowhere to be found in the Spanish Civil Code, the framers of our present Civil Code incorporated implied trusts on top of *quasi-contract*s, both of which embody the principle of equity above strict legalism.[2] (Phil. National Bank vs. Court of Appeals, 217 SCRA 347 [1993].)

The doctrine of implied trust if based on an illegal contract cannot be invoked. (Homena vs. Casa, 157 SCRA 232 [1988].) Being founded in equity, trust can never result from acts violative of the law. (Deluao vs. Casteel, 29 SCRA 350 [1969]; Art. 1442.)

Distinctions between express trusts and implied trusts.

The following may be mentioned:

(1) *Creation of trust.* — Express trusts are created by the intention of the trustor or parties, while implied trusts come into

[2]"A trust is as much a misnomer as a 'quasi-contract,' so far removed they are from trusts and contracts proper, respectively. In the case of a constructive trust, as in the case of a quasi-contract, a relationship is 'forced' by operation of law upon the parties, not because of any intention on their part but in order to prevent unjust enrichment, thus giving rise to certain obligations not within the contemplation of the parties." *(Ibid.)*

being by operation of law. (Art. 1441.) Express trusts are created by the direct and positive acts of the parties by some writing or deed or will or by words evidencing an intention to create a trust. On the other hand, implied trusts are those which, without being expressed, are deducible from the nature of the transaction or imposed by operation of law, independently of the particular intention of the parties. Thus, if the intention to establish a trust is clear, it is express; if such intention is to be taken from the circumstances or other matters indicative of such intent, then it is implied (Cuaycong vs. Cuaycong, 21 SCRA 1192 [1967].);

(2) *Proof of trust.* — An express trust concerning an immovable or any interest therein cannot be proved by parol evidence, while an implied trust concerning an immovable or any interest therein may be proved by oral evidence (Art. 1457.); and

(3) *Repudiation of trust.* — In order that laches or acquisitive prescription may bar an action to enforce an express trust, an express repudiation made known to the beneficiary is required, while laches constitutes a bar to actions to enforce an implied trust even where there is no repudiation, unless there is concealment of the fact giving rise to the trust. (Diaz vs. Gorricho and Aguado, 103 Phil. 261 [1958]; Heirs of Candelaria vs. Romero, 109 Phil. 500 [1960]; Fabian vs. Fabian, 22 SCRA 231 [1968].) An express trust does not prescribe except when the trustee repudiates the trust.

While no time limit is imposed for the enforcement of rights under an express trust, prescription may, however, bar a beneficiary's action for recovery, if a repudiation of the trust is proven by clear and convincing evidence and made known to the beneficiary. (Secuya vs. Vda. de Selma, 326 SCRA 244 [2000].)

Implied trust converted to express trust.

An implied trust may be converted to an express trust by the recognition by the implied trustee of the right to the property of the owner.

(1) *Trustee acknowledged in a public instrument sale of land by his parents to beneficiary.* — In a case, where the plaintiff sought a reconveyance of a parcel of land he bought from defendant's parents but which was inadvertently included in the certificate

of title covering defendant's land, more than ten years from the issuance of said title, the Supreme Court took the stand that if such erroneous inclusion initially created an implied trust, the trust was converted into an express trust when subsequently the defendant explicitly acknowledged in a public instrument the sale of said land by his parents and bound himself further, to defend plaintiff's title against any claims whatsoever; it having been created *by the will of the parties*, no particular words being required for the creation of an express trust, it being sufficient that a trust is clearly intended — and hence, was no longer subject to the statute of limitations until and unless repudiated. (Tamayo vs. Callejo, 46 SCRA 27 [1972].)

(2) *Trustee directed his tenant to pay rentals to beneficiary and allowed latter to take possession.* — In a decision that had become final and executory, the trial court declared that the defendant had the right to redeem the property in question and ordered the plaintiff to make the resale of the property in favor of the defendant. It was held that such declaration created an implied trust for the defendant to redeem, subject to the payment of the redemption price. Where pursuant to the decision, the plaintiff directed the tenant to pay his rentals to the defendant instead of to him, meaning the defendant had a right to said rentals, and allowed the latter to take possession of the property when the tenant left the same, such acts should be construed as a recognition by the plaintiff of the fact that the property though still in his name, was to be held in trust for the defendant, to be conveyed to the latter upon payment of the purchase price. The trust became an express one. (see Geronimo and Isidro vs. Nava and Aquino, 105 Phil. 145 [1959].)

Acquisition of property through prescription.

The rule that a trustee cannot acquire by prescription ownership over property entrusted to him until and unless he repudiates the trust, applies to express trusts and resulting implied trusts. (Vda. de Esconde vs. Court of Appeals, 253 SCRA 66 [1996]; Lopez vs. Court of Appeals, 574 SCRA 26 [2008].) An action for reconveyance will not prescribe as long as the property stands in the name of the trustee. To allow prescription would be to permit a trustee to acquire title against the principal and

the true owner. (Intestate Estate of Alexander T. Ty vs. Court of Appeals, 356 SCRA 661 [2001].)

The settled rule in constructive implied trusts is that prescription may supervene even if the trustee does not repudiate the relationship. Necessarily, repudiation of the said trust is not a condition precedent to the running of the prescriptive period. *(Ibid.)* In resulting trusts, the rule of imprescriptibility may apply for as long as the trustee has not repudiated the trust. Once the resulting trust is repudiated, however, it is converted into a constructive trust and is subject to prescription. (O'laco vs. Co Cho Chit, 220 SCRA 656 [1993]; Vda. de Esconde vs. Court of Appeals, *supra*; Aznar Brothers Realty Co. vs. Aying, 458 SCRA 496 [2005]; Lopez vs. Court of Appeals, *supra*.)

(1) *By trustee.* — It is a well-settled rule that the possession of a trustee is, in law, possession of the *cestui que trust* and, therefore, it cannot be a good ground for title by prescription. (Lagura vs. Levantino, 71 Phil. 566 [1941].) Co-ownership is a form of trust and every co-owner is a trustee for the other. (Castrillo vs. Court of Appeals, 10 SCRA 249 [1964]; Sotto vs. Teves, 86 SCRA 154 [1978]; Bargayo vs. Camumot, 40 Phil. 857 [1920].) No prescription shall run in favor of a co-owner against his co-owners or co-heirs as long as he expressly or impliedly recognizes the co-ownership. (Delima vs. Court of Appeals, 201 SCRA 641 [1991].) There should be a clear repudiation of co-ownership duly communicated to the other co-owners.

The *express trusts* disable the trustee from acquiring for his own benefit the property committed to his management or custody, at least while he does not openly repudiate the trust and makes such repudiation known to the beneficiary. For this reason, the rules on adverse possession do not apply to "continuing and subsisting (*i.e.*, unrepudiated) trusts." (Fabian vs. Fabian, 20 SCRA 231 [1968].)

The trustee may claim title by prescription founded on adverse possession where it appears that:

> (a) he has performed open and unequivocal acts of repudiation amounting to an ouster of the *cestui que trust* or the other co-owners;

(b) such positive acts of repudiation have been made known to the *cestui que trust* or the other co-owners;

(c) the evidence thereon should be clear and conclusive or convincing (Ramos vs. Ramos, 61 SCRA 284 [1974]; Valdez vs. Olorga, 51 SCRA 71 [1973]; Lagura vs. Levantino, 71 Phil. 566 [1941]; Salinas vs. Tuazon and Roman, 55 Phil. 729 [1931]; Salvador vs. Court of Appeals, 243 SCRA 239 [1995]; Sta. Ana vs. Panlasegue, 500 SCRA 476 [2006].); and

(d) the period fixed by law has prescribed. (See Arts. 1132, 1134, 1137.) The period will commence to run from and after said repudiation and the knowledge thereof by the *cestui que trust*. (Salinas vs. Tuazon and Roman, *supra*.)

(2) *By third persons.* — Though the statute of limitations does not run between trustee and *cestui que trust* as long as the trust relation subsists, it does run between the trust and third persons. Thus, a third person who holds actual, open, public, and continuous possession of a land, adversely to the trust, acquires title to the land by prescription as against such trust. (Government vs. Abadilla, 46 Phil. 642 [1924].)

Acts amounting to repudiation of trust.

Acts which may be adverse to strangers may not be sufficiently adverse to the *cestui que trust*. A mere silent possession of the trustee unaccompanied with acts amounting to an ouster of the *cestui que trust* cannot be construed as an adverse possession. (Lagura vs. Levantino, *supra*.) His mere receipts of rents and profits from the property, the erection of fences and buildings adapted for the cultivation of the land held in trust, and the payment of land taxes, do not by themselves serve as proof of exclusive ownership. (Huang vs. Court of Appeals, 236 SCRA 420 [1994]; Salvador vs. Court of Appeals, 243 SCRA 239 [1995].) An action to compel the trustee to convey property registered in his name for the benefit of the *cestui que trust* does not prescribe unless the trustee repudiates the trust. (Viloria vs. Court of Appeals, 309 SCRA 529 [1999].) A denial of the trust made by a trustee to one who at the time of such repudiation is a minor,

does not have the effect of abrogating the trust relation. (Castro vs. Castro, 57 Phil. 675 [1933].)

In *Pangan vs. Court of Appeals* (166 SCRA 375 [1988].), the Supreme Court had occasion to lay down specific acts which are considered as acts of repudiation:

(a) Filing by a trustee of an action in court against the trustor to quiet title to property, or for recovery of ownership thereof, held in possession by the former, may constitute an act of repudiation of the trust reposed on him by the latter.

(b) The *issuance of the certificate of title* would constitute an open and clear repudiation of any trust, and in the lapse of more than 20 years, open and adverse possession as owner would certainly suffice to vest title by prescription.

(c) An action for the reconveyance of land based on implied or constructive trust prescribes within 10 years. And it is from the date of the *issuance of such title* that the effective assertion of adverse title for purposes of the statute of limitations is counted.

(d) The prescriptive period may only be counted from the time petitioners repudiated the trust relation in 1955 upon the *filing of the complaint for recovery of possession* against private respondents so that the counterclaim of the private respondents contained in their amended answer wherein they asserted absolute ownership of the disputed realty by reason of the continuous and adverse possession of the same is well within the 10-year prescriptive period.

(e) There is clear repudiation of a trust when one who is an apparent administrator of property causes the cancellation of the title thereto in the name of the apparent beneficiaries and gets a new certificate of title in his own name.

(f) It is only when the defendants, alleged co-owners of the property in question, *executed a deed of partition and on the strength thereof obtained the cancellation of the title* in the name of their predecessor and the issuance of a new one wherein they appear as the new owners of a definite area each, thereby in effect denying or repudiating the ownership of one of the

plaintiff's over his alleged share in the entire lot, that the statute of limitations started to run for the purposes of the action instituted by the latter seeking a declaration of the existence of the co-ownership and of their rights thereunder. (see Salvador vs. Court of Appeals, *supra*.)

Prescriptibility of action for reconveyance based on implied trust.

(1) *Period of prescription.* — An action for reconveyance is a legal remedy granted to a rightful owner of land wrongfully or erroneously registered under the Torrens System in the name of another to compel the latter to reconvey the land to him even after one (1) year from the issuance of the decree of registration, for such action does not seek to set aside the decree which is respected as incontrovertible and no longer open to review, but instead seeks to transfer or reconvey the land wrongfully or erroneously registered in another person's name from said registered owner to the rightful owner or to one with a better right. (Esconde vs. Borlongay, 152 SCRA 603 [1987]; Tomas vs. Court of Appeals, 185 SCRA 627 [1990]; Caro vs. Sucaldito, 458 SCRA 595 [2005].)

It is now well-settled that an action for reconveyance to enforce an implied trust in one's favor prescribes in ten (10) years[3] (Amerol vs. Bagumbaran, 154 SCRA 396 [1987]; Cuaycong vs. Cuaycong, 21 SCRA 1192 [1967]; Carantes vs. Court of Appeals, 76 SCRA 514 [1977]; Jaramil vs. Court of Appeals, 78 SCRA 420 [1977]; Vda. de Nacalaban vs. Court of Appeals, 80 SCRA 428 [1977]; Armamento vs. Guerrero, 96 SCRA 178 [1980]; Amansec vs. Melendez, 98 SCRA 639 [1980]; Heirs of Maria R. Vda. de Vega vs. Court of Appeals, 199 SCRA 168 [1991]; Tale vs. Court

[3]The prescription of an action and the acquisitive prescription of ownership are two different things. For example, the action by the heirs for partition does not prescribe, but the defendant may raise the defense of acquisitive prescription. Similarly, the imprescriptibility of an action to annul a void contract does not necessarily mean that the plaintiff is perpetually allowed to recover the property, subject of the void contract, for ownership may have been lost through prescription or laches in the interval during which he slept over his right. Simply put, the imprescriptibility of an action is distinct from the prescription of ownership and rights. (Vda. De Rigonan vs. Derecho, 463 SCRA 627 [2005].)

of Appeals, 208 SCRA 266 [1992]; Vda. De Gualberto vs. Go, 463 SCRA 671 [2005].) from the time the right of action accrues, the action being based upon an obligation created by law (see Art. 1144[2].) because just as a resulting trust is an offspring of the law, so is the corresponding obligation to convey the property to the true owner. (Huang vs. Court of Appeals, 236 SCRA 420 [1994].)

It is incumbent upon the party who sets up the defense of prescription (affirmative) to prove the date from which the prescriptive period began to run. (Aznar Brothers Realty Co. vs. Court of Appeals, 458 SCRA 96 [2005].)

(2) *Where person claiming to be owner in actual possession of property.* — The prescriptive rule applies only when the plaintiff or the person enforcing the trust is not in possession of the contested property, since if a person claiming to be the owner thereof is in actual possession of the property, the right to seek reconveyance, which, in effect, seeks to quiet title to property (see Arts. 476-481.), does not prescribe (Heirs of Jose Olviga vs. Court of Appeals, 227 SCRA 330 [1993]; Vda. de Esconde vs. Court of Appeals, 253 SCRA 66 [1996]; Viloria vs. Court of Appeals, 309 SCRA 529 [1999]; Reyes vs. Court of Appeals, 315 SCRA 626 [1999]; Development Bank of the Phils. vs. Court of Appeals, 331 SCRA 267 [2000]; Philippine Economic Zone Authority vs. Fernandez, 358 SCRA 489 [2001]; Vda. de Retuerto vs. Barz, 372 SCRA 712 [2001]; Delfin vs. Villones, 485 SCRA 38 [2006]; Heirs of S. Hermosella vs. Remoquillo, 523 SCRA 403 [2007].), for he may wait until his possession is disturbed or his title is attacked before taking steps to vindicate his right.

The reason for the rule is that his undisturbed possession gives him the continuing right to seek the aid of a court of equity to ascertain and determine the nature of the adverse claim of a third party and its effect on its own title, which right can be claimed only by one who is in possession. (Vda. de Cabrera vs. Court of Appeals, 267 SCRA 339 [1997].) The owner of real estate has possession either when he himself is physically in occupation of the property, or when another person who recognizes his rights as owner is in such occupancy. (Reyes vs. Court of Appeals, *supra*; see Art. 524.)

(3) *When prescriptive period begins to run.* — The ten-year period[4] of prescription of an action for reconveyance[5] of property (real or personal) based on an implied trust starts from the moment the law creates the trust (when the cause of action arises) because the so-called trustee does not recognize any trust, and has no intention to hold for the beneficiary. (see Repique vs. Padilla, [C.A.] No. 26617-R, Feb. 6, 1965; Diaz vs. Garricho, 103 Phil. 244 [1958]; Ecsay vs. Court of Appeals, 61 SCRA 369 [1974]; Salao vs. Salao, 70 SCRA 65 [1976].)

(a) It has been held that where the action for reconveyance of real property is based on constructive trust (see Art. 1456.) resulting from its fraudulent registration in the name of another, the action may be filed from the discovery of the fraud or notice thereof, which is deemed to have taken place from the inscription of the instrument and/or the issuance of the

[4]In the case of *De la Cerna vs. De la Cerna* (72 SCRA 515 [1976]), the Supreme Court stated that an action founded exclusively on fraud prescribes in four (4) years and one based on constructive trust is barred after ten (10) years. (see also Fabian vs. Fabian, 22 SCRA 231 [1968]; Guerrero vs. Court of Appeals, 126 SCRA 109 [1983]; Marcopper Mining Corp. vs. Garcia, 143 SCRA 178 [1986]; Bejoc vs. Cabreros, 464 SCRA 78 [2005].)

In *Balbin vs. Medalla* (108 SCRA 666 [1981]), the court, in holding that the prescriptive period for a reconveyance action is four years, erroneously relied on *Gerona vs. de Guzman* (11 SCRA 153 [1964]). But in *Gerona*, the fraud was discovered on June 25, 1948, before the effectivity of the new Civil Code on August 30, 1950; hence, Section 43(3) of the old Code of Civil Procedure (Act No. 190.) was applied. (Amerol vs. Bagumbaran, *supra.*) According to *J.*, Padilla, concurring and dissenting, in the Amerol case, "if the fraud committed was but an incident to the registration of land *(dolo incidente),* the action for reconveyance prescribes in ten years. But where it is necessary to annul a deed or title before relief could be granted, as when fraud, which vitiates consent *(dolo causante),* is alleged to have been committed in the execution of the deed which became the basis for the registration of a parcel of land, the action for reconveyance should be filed within four years from the discovery of the fraud."

In *Tale vs. Court of Appeals* (208 SCRA 206 [1992].), the Supreme Court categorically ruled that an action for reconveyance based on an implied trust prescribes in 10 years, and not otherwise, thereby modifying previous decisions holding that the prescriptive period was four (4) years. (O'laco vs. Co Cho Chit, 220 SCRA 656 [1993].)

[5]In an action for reconveyance, the decree of registration is respected as incontrovertible. What is sought instead is the transfer of the property, *i.e.*, the title thereof, which has been wrongfully or erroneously registered in another person's name, to its rightful and legal owner, or to one with a better right. (Amerol vs. Bagumbaran, *supra.*) If the property has passed into the hands of an innocent purchaser for value, the remedy of the landowner is to bring an action for damages. (Quiniano vs. Court of Appeals, 39 SCRA 221 [1971]; Alvarez vs. Intermediate Appellate Court, 185 SCRA 8 [1990]; Pasiño vs. Monterroyo, 560 SCRA 739 [2008]; Daclag vs. Macabulig, 560 SCRA 137 [2008].)

new certificate of title by virtue thereof.[6] (see Vda. de Buncio vs. De Leon, 156 SCRA 352 [1987]; Gerona vs. De Guzman, 11 SCRA 153 [1964]; Salvatierra vs. Court of Appeals, 73 SCAD 586, 260 SCRA 45 [1996]; Leyson vs. Bontuyan, 452 SCRA 94 [2005].)

The reference point is the date of registration of the deed or the date of issuance of said new certificate of title of the property which constitutes constructive notice to the public.[7] (Jaramil vs. Court of Appeals, *supra*; Duque vs. Domingo, 80 SCRA 654 [1977]; Vda. de Nacalaban vs. Court of Appeals, *supra.*; Vda. de Pama vs. Pama, 124 SCRA 377 [1983]; Caro vs. Court of Appeals, 180 SCRA 401 [1981]; Vda. de Cabrera vs. Court of Appeals, 267 SCRA 339 [1997]; Manangan vs. Delos Reyes, 308 SCRA 139 [1999]; Villanueva-Mijares vs. Court of Appeals, 330 SCRA 349 [2000]; Vda. de Delgado vs. Court of Appeals, 363 SCRA 758 [2001]; Aznar Brothers Realty Co. vs. Court of Appeals, 458 SCRA 496 [2005].) It constitutes an open and clear repudiation of the alleged fiduciary or trust relationship and the lapse of ten years of adverse possession is sufficient to vest title by adverse possession. (Delima vs. Court of Appeals, 201 SCRA 641 [1991].) This rule applies only to the remedy of reconveyance which has its basis on Section 53 (par. 3.) of P.D. No. 1529, otherwise known as the Property Registration Decree and Article 1456 of the Civil Code. Reconveyance is available in case of registration of property procured by *fraud,* thereby *creating* a constructive

[6]The registration of the instrument must be done in the proper registry, in order to affect and bind the land and operate as constructive notice to the world. Thus, if the land is registered under the Land Registration Act (Act No. 496.) or the Property Registration Decree (Pres. Decree No. 1529.) and has, therefore, a torrens title, and it is sold but the subsequent sale is registered not under the Act or Decree but under Act No. 3344, covering transactions affecting real estate not registered under the torrens system, such sale is not considered registered. (Spouses Abrigo vs. De Vera, 432 SCRA 544 [2004]; Aznar Brothers Penalty Co. vs. Court of Appeals, 458 SCRA 96 [2005].)

[7]In *Bueno vs. Reyes* (29 SCRA 1179 [1969].), where A, in violation of his agreement, instead of registering the property in B's name, registered the same in his (A's) and his brothers' names, the Supreme Court held that where the constructive trust arose by reason of "bad faith or mistake," the cause of action must be deemed to have accrued only upon discovery of such bad faith or mistake, which in this case, was held to start from the discovery of the registration by A of the disputed property.

trust between the parties. (Huang vs. Court of Appeals, 236 SCRA 420 [1994].)

(b) In another case, however, where the ownership of land was sold fictitiously to avoid a foreclosure of mortgage, it was ruled that the ten-year prescriptive period should be counted not from the registration of the simulated sale (see Arts. 1345, 1346.), but from the date of recording of the release of mortgage, on which date the *cestui que trust* was charged with the knowledge of the settlement of the mortgage obligation, the attainment of the purpose for which the trust was created. (Tongoy vs. Court of Appeals, 123 SCRA 99 [1983].)

(c) If the legitimate owner of the subject property which was fraudulently registered in the name of another had always been in possession thereof, the constructive notice rule cannot be applied. The action for reconveyance is in reality an action to quiet title; therefore, the action is imprescriptible. (Caragay-Layno vs. Court of Appeals, 133 SCRA 718 [1984].) Actions for reconveyance grounded on the nullity of the conveyance of the subject property are imprescriptible. (Agne vs. Director of Lands, 181 SCRA 793 [1990].)

(d) In a case, where the registration under the Torrens System was secured through fraudulent misrepresentation, the period was reckoned not from the date of registration but from the time the true owner actually discovered the act of defraudation. The Torrens title, according to the Supreme Court, does not furnish a shield for fraud. (Adille vs. Court of Appeals, 157 SCRA 455 [1988]; see Art. 1456.) In the absence of fraud, the period should be counted from the date adverse title was asserted, that is, from the registration of the title. (see Ramos vs. Intermediate Appellate Court, 175 SCRA 70 [1989].)

(e) Generally, an action for reconveyance of real property based exclusively on fraud prescribes in four (4) years from the discovery of the fraud;[8] such discovery is deemed to have

[8]The four-year period applies if the complaint seeks to annul a voidable contract under Articles 1390 and 1391 of the Civil Code.

taken place upon the issuance of the certificate of title over the property. If the action is based on implied or constructive trust, it prescribes in 10 years from the alleged fraudulent registration or date of issuance of the certificate of title over the property. (see Art. 1456.) Since such registration or issuance operates as a constructive notice to the whole world, the discovery is deemed to have taken place at that time. (Bejoc vs. Cabreros, 464 SCRA 78 [2005].) This is the general rule. It has been held, however, that where the defendant acted in bad faith in securing title over real property, he is not entitled to the protection of the law for the law cannot be used as a shield for frauds and the prescriptive period for the filing of the action for reconveyance based on implied trust must be reckoned from the *actual* discovery of the fraud where such discovery was made *after* the date of registration. (see Government Service Insurance System vs. Santiago, 414 SCRA 563 [2003]; Adille vs. Court of Appeals, *supra*; Samonte vs. Court of Appeals, 361 SCRA 173 [2001].)

(3) *Where rights of the beneficiary are recognized by the trustee.* — In such case, the ten-year period of prescription commences to run from the time the trustee begins to assert his title or repudiate the trust, or to hold adversely, as when the trustee files an ejectment suit against the beneficiary (Repique vs. Padilla, [C.A.] No. 26617-R, Feb. 6, 1963; Coronel vs. Pecson, [C.A.] 67 O.G. 8139; see also Buencamino vs. Matias, 16 SCRA 849 [1966].), or when he registers the deed of assignment of property to him and secures the cancellation of the certificate of title in the name of the former owner, and the issuance of new certificate of title in his own name, or when he sells portions of the property. The exercise of such rights of dominion is anathema to the concept of a continuing and subsisting trust. (Carantes vs. Court of Appeals, 76 SCRA 514 [1977].)

Continuous recognition of a resulting trust precludes any defense of prescription or laches in a suit to declare and enforce the trust. (Buencamino vs. Matias, *supra*.) Where the predecessor-in-interest of the claimant has appeared to be the registered owner of the property under the Torrens System for more than 30 years, his title has become indefeasible and his dominical rights over it

can no longer be challenged. In such case, any insinuation as to the existence of an implied or constructive trust should not be allowed. (Gonzales vs. Intermediate Appellate Court, 204 SCRA 106 [1991].)

ILLUSTRATIVE CASE:

When failure to pay share of one of co-owners as promised by new co-owner (buyer from a co-owner) will constitute an act of repudiation.

Facts: A, etc. and B are the co-owners of a fishpond which they inherited from their parents. Without the knowledge of A, etc., B sold his undivided share to C in a private contract of sale. A, etc. brought action to recover their shares against C who relied on the defense of prescription in resisting the action, alleging adverse possession. C argues that he has not been giving A, etc. their share of the fish harvested and by such act, he has shown repudiation of the trust which may have been created.

It appears, however, that C had promised one of the heirs (A, etc.) to pay him for his share in the fishpond. No date has been fixed for the fulfillment of the promise. C has not paid as promised.

Issue: Does the failure of C to pay constitute a repudiation of the trust?

Held: No. (1) *No unequivocal act of refusal to make payment.* — The promise made by C interrupted his possession as a source of prescriptive rights. It manifested his continuing recognition of the right of A, etc. as long as the promise was not expressly withdrawn. To constitute the failure to pay as promised as an act of repudiation of the trust, or as a manifestation of adverse possession, there should be an unequivocal act of refusal to make payment, or a definite reneging from the promise. This can happen only if a date has been fixed for the fulfillment of the promise, but the period had lapsed without the promise having been redeemed.

(2) *New co-owner's possession not completely adverse or open.* — Furthermore, it appearing that the tax declaration to the property remained in the parents of A, etc., C's possession was not completely adverse or open, nor was it truly in the concept

> of an owner, which are indispensable elements for prescription to become legally effective as a means of acquiring real property. Finally, when one harvests from a fishpond of which is only a part-owner, it must be assumed that his harvest is only to the extent he is rightfully entitled to, until the contrary is positively shown. *(Sunga vs. De Guzman, 90 SCRA 618 [1979].)*

(4) *When tacking of possession not permitted.* — When a person through fraud succeeds in registering a land in his name, the law creates what is called a constructive trust in favor of the defrauded party. (see Art. 1456.) The latter is granted the right to recover the property fraudulently registered within the period of ten (10) years.

In the computation of time necessary for prescription, the present possessor may complete the period necessary for prescription by tacking his possession to that of his grantor. (see Art. 1138.) This rule, however, applies only where there is privity between successive possessors. It does not apply where the possessor came into possession of the property in dispute by virtue of sale that is null and void *ab initio* because the sale was entered into contrary to public policy or is absolutely fictitious or simulated. (Ruiz vs. Court of Appeals, 79 SCRA 525 [1977].)

(5) *Where property in possession of third person.* — The only limitation upon the right of the beneficiary to recover title over the property held in trust is that the same must not have been transferred to an innocent purchaser for value in which event, his remedy is to ask for damages. (Bogayos vs. Guilao, 64 Phil. 347 [1937]; Rosario vs. Rosario, 101 Phil. 972 [1957]; see Khemani vs. Heirs of A. Trinidad, 540 SCRA 83 [2007].)

In a case, however, the claim by the respondent that reconveyance would not be legally possible because the property under litigation has already been mortgaged by him to a bank was held untenable for, otherwise, the judgment for reconveyance could be negated at the will of the holder of the title by the simple expedient of constituting a mortgage or other encumbrance on the property. Being doubly in bad faith, the respondent must suffer the consequences. Given the undisputed facts of the case, the mortgage was declared void and its consequences were left

between the mortgagor and the mortgagee. The Court observed that the mortgagee might even be faulted for not making the requisite investigation on the possession of the land mortgaged. (Amerol vs. Bagumbaran, *supra*.)

Laches in action to enforce a trust.

(1) *In case of express trusts.* — A *cestui que trust* is entitled to rely upon the fidelity of the trustee. Laches applies from the time the trustee openly denies or repudiates the trust and the beneficiary is notified thereof, or is otherwise plainly put on guard against the trustee. (54 Am. Jur. 558-559.) The repudiation of the trust must be clearly proved by the trustee. (Guzman vs. Aquino, 40 SCRA 236 [1970].)

In express trusts, the delay of the beneficiary is directly attributable to the trustee who undertakes to hold the property for the former, or who is linked to the beneficiary by a confidential or fiduciary relation. The trustee's possession is, therefore, not adverse to the beneficiary until and unless the latter is made aware that the trust has been repudiated. In constructive trusts (that are imposed by law), there is neither promise nor fiduciary relation. (Diaz vs. Gorricho, 103 Phil. 261 [1958].)

When it does not appear when the trustee repudiated the existence of the fiduciary relation, the same shall be taken to have been made only upon the filing of his answer to the complaint. (Buencamino vs. Matias, 16 SCRA 849 [1966].)

(2) *In case of implied trusts.* — It is well-established in American law of trusts (expressly made applicable by Art. 1442.) that implied trusts, as distinguished from express trusts, may be barred not only by prescription but also by laches. (Caridad vs. Henarez, [Unrep.] 97 Phil. 973 [1955]; Fabian vs. Fabian, 22 SCRA 231 [1968]; Vda. De Rigonan vs. Derecho, 463 SCRA 627 [2005]; Pilapil vs. Heirs of M.R. Briones, 514 SCRA 197 [2007].) Laches constitutes a defense to suit to declare and enforce an implied trust, and for the purpose of the rule, express repudiation is not required, unless the trustee fraudulently and successfully conceals the facts giving rise to the trust. (54 Am. Jur. 409; Fabian vs. Fabian, 22 SCRA 231 [1968].) Inasmuch as the so-called

trustee in a constructive or implied trust does not recognize any trust, and has no intent to hold for the beneficiary, the latter is not justified in delaying action to recover his property. It is his fault if he delays. If he so delays, his action may be barred by laches or extinctive prescription. (Diaz vs. Gorricho, *supra*.) The law protects those who are vigilant of their rights.

It is well-settled that the negligence or omission to assert a right within a reasonable time warrants not only a presumption that the party entitled to assert it either had abandoned it or declined to assert it but also casts doubt on the validity of the claim, since it is human nature for persons to assert their rights most vigorously when threatened or invaded. Such undue neglect or delay to assert a right taken in conjunction with the lapse of time, more or less great, and other circumstances causing prejudice to the adverse party, operates as a bar in equity.[9] (Guerrero vs. Court of Appeals, 126 SCRA 109 [1983]; Gonzales vs. Intermediate Appellate Court, 204 SCRA 106 [1992].)

The defense of laches is an equitable one and does not concern itself with the character of the defendant's title but only with whether or not by reason of plaintiff's long inaction or inexcusable neglect, he should be barred from asserting his claim at all, because to allow him to do so would be inequitable and unjust to defendant. Laches is not concerned merely with lapse of time, unlike prescription. While the latter deals with the fact of delay, laches deals with the effect of unreasonable delay. (Palmera vs. Civil Service Commission, 235 SCRA 87 [1994]; Vda. de Cabrera vs. Court of Appeals, 267 SCRA 339 [1997].)

[9]Thus, in *Phil. National Bank vs. Court of Appeals* (217 SCRA 347 [1993].), the Supreme Court ruled that although only seven (7) years had elapsed after the petitioner bank erroneously credited the private respondent with the amount claimed by it (bank), the claim was already barred by laches. "Petitioner would attribute its mistake to the heavy volume of international transactions handled by the bank. Such specious reasoning is not persuasive. It is unbelievable for a bank, and a government bank at that which regularly publishes its balanced financial statements, annually or more frequently, by the quarter, to notice its error only seven (7) years later. As a universal bank with worldwide operations, PNB cannot afford to commit such costly mistakes. Moreover, as between parties where negligence is imputable to one and not to the other, the former must perforce bear the consequences of its neglect. Hence, petitioner should bear the cost of its own negligence."

The doctrine of laches, however, is less strictly applied between near relatives than when the parties are strangers to each other. The existence of a confidential relationship is an important consideration as it tends to excuse an otherwise unreasonable delay. (Sotto vs. Teves, 86 SCRA 154 [1978].) Where a party clearly has no cause of action, the issue of prescription or laches becomes irrelevant. (Homena vs. Casa, 157 SCRA 232 [1988].)

ART. 1448. There is an implied trust when property is sold, and the legal estate is granted to one party but the price is paid by another for the purpose of having the beneficial interest of the property. The former is the trustee, while the latter is the beneficiary. However, if the person to whom the title is conveyed is a child, legitimate or illegitimate, of the one paying the price of the sale, no trust is implied by law, it being disputably presumed that there is a gift in favor of the child.[10]

Sale to a party but price paid by another.

(1) *General rule.* — A resulting trust arises in favor of a person from whom a consideration comes for a conveyance of property, whether realty or personalty, to another. The presumption is that he who pays for a thing intends a beneficial interest therein for himself. (Huang vs. Court of Appeals, 236 SCRA 420 [1994]; Intestate Estate of A.T. Ty vs. Court of Appeals, 356 SCRA 661 [2001].) The trust created is sometimes referred to as a *purchase money resulting trust.* It is created in order to effectuate what the law presumes to have been the intention of the parties in the circumstances that the person to whom the land was conveyed held it as trustee for the person who supplied purchase money. It is essential that (a) there be an actual payment of money, property, or service, or an equivalent constituting valuable consideration

[10]Article 1448 was held not applicable where the transaction took place before the Civil Code became effective on August 30, 1950. (Banawa vs. Miraseo, 97 SCRA 517 [1980].)

(54 Am. Jur. 158-159.) and (b) such consideration must be furnished by the alleged beneficiary of a resulting trust. The trust created is sometimes referred to as a *purchase money resulting trust.* (Morales vs. Court of Appeals, 274 SCRA 282 [1997], citing 76 Am. Jur. 2d, Trusts, Secs. 179-180 [1992]; Camilang vs. Burcena, 482 SCRA 342 [2006]; Herbon vs. Polad, 495 SCRA 544 [2006].)

The trust is rebuttable by proof of a contrary intention of the person from whom the consideration comes, and such proof may be by parol evidence. The trust results only in favor of one advancing the consideration, and not in favor of one for whose benefit the purchase may have been made. (54 Am. Jur. 158.)

(2) *Exceptions.* — However, no trust is implied if the person to whom the legal estate is conveyed is a child, legitimate or illegitimate, of the payor, because it is presumed that a gift or donation was intended in favor of the child. This presumption of a gift is rebuttable by proof of a contrary intention, and on such rebuttal, a resulting trust arises. (see *Ibid*., 160.) The reason for the presumption lies in the fact that the trustee may be under a disability. Besides, it is unnatural that a parent could convey in a roundabout manner his property to his direct heirs (children) as trustee if he could do it directly by way of gift.

The parties must necessarily be subject to the same limitations on allowable stipulations in ordinary contracts. What the parties then cannot expressly provide in their contracts for being contrary to law, morals, good customs, public order, or public policy (Art. 1306.), they cannot impliedly or implicitly do so in the guise of a resulting trust. Thus, if the purpose of the payor of the consideration in having title placed in the name of another was to evade some rule of law, the courts will not assist the payor in achieving his improper purpose (*e.g*., an alien or applicant who is ineligible to hold title to land, who used a person as a dummy) by enforcing a resulting trust for him in accordance with the "clean hands" doctrine. The trust is invalid if its enforcement would be against public policy, even though its performance does not involve the commission of a criminal or tortious act by the trustee. However, the court, on equitable grounds, may allow the payor to recover what he had paid with

legal interest. (Ramos vs. Court of Appeals, 232 SCRA 348 [1994]; Pigao vs. Rabanillo, 488 SCRA 546 [2006].)

EXAMPLE:

A property is sold to X who acquires title but the price is paid by Y for the purpose of having the beneficial interest in the property. By operation of law, an implied trust arises with X as the trustee and Y, the beneficiary.

If X is the legitimate or illegitimate child of Y, no trust is implied by law. It is disputably presumed that there is a gift in favor of X, and consequently no trust is created in favor of Y, absent any clear proof to rebut the presumption.

ILLUSTRATIVE CASE:

Vendee of a parcel of land paid in the name of vendor the purchase price due from the latter to a third person, with title being subsequently issued in name of such vendor.

Facts: A and his brother B bought each a lot. After paying the first two installments corresponding to his lot, B sold his interest therein to A who then reimbursed him the amount he had already paid, and thereafter continued payment of the remaining installments until the whole purchase price had been fully satisfied.

Although B had no more interest over the lot, the subsequent payments made by A until fully paid were made in the name of B with the understanding that the necessary documents of transfer will be made later, "the transaction being from brother to brother." A transfer certificate of title was issued to B.

The heirs of A brought action against the heirs of B for the reconveyance of the property.

Issue: Was there an express trust or an implied trust?

Held: The trust created is an implied trust. It is apparent that A who furnished the consideration intended to obtain a beneficial interest in the property in question. Having supplied the purchase money, it may naturally be presumed that he intended the purchase for his own benefit. The property was acquired by B under circumstances which show that it was conveyed to him on the faith of his intention to hold it for, or convey it to, the grantor A. *(Heirs of Candelaria vs. Romero, 109 Phil. 500 [1960].)*

Purchase by a person with his own funds for another.

One corollary of the rule that a conveyance to one person on a consideration from another raises a resulting trust in favor of the latter is that purchase by one person, on a consideration furnished by himself, where he takes the conveyance in the name of another, raises a resulting trust in favor of the former.

The rule rests on the presumption or implication of law of the intention of the purchaser that he intends the purchase for his own benefit and the conveyance in the name of another as a matter of convenience or arrangement for collateral purposes. (54 Am. Jur. 161-162; see Art. 1455.) The trust which results under such circumstances does not arise from contract or agreement of the parties, but from the facts and circumstances, that is to say, it results because of equity and arises by implication or operation of law. (Lim vs. Court of Appeals, 65 SCRA 160 [1975].)

ILLUSTRATIVE CASE:

A person, to prevent sale at public auction of forfeited real estate belonging to another, paid the delinquent taxes due on the property.

Facts: To prevent the eventual sale at public auction of the land of A (deceased owner) which was forfeited by the Government for delinquency in payment of real estate taxes, B paid the delinquent taxes and accepted receipts for payments issued in the name of A.

Issue: Did B acquire the rights of A in and to said property by reason of said payments?

Held: No. B became a trustee of the land for the benefit of the heirs of A. *(Villarta vs. Cuyno, 17 SCRA 100 [1966].)*

ART. 1449. There is also an implied trust when a donation is made to a person but it appears that although the legal estate is transmitted to the donee, he nevertheless is either to have no beneficial interest or only a part thereof.

Donation to a person but beneficial interest vested in another.

An implied trust arises on a donation of property where it appears that although the legal estate is transmitted to the donee, he is to have no beneficial interest or only a part thereof. In such case, a trust results in favor of the person in whom it is intended to vest the beneficial interest in the property donated, with the donee being the trustee.[11]

EXAMPLE:

Property is donated by A to B but only the legal title is transmitted to B, the beneficial ownership of the whole property or a part thereof being vested in C.

Here, a trust is established by implication of law with B as the trustee and C, the beneficiary.

ART. 1450. If the price of a sale of property is loaned or paid by one person for the benefit of another and the conveyance is made to the lender or payor to secure the payment of the debt, a trust arises by operation of law in favor of the person to whom the money is loaned or for whom it is paid. The latter may redeem the property and compel a conveyance thereof to him.

Purchase with borrowed funds.

(1) *Trust in favor of lender.* — The general rule is that the use of borrowed money in making a purchase *does not* raise a resulting trust in favor of the lender, even where the money is loaned to enable the borrower to purchase the property in question and the borrower promises, but fails, to execute a mortgage on the property after it is purchased to secure the loan. Nor does the use of money given to one for the purchase of property raise a resulting trust on the property in favor of the donor. (54 Am. Jur. 163.)

[11] Art. 1061. Every compulsory heir, who succeeds with other compulsory heirs, must bring into the mass of the estate any property or right which he may have received from the decedent, during the lifetime of the latter, by way of donation, or any other gratuitous title, in order that it may be computed in the determination of the legitime of each heir, and in the account of the partition. (1035a)

(2) *Trust in favor of borrower.* — When money is borrowed to purchase property, and the conveyance is made, not to the borrower, but to the lender who takes title to the property in his own name in order to secure the loan, a resulting trust in the property, binding the lender or payor (trustee) in favor of the borrower (beneficiary), arises. In this case, the real purchaser is the borrower. After payment of the amount loaned or paid, he has the right to redeem the property and compel a conveyance thereof to him (Art. 1450; Trinidad vs. Ricafort, 7 Phil. 449 [1907].), even if there is no mention of the interest of the borrower in the title of the lender.

An agreement between the parties whereby the property purchased shall be considered sold to the trustee in case the beneficiary fails to reimburse him is tantamount to a *pactum commissorium,* which is expressly prohibited by Article 2088 of the Civil Code[12] for in such case there would be automatic appropriation of the property by the trustee in the event of failure of the beneficiary to pay the loan. (Nakpil vs. Intermediate Appellate Court, 225 SCRA 456 [1993].)

EXAMPLE:

A buys a land in his own name from B with money borrowed from or paid by C. There is no trust here. The relation between A and C is that of debtor and creditor.

If the property is conveyed to C to secure the amount advanced, an implied trust is created by operation of law. C becomes the trustee and A, the beneficiary. But it is only after A reimburses C of the purchase price that the former can compel conveyance of the purchased property from the latter.

ART. 1451. When land passes by succession to any person and he causes the legal title to be put in the name of another, a trust is established by implication of law for the benefit of the true owner.

[12]Art. 2088. The creditor cannot appropriate the things given by way of pledge or mortgage, or dispose of them. Any stipulation to the contrary is null and void. (1859a)

Legal title to land inherited by heir placed in name of another.

Succession is a mode of acquisition by virtue of which the property, rights, and obligations to the extent of the value of the inheritance, of a person are transmitted through his death to another or others either by his will or by operation of law. (Art. 774.) The rights to the succession are transmitted from the moment of the death of the decedent. (Art. 777.)

Where a person who has acquired land by inheritance causes the legal title to be placed in the name of another, a resulting trust is presumed in law in favor of the true owner, the heir. (see Custodio vs. Casiano, 9 SCRA 841 [1963].) Here, the heir himself by his voluntary action, causes the registration of his legal title under the name of another person. (Pilapil vs. Heirs of M.R. Briones, 484 SCRA 308 [2006].) Where, through fraudulent representations or by pretending to be the sole heir of the deceased, an heir succeeded in having the original title of a land in the name of the deceased cancelled and a new one issued in his name thereby enabling him to possess the land and get its produce, there is created what is called "constructive trust" in favor of the defrauded. (Baysa vs. Baysa, [C.A.] 53 O.G. 728, Oct. 2, 1957.)

No trust relationship can exist over a property in favor of an heir as beneficiary where it appears that the deceased predecessor had no title to the property in question. (De la Cruz vs. De la Cruz, 130 SCRA 666 [1984].)

ART. 1452. If two or more persons agree to purchase property and by common consent the legal title is taken in the name of one of them for the benefit of all, a trust is created by force of law in favor of the others in proportion to the interest of each.

Legal title to property purchased taken in one co-owner.

Where property is purchased by two or more persons and by common consent the legal title is placed in the name of only one

of the co-owners for the benefit of all, a trust arises by implication of law in favor of the others in proportion to the interest of each. (see Valdez vs. Olorga, 51 SCRA 71 [1973]; Nito vs. Court of Appeals, 225 SCRA 231 [1993].)

The property must be capable of private ownership; otherwise, Article 1452 is not applicable, as in the case of a fishpond of public domain the title to which remains in the Government. (Deluao vs. Casteel, 29 SCRA 350 [1969].)

ILLUSTRATIVE CASES:

1. *The agreement of the parties is that the property would be bought in the name and for the account of the two of them and the third would be paid a commission as compensation on the sale of the property.*

Facts: Although the original proposal was for the parties to purchase the property jointly, the same was abandoned and the parties subsequently agreed that A and B would buy the property exclusively in their names and for their own account, to avoid the difficulties to be encountered in acquiring the property in common.

C accepted this proposition with the understanding that the property would be sold as soon as a buyer who can pay P300,000.00 could be found, with the obligation on the part of A and B to pay C 20% of the proceeds after deducting the purchase price thereof.

Issue: Is Article 1452 applicable?

Held: No, because nothing contained in the agreement would indicate that the property was being purchased for the benefit of A, B, and C. The recitals in the contract containing the obligation assumed by A and B merely refer to the services rendered by C as broker who negotiated the sale of the property to A and B, and which A and B agreed to compensate. The terms of the contract admit no doubt that the 20% to be paid C is of any amount which may be obtained by the sale of the property after deducting the purchase price therefor, which shall be taken from the liquidated benefit obtained by the owners out of the sale of said property.

Neither is Article 1453 applicable, because there is absolutely nothing in the agreement which even remotely indicates

that the property was conveyed to A and B in reliance upon their declared intention to hold it for, or transfer it to another or the grantor. *(Calero vs. Carrion, 107 Phil. 549 [1960].)*

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2. *Title to property purchased with funds furnished by members of an association without legal personality was placed in the name of one of them.*

Facts: A number of Chinese merchants raised a fund by voluntary subscription with which they purchased a valuable tract of land and erected a large building to be used as a sort of club house for the mutual benefit of the subscribers to the fund. The subscribers organized themselves into an irregular association, which had no regular articles of association and was not registered in any commercial registry or elsewhere.

The association not having any existence as a legal entity, it was agreed to have the title to the property placed in the name of A, one of the members of the association.

Issue: Has A the right to set up title in himself to the club property as well as to the rents accruing therefrom?

Held: No. The evidence clearly discloses not only that the funds with which the property in question was purchased were furnished by the members of the association but that A, in whose name it was registered, received and holds the property as the agent and trustee of the association. In this case, the legal title of A is not questioned and the other members of the association do not seek such cancellation but they maintain that A holds it under an obligation, both express and implied, to deal with it exclusively for the benefit of the members of the association and subject to their will. (*Uy Aloc vs. Cho Jan Ling, 19 Phil. 202 [1911];* see Compania General de Tabacos vs. Topino, 54 Phil. 33 [1929]; Martinez vs. Martinez, 1 Phil. 647 [1902].)

ART. 1453. When property is conveyed to a person in reliance upon his declared intention to hold it for, or transfer it to another or the grantor, there is an implied trust in favor of the person whose benefit is contemplated.

Conveyance under a promise to hold for, or transfer to another.

The trust established by virtue of this article is based on the promise or representation of the grantee to hold the property conveyed for, or transfer it to another or the grantor. The grantee is estopped from asserting ownership in himself by denying his representation as against the person for whose benefit the implied trust is created.

The rule in Article 1453 is founded upon equity, particularly where on the faith of the agreement or understanding, the grantee is enabled to gain an advantage in the purchase of the property or where the consideration or part thereof has been furnished by or for another. Thus, it has been held that where property is taken by a person under an agreement to hold it for or convey it to another or to the grantor, or on certain conditions, a trust results for the benefit of such other or his heirs, which equity will enforce according to the agreement. (89 C.J.S. 960; Heirs of Candelaria vs. Romero, 109 Phil. 500 [1960]; Rosario vs. Court of Appeals, 310 SCRA 464 [1999].)

Likewise, a person who, before consolidation of property in the purchaser under a contract of sale with *pacto de retro*, agrees with the vendors to buy the property and administer it until all debts constituting an encumbrance thereon shall have been paid after which the property shall be turned back to the original owners, is bound by such agreement; and upon buying the property under these circumstances, such person becomes in effect a trustee and is bound to administer the property in this character. (Martinez vs. Grano, 42 Phil. 35 [1921].)

Article 1453 would apply if the person conveying the property did not expressly state that he was establishing the trust. (Cuaycong vs. Cuaycong, 21 SCRA 1192 [1967].)

ART. 1454. If an absolute conveyance of property is made in order to secure the performance of an obligation of the grantor toward the grantee, a trust by virtue of law is established. If the fulfillment of the obligation is offered by the grantor when it becomes due, he may demand the reconveyance of the property to him.

Absolute conveyance to a person to secure performance of grantor's obligation.

Ordinarily, the creditor will require the execution by the debtor of a mortgage (see Art. 2124.) or a pledge (see Art. 2093.) as security for the fulfillment of the latter's obligation. In this case, the mortgagee or pledgee does not become a trustee. But if an absolute conveyance of property is made instead in order to guarantee the performance of an obligation of the grantor toward the grantee, an implied trust is created by operation of law for the benefit of the grantor.

Upon offering to the grantee the fulfillment of the obligation, the grantor is entitled to a deed of reconveyance of the property so long as the rights of innocent third parties have not intervened.

ART. 1455. When any trustee, guardian or other person holding a fiduciary relationship uses trust funds for the purchase of property and causes the conveyance to be made to him or to a third person, a trust is established by operation of law in favor of the person to whom the funds belong.

Purchase of property with use of trust funds.

A purchase by a trustee, guardian or other person holding a fiduciary relationship of property, where he takes the conveyance in his own or third person's name, using trust funds for the purchase, establishes a *resulting* trust for the benefit of the person to whom the funds belong. Thus, an agent is bound to return to the principal the property acquired with the funds and at the instance of the principal. He holds the property in trust for his employer or principal who can bring an action to compel a conveyance to him subject to the rights of an innocent purchaser for value. (see Sy-Juco and Viardo vs. Sy-Juco, 40 Phil. 634 [1920]; Camacho vs. Municipality of Baliwag, 28 Phil. 466 [1914].)

"The rule stands on the moral obligation to refrain from placing one's self in positions which ordinarily excite conflicts between self-interest and integrity. It seeks to remove the temp-

tation that might arise out of such a relation to serve one's self-interest at the expense of one's integrity and duty to another, by making it impossible to profit by yielding to temptation. It applies universally to all who come within its principle." (Severino vs. Severino, 44 Phil. 343 [1922].)

The above rule of a resulting trust goes, of course, to the fact of consideration, and has nothing to do with fraud or breach of confidence. A constructive trust arises on a purchase with the use of trust funds where there is fraud or breach of confidence. (see 54 Am. Jur. 163.)

ART. 1456. If property is acquired through mistake or fraud, the person obtaining it is, by force of law, considered a trustee of an implied trust for the benefit of the person from whom the property comes.

Acquisition of property through mistake or fraud.

(1) *Constructive trust created.* — Article 1456 illustrates a constructive trust. Where a party acquires through mistake or fraud a legal title to property to which another has a better right, there is created by law what is termed in jurisprudence as "constructive trust" in favor of the aggrieved party who is truly entitled to it or his successors-in-interest, and grants to the latter the right to recover his or their title over the property by way of reconveyance while the same has not yet passed to an innocent purchaser for value, in keeping with the primary principle of law and equity that one should not unjustly enrich himself at the expense of another.[13] According to the Supreme Court (in Diaz vs. Gorricho, 103 Phil. 261 [1958].), Article 1456 merely expresses a rule recognized in *Gayondato vs. Insular Treasurer.* (49 Phil. 244 [1926].)

The presence of fraud or mistake creates an implied trust for the benefit of the rightful and legal owner giving him the right

[13]The grantor may operate to avail of an action to enforce a constructive trust or the quasi-contract of *solutio indebiti* under Article 2154. (Phil. National Bank vs. Court of Appeals, 217 SCRA 347 [1993].) Under Article 1145(2), however, an action upon a quasi-contract must be commenced within six (6) years.

to seek reconveyance of the property. All that must be alleged in the complaint are two (2) facts: (a) that the plaintiff was the owner of the property; and (b) that the defendant had illegally dispossessed him of the same. (Heirs of A. Kionisala vs. Heirs of H. Dacut, 378 SCRA 206 [2002]; Heirs of M. Sanjoyo vs. Heirs of M. Quijano, 449 SCRA 15 [2005]; Mendezabel vs. Apao, 483 SCRA 587 [2006].)

Applying the rule in Article 1456,[14] the Supreme Court, held that a buyer of a parcel of land at a public auction to satisfy a judgment against a widow, acquired only 1/2 interest on the land corresponding to the share of the widow and the other half belonging to the heirs of her husband became impressed with a constructive trust in behalf of said heirs. (Noel vs. Court of Appeals, 240 SCRA 78 [1995]; see Salvatierra vs. Court of Appeals, 260 SCRA 45 [1996].)

A purchaser in bad faith is, by Article 1456, considered a trustee of an implied trust for the benefit of the true owner of the property. That being the case, he may not successfully set up prescription as a defense. (Francisco vs. Magbitang, 173 SCRA 382 [1989].) Under the Article, the "mistake" or "fraud" that results in an implied trust being impressed upon the property involved, may be the mistake or fraud of a third person, and need not be a mistake or fraud committed directly by the trustee himself under the implied trust. (see Sumaoang vs. Judge, RTC, 215 SCRA 136 [1992].)

(2) *Not trust in the technical sense.* — The use of the word "trust" in Article 1456 is not basically accurate. The law has styled such a situation a "trust" and the person obtaining the property a "trustee" for want of a better term as such person has no title to the property and really holds it for the true owner. (Gayondato vs. Treasurer, *supra*; Sevilla vs. De los Angeles, 97 Phil. 875 [1955]; Manlicon vs. De Vera, 86 Phil. 115 [1950]; Gemora vs. F.M. Yaptico and Co., 52 Phil. 161 [1928]; Ramos vs. Ramos, 61 SCRA 284 [1974].) "But as courts are agreed in administering the same rem-

[14]Although this provision is not retroactive in character, it merely expresses a rule already recognized by our courts prior to the effectivity of the Civil Code. (Vda. De Rigonan vs. Derecho, 463 SCRA 627 [2005].)

edy in a certain class of frauds as are administered in fraudulent breaches of trusts, and as courts and the profession have concurred in calling such frauds as constructive frauds, there can be no misapprehension in continuing the same phraseology while a change might lead to confusion and misunderstanding.'' (Estate of the Late M. Jacob vs. Court of Appeals, 283 SCRA 474 [1998].)

The trust alluded to, as just pointed out, is constructive trust arising by operation of law. It is not trust in the technical sense (Gonzales vs. Intermediate Appellate Court, 204 SCRA 106 [1991].) for in a typical trust, confidence is reposed in one person for the benefit of another respecting property which is held by the former for the benefit of the latter.[15] (see Art. 1440; Phil. National Bank vs. Court of Appeals, 217 SCRA 347 [1993].) It is created as a means of affording relief to the innocent, and constitutes a remedial device "through which preference of self is made subordinate to loyalty to others.'' (Sumaoang vs. Judge, RTC, *supra*.)

(3) *Remedy of owner under the torrens system.* — The sole remedy of the landowner whose property has been wrongfully or erroneously registered under the torrens system in another's name is, after one year from the date of the decree of registration, not to set aside the decree but, respecting it as incontrovertible and no longer open to review, to bring an ordinary action in the ordinary court of justice for reconveyance or, if the property has passed into the hands of an innocent purchaser for value, for damages. (Aban vs. Cedeña, [Unrep.] 103 Phil. 1153 [1958]; Director of Lands vs. Register of Deeds of Rizal, 92 Phil. 826 [1953]; see Armamento vs. Guerrero, 96 SCRA 178 [1980]; Gomez vs. Duyan, 453 SCRA 708 [2005]; Ceervantes vs. Court of Appeals, 503 SCRA 451 [2006]; see Sec. 53, Pres. Decree No. 1529 [Property Registration Decree].)

[15]A constructive trust unlike an express trust does not emanate from, or generate a fiduciary relation. While in an express, a beneficiary and trustee are linked by confidential or fiduciary relations, in a constructive trust, there is neither a promise nor a fiduciary relation to speak of and the so-called trustee neither accepts any trust nor intends holding the property for the beneficiary. (Vda. De Esconde vs. Court of Appeals, 253 SCRA 66 [1996]; Aznar Brothers Realty Co. vs. Aying, 458 SCRA 496 [2005].)

The principle that a trustee who takes a torrens title in his name cannot repudiate the trust by relying on the registration, is a well-known exception to the principle of conclusiveness of a certificate of title. (Adriano vs. Court of Appeals, 328 SCRA 738 [2000].) The beneficiary has the right to enforce the trust, notwithstanding the irrevocability of the torrens title, and the trustee and his successors-in-interest are bound to execute the deed of reconveyance. After all, the torrens system was never designed to shield and protect one who had committed fraud or misrepresentation and thus holds title in bad faith. (Mun. of Victorias vs. Court of Appeals, 149 SCRA 32 [1987]; Amerol vs. Bagumbaran, 154 SCRA 396 [1987]; Adille vs. Court of Appeals, 157 SCRA 455, 546 [1988].) It does not create or vest title but only confirms and records title already existing and vested. Where one does not have any rightful claim over a real property, the torrens system of registration can confirm or record nothing. (Rosario vs. Court of Appeals, 310 SCRA 464 [1999].)

Where a party is in actual possession of the property, the action to enforce the trust and recover the property and thereby quiet title thereto, is imprescriptible. (Heirs of Clemente Ermac vs. Heirs of Vicente Ermac, 403 SCRA 291 [2003].)

ILLUSTRATIVE CASES:

1. *A co-owner (an heir) bequeathed to her husband in a will the property held in co-ownership without the consent of the other co-owners (heirs).*

Facts: The lots in question were the conjugal property of A and B. After A died in 1912, the lots and other properties descended in testate succession to B, his widow, and two children, C and D. As counsel for the heirs entrusted with the settlement of the estate, S filed in 1913 in the testate proceedings, a motion praying that the executrix of the estate be relieved from presenting a project of partition inasmuch as the heirs desired to conserve *pro indiviso* the properties in their possession. Shortly, thereafter, S married D.

In the course of time, new titles to the properties were issued in the name only of D and then in the name of S after D died. D bequeathed all her properties to S.

After S's death in 1966 (B also having died earlier), the heirs of C filed an action for reconveyance to them of the lots alleging that in the course of the years, S had managed to obtain titles to the lots under his name to the prejudice of the other heirs. The estate contended that the motion filed by S did not create a trust but only a simple co-ownership.

Issues: (1) What is the legal effect of the agreement embodied in the pleading executed by the heirs to preserve the properties in the estate in co-ownership?

(2) Are the heirs of C entitled to reconveyance of the lots in question?

Held: (1) The legal effect of said agreement is to create a form of an express trust among the heirs as co-owners of the properties. Co-ownership is a form of trust and every co-owner is a trustee for the others.

(2) A fiduciary relationship may exist even if the title to the property subject to the trust appears in the name of the trustee alone, because in cases of trusteeship, the legal title usually appears in the name of the trustee, while the equitable title remains with the *cestui que trust*. True it is that torrens titles were issued in the name of D, but the principle holds that a trustee who takes a torrens title in his name cannot repudiate the trust by relying on the registration, which is one of the well-known limitations upon the finality of a decree of title.

Neither can the will executed by D deprive the other heirs of their ownership over the parcels of land. These lots were trust properties; D was holding them in trust for her sister C and the latter's children. Not being the absolute owner thereof, D could not legally convey their ownership by including them in her will. *(Sotto vs. Teves, 86 SCRA 154 [1978].)*

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2. *Oppositor to application for registration of land withdrew his opposition on promise of applicant to give him another property or pay its price.*

Facts: Under a compromise agreement executed sometime in 1925, A agreed to withdraw his opposition to the application for registration of a parcel of land by B upon the commitment of the latter to give A another piece of land of equal area or

pay its price of P400.00, for which reason B was able to obtain torrens title to the property.

However, A and his heirs continued in possession of the land until A sold the property to C on April 30, 1980. C remained in possession and was never disturbed in his occupancy until the filing of the original complaint for recovery of possession by B after a demand was made upon C.

Issue: May a trust relationship be recognized in favor of A (or his heirs)?

Held: Yes. While no express trust was created as there was no direct and positive intent to create a trust relationship between the parties to the compromise agreement (see Arts. 1441, 1444.), nor can an implied trust be inferred under Article 1456 because B acquired the property of A not through mistake or fraud but by reason of the voluntary agreement of A to withdraw his opposition, a trust relationship may be recognized in equity to the end that unjust enrichment may be prevented. The Civil Code, in enumerating cases of implied trust (Arts. 1448-1456.), specifically stipulates in Article 1447 that the enumeration does not exclude others established by the general law of trust, subject to the limitation laid down in Article 1442.

The prescriptive period of 10 years in constructive trust is counted from the time the trust is repudiated; in this case, in 1955 upon the filing of the complaint for recovery of possession. *(Roa, Jr. vs. Court of Appeals, 123 SCRA 3 [1983].)*

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3. *Party allegedly defrauded by fraudulent registration of property has no right to the same.*

Facts: M Corporation purchased in 1972 a parcel of land from S who had been in continuous and adverse possession of the property since 1921, having consistently declared it for taxation purposes in his name and religiously paid taxes thereon to the government. It appears that G obtained a free patent to the property and the corresponding original certificate of title in his name.

M claimed that it was not able to assert its rights over the disputed land because it had no notice of the proceedings before the Bureau of Lands; that G, through fraud and misrepresentation succeeded in misleading the Director of Lands to be-

lieve that the land was still part of the public domain; and that a "constructive fraud" was created in its favor as the defrauded party.

Issue: Was an implied or constructive trust created?

Held: No. M is not entitled to be declared the true and lawful owner of the land in question. The mere more than 30 years possession of the property by S did not automatically divest the land of its public character. S did not do anything to secure a title or confirm his imperfect title, assuming he was entitled to the same.

An implied or constructive fraud presupposes the existence of a defrauded party who is the rightful owner of the disputed property. G could not have committed fraud against M or S, in view of the absence of any relationship, fiduciary or otherwise, between them which would justify the creation of an implied trust. There being no constructive trust, M cannot invoke the ten-year prescriptive period within which to file an action for reconveyance. Even assuming that G was guilty of fraud and M was entitled to the issuance of a patent, the action should have been filed within four (4) years from the issuance of the original certificate of title in favor of G. *(Marcopper Mining Corp. vs. Garcia, 143 SCRA 178 [1986].)*

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4. *Buyer of mortgaged property, with full knowledge of the mortgage, demands reconveyance from the seller/mortgagor who was able to buy said property from the mortgagee after the property was legally foreclosed and ownership duly consolidated in the name of the mortgagee, and to sell again to another.*

Facts: Spouses M and N, petitioners, sold on installment an undivided 1/2 portion of their residential house and lot to spouses C and D. The property was then mortgaged to the GSIS which fact was known to D and C who took possession of the premises upon payment of the first installment. Some payments were made by spouses C and D to the petitioners while some were made directly to the GSIS. Two months before the expiration of the period to redeem the property which was foreclosed by the GSIS and sold at public auction, the GSIS being the highest bidder, petitioners executed a deed of absolute sale of the property in favor of the Spouses C and D.

The petitioners succeeded in reacquiring the property from the GSIS after title to the property was consolidated in its favor. Upon registration of the absolute deed of sale executed by the GSIS, a new certificate of title was issued in favor of the petitioners. Subsequently, the petitioners mortgaged the same property to a bank. Then, they sold the property to petitioner IC who agreed to assume the mortgage.

C filed an ejectment case against private respondent C (already a widow) who later filed a complaint for quieting of title against the spouses M and N and IC, praying for the issuance to her of a certificate of title over the property.

Issue: The main issue is whether under the facts stated, the spouses M and N are under any legal duty to reconvey the property in question to respondent C.

Held: No. (1) *Petitioners did not act in bad faith.* — "There is no sufficient basis for the trial court to conclude that herein petitioners acted in bad faith in their dealings with the Campo spouses. The latter had full knowledge of the existing mortgage of the whole property in favor of GSIS prior to the sale of the one-half portion to them. There is also no showing that as one of the considerations of the sale, herein petitioners undertook to release the property from the mortgage at all costs. With this condition of the property at the time of the sale, private respondents were forewarned of the consequences of their transaction with the petitioners."

(2) *Petitioners did not deliberately allow the mortgage to be foreclosed.* — "There is also no basis to conclude that petitioners deliberately allowed the loan to lapse and the mortgage to be foreclosed. No specific act or series of acts were presented and proven from which it could be safely concluded that the failure of petitioners to pay off their loan was deliberate. They explained that their financial condition prevented them from dutifully complying with their obligations to the GSIS. In a display of their good faith and fair dealing after the property was foreclosed, the petitioners, realizing the imminent loss of the said property, even granted the private respondent the right to redeem it from the GSIS. This right was granted in the Deed of Absolute Sale executed by petitioners in favor of the Campo spouses. Moreover, it was also stipulated that private respondent recognized the superior lien of GSIS on the property and agreed to be bound by the terms and conditions

of the mortgage. These stipulations were all contained in the Deed.

In view of the failure of either the Manzanilla spouses or the Campo spouses to redeem the property from GSIS, title to the property was consolidated in the name of GSIS. The new title cancelled the old title in the name of the Manzanilla spouses. GSIS at this point had a clean title free from any lien in favor of any person including that of the Campo spouses.''

(3) *Action to quiet title must fail.* — "If it were true that petitioners deliberately allowed the loan to lapse and the mortgage to be foreclosed, we do not see how these circumstances can be utilized by them to their advantage. There was no guarantee that petitioners would be able to redeem the property in the event the mortgage thereon was foreclosed as in fact they failed to redeem because they had no money. On the other hand, had they opted to eventually exercise their right of redemption after foreclosure, they would be under a legal duty to convey one-half portion thereof sold to the Campo spouses because by then, title to the property would still be in their name.

Either way, petitioners were bound to lose either the entire property in case of failure to redeem or the one-half portion thereof sold to private respondent in the case of redemption. Further, should petitioners let the period of redemption lapse without exercising the right of redemption, as what happened in this case, there was no guarantee that the same could be reacquired by them from GSIS nor would GSIS be under any legal duty to resell the property to them.

There may be a moral duty on the part of petitioners to convey the one-half portion of the property previously sold to private respondents. However, they are under no legal obligation to do so. Hence, the action to quiet title filed by private respondent must fail.''

(4) *There was no mistake or fraud on the part of petitioners.* — "Article 1456 has no application in the case at bar.

There was no mistake nor fraud on the part of petitioners when the subject property was reacquired from the GSIS. The fact that they previously sold one-half portion thereof has no more significance in this re-acquisition. Private respondent's right over the one-half portion was obliterated when absolute ownership and title passed on to the GSIS after the foreclosure

sale. The property as held by GSIS had a clean title. The property that was passed on to petitioners retained that quality of title."

(5) *Second buyer acted in good faith.* — "As regards the rights of private respondent Ines Carpio, she is a buyer in good faith and for value. There was no showing that at the time of the sale to her of the subject property, she knew of any lien on the property except the mortgage in favor of the Biñan Rural Bank. No other lien was annotated on the certificate of title. She is also not required by law to go beyond what appears on the face of the title. When there is nothing on the certificate of title to indicate any cloud or vice in the ownership of the property or any encumbrances thereon, the purchaser is not required to explore further than what the Torrens Title upon its face indicates in quest for any hidden defect or inchoate right thereof." *(Manzanilla vs. Court of Appeals, 183 SCRA 207 [1990].)*

ART. 1457. An implied trust may be proved by oral evidence.

Proof of implied trust.

An express trust concerning an immovable or any interest therein may not be proved by parol or oral evidence. (Art. 1443.)

(1) An implied trust, however, whether involving realty or personalty, may be proved by oral evidence. (Art. 1457.) Thus, where the grantor conveys land to the grantee with the understanding that after the latter's death the property would be returned to the grantor or his heirs, an implied trust is created in favor of the grantor or his heirs (Art. 1453.) which may be proved by parol evidence. (Magtulis vs. Espartero, 9 C.A. Rep. 67.)

Trustworthy oral evidence is required to prove an implied trust because oral evidence can be easily fabricated. It cannot rest on loose, equivocal or indefinite declarations. (Salao vs. Salao, supra.; De Leon vs. Molo-Peckson, 6 SCRA 978 [1962]; Ong Ching Po vs. Court of Appeals, 239 SCRA 341 [1994]; Morales vs. Court of Appeals, 274 SCRA 282 [1997].) In order to establish an implied trust in real property, by parol evidence, the proof should be as fully convincing as if the acts giving rise to the trust obligation

are proven by an authentic document. An implied trust, in fine, cannot be established upon vague and inconclusive proof. (Heirs of L. Yap vs. Court of Appeals, 312 SCRA 603 [1999].)

(2) An implied trust cannot be established contrary to the recitals of a Torrens Title, upon vague and inconclusive proof. (Salao vs. Salao, 70 SCRA 65 [1976].) Thus, in a case, where the supposed trustees had appeared to be the registered owners of the lot in question for more than forty years and had possessed it during that period, and the trustors who created the alleged trust, died a long time ago, "their title and possession cannot be defeated by oral evidence which can be easily fabricated. Any pretension as to the existence of an implied trust should not be countenanced." (Sinaon vs. Sorongon, 134 SCRA 407 [1985].)

(3) The doctrine of implied trust finds no application where there are no proven facts to support it. While an implied trust (of real and personal property) does not require the formalities of an express trust over realty which as mandated by Article 1443 cannot be proved by oral evidence, still there must be proof that the trustor wanted to grant one party only the beneficial ownership of a property, although said beneficiary may have legal title in himself. (Ferrer-Lopez vs. Court of Appeals, 150 SCRA 393 [1987].)

(4) The bare existence of confidential relation between grantor and grantee (mother-in-law and son-in-law) does not, standing alone, raise the presumption of fraud. A deed (of sale) will not be set aside merely because the grantor and the grantee sustained a confidential relationship where the evidence shows no fraud or abuse of confidence. (Esquivias vs. Court of Appeals, 270 SCRA 803 [1997].)

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Comments and Cases on
PARTNERSHIP, AGENCY, and TRUSTS

By

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Aklat-Aralin sa Bagong Konstitusyon, etc.

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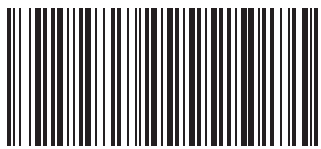

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PREFACE

Under the new law curriculum, partnership, agency, and trusts are taken together as "Business Organization I." Their integration into one course is proper as they are relatively short subjects, aside from the fact that they are closely related. The first is really a branch of the second, while the third has many of the elements of both.

In this work, which is now on its eight edition, the legal provisions are not only discussed; in many instances, they are concisely illustrated by means of hypothetical situations, and by actual cases which have been reduced to their bare essentials. Needless to state, the latest decisions laid down by the Supreme Court available as of this writing are included in this new edition.

June 2010

HECTOR S. DE LEON

HECTOR M. DE LEON, JR.

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