
Q & A BAR 2000-2015

• SUGGESTED ANSWERS TO BAR EXAMINATION QUESTIONS •

MERCANTILE LAW

-Arranged by Topic-

Sources:

THE UP LAW COMPLEX (1997-2007, 2009, 2010)
THE UP BAR REVIEW INSTITUTE (2012, 2013, 2014, 2015)
PHILIPPINE ASSOCIATION OF LAW SCHOOLS (2007, 2008)

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A PERSONAL NOTE FROM THE EDITOR

Dearest Fellow Bar Warriors,

All praises is due to Him who is the Source of All Knowledge and Wisdom!

I am very pleased to share with you this piece which I have been working on for the past three years. Despite the difficulty in having to re-page, proofread and re-classify the topics, two reasons compelled me into further re-updating: ONE, my first update is fraught with typographical errors; and TWO, I blame this Bar Q & A for making me pass the 2015 Bar Exam. :-) This work is, therefore, my little way of giving back and sharing such an amazing blessing.

To effectively use this work, it is recommended that the student/bar reviewee answer the questions first before reading the suggested answers. It may be that one's answer is not the same as that of the suggested answer -- one should not be disheartened. Remember, these are mere suggested answers. Further, one should also pay attention to topics frequently asked. By doing so, one can at least get an idea which topics are 'BAR-able', so to speak, and which are not. To the former, one should devote time; to the latter, familiarity will suffice.

As a piece of unsolicited advise from one who has tasted the 'anguish of defeat and the glory of the hour triumphant', no matter how much you have given up on yourself, NEVER GIVE UP ON THE MERCY OF GOD! For "verily, with each hardship comes relief".

- Atty. MSLD -

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¹ "GIVE CREDIT WHEN IT'S DUE.":

The arrangement and classification of concepts in this work was inspired by and heavily adopted from the Original Compilers: Atty. Janette Lagui-Icao and Atty. Alex Andrew P. Icao (2005 Edition Updated by Romualdo L. Señeris II, LLB. in April 19, 2007; Further re-updated by alias "*Dondee the Retaker 2007*"—all of SILIMAN UNIVERSITY COLLEGE OF LAW; recently re-updated by alias "Rollan, Faith Chareen —Pet2xll D. Salise, Hector Christopher —Jay-Arhll Jr. M."—all of University of San Jose-Recoletos School of Law.

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GENERAL PRINCIPLES

Joint Account (2000)

What is a joint account? (2%)

SUGGESTED ANSWER:

A joint account is a transaction of merchants where other merchants agree to contribute the amount of capital agreed upon, and participating in the favorable or unfavorable results thereof in the proportion they may determine.

Joint Account vs. Partnership (2000)

Distinguish joint account from partnership. (3%)

SUGGESTED ANSWER:

The following are the distinctions between joint account and partnership:

- (1) A partnership has a firm name while a joint account has none and is conducted in the name of the ostensible partner.
- (2) While a partnership has juridical personality and may sue or be sued under its firm name, a joint account has no juridical personality and can sue or be sued only in the name of the ostensible partner.
- (3) While a partnership has a common fund, a joint account has none.
- (4) While in a partnership, all general partners have the right of management, in a joint account, the ostensible partner manages its business operations.
- (5) While liquidations of a partnership may, by agreement, be entrusted to a partner or partners, in a joint account liquidation thereof can only be done by the ostensible partner

Presumption: Habitually Engaging in Commerce (2009)

Cecilio is planning to put up a grocery store in the subdivision where he and his family reside. To promote this proposed business venture, he told his wife and three children to send out promotional text messages to all the residents in the subdivision. Cecilio's family members did as instructed, and succeeded in reaching, through text messages, more than 80% of the residents in the subdivision.

Is Cecilio habitually engaged in commerce even if the grocery store has yet to be established? Explain your answer. (3%)

SUGGESTED ANSWER:

Yes. Even if the grocery store has yet to be established, Cecilio already habitually engaged in commerce, when per his instruction the members of his family contacted more than 80% the residents of the subdivision where they reside. According to Article 3 of the Code of Commerce, "legal presumption of habitually engaging in commerce shall exist from the moment the person who intends to engage therein announces through circulars, newspapers, handbills, posters exhibited to the public, or in any other manner whatsoever an establishment which has for its object some commercial operation." Text messages may qualify to be equivalent to electronic documents.

LETTERS OF CREDIT

Letters of Credit; Nature (2012)

b. Explain the nature of Letters of Credit as a financial device. (5%)

SUGGESTED ANSWER:

(b) A letter of credit is a financial device developed by merchants as a convenient and relatively safe mode of dealing with sales of goods to satisfy the seemingly irreconcilable interests of a seller, who refuses to part with his goods before he is paid, and a buyer, who wants to have control of the goods before paying.

To break the impasse, the buyer may be required to contract a bank to issue a letter of credit in favor of the seller so that, by virtue of the letter of credit, the issuing bank can authorize the seller to draw drafts and engage to pay them upon their presentment simultaneously with the tender of documents required by the letter of credit. The buyer and the seller agree on what documents are to be presented for payment, but ordinarily they are documents of title evidencing or attesting to the shipment of the goods to the buyer. Once the credit is established, the seller ships the goods to the buyer and in the process secures the required shipping documents or documents of title.

To get paid, the seller executes a draft and presents it together with the required documents to the issuing bank. The issuing bank redeems the draft and pays cash to the seller if it finds that the documents submitted by the seller conform with what the letter of credit requires. The bank then obtains possession of the documents upon paying the seller.

The transaction is completed when the buyer reimburses the issuing bank and acquires the documents entitling him to the goods. Under this arrangement, the seller gets paid only if he delivers the documents of title over the goods, while the buyer acquires the said documents and control over the goods only after reimbursing the bank. (*Bank of America NT & SA v. CA, et al.*, G.R. No. 105395, December 10, 1993)

However, letters of credit are also used in non-sale settings where they serve to reduce the risk of nonperformance. Generally, letters of credit in non-sale settings have come to be known as standby letters of credit. (*Transfield Philippines, Inc. v. Luzon Hydro Corporation, et al.*, G.R. No. 146717, November 22, 2004)

(Note: In respect of Question (a), it is recommended that examinees be given full credit for whatever answer they gave because the matter involved in Question (a) is outside the scope of the 2012 Bar Examination in Mercantile Law. Both the Supreme Court Rules of Procedure on Corporate Rehabilitation (2008) and the Financial Rehabilitation and Insolvency Act (FRIA) of 2010 (RA 10142) are not included in the 2012 Syllabus for the Bar Examination in

Mercantile Law. Neither is the matter referred to in any of the topics under Letters of Credits and the Corporation Code in the aforementioned Syllabus. In any case, our suggested answers to both Questions (a) and (b) are herein set out.

Letters of Credit; Three Distinct Contract Relationships (2002)

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

SUGGESTED ANSWER:

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

1. Between the applicant/buyer/importer and the beneficiary/seller/exporter – The applicant/buyer/importer is the one who procures the letter of credit and obliges himself to reimburse the issuing bank upon receipt of the documents of title, while the beneficiary/seller/exporter is the one who in compliance with the contract of sale ships the goods to the buyer and delivers the documents of title and draft to the issuing bank to recover payment for the goods. Their relationship is governed by the contract of sale.
2. Between the issuing bank and the beneficiary/seller/exporter – The issuing bank is the one that issues the letter of credit and undertakes to pay the seller upon receipt of the draft and proper documents of title and to surrender the documents to the buyer upon reimbursement. Their relationship is governed by the terms of the letter of credit issued by the bank.
3. Between the issuing bank and the applicant/buyer/importer – Their relationship is governed by the terms of the application and agreement for the issuance of the letter of credit by the bank.

Letter of Credit; Independence Principle (2010)

The Supreme Court has held that fraud is an exception to the —independence principle governing letters of credit. Explain this principle and give an example of how fraud can be an exception. (3%)

SUGGESTED ANSWER:

The “independence principle” posits that the obligations of the parties to a letter of credit are independent of the obligations of the parties to the underlying transaction. Thus, the beneficiary of the letter of credit, which is able to comply with the documentary requirements under the letter of credit, must be paid by the issuing or confirming bank, notwithstanding the existence of a dispute between the parties to the underlying transaction, say a contract of sale of goods where the buyer is not satisfied with the quality of the goods delivered by the seller. The Supreme Court in *Transfield Philippines, Inc. v. Luzon Hydro Corporation*, 443

SCRA 307 (2004) for the first time declared that fraud is an exception to the independence principle. For instance, if the beneficiary fraudulently presents to the issuing or confirming bank documents that contain material facts that, to his knowledge, are untrue, then payment under the letter of credit may be prevented through a court injunction.

Letters of Credit; Liability of a Notifying Bank (2003)

a) What liability, if any is incurred by an advising or notifying bank in a letter of credit transaction?

SUGGESTED ANSWER:

b) Bravo Bank received from Cisco Bank by registered mail an irrevocable letter of credit issued by Delta Bank for the account of Y Company in the amount of US\$10,000,000 to cover the sale of canned fruit juices. The beneficiary of the letter of credit was X Corporation which later on partially availed itself of the letter of credit by submitting to Bravo Bank all documents relative to the shipment of the cans of fruit juices. Bravo Bank paid X Corporation for its partial availment. Later, however, it refused further availment because of suspicions of fraud being practiced upon it and, instead, sued X Corporation to recover what it had paid the latter. How would you rule if you were the judge to decide the controversy? (6%)

SUGGESTED ANSWER:

Letter of Credit; Liabilities of a Confirming and Notifying Bank (2008)

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

presented a claim against Atlantic Bank by executing a draft against the letter of credit.

(A) Can Atlantic Bank refuse payment due to the unresolved controversy? Explain. (3%)

SUGGESTED ANSWER:

No, Atlantic Bank cannot refuse payment to the unresolved controversy between the two companies. The Bank is solidarily liable to pay based on the terms and conditions of the Letter of Credit. In *FEATI Bank v. Court of Appeals*, G.R. No. 94209, 30 April 1991, the Court held that an irrevocable letter of credit is independent of the contract between the buyer-applicant and the seller-beneficiary.

(B) Can X Corporation claim directly from PT Construction Corp.? Explain. (3%)

SUGGESTED ANSWER:

Yes, X Corporation can claim directly from PT Construction Corp. The irrevocable letter of credit was merely a security arrangement that did not replace the main contract between the two companies. In *FEATI Bank c. CA*, G.R. No. 94209, 30 April 1991, opening a letter of credit does not involve a specific appropriation of money in favor of the beneficiary. It only signifies that the beneficiary may draw funds up to the designated amount. It does not mean that a particular sum of money has been specifically reserved or held in trust.

Letters of Credit; Mortgagor as Issuing Bank (2005)

Ricardo mortgaged his fishpond to AC Bank to secure a P1 Million loan. In a separate transaction, he opened a letter of credit with the same bank for \$500,000.00 in favor of HS Bank, a foreign bank, to purchase outboard motors. Likewise, Ricardo executed a Surety Agreement in favor of AC Bank. The outboard motors arrived and were delivered to Ricardo, but he was not able to pay the purchase price thereof.

a) Can AC Bank take possession of the outboard motors? Why?

SUGGESTED ANSWER:

a) No, for AC Bank has no legal standing, much less a lien, on the outboard motors. Insofar as AC Bank is concerned, it has privity with the person of Ricardo under the Surety Agreement, and a lien on the fishpond based on the real estate mortgage constituted therein.

b) Can AC Bank also foreclose the mortgage over the fishpond? Explain. (5%)

SUGGESTED ANSWER:

b) Yes, but only to enforce payment of the principal loan of P1million secured by the real estate mortgage on the fishpond.

Letters of Credit; Standby Letter of Credit (2015)

A. A standby letter of credit was issued by ABC Bank to secure the obligation of X Company to Y Company. Under the standby letter of credit, if there is failure on the part of X Company to perform its obligation, then Y Company will submit to ABC Bank a certificate of default (in the form prescribed under the standby letter of credit)

and ABC Bank will have to pay Y Company the defaulted amount. Subsequently, Y Company submitted to ABC Bank a certificate of default notwithstanding the fact that X Company was not in default. Can ABC Bank refuse to honor the certificate of default? Explain. (3%)

SUGGESTED ANSWER:

No. Under the doctrine of independence in a letter of credit, the obligation of the issuing bank to pay the beneficiary is distinct and independent from the main and originating contract underlying the letter of credit. Such obligation to pay does not depend on the fulfillment or non-fulfilment of the originating contract. It arises upon tender of the stipulated document under the letter of credit. In the present case, the tender of the certificate of default entitles Y to payment under the standby letter of credit notwithstanding the fact that X Company was not in default. This is without prejudice to the right of X company to proceed against Y Company under the law on contracts and damages. (*Insular Bank of Asia and America v. Intermediate Appellate Court* 167 SCRA 450 [1988])

ALTERNATIVE ANSWER:

Under the fraud exception principle, the beneficiary may be enjoined from collecting on the letter of credit in case of fraudulent abuse of credit. The issuance of a certificate of default despite the fact that X company is not in default constitutes fraudulent abuse of credit (*Transfield Philippines v. Luzon Hydro Corporation*, 443 SCRA 307[2004]).

Letters of Credit; Applicability of Uniform Customs & Practice Credits of the Int'l Chamber of Commerce (2015)

B. Is the Uniform Customs and Practice for Documentary Credits of the International Chamber of Commerce applicable to commercial letters of credit issued by a domestic bank even if not expressly mentioned in such letters of credit? What is the basis for your answer? (3%)

SUGGESTED ANSWER:

Yes, the Supreme Court has held that in the observance of the Uniform Customs and Practice in the Philippines is justified by Article 2 of the Code of Commerce which enunciates that in the absence of any particular provision in the Code Commerce, commercial transactions shall be governed by generally-observed usages and customs (*Bank of the Philippine Islands v. De Rent Fabric Industries, Inc.* 35 SCRA 253[1970]).

TRUST RECEIPTS LAW

Trust Receipts (2007)

C contracted D to renovate his commercial building. D ordered construction materials from E and received delivery thereof. The following day, C went to F Bank to apply for loan to pay for the construction materials. As security for the loan, C was made to execute a trust receipt. One year later, after C failed to pay the balance of the loan, F Bank charged him with violation of the Trust Receipts Law. (5%)

(A) What is a Trust Receipt?

SUGGESTED ANSWER:

A Trust Receipt is a written or printed document signed by the entrustee in favor of the entruster containing terms and conditions substantially complying with the provision of the Trust Receipts Law, whereby the bank as entruster releases the goods to the possession of the entrustee but retains ownership thereof while the entrustee may sell the goods and apply the proceeds for the full payment of his liability to the bank (Section 3(j), Trust Receipts Law).

(B) Will the case against C prosper? Reason briefly.

SUGGESTED ANSWER:

No, the case against C will not prosper. Since C received the Construction material from E Before the trust receipt transaction was a simple loan, with the trust receipt merely as a collateral or security for the loan. This is inconsistent with a trust receipt transaction where the title to the goods remains with the bank and the goods are released to the entrustee before the loan is granted (Consolidated Bank and Trust Corporation v. Court of Appeals, 356 SCRA 671 [2001]).

Trust Receipts; Obligations o an Entrustee (2012)

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

a. Is the action of CCC Car, Inc. legally justified? Explain your answer. (5%)

SUGGESTED ANSWERS:

(a) No. It is the obligation of CCC Car, Inc., as entrustee, to receive the proceeds of the sale of the Mercedes Benz S class vehicles in trust for BBB Bank, as entruster, and turn over the same to BBB

Bank to the extent of the amount owing to the latter or as appears in the trust receipt (Sec. 9(2), Trust Receipts Law).

Trust Receipt; Security for a Loan (2008)

Tom Cruz obtained a loan of P1 Million from XYZ Bank to finance his purchase of 5,000 bags of fertilizer. He executed a trust receipt in favor of XYZ Bank over the 5,000 bags of fertilizer. Tom Cruz withdrew the 5,000 bags from the warehouse to be transported to Lucena City where his store was located. On the way, armed robbers took from Tom Cruz the 5,000 bags of fertilizer. Tom Cruz now claims that his obligation to pay the loan to XYZ Bank is extinguished because the loss was not due to his fault. Is Tom Cruz correct? Explain. (4%)

SUGGESTED ANSWER:

No, Tom Cruz's obligation to pay the loan covered by the trust receipts to XYZ

A "Trust receipt" is merely a collateral agreement which serves as security for a loan, with the Bank appearing as the owner of the goods. The Bank cannot dispose of the goods in any manner it chooses, because it is not the true owner thereof (Rosario Textile Miss v. Home Bankers, G.R. No. 137232, 29 June 2005, citing Sia v. People, G.R. No. 30896, 28 April 1983, Abad v. CA, G.R. No. 42735, 22 January 1990, and PNB v. Pineda, G.R. No. 46658, 13 May 1991). The loss of the goods covered by the trust receipts cannot extinguish the principal obligation of the borrower to pay the bank (Landl& Company [Phil.] v. Metropolitan Bank, G.R. 159622, 30 July 2004).

Trust Receipts vs. Simple Loan (2013)

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

When the extended loan period expired without any significant payment from Delano (not even to the extent of the proceeds of the sale of the iron pellets), BDP Bank consulted you on how to proceed against Delano. The bank is contemplating the filing of estafa pursuant to the provisions of Pres. Decree No. 115 (Trust Receipts Law) to force Delano to turn in at least the proceeds of the sale of the iron pellets.

Would you, as bank counsel and as an officer of the court, advise the bank to proceed with its contemplated action? (8%)

SUGGESTED ANSWER:

I will not advise BDP Bank to file a criminal case for estafa against Delano. Delano received the iron pellets he imported one year before the trust receipt was executed. As held by the Supreme Court, where the execution of trust receipt agreement was made after the goods covered by it

had been purchased by and delivered to the entrustee and the latter as a consequence acquired ownership to the goods, the transaction **does** not involve a trust receipt but a simple loan even though the parties denominated the transaction as one of trust receipt (*Colinares vs. Court of Appeals*, 339 SCRA 609, 2000; *Consolidated Bank and Trust Corporation v. CA*, 356 SCRA 671, 2001).

Trust Receipts; Liability for Estafa (2015)

A. Maine Den, Inc. opened an irrevocable letter of credit with Fair Bank, in connection with Maine Den, Inc.'s importation of spare parts for its textile mills. The imported parts were released to Maine Den, Inc. after it executed a trust receipt in favor of Fair Bank. When Maine Den, Inc. was unable to pay its obligation under the trust receipt, Fair Bank sued Maine Den, Inc. for estafa under the Trust Receipts Law. The court, however, dismissed the suit. Was the dismissal justified? Why or why not? (3%)

SUGGESTED ANSWER:

The dismissal for the complaint of estafa is justified. Under recent jurisprudence, the Supreme Court held that transactions referred to in relation to trusts receipts mainly involved sales and if the entruster knew even before the execution of the alleged trust receipt agreement that the goods subject of the trust receipt were never intended by the entrustee for resale or for the manufacture of items to be sold, the agreement is not a trust receipt but a simple loan, notwithstanding the label. In the case, the object of the trust receipt, spare parts for textile mills, were for the use of the entrustee and never intended for sale. As such, the transaction is a simple loan. (*Ng v. People of the Philippines*, 619 SCRA 291[2010]; *Land Bank v. Perez*, 672 SCRA 117[2012] and *Hur Ting Yang v. People of the Philippines*, 703 SCRA 606[2013]).

Trusts Receipts; Defenses Against Criminal Liability (2003)

PB & Co., Inc., a manufacturer of steel and steel products, imported certain raw materials for use by it in the manufacture of its products. The importation was effected through a trust receipt arrangement with AB Banking corporation. When it applied for the issuance by AB Banking Corporation of a letter of credit, PB & Co., Inc., did not make any representation to the bank that it would be selling what it had imported. It failed to pay the bank. When demand was made upon it to account for the importation, to return the articles, or to turn-over the proceeds of the sale thereof to the bank, PB & Co., Inc., also failed. The bank sued PB & Co.'s President who was the signatory of the trust receipt for estafa. The President put up the defense that he could not be made liable because there was no deceit resulting in the violation of the trust receipt. He also submitted that there was no violation of the trust receipt because the raw materials were not sold but used by the corporation in the manufacture of its products. Would those defenses be sustainable? Why? (6%)

SUGGESTED ANSWER:

Trust Receipts; Res Perit Domino (2015)

B. Does the rule "*res perit domino*" apply in trust receipt transactions? Explain. (2%)

SUGGESTED ANSWER:

No. this is because the loss of goods, documents or instruments which are the subject of a trust receipt pending their disposition, irrespective of whether or not it was due to the fault or negligence of the entrustee, shall not extinguish the entrustee's obligation to the entruster for the value thereof.

Also, while the entruster is made to appear as owner of the goods covered by the trust receipt, such ownership is only a legal fiction to enhance the entruster's security interest over the goods (*Section 10 of PD 115, Rosario Textile Mills Corp. v. Home Bankers Savings and Trust Company*, 462 SCRA 88[2005]).

WAREHOUSE RECEIPTS LAW

Warehouseman's Lien; Lost Upon Surrender of Possession Over the Goods (2009)

TRUE OR FALSE. (B) Under the Warehouse Receipts Law, the warehouseman loses his lien upon the goods when he surrenders possession thereof.

SUGGESTED ANSWER:

True. A lien is dependent on possession. When a warehouseman surrenders possession, he thereby loses his lien on the goods over which he no longer has possession (Sec. 29 (a), Warehouse Receipts Law).

Warehouseman; Validity of Stipulations Excusing Him from Negligence (2000)

S stored hardware materials in the bonded warehouse of W, a licensed warehouseman under the General Bonded Warehouse Law (Act 3893 as amended). W issued the corresponding warehouse receipt in the form he ordinarily uses for such purpose in the course of his business. All the essential terms required under Section 2 of the Warehouse Receipts Law (Act 2137 as amended) are embodied in the form. In addition, the receipt issued to S contains a stipulation that W would not be responsible for the loss of all or any portion of the hardware materials covered by the receipt even if such loss is caused by the negligence of W or his representatives or employees. S endorsed and negotiated the warehouse receipt to B, who demanded delivery of the goods. W could not deliver because the goods were nowhere to be found in his warehouse. He claims he is not liable because of the free-from-liability clause stipulated in the receipt. Do you agree with W's contention? Explain. (5%)

SUGGESTED ANSWER:

No. I do not agree with the contention of W. The stipulation that W would not be responsible for the loss of all or any portion of the hardware materials covered by the receipt even if such loss is caused by the negligence of W or his representative or employees is void. The law requires that a warehouseman should exercise due diligence in the care and custody of the things deposited in his warehouse.

Warehouseman; Obligations; Delivery of Goods (2007)

Alex deposited goods for which Billy, a warehouseman, issued a negotiable warehouse receipt wherein the good were deliverable to Alex or order. Alex negotiated the receipt to Caloy. Thereafter, Dario a creditor, secured notice of levy over the goods on the warehouseman.

(A) To whom would the warehousemen deliver the goods upon demand? (5%)

SUGGESTED ANSWER:

The warehouseman should deliver the goods upon demand to Caloy who is a holder of the receipt in good faith and for value. The goods cannot be levied upon by the creditor of Alex after it was negotiated to

Caloy (Section 25, Negotiable Instruments Law).

(B) Would your answer be the same if the warehouseman issued a non-negotiable warehouse receipt? Reason briefly. (5%)

SUGGESTED ANSWER:

No, my answer would not be the same if the warehouseman issued a non-negotiable warehouse receipt. In such case. The warehouseman should deliver the goods to Dario, if the notice of levy was served on the warehouseman prior to the notification of the warehouseman by Alex or Caloy of the transfer of the non-negotiable receipt. In such case, the title of Caloy would be defeated by the notice of levy by Dario (Section 42, Warehouse Receipts Law).

Warehouse Receipts; Who Has Right to the Goods (2005)

Jojo deposited several cartons of goods with SN Warehouse Corporation. The corresponding warehouse receipt was issued

to the order of Jojo. He endorsed the warehouse receipt to EJ who paid the value of the goods deposited. Before EJ could withdraw the goods, Melchor informed SN Warehouse Corporation that the goods belonged to him and were taken by Jojo without his consent. Melchor wants to get the goods, but EJ also wants to withdraw the same. (5%)

a. Who has a better right to the goods? Why?

SUGGESTED ANSWER:

EJ has a better right to the goods, being covered by a negotiable document of title, namely the warehouse receipts issued to the "order of Jojo." Under the Sales provisions of the Civil Code on negotiable documents of title, and under the provisions of the Warehouse Receipts Law, when goods deposited with the bailee are covered by a negotiable document of title, the endorsement and delivery of the document transfers ownership of the goods to the transferee. By operation of law, the transferee obtains the direct obligation of the bailee to hold the goods in his name." (Art. 1513, Civil Code; Section 41, Warehouse Receipts Law) Since EJ is the holder of the warehouse receipt, he has the better right to the goods. SN Warehouse is obliged to hold the goods in his name.

b. If SN Warehouse Corporation is uncertain as to who is entitled to the property, what is the proper recourse of the corporation? Explain.

SUGGESTED ANSWER:

SN Warehouse can file an INTERPLEADER to compel EJ and Melchor to litigate against each other for the ownership of the goods. Sec. 17 of the Warehouse Receipts Law states, "If more than one person claims the title or possession of the goods, the warehouseman may, either as a defense to an action brought against him for non-delivery of the goods or as an original suit, whichever is appropriate, require all known claimants to interplead."

NEGOTIABLE INSTRUMENTS LAW

Negotiable Instruments; Kinds of Negotiable Instrument; Words of Negotiability (2002)

A. Define the following:

- (1) a negotiable promissory note,
- (2) a bill of exchange and
- (3) a check. (3%)

SUGGESTED ANSWER:

A.

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

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

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

B. You are Pedro Cruz. Draft the appropriate contract language for (1) your negotiable promissory note and (2) your check, each containing the essential elements of a negotiable instrument (2%)

SUGGESTED ANSWER:

(1) Negotiable promissory note –

September 15,
2002

For value received, I hereby promise to pay
Juan Santos or order the sum of TEN THOUSAND
PESOS (P10,000) thirty (30) days from date hereof.

(Signed) Pedro Cruz

(2) Check –

September 15, 2002

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

(Signed) Pedro Cruz

To: Philippine National Bank
Escolta, Manila Branch

Negotiable Instruments; Negotiability (2002)

Which of the following stipulations or features of a promissory note (PN) affect or do not affect its negotiability, assuming that the PN is otherwise negotiable? Indicate your answer by writing the paragraph number of the stipulation or feature of the PN

as shown below and your corresponding answer, either —Affected or —Not affected. Explain (5%).

a) The date of the PN is —February 30, 2002. II

b) The PN bears interest payable on the last day of each calendar quarter at a rate equal to five percent (5%) above the then prevailing 91-day Treasury Bill rate as published at the beginning of such calendar quarter.

c) The PN gives the maker the option to make payment either in money or in quantity of palay or equivalent value.

d) The PN gives the holder the option either to require payment in money or to require the maker to serve as the bodyguard or escort of the holder for 30 days.

SUGGESTED ANSWER:

a) Paragraph 1 – negotiability is NOT AFFECTED. The date is not one of the requirements for negotiability.

b) Paragraph 2 – negotiability is NOT AFFECTED. The interest is to be computed at a particular time and is determinable. It does not make the sum uncertain or the promise conditional.

c) Paragraph 3 – negotiability is AFFECTED. Giving the maker the option renders the promise conditional

d) Paragraph 4 – negotiability is —NOT AFFECTED. Giving the option to the holder does not make the promise conditional.

Negotiable Instruments; Negotiability; Requisites (2000)

a) MP bought a used cell phone from JR. JR preferred cash but MP is a friend so JR accepted MP's promissory note for P10,000. JR thought of converting the note into cash by endorsing it to his brother KR. The promissory note is a piece of paper with the following hand-printed notation:

MP WILL PAY JR TEN THOUSAND PESOS IN
PAYMENT FOR HIS CELLPHONE 1 WEEK FROM
TODAY.

Below this notation MP's signature with "8/1/00" next to it, indicating the date of the promissory note. When JR presented MP's note to KR, the latter said it was not a negotiable instrument under the law and so could not be a valid substitute for cash. JR took the opposite view, insisting on the note's negotiability. You are asked to referee. Which of the opposing views is correct?

SUGGESTED ANSWER:

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

b) TH is an indorsee of a promissory note that simply states:

PAY TO JUAN TAN OR ORDER 400 PESOS

The note has no date, no place of payment and no consideration mentioned. It was signed by MK and written under his letterhead specifying the address, which happens to be his residence. TH accepted the promissory note as payment for services rendered to SH,

who in turn received the note from Juan Tan as payment for a prepaid cell phone card worth 450 pesos. The payee acknowledged having received the note on August 1, 2000. A Bar reviewee had told TH, who happens to be your friend, that TH is not a holder in due course under Article 52 of the Negotiable Instruments Law (Act 2031) and therefore does not enjoy the rights and protection under the statute. TH asks for our advice specifically in connection with the note being undated and not mentioning a place of payment and any consideration. What would your advice be? (2%).

SUGGESTED ANSWER:

b) The fact that the instrument is undated and does not mention the place of payment does not militate against its being negotiable. The date and place of payment are not material particulars required to make an instrument negotiable. The fact that no mention is made of any consideration is not material. Consideration is presumed.

Negotiable Instruments; Negotiability; Requirements (2013)

Antonio issued the following instrument:

August 10, 2013
Makati City

P100, 000.00

Sixty days after date, I promise to pay Bobby or his designated representative the sum of ONE HUNDRED THOUSAND PESOS (P 100,000.00) from my BPI Acct. No. 1234 if, by this due date, the sun still sets in the west to usher in the evening and rises in the east the following morning to welcome the day.

(Sgd.) Antonio Reyes

Explain each requirement of negotiability present or absent in the instrument. (8%)

SUGGESTED ANSWER:

1. The instrument contains a promise to pay and was signed by the maker, Antonio Reyes (*Section 1(a) of Negotiable Instruments Law*).
2. The promise to pay is unconditional insofar as the reference to the setting of the sun in the west in the evening and its rising in the east in the morning are concerned. These are certain to happen (*Section 4(c) of Negotiable Instruments Law*). The promise to pay is conditional, because the money will be taken from a particular fund. BPI Account No. 1234 (*Section 3 of Negotiable Instruments Law*).
3. The instrument contains a promise to pay a sum certain in money, P100, 000.00 (*Section (b) of Negotiable Instruments Law*).
4. The money is payable at a determinable future time, six, days after August 10, 2013 (*Section 4(a) of Negotiable Instruments Law*).
5. The instrument is not payable to order or to bearer (*Section 1(d) of Negotiable Instruments Law*).

Negotiable Instruments; Negotiability; Promissory Note (2012)

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

- a. I promise to pay A or bearer Php100, 000.00 from my inheritance which I will get after the death of my father. (2%)

SUGGESTED ANSWERS:

(a) Not negotiable. There is no unconditional promise to pay a sum certain in money (Sec. 1(b), NIL) as the promise is to pay the amount out of a particular fund, i.e., the inheritance from the father of the promisor (Sec. 3, NIL).

- b. I promise to pay A or bearer Php100, 000 plus the interest rate of ninety (90) – day treasury bills. (2%)

SUGGESTED ANSWERS:

(b) Not negotiable. There is no unconditional promise to pay a sum certain in money. The promise to pay "the interest rate of ninety (90)-day treasury bills" is vague because, first, there are no 90-day treasury bills (although there are 91- day, 182-day, and 364-day bills); second, the promise does not specify whether the so-called "interest rate" is that established at the primary market (where now T-bills are sold for the first time by the Bureau of Treasury) or at the secondary market (where T-bills can be bought and sold after they have been issued in the primary market);, and third, T- bills are conventionally quoted in terms of their discount rate, rather than their interest rate. They do *not* pay any interest directly; instead, they are sold at a discount of their face value and thus "earn" by selling at face value upon maturity. (See, among others, www.treasury.gov.ph/govsec/aboutsec.htm)

(Note: In respect of Question (b), it is recommended that examinees be given full credit for whatever answer they gave on account of its vagueness, as explained more fully in the suggested answer to Question (b).)

- c. I promise to pay A or bearer the sum of Php100, 000 if A passes the 2012 bar exams. (2%)

SUGGESTED ANSWERS:

(c) Not negotiable. The promise to pay is subject to a condition, i.e., that A will pass the 2012 Bar exams (Sec. 1[b], NIL).

- d. I promise to pay A or bearer the sum of Php100.000 on or before December 30, 2012. (2%)

SUGGESTED ANSWERS:

(d) Negotiable. It conforms fully with the requirements of negotiability under Section 1, NIL.

- e. I promise to pay A or bearer the sum of Php100, 000. (2%)

SUGGESTED ANSWERS:

(e) Negotiable. It conforms fully with the requirements of negotiability under Section 1, NIL. It is payable on demand because the note

does not express a time for its payment (Sec. 7[b], NIL).

Negotiable Instrument: Negotiable Document vs. Negotiable Instrument (2005)

Distinguish a negotiable document from a negotiable instrument. (2%)

SUGGESTED ANSWER:

Negotiable Instrument have requisites of Sec. 1 of the NIL, a holder of this instrument have right of recourse against intermediate parties who are secondarily liable, Holder in due course may have rights better than transferor, its subject is money and the Instrument itself is property of value. On the other hand, negotiable document does not contain requisites of Sec. 1 of NIL, it has no secondary liability of intermediate parties, transferee merely steps into the shoes of the transferor, its subject are goods and the instrument is merely evidence of title; thing of value are the goods mentioned in the document.

Negotiable Instrument vs. Negotiable Document; Negotiability (2005)

State and explain whether the following are negotiable instruments under the Negotiable Instruments Law: (5%)

- 1) Postal Money Order;
- 2) A certificate of time deposit which states —
This is to certify that bearer has deposited in this bank the sum of FOUR THOUSAND PESOS (P4,000.00) only, repayable to the depositor 200 days after date.
- 3) Letters of credit;
- 4) Warehouse receipts;
- 5) Treasury warrants payable from a specific fund.

SUGGESTED ANSWER:

- 1) **Postal Money Order – Non-Negotiable** as it is governed by postal rules and regulation which may be inconsistent with the NIL and it can only be negotiated once.
- 2) **A certificate of time deposit which states —This is to certify that bearer has deposited in this bank the sum of FOUR THOUSAND PESOS (P4,000.00) only, repayable to the depositor 200 days after date.** — **Non-Negotiable** as it does not comply with the requisites of Sec. 1 of NIL
- 3) **Letters of credit - Non-Negotiable**
- 4) **Warehouse receipts - Non-Negotiable** for the same as Bill of Lading it merely represents good, not money.
- 5) **Treasury warrants payable from a specific fund - Non-Negotiable** being payable out of a particular fund.

Negotiable Instruments; Illicit/Illegal Consideration (2007)

R issued a check for P1m which he used to pay S for killing his political enemy. (10%)

(A) Can be the check be considered a negotiable

instrument?

SUGGESTED ANSWER:

Yes, the check can be considered a negotiable instrument even if it was issued to pay S to kill his political enemy. The validity of the consideration is not one of the requisites of a negotiable instruments (Section 1, Negotiable Instruments Law.) it merely constitute a defect of title (Section 55, Negotiable Instruments Law).

(B) Does S have a cause of action against R in case of dishonor by the drawee bank?

SUGGESTED ANSWER:

No, s does not have a cause of action against R in case of dishonor of the check by the drawee bank. S is not a holder in due course, thus, R can raise the defense that the check was issued for an illegal consideration (Section 58, Negotiable Instruments Law).

(C) It S negotiated the check to T, who accepted it in good faith and for value, may R be held secondarily liable by T? Reason Briefly in (a), (b) and (c).

SUGGESTED ANSWER:

Yes, R may be held secondarily liable by T who took the check in good faith and for value. T is a holder in due course. R cannot raise the defense of illegality of the consideration, because T took the check free from the defect of title of S (Section 57, Negotiable Instruments Law).

Negotiable Instruments; Illicit/Illegal Consideration; Lawful Dishonor (2009)

Lorenzo drew a bill of exchange in the amount of P100,000.00 payable to Barbara or order, with his wife, Diana, as drawee. At the time the bill was drawn. Diana was unaware that Barbara is Lorenzo's paramour.

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

(A) Was the bill lawfully dishonored by Diana? Explain. (3%)

SUGGESTED ANSWER:

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

(B) Does the illicit cause or consideration adversely affect the negotiability of the bill? Explain. (3%)

SUGGESTED ANSWER:

No. the illicit cause or consideration does not adversely affect the negotiability of the bill, especially in the hands of a holder in due course. Under Sec. 1 of the Negotiable Instruments law, the bill of exchange is a negotiable instrument. Every negotiable instrument is deemed prima facie to have been issued for valuable consideration, and every

person whose signature appears thereon is deemed to have become a party thereto for value (Sec. 24, Negotiable Instruments Law).

Negotiable Instruments: Subject to a Term (2009)

TRUE OR FALSE. (D) A document, dated July 15, 2009 that reads:

Pay to X or order the sum of \$5,000.00 five days after his pet dog, Sparky, dies. Signed Y.

is a negotiable instrument.

SUGGESTED ANSWER:

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

(Note: This answers presumes that there is a drawee)

Negotiable Instruments; Bill of Exchange Treated as Promissory Note (2015)

C. When can you treat a bill of exchange as a promissory note? (3%)

SUGGESTED ANSWER:

A bill of exchange may be treated as a promissory note in the following instances:

1. The drawee is a fictitious person or a person not having the capacity to contract.

2. The drawer and the drawee are one and the same person.

3. Where the instrument is so ambiguous that there is a doubt as to whether the instrument is a bill or a note, at the option of the holder (Sections 130 and 17 of the Negotiable Instruments Law)

Incomplete & Delivered (2004)

AX, a businessman, was preparing for a business trip abroad. As he usually did in the past, he signed several checks in blank and entrusted them to his secretary with instruction to safeguard them and fill them out only when required to pay accounts during his absence. OB, his secretary, filled out one of the checks by placing her name as the payee. She filled out the amount, endorsed and delivered the check to KC, who accepted it in good faith for payment of gems that KC sold to OB. Later, OB told AX of what she did with regrets. AX timely directed the bank to dishonor the check. Could AX be held liable to KC? Answer and reason briefly. (5%)

SUGGESTED ANSWER:

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

Incomplete and Delivered (2005)

Brad was in desperate need of money to pay his debt to Pete, a loan shark. Pete threatened to take Brad's life if he failed to pay. Brad and Pete went to see Señorita Isobel, Brad's rich cousin, and asked her if she could sign a promissory note in his favor in the amount of P10,000.00 to pay Pete. Fearing that Pete would kill Brad, Señorita Isobel acceded to the request. She affixed her signature on a piece of paper with the assurance of Brad that he will just fill it up later. Brad then filled up the blank paper, making a promissory note for the amount of P100,000.00. He then indorsed and delivered the same to Pete, who accepted the note as payment of the debt. What defense or defenses can Señorita Isobel set up against Pete? Explain. (3%)

SUGGESTED ANSWER:

The defense (personal defense) which Señorita Isobel can set up against Pete is that the amount of P100,000.00 is not in accordance with the authority given to her to Brad (in the presence of Pete) and that Pete was not a holder in due course for acting in bad faith when accepted the note as payment despite his knowledge that it was only 10,000.00 that was allowed by Señorita Isobel during their meeting with Brad.

Incomplete, Delivered; Doctrine: Comparative Negligence (2008)

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

(A) If you were the judge, what issues would you consider relevant to resolve the case? Explain. (3%)

SUGGESTED ANSWER:

The filling up by the officer of his name as payee does not constitute forgery, and contemplates a mechanically incomplete but delivered instrument. Under Sec. 14 of the NIL, in order to enforce an incomplete but delivered instrument against a prior party, it must be filled-up strictly in accordance with the authority given. The doctrine of comparative negligence provides that AB Corp. is deemed negligent for having issued the check with a blank payee section that facilitated the fraud; it should be AB Corp. that must bear the loss, and not XY Bank.

(B) How would you decide the case? Explain. (2%)

SUGGESTED ANSWER:

I would find AB Corp. liable for its negligence in delivering an incomplete instrument to XY Bank (Sec. 14, NIL).

Incomplete Instruments; Incomplete Delivered Instruments vs. Incomplete Undelivered Instrument (2006)

Jun was about to leave for a business trip. As his usual practice, he signed several blank checks. He instructed Ruth, his secretary, to fill them as payment for his obligations. Ruth filled one check with her name as payee, placed P30,000.00 thereon, endorsed and delivered it to Marie. She accepted the check in good faith as payment for goods she delivered to Ruth. Eventually, Ruth regretted what she did and apologized to Jun. Immediately he directed the drawee bank to dishonor the check. When Marie encashed the check, it was dishonored.

1. Is Jun liable to Marie? (5%)

SUGGESTED ANSWER:

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

2. Supposing the check was stolen while in Ruth's possession and a thief filled the blank check, endorsed and delivered it to Marie in payment for the goods he purchased from her, is Jun liable to Marie if the check is dishonored? (5%)

SUGGESTED ANSWER:

No. Even though Marie is a holder in due course, this is an incomplete and undelivered instrument, covered by Section 15 of the Negotiable Instruments Law. Where an incomplete instrument has not been delivered, it will not, if completed and negotiated without authority, be a valid contract in the hands of any holder, as against any person, including Jun, whose signature was placed thereon before delivery. Such defense is a real defense even against a holder in due course, available to a party like Jun whose signature appeared prior to delivery.

Incomplete and Undelivered Instruments; Holder in Due Course (2000)

PN makes a promissory note for P5,000.00, but leaves the name of the payee in blank because he wanted to verify its correct spelling first. He mindlessly left the note on top of his desk at the end of the workday. When he returned the following morning, the note was missing. It turned up later when X presented it to PN for payment. Before X, T, who turned out to have filched the note from PN's office, had endorsed the note after inserting his own name in the blank space as the payee. PN dishonored the note, contending that he did not authorize its completion and delivery. But X said he had no participation in, or knowledge about, the pilferage and alteration of the note and therefore he enjoys the rights of a holder in due course under the Negotiable Instruments Law.

a) Who is correct and why? (3%)

SUGGESTED ANSWER:

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

b) Can the payee in a promissory note be a —holder in due course within the meaning of the Negotiable Instruments Law (Act 2031)? Explain your answer. (2%)

SUGGESTED ANSWER:

b) A payee in a promissory note cannot be a —holder in due course within the meaning of the Negotiable Instruments Law, because a payee is an immediate party in relation to the maker. The payee is subject to whatever defenses, real or personal, available to the maker of the promissory note.

ALTERNATIVE ANSWER:

b) A payee can be a —holder in due course. A holder is defined as the payee or indorsee of the instrument who is in possession of it. Every holder is deemed prima facie to be a holder in due course.

Forgery; Defenses (2004)

CX maintained a checking account with UBANK, Makati Branch. One of his checks in a stub of fifty was missing. Later, he discovered that Ms. DY forged his signature and succeeded to encash P15,000 from another branch of the bank. DY was able to encash the check when ET, a friend, guaranteed due execution, saying that she was a holder in due course. Can CX recover the money from the bank? Reason briefly. (5%)

SUGGESTED ANSWER:

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

Checks: Crossed Checks (2005)

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

SUGGESTED ANSWER:

A Crossed Check under accepted banking practice, crossing a check is done by writing two parallel lines diagonally on the left top portion of the checks. The crossing is special where the name of the bank or a business institution is written between the two parallel lines, which mean that the drawee should pay only with the intervention of that company.

Effects of Crossed Checks:

- 1) The check may not be encashed but only deposited in the bank.**
- 2) The check may be negotiated only once—to one who has an account with a bank.**

- 3) The act of crossing the check serves as a warning to the holder that the check has been issued for a definite purpose, so that he must inquire if he has received the check pursuant to that purpose; otherwise, he is not a holder in due course.

Checks: Crossed Checks vs. Cancelled Checks (2004)
Distinguish clearly (1) crossed checks from cancelled checks;

SUGGESTED ANSWER:

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

Checks; Forged Check; Effects (2006)

Discuss the legal consequences when a bank honors a forged check. (5%)

SUGGESTED ANSWER:

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

On the other hand, if the drawee bank pays under forged indorsement, the drawee bank is still liable the payee as it has guaranteed the genuineness of all prior indorsements. However, the drawee bank may generally pass liability back through the collection chain to the party who obtained the check from the forger and from the forger himself. (*Associated Bank v. Court of Appeals*, 252 SCRA 620, 631-632 [1992])

Check; Manager's Check (2015)

B. Is a manager's check as good as cash? Why or why not? (2%)

SUGGESTED ANSWER:

Yes, the Supreme Court held in various decisions that a manager's check is as good as cash. A manager's check is a check drawn by the bank against itself. It is deemed pre-accepted by the bank from the moment of issuance. The check becomes the primary obligation of the bank which issues it and constitutes its written promise to pay. By issuing it, the bank in effect commits its total resources, integrity and honor behind the check. (*Tan v. Court of Appeals*, 239 SCRA 310 [1989]; *International Corporate bank v. Gueco*, 351 SCRA 516 [2001]; *Metrobank and Trust Company v. Chiok*, GR No. 172652, November 26, 2014)

ALTERNATIVE ANSWER:

Manager's check is not legal tender because under Article 1249 of the Civil Code, checks do not produce the effect of payment until encashed or through the fault of the creditor, their value has been impaired. Moreover, under the Central Bank Act, the debtor cannot compel the creditor to accept checks in payment of a debt whether public or private (*Article 60 of RA 7653*)

Checks; Liability; Drawee Bank (1995)

Mario Guzman issued to Honesto Santos a check for P50th as payment for a 2nd hand car. Without the knowledge of Mario, Honesto changed the amount to P150th which alteration could not be detected by the naked eye. Honesto deposited the altered check with Shure Bank which forwarded the same to Progressive Bank for payment. Progressive Bank without noticing the alteration paid the check, debiting P150th from the account of Mario. Honesto withdrew the amount of P15th from Shure Bank and disappeared. After receiving his bank statement, Mario discovered the alteration and demanded restitution from Progressive Bank. Discuss fully the rights and the liabilities of the parties concerned.

SUGGESTED ANSWER:

The demand of Mario for restitution of the amount of P150,000 to his account is tenable. Progressive Bank has no right to deduct said amount from Mario's account since the order of Mario is different. Moreover, Progressive Bank is liable for the negligence of its employees in not noticing the alteration which, though it cannot be detected by the naked eye, could be detected by a magnifying instrument used by tellers. As between Progressive Bank and Shure Bank, it is the former that should bear the loss. Progressive Bank failed to notify Shure Bank that there was something wrong with the check within the clearing hour rule of 24 hours.

Checks; Liability; Drawee Bank (2015)

A. Nadine has a checking account with Fair & Square Bank. One day, she lost her checkbook and the finder was able to forge her signature and encash the forged check. Will Nadine be able to recover the amount debited from her checking account from Fair & Square Bank? Justify your answer. (3%)

SUGGESTED ANSWER:

Yes, Nadine should be able to recover the amount debited from her checking account from Fair and Square Bank. The Bank is supposed to know the signature of its clients. The Bank was thus negligent in not detecting the forgery of Nadine's signature and paying the check. Under the circumstances, there was no negligence on the part of Nadine which would preclude her from invoking forgery (*Philippine National bank v. Quimpo*, 158 SCRA 583 [1988]).

Checks; Presentment (2003)

A bank issues its own check. May the holder hold the bank liable thereunder if he fails to—

- prove presentment for payment, or
- present the bill to the drawee for acceptance? Explain your answers. (4%)

SUGGESTED ANSWER:

Checks; Validity; Waiver of Bank's liability for negligence (1991)

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

SUGGESTED ANSWER:

In the event that Mr. Lim, in fact, had sufficient legal reasons to issue the stop payment order, he may sue BPI for paying against his order. The waiver executed by Mr. Lim did not mean that it need not exercise due diligence to protect the interest of its account holder. It is not amiss to state that the drawee, unless the instrument has earlier been accepted by it, is not bound to honor payment to the holder of the check that thereby excludes it from any liability if it were to comply with its stop payment order (Sec 61 NIL)

ALTERNATIVE ANSWER:

1991 6b) BPI would not be liable to Mr Lim. Mr Lim and BPI are governed by their own agreement. The waiver executed by Mr Lim, neither being one of future fraud or gross negligence, would be valid. The problem does not indicate the existence of fraud or gross negligence on the part of BPI so as to warrant liability on its part.

Checks; Other Functions/Purposes (2014)

Paul George Pua (Pua) filed a complaint for a sum of money against the spouses Benito and Caroline James (Spouses James). In the complaint, Pua prayed that the defendants pay Pua the amount of P8, 500,000.00, covered by a check. Pua asserts that defendants owed him a sum of money way back in 1988 for which the Spouses James gave him several checks. These checks, however, had all been dishonored and Pua has not been paid the amount of the loan plus the agreed interest. In 1996, the Spouses James approached Pua to get the computation of their liability including the 2% compounded interest. After bargaining to lower the amount of their liability, the Spouses James gave Pua postdated check bearing the discounted amount of P8, 500,000.00. Like the 1988 checks, the drawee bank likewise dishonored this check. To prove his allegations, Pua submitted the original copies of the 17 checks issued by Caroline in 1988 and the check issued in 1996, Manila trust Check No. 750. The Spouses James, on the other hand, completely denied the existence of the debt asserting that they had never approached Pua to borrow money in 1988 or in 1996. They assert, instead, that Pua is simply acting at the instance of his sister, Lilian, to file a false charge against them using a check left to fund a

gambling business previously operated by Lilian and Caroline. Decide. (5%)

SUGGESTED ANSWER:

I will decide in favor of Pua and against the Spouses James.

A check is evidence of indebtedness and proof of an obligation. It can be used in lieu of and for the same purpose as a promissory note. In other words, a check functions more than a promissory note since it only contains an undertaking to pay an amount of money but is an order addressed to a bank and partakes of a representation that the drawer has funds on deposit against which the check is drawn, sufficient to ensure payment upon its presentation to the bank. A check, the entries of which are in writing, could prove a loan transaction. Thus, under the Negotiable Instruments Law, every negotiable instrument is deemed prima facie to have been issued for a valuable consideration, and every person whose signature appears thereon to have become a party for value. (Pua v. Spouses Benito Tiong, G.R. 198660, October 23, 2013).

Checks; Notice of Dishonor (2009)

Gaudencio, a store owner, obtained a P1-million loan from Bathala Financing Corporation (BFC). As security, Gaudencio executed a —Deed of Assignment of Receivables. Assigning fifteen checks received from various customers who bought merchandise from his store. The checks were duly indorsed by Gaudencio's customers.

The Deed of Assignment contains the ff. stipulation:

—If, for any reason, the receivables or any part thereof cannot be paid by the obligors,

the ASSIGNOR unconditionally and irrevocably agrees to pay the same, assuming the liability to pay by way of penalty, three percent of the total amount unpaid, for the period of delay until the same is fully paid.”

When the checks became due, BFC deposited them for collection, but the drawee banks dishonored all the checks for one of the ff. reasons: —account closed, —payment stopped, —account under garnishment, —or —insufficiency of funds.

BFC wrote Gaudencio notifying him of the dishonored checks, and demanding payment of the loan. Because Gaudencio did not pay, BFC filed a collection suit.

In his defense, Gaudencio contended that (a) BFC did not give timely notice of dishonor (of the checks); and (b) considering that the checks were duly indorsed, BFC should proceed against the drawers and the indorsers of the checks. Are Gaudencio's defenses tenable? Explain. (5%)

SUGGESTED ANSWER:

No. Gaudencio's defenses are untenable. The cause of action of BFC was really on the contract of loan, with the checks merely serving as collateral to

secure the payment of the loan. By virtue of the Deed of Assignment which he signed, Gaudencio undertook to pay for the receivables if for any reason they cannot be paid by the obligors (Velasquez v. Solidbank Corporation, 550 SCRA 119 (2008)).

Promissory Note; Place of Payment (2000)

PN is the holder of a negotiable promissory note within the meaning of the Negotiable Instruments Law (Act 2031). The note was originally issued by RP to XL as payee. XL indorsed the note to PN for goods bought by XL. The note mentions the place of payment on the specified maturity date as the office of the corporate secretary of PX Bank during banking hours. On maturity date, RP was at the aforesaid office ready to pay the note but PN did not show up. What PN later did was to sue XL for the face value of the note, plus interest and costs. Will the suit prosper? Explain. (5%)

SUGGESTED ANSWER:

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

Promissory Note; Joint Liability (2001)

X, Y and Z signed a promissory note in favor of A stating:

We promise to pay A on December 31, 2001 the sum of P5,000.00

When the note fell due, A sued X and Y who put up the defense that A should have impleaded Z. Is the defense valid? Why? (5%)

SUGGESTED ANSWER:

The defense is not valid. The liability of X, Y, and Z under the promissory note is joint. Such being the case, Z is not an indispensable party. The fact that A did not implead Z will not prevent A from collecting the proportionate share of X and Y in the payment of the loan. *(Observation: Even if the liability of X, Y, and Z is solidary, the defense would still not be valid)*

Parties; Bearer Instruments; Liabilities of Maker and Indorsers (2001)

A issued a promissory note payable to B or bearer. A delivered the note to B. B indorsed the note to C. C placed the note in his drawer, which was stolen by the janitor X. X indorsed the note to D by forging C's signature. D indorsed the note to E who in turn delivered the note to F, a holder in due course, without indorsement. Discuss the individual liabilities to F of A, B and C. (5%)

SUGGESTED ANSWER:

A is liable to F. As the maker of the promissory note, A is directly or primarily liable to F, who is a holder in due course. Despite the presence of the special indorsements on the note, these do not

detract from the fact that a bearer instrument, like the promissory note in question, is always negotiable by mere delivery, until it is indorsed restrictively For Deposit Only.

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

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

ALTERNATIVE ANSWER:

As a general endorser, B is secondarily liable to F. C is liable to F since it is due to the negligence of C in placing the note in his drawer that enabled X to steal the same and forge the signature of C relative to the indorsement in favor of D. As between C and F who are both innocent parties, it is C whose negligence is the proximate cause of the loss. Hence C should suffer the loss.

Parties; Drawer's Liability to the Holder in Due Course (2012)

X borrowed money from Y in the amount of Php1 Million and as payment, issued a check. Y then indorsed the check to his sister Z for no consideration. When Z deposited the check to her account, the check was dishonored for insufficiency of funds.

a. Is Z a holder in due course? Explain your answer. (5%)

SUGGESTED ANSWERS:

a) Z is not a holder in due course. She did not give any valuable consideration for the check. To be a holder in due course, the holder must have taken the check in good faith and for value (Sec. 52[c], Negotiable Instruments Law).

b. Who is liable on the check? The drawer or the indorser? Explain your answer. (5%)

SUGGESTED ANSWERS:

b) X, the drawer, will be liable. As drawer, X engaged that on due presentment the check would be paid according to its tenor and that if it is dishonored and he is given notice of dishonor, he will pay the amount to the holder (Sec. 61, NIL). No notice of dishonor need be given to X if he is aware that he has insufficient funds in his account. Under Section 114(d) of the Negotiable Instruments Law, notice of dishonor is not required to be given to the drawer

where he has no right to expect that the drawee will honor the instrument.

Z cannot hold Y, the endorser, liable as the tatter can raise the defense that there was no valuable consideration for the endorsement of the check (Sec. 58, NIL).

Parties; Drawer; Drawee Bank; Liability (2010)

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

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

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

Marlon thereupon sues LYRIC Bank which in turn files a third-party complaint against YAMAHA Bank. Discuss the respective rights and liabilities of the banks. (5%)

SUGGESTED ANSWER:

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

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

However, since the issuance of the check was attended with the negligence of Lyric Bank, it should share the loss with Yamaha Bank on a fifty percent basis (Allied Banking Corporation v. Lim Sio Wan, 549 SCRA 504 (2008)).

Parties; Drawee Bank; Liability; Forgery (2008)

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

(A) Pancho asked the payor bank to recredit his account. Should the bank comply? Explain fully. (3%)

SUGGESTED ANSWER:

Yes, Sec. 41 of the NIL provides that all payees or indorsees who are not partners must indorse jointly, unless the one indorsing has authority to endorse for the others. Since the signature of Gerard was forged, then the endorsement by Bong was wholly inoperative. The Bank is under strict liability to pay to the order of payee. Payment under a forged

endorsement is not to the drawer's order, and consequently, the drawee bank must bear the loss as against the drawer (Associated Bank v. CA, G.R. Nos. 107382 and 107612, 31 January 1996).

(B) Based on the facts, was Pancho as drawer discharged on the instrument? Why? (2%)

SUGGESTED ANSWER:

No. The payee Gerard can recover as he still retains his claim on the debt of Pancho.

Parties; Drawee Bank; Liability for Forgery (2009)

(E) —A bank is bound to know its depositor's signature is an inflexible rule in determining the liability of a bank in forgery cases.

SUGGESTED ANSWER:

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

Parties; Accommodation Party (2003)

Susan Kawada borrowed P500,000 from XYZ Bank which required her, together with Rose Reyes who did not receive any amount from the bank, to execute a promissory note payable to the bank, or its order on stated maturities. The note was executed as so agreed. What kind of liability was incurred by Rose, that of an accommodation party or that of a solidary debtor? Explain. (4%)

SUGGESTED ANSWER:

Parties; Accommodation Party (2003)

Juan Sy purchased from —All Appliance Center one generator set on installment with chattel mortgage in favor of the vendor. After getting hold of the generator set, Juan Sy immediately sold it without consent of the vendor. Juan Sy was criminally charged with estafa. To settle the case extra judicially, Juan Sy paid the sum of P20,000 and for the balance of P5,000.00 he executed a promissory note for said amount with Ben Lopez as an accommodation party. Juan Sy failed to pay the balance.

1) What is the liability of Ben Lopez as an accommodation party? Explain.

SUGGESTED ANSWER:

2) What is the liability of Juan Sy?

SUGGESTED ANSWER:

Parties; Accommodation Party (2005)

Dagul has a business arrangement with Facundo. The latter would lend money to another, through Dagul, whose name would appear in the promissory note as the lender. Dagul would then immediately indorse the note to Facundo. Is Dagul an accommodation party? Explain. (2%)

SUGGESTED ANSWER:

YES! Dagul is an accommodation party because in the case at bar, he is essentially, a person who signs as maker without receiving any consideration, signs as an accommodation party merely for the purpose of lending the credit of his name. And as an accommodation party he cannot set up lack of consideration against any holder, even as to one who is not a holder in due course.

Parties; Holder in Due Course; Indorsement in blank (2002)

A. AB issued a promissory note for P1,000 payable to CD or his order on September 15, 2002. CD indorsed the note in blank and delivered the same to EF. GH stole the note from EF and on September 14, 2002 presented it to AB for payment. When asked by AB, GH said CD gave him the note in payment for two cavans of rice. AB therefore paid GH P1,00 on the same date. On September 15, 2002, EF discovered that the note of AB was not in his possession and he went to AB. It was then that EF found out that AB had already made payment on the note. Can EF still claim payment from AB? Why? (3%)

SUGGESTED ANSWER:

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

B. As a sequel to the same facts narrated above, EF, out of pity for AB who had already paid P1,000.00 to GH, decided to forgive AB and instead go after CD who indorsed the note in blank to him. Is CD still liable to EF by virtue of the indorsement in blank? Why? (2%)

SUGGESTED ANSWER:

B. No, because CD negotiated the instrument by delivery.

Parties; Accommodation Party; Liability (2014)

A criminal complaint for violation of B.P. 22 was filed by Foton Motors (Foton), an entity engaged in the business of car dealership, against Pura Felipe (Pura) with the

Office of the City Prosecutor of Quezon City. The Office found probable cause to indict Pura and filed an information before the Metropolitan Trial Court (MeTC) of Quezon City, for her issuance of a postdated check in the amount of P1, 020,000.00 which was subsequently dishonored upon presentment due to "Stop Payment."

Pura issued the check because her son, Freddie, attracted by a huge discount of P220,000.00, purchased a Foton Blizzard 4x2 from Foton. The term of the transaction was Cash-on-Delivery and no down payment was required. The car was delivered on May 14, 1997, but Freddie failed to pay upon delivery. Despite non-payment, Freddie took possession of the vehicle.

Pura was eventually acquitted of the charge of violating B.P. 22 but was found civilly liable for the amount of the check plus legal interest. Pura appealed the decision as regards the civil liability, claiming that there was no privity of contract between Foton and Pura. No civil liability could be adjudged against her because of her acquittal from the criminal charge. It was Freddie who was civilly liable to Foton, Pura claimed. Pura added that she could not be an accommodation party either because she only came in after Freddie failed to pay the purchase price, or six (6) months after the execution of the contract between Foton and Freddie. Her liability was limited to her act of issuing a worthless check, but by her acquittal in the criminal charge, there was no more basis for her to be held civilly liable to Foton. Pura's act of issuing the subject check did not, by itself, assume the obligation of Freddie to Foton or automatically make her a party to the contract. Is Pura liable? (5%)

SUGGESTED ANSWER:

Pura is liable for Foton Motors because it sold a car to her son and was a holder for value of the check issued in its favor by Pura. Any person criminally liable for felony is also civilly liable. Thus, her acquittal in the criminal charge does not carry with its extinction of her civil liability unless the extinction proceeds from a declaration in a final judgment that the fact from which the civil might arise did not exist. (People v. Maniego, G.R. L-30910, February 27, 1987).

More specifically, Pura is liable as an accommodation party. Under Section 29 of the Negotiable Instruments Law, an accommodation party is one who has signed the instrument as maker, drawer, acceptor, or indorser, without receiving value therefor, and for the purpose of lending his name to some other person. Such a person is liable on the instrument to a holder for value, notwithstanding such holder, at the time of taking the instrument, knew him to be only an accommodation party.

Pura's liability existed although Pura issued the check after the delivery of the car. Under Section 25 of the Negotiable Instruments Law, an antecedent or pre-existing debt constitutes value and is deemed such whether the instrument is payable on demand or at a future time.

Parties; Subsequent Party; Liability (2008)

(A) As a rule under the Negotiable Instruments Law, a

subsequent party may hold a prior party liable but not vice versa. Give two (2) instances where a prior party may hold a subsequent party liable. (2%)

SUGGESTED ANSWER:

In the following cases, a prior party may hold a subsequent party liable: (1) where an instrument is negotiated back to a prior party, and he reissues and further negotiates the same, he is entitled to enforce payment against a subsequent party who qualifies as an intervening party to whom the prior party is not personally liable; and (2) in the case of an accommodation party arrangement, where the accommodation party may recover from the party accommodated, even when the latter is a subsequent party (Sec. 29, NIL).

Parties; Holder in Due Course; Shelter Principle (2008)
(B) How does the —shelter principle embodied in the Negotiable Instruments Law operate to give the rights of a holder-in-due course to a holder who does not have the status of a holder-in-due course? Briefly explain. (2%)

SUGGESTED ANSWER:

The “shelter principle” provides that a holder who is not himself a holder in due course but is not a party to any fraud or illegality affecting the instrument, and who derives his title from a holder in due course, acquires the rights of a holder in due course (Sec. 58, NIL).

Parties; Indorser: Irregular Indorser vs. General Indorser (2005)

Distinguish an irregular indorser from a general indorser. (3%)

SUGGESTED ANSWER:

Irregular Indorser is not a party to the instrument but he places his signature in blank before delivery. He is not a party but he becomes one because of his signature in the instrument. Because his signature he is considered an indorser and he is liable to the parties in the instrument. While, a General Indorser warrants that the instrument is genuine, that he has a good title to it, that all prior parties had capacity to contract; that the instrument at the time of the indorsement is valid and subsisting; and that on due presentment, the instrument will be accepted or paid or both accepted and paid according to its tenor, and that if it is dishonored, he will pay if the necessary proceedings for dishonor are made.

Discharge by Novation (2014)

Bong bought 300 bags of rice from Ben for P300,000.00. As payment, Bong indorsed to Bena Bank of the Philippine Islands (BPI) check issued by Baby in the amount of P300,000.00. Upon presentment for payment, the BPI check was dishonored because Baby's account from which it was drawn has been closed. To replace the dishonored check, Bong indorsed a crossed Development Bank of the Philippines (DBP) check issued also by Baby for P300, 000.00. Again, the check was dishonored because of insufficient funds. Ben sued Bong and Baby on the dishonored BPI check. Bong interposed

the defense that the BPI check was discharged by novation when Ben accepted the crossed DBP check as replacement for the BPI check. Bong cited Section 119 of the Negotiable Instruments Law which provides that a negotiable instrument is discharged "by any other act which will discharge a simple contract for the payment of money." Is Bong correct? (4%)

SUGGESTED ANSWER:

Bong is not correct. His claim that the BPI check was discharged by novation when Ben accepted the crossed DBP check as replacement for the BPI check is unmeritorious.

Ben's acceptance of the DBP check, which replaced the dishonored BPI check, did not result in novation as there was no express agreement to establish that Bong was already discharged from his liability to pay Ben the amount of P300, 000.00 as payment for the 300 bags of rice. Novation is never presumed. There must be an express intention to novate. In fact, when the DBP check was delivered to Ben, the same was also indorsed by Bong which shows Bong's recognition of the existing obligation to Ben to pay P214,000.00 subject of the replaced BPI check.

Moreover, Ben's acceptance of DBP check did not result in any incompatibility, since two checks – BPI and DBP checks – were precisely for the purpose of paying the amount of P214,000.00, i.e., the credit obtained from the purchase of the 300 bags of rice from Ben. Indeed, there was no substantial change in the object or principal condition of the obligation of Bong as the indorser of the check to pay the amount of P214,000.00. It would appear that Ben accepted the DBP check to give Bong the chance to pay his obligation. (Salazar v. J.Y. Brothers Marketing Corporation, G.R. 171998, dated October 20, 2010).

INSURANCE CODE

Perfection of Insurance Contracts (2003)

Josie Gatbonton obtained from Warranty Insurance Corporation a comprehensive motor vehicle insurance to cover her brand new automobile. She paid, and the insurer accepted payment in check. Before the check could be encashed, Josie was involved in a motor vehicle accident where her car became a total wreck. She sought payment from the insurer. Could the insurer be made liable under the insurance coverage? (6%)

SUGGESTED ANSWER:

Perfection of Insurance Contracts (2009)

Antarctica Life Assurance Corporation (ALAC) publicly offered a specially designed insurance policy covering persons between the ages of 50 to 75 who may be afflicted with serious and debilitating illnesses. Quirico applied for insurance coverage, stating that he was already 80 years old. Nonetheless, ALAC approved his application. Quirico then requested ALAC for the issuance of a cover note while he was trying to raise funds to pay the insurance premium. ALAC granted the request. Ten days after he received the cover note, Quirico had a heart seizure and had to be hospitalized. He then filed a claim on the policy.

(A) Can ALAC validly deny the claim on the ground that the insurance coverage, as publicly offered, was available only to persons 50 to 75 years of age? Why or why not? (2%)

SUGGESTED ANSWER:

No. By approving the application of Quirino who disclosed that he was already 80 years old, ALAC waived the age requirement. ALAC is now stopped from raising such defense of age of the insured.

(B) Did ALAC's issuance of a cover note result in the perfection of an insurance contract between Quirico and ALAC? Explain. (3%)

SUGGESTED ANSWER:

The issuance of a cover note by ALAC resulted in the perfection of the contract of insurance. In that case, it is only because there is delay in the issuance of the policy that the cover notes was issued.

The cover note is a receipt whereby the company agrees to insure the insured for 60 days pending the issuance of a regular policy. No separate premium is to be paid on a cover note. It is not a separate policy but is integrated in the regular policy to be subsequently issued.

Bond: Cash Bond vs. Surety Bond (2004)

Distinguish clearly cash bond from surety bond.

SUGGESTED ANSWER:

A SURETY BOND is issued by a surety or insurance company in favor of a designated beneficiary, pursuant to which such company acts as a surety to the debtor or obligor of such beneficiary. A CASH BOND is a security in the form of cash established by a guarantor or surety to secure the obligation of another.

Beneficiary: Effects: Irrevocable Beneficiary (2005)

What are the effects of an irrevocable designation of a beneficiary under the Insurance Code? Explain. (2%)

SUGGESTED ANSWER:

The irrevocable designation gives the beneficiary a vested right over Life Insurance. The Insured cannot act to divest the irrevocable beneficiary, in whole or in part, without the beneficiary's consent. To be specific:

- (1) The beneficiary designated in a life insurance contract cannot be changed without the consent of the beneficiary because he has a vested interest in the policy (*Philamlife v. Pineda, G.R. No. 54216, July 19, 1989, citing Grcio v. Sun Life, G.R. No. 23703, September 28, 1925; and Go v. Redfern, G.R. No. 47705, April 25, 1941*);
- (2) Neither can the Insured take the cash surrender value, assign or even borrow on said policy without the beneficiary's consent (*Nario v. Philamlife, G.R. No. 22796, June 26, 1967*);
- (3) The Insured cannot add another beneficiary because that would reduce the amount which the first beneficiary may recover and therefore adversely affect his vested right (*Go v. Redfern, G.R. No. 47705, April 25, 1941*);
- (4) Unless the policy allows, the Insured cannot even designate another beneficiary should the original beneficiary predecease him. His estate acquires the beneficiary's vested right upon his death; and
- (5) The Insured cannot allow his creditors to attach or execute on the policy. (*Philamlife v. Pineda, G.R. No. 54216, July 19, 1989*)

Beneficiary: Rights; Irrevocable Beneficiary (2005)

Jacob obtained a life insurance policy for P1 Million designating irrevocably Diwata, a friend, as his beneficiary. Jacob, however, changed his mind and wants Yob and Jojo, his other friends, to be included as beneficiaries considering that the proceeds of the policy are sufficient for the three friends. Can Jacob still add Yob and Jojo as his beneficiaries? Explain. (2%)

SUGGESTED ANSWER:

No, Jacob can no longer add Yob and Jojo as his beneficiaries in addition to Diwata. As the irrevocable beneficiary, Diwata has acquired a-vested right over Jacob's life insurance policy. Any additional beneficiaries will reduce the amount which Diwata, as the first beneficiary, may recover, which will adversely affect her vested right. (*Go v. Redfern, G.R. No. 47705, April 25, 1941*)

Beneficiary; Designation Thereof; Incontestability Clause (2014)

On July 3, 1993, Delia Sotero (Sotero) took out a life insurance policy from Ilocos Bankers Life Insurance Corporation (Ilocos Life) designating Creencia Aban (Aban), her niece, as her beneficiary. Ilocos Life issued Policy No. 747, with a face value of P100,000.00, in Sotero's favor on August 30, 1993, after the requisite medical examination and payment of the premium.

On April 10, 1996, Sotero died. Aban filed a claim for the insurance proceeds on July 9, 1996. Ilocos Life conducted an investigation into the claim and came out with the following findings:

1. Sotero did not personally apply for insurance coverage, as she was illiterate.
2. Sotero was sickly since 1990.
3. Sotero did not have the financial capability to pay the premium on the policy.
4. Sotero did not sign the application for insurance.
5. Aban was the one who filed the insurance application and designated herself as the beneficiary.

For the above reasons and claiming fraud, Ilocos Life denied Aban's claim on April 16, 1997, but refunded the premium paid on the policy. (6%)

(A) May Sotero validly designate her niece as beneficiary?

SUGGESTED ANSWER:

Yes, Sotero may validly designate her niece as beneficiary. The same is not prohibited under the Insurance Code or any other law pertinent to the problem.

(B) May the incontestability period set in even in cases of fraud as alleged in this case?

SUGGESTED ANSWER:

Yes, the incontestability period applies even in cases of fraud as claimed in this problem. Note that the findings are those of the insurer and these were made in an investigation conducted unilaterally by the insurer more than 3 years after the policy was taken out by Sotero. These finding may very well be dismissed as self-serving considering the incontestability clause set out in Section 48 of the Insurance Code.

Section 48 regulates both the actions of the insurers and prospective takers of life insurance. It gives insurers enough time to inquire whether the policy was obtained by fraud, concealment, or misrepresentation; on the other hand, it forewarns scheming individuals that their attempts at insurance fraud would be timely uncovered – thus deterring them from venturing into such nefarious enterprise. At the same time, legitimate policy holders are absolutely protected from unwarranted denial of their claims or delay in the collection of insurance proceeds occasioned by allegations of fraud, concealment, or misrepresentation by insurers, claims which may no longer be set up after the two-year period expires as ordained under the law.

Thus, the self-regulating feature of Section 48 lies in the fact that both the insurer and the insured are given the assurance that any dishonest scheme to obtain life insurance would be exposed, and attempts at unduly denying a claim would be struck down. Life insurance policies that pass the statutory two-year period are essentially treated as legitimate and beyond question, and the individuals who wield them are made secure by the thought that they will be paid promptly upon claim. In this manner, Section 48 contributes to the stability of the insurance industry.

Section 48 prevents a situation where the insurer knowingly continues to accept annual premium payments on life insurance, only to later on deny a claim on the policy on specious claims of fraudulent concealment and misrepresentation, such as what obtains in the instant case. Thus, instead of conducting at the first instance an investigation into the circumstances surrounding the issuance of the insurance policy which would have timely exposed the supposed flaws and irregularities attending it as it now professes, Ilocos Life appears to have turned a blind eye and opted instead to continue collecting the premiums on the policy. For nearly three years, petitioner collected the premiums and devoted the same to its own profit. It cannot now deny the claim when it is called to account. Section 48 must be applied to it with full force and effect.

Insurers may not be allowed to delay the payment of claims by filing frivolous cases in court, hoping that the inevitable may be put off for years – or even decades – by the pendency of these unnecessary court cases. In the meantime, they benefit from collecting the interest and/or returns on both the premiums previously paid by the insured and the insurance proceeds which should otherwise go to their beneficiaries. The business of insurance is a highly regulated commercial activity in the country, and is imbued with public interest. An insurance contract is a contract of adhesion that must be construed liberally in favor of the insured and strictly against the insurer in order to safeguard the [former's] interest. (Manila Bankers Life Insurance Corp. vs. Aban, G. R. 175666, July 29, 2013)

(C) Is Aban entitled to claim the proceeds under the policy?

SUGGESTED ANSWER:

Yes, Aban is entitled to claim the proceeds under the policy as beneficiary for the same reasons adduced in (B) above.

Beneficiary; Death of Insured Due to Beneficiary (2008)

On January 1, 2000, Antonio Rivera secured a life insurance from SOS Insurance Corp. for P1 Million with Gemma Rivera, his adopted daughter, as the beneficiary. Antonio Rivera died on March 4, 2005 and in the police investigation, it was ascertained that Gemma Rivera participated as an accessory in the killing of Antonio Rivera. Can SOS Insurance Corp. avoid liability by

setting up as a defense the participation of Gemma Rivera in the killing of Antonio Rivera? Discuss with reasons. (4%)

SUGGESTED ANSWER:

Under Sec. 12 of the Insurance Code. The interest of a beneficiary shall be forfeited when the beneficiary is the principal, accomplice, or accessory in willfully bringing about the death of the insured. In which event, the nearest relative of the insured shall receive the proceeds of said insurance, if not otherwise disqualified. Thus, the insurance company must still pay out the proceed of the life insurance policy to the nearest qualified relative of the insured.

Insurable Interest: Public Enemy (2000)

May a member of the MILF or its breakaway group, the Abu Sayyaf, be insured with a company licensed to do business under the Insurance Code of the Phils (PD 1460)? Explain. (3%)

SUGGESTED ANSWER:

A member of the MILF or the Abu Sayyaf may be insured with a company licensed to do business under the Insurance Code of the Phils. What is prohibited to be insured is a public enemy. A public enemy is a citizen or national of a country with which the Philippines is at war. Such member of the MILF or the Abu Sayyaf is not a citizen or national of another country, but of the Philippines.

Insurable Interest; Life vs. Property Insurance (2000)

IS, an elderly bachelor with no known relatives, obtained life insurance coverage for P250,000.00 from Starbrite Insurance Corporation, an entity licensed to engage in the insurable business under the Insurance Code of the Philippines (PD1460). He also insured his residential house for twice that amount within the same corporation. He immediately assigned all his rights to the insurance proceeds to BX, a friend-companion living with him. Three years later, IS died in a fire that gutted his insured house two days after he had sold it. There is no evidence of suicide or arson or involvement of BX in these events. BX demanded payment of the insurance proceeds from the two policies, the premiums for which IS had been faithfully paying during all the time he was alive. Starbrite refused payment, contending that BX had no insurable interest and therefore was not entitled to receive the proceeds from IS's insurance coverage on his life and also on his property. Is Starbrite's contention valid? Explain? (5%)

SUGGESTED ANSWER:

Starbrite is correct with respect to the insurance coverage on the property of IS. The beneficiary in the property insurance policy or the assignee thereof must have insurable interest in the property insured. BX, a mere friend-companion of IS, has no insurable interest in the residential house of IS. BX is not entitled to receive the proceeds from IS's insurance on his property. As to the insurance coverage on the life of IS, BX is entitled to receive the proceeds. There is no requirement that BX should have

insurable interest in the life of IS. It was IS himself who took the insurance on his own life.

Insurable Interest; Life vs. Property Insurance (2002)

Distinguish insurable interest in property insurance from insurable interest in life insurance. (5%)

SUGGESTED ANSWER:

- a) In property insurance, the expectation of benefit must have a legal basis. In life insurance, the expectation of benefit to be derived from the continued existence of a life need not have any legal basis.
- b) In property insurance, the actual value of the interest therein is the limit of the insurance that can validly be placed thereon. In life insurance, there is no limit to the amount of insurance that may be taken upon life.
- (1) In property insurance, an interest insured must exist when the insurance takes effect and when the loss occurs but need not exist in the meantime. In life insurance, it is enough that insurable interest exists at the time when the contract is made but it need not exist at the time of loss.

Insurable Interest; Property Insurance (2001)

JQ, owner of a condominium unit, insured the same against fire with the XYZ Insurance Co., and made the loss payable to his brother, MLQ. In case of loss by fire of the said condominium unit, who may recover on the fire insurance policy? State the reason(s) for your answer. (5%)

SUGGESTED ANSWER:

JQ can recover on the fire insurance policy for the loss of said condominium unit. He has the insurable interest as owner-insured. As beneficiary in the fire insurance policy, MLQ cannot recover on the fire insurance policy. For the beneficiary to recover on the fire or property insurance policy, it is required that he must have insurable interest in the property insured. In this case, MLQ does not have insurable interest in the condominium unit.

Insurable Interest; Property Insurance (2015)

A. Novette entered into a contract for the purchase of certain office supplies. The goods were shipped. While in transit, the goods were insured by Novette. Does she have an insurable interest over the goods even before delivery of the same to her? Explain. (2%)

SUGGESTED ANSWER:

Yes, Novette has an insurable interest in the goods. The contract of sale was already perfected and Novette acquired interest thereon although the goods have yet to be delivered.

Insurable Interest; Building Destroyed by Fire (2010)

To secure a loan of P10 million, Mario mortgaged his building to Armando. In accordance with the loan arrangements, Mario had the building insured with First Insurance Company for P10 million, designating Armando as the beneficiary.

Armando also took an insurance of the building upon his own interest with Second Insurance Company for P5 million.

The building was totally destroyed by fire, a peril insured against under both insurance policies. It was subsequently determined that the fire had been intentionally started by Mario and that in violation of the loan agreement, he had been storing inflammable materials in the building.

(A) How much, if any, can Armando recover from either or both insurance companies? (2%)

SUGGESTED ANSWER:

Armando can receive P5 million from Second Insurance Company. As mortgagee, he had an insurable interest in the building (*Panlileo v. Cosio*, 97 Phil. 919 (1955)). Armando cannot collect anything from First Insurance Company. First Insurance Company is not liable for the loss of the building. First, it was due to a willful act of Mario, who committed arson (Section 87 of the Insurance Code; *East Furnitures, Inc. v. Globe & Rutgers Fire Insurance Company*, 57 Phil. 576 (1932)). Second, fire insurance policies contain a warranty that the insured will not store hazardous materials within the insured premises. Mario breached this warranty when he stored inflammable materials in the building. (*Young v. Midland Textile Insurance Company*, 30 Phil. 617 (1915)). These two factors exonerate First Insurance Company from liability to Armando as mortgagee even though it was Mario who committed them (Section 8 of the Insurance Code).

(B) What happens to the P10 million debt of Mario to Armando? Explain. (3%)

SUGGESTED ANSWER:

Since Armando would have collected P5 million from Second Insurance Company, this amount should be considered as partial payment of the loan. Armando can only collect the balance of P5 million (*Panlileo v. Cosio*, supra). Second Insurance Company can recover from Mario the amount of P5 million it paid, because it became subrogated to the rights of Armando (*Panlileo v. Cosio*, supra).

Insurable Interest; Assignment Thereof (2009)

Ciriaco leased a commercial apartment from Supreme Building Corporation (SBC). One of the provisions of the one-year lease contract states:

—18.xxx The LESSEE shall not insure against fire the chattels, merchandise, textiles, goods and effects placed at any stall or store or space in the leased premises without first obtaining the written consent of the LESSOR. If the LESSEE obtains fire insurance coverage without the consent of the LESSOR, the insurance policy is deemed assigned and transferred to the LESSOR for the latter's benefit.

Notwithstanding the stipulation in the contract, without the consent of SBC, Ciriaco insured the merchandise inside the leased premises against loss by fire in the

amount of P500, 000 with First United Insurance Corporation (FUIC).

A day before the lease contract expired, fire broke out inside the leased premises, damaging Ciriaco's merchandise. Having learned of the insurance earlier procured by Ciriaco, SBC demanded from FUIC that the proceeds of the insurance policy be paid directly to it, as provided in the lease contract.

Who is legally entitled to receive the insurance proceeds? Explain. (4%)

SUGGESTED ANSWER:

Ciriaco is entitled to receive the proceeds of the insurance policy. The stipulation that the policy is deemed assigned and transferred to SBC is void, because SBC has no insurable interest in the merchandise of Ciriaco (*Cha v. Court of Appeals*, 277 SCRA 690 (1997)).

Insurable Interest; Void Marriage (2014)

Carlo and Bianca met in the La Boracay festivities. Immediately, they fell in love with each other and got married soon after. They have been cohabiting blissfully as husband and wife, but they did not have any offspring. As the years passed by, Carlo decided to take out an insurance on Bianca's life for P1, 000,000.00 with him (Carlo) as sole beneficiary, given that he did not have a steady source of income and he always depended on Bianca both emotionally and financially. During the term of the insurance, Bianca died of what appeared to be a mysterious cause so that Carlo immediately requested for an autopsy to be conducted. It was established that Bianca died of a natural cause. More than that, it was also established that Bianca was a transgender all along – a fact unknown to Carlo. Can Carlo claim the insurance benefit? (5%)

SUGGESTED ANSWER:

Yes, Carlo can claim the insurance benefit. He had insurable interest on Bianca's life under Section 10 [b] of the Insurance Code as the problem states that Carlo "always depended on Bianca both emotionally and financially." The insurable interest upon the life of another under the aforesaid provision need not be based on kinship or legal obligation to give support (see *Alvendiam*, *The Law of Insurance in the Philippines*, 1968 ed., p. 42; *Martin*, *Commentaries and Jurisprudence on the Philippine Commercial Laws*, vol. 2, 1986 ed., p.21). The fact that their marriage may be void is irrelevant.

Double Insurance (2005)

When does double insurance exist? (2%)

SUGGESTED ANSWER:

Under Section 93 of the Insurance Code, there is double insurance when there is over-insurance with two or more companies, covering the same property, the same insurable interest and the same risk. Double insurance exists where the same person is insured by several insurers separately in respect of the same subject matter and interests. (*Geagonia v. Court of Appeals*, G.R. No. 114427, February 6, 1995)

Double Insurance; Several Insurers (2005)

What is the nature of the liability of the several insurers in double insurance? Explain. (2%)

SUGGESTED ANSWER:

The nature of the liability of the several insurers in double insurance is that each insurer is bound to the contribute ratably to the loss in proportion to the amount for which he is liable under his contract as provided for by Sec 94 of ICP par. The ratable contribution of each of each insurer will be determined based on the following formula: $\text{AMOUNT OF POLICY} \div \text{TOTAL INSURANCE TAKEN} \times \text{LOSS} = \text{LIABILITY OF THE INSURER}$.

ALTERNATIVE ANSWER:

Each insurer is bound, as between himself and other insurers, to contribute ratably to the loss in proportion to the amount for which he is liable under his contract. (Sec. 94, Insurance Code)

Double Insurance (2008)

Terrazas de Patio Verde, a condominium building, has a value of P50 Million. The owner insured the building against fire with three (3) insurance companies for the following amounts:

Northern Insurance Corp. – P20 Million
Southern Insurance Corp. – P30 Million
Eastern Insurance Corp. – P50 Million

(A) Is the owner's taking of insurance for the building with three (3) insurers valid? Discuss. (3%)

SUGGESTED ANSWER:

Taking out insurance covering the same property, same insurable interest and same risk with three insurance companies is "double insurance," recognized under Sec. 93 of the Insurance Code. However, in *American Home Assurance Co. v. Chua*, G.R. No. 130421, 28 June 1999, the court referred to the common inclusion of the "other insurance clause" in fire insurance policies, requiring disclosure of co-insurance of the same property with other insurers.

(B) The Building was totally razed by fire. If the owner decides to claim from Eastern Insurance Corp. only P50 Million, will the claim prosper? Explain. (2%)

SUGGESTED ANSWER:

Insured can recover from Eastern Insurance Corp. up to the extent of his loss. However, Eastern may refuse to pay if the policy contains an "other insurance clause" stipulating that non-disclosure of double insurance will void the policy (*Geagonia v. Country Bankers Insurance*, G.R. No. 114427, 06 February 1995.) As there is no indication of a contractual prohibition on double or other insurance, all insurance contracts over the building are deemed valid and enforceable.

The law prohibits double or over-recovery, not double insurance. Since Eastern insured the property up to 50% of the total coverage, it is liable for only 50% of the total actual loss. Eastern insurance

Corp. is liable to the extent of its coverage but may recover one-half of the total indemnity from the co-insurers in the proportion of 60% (Southern Insurance) – 40% (Northern Insurance).

Double Insurance (2012)

X borrowed from CCC Bank. She mortgaged her house and lot in favor of the bank. X insured her house. The bank also got the house insured.

a. Is this double insurance? Explain your answer. (3%)

SUGGESTED ANSWERS:

a. No, there is no double insurance. Double insurance exists where the same person is insured by several insurers separately with respect to the same subject and interest. (Sec. 93, Insurance Code)

b. Is this legally valid? Explain your answer. (3%)

SUGGESTED ANSWERS:

b. Yes, X and CCC Bank can both insure the house as they have different insurable interests therein. X, the borrower-mortgagor, has an insurable interest in the house being the owner thereof while CCC Bank, the lender, also has an insurable interest in the house as mortgagee thereof.

c. In case of damage, can X and CCC Bank separately claim for the insurance proceeds? (4%)

SUGGESTED ANSWERS:

c. Yes. If X obtained an open policy then she could claim an amount corresponding to the extent of the damage based on the value of the house determined as of the date the damage occurred, but not to exceed the face value of the insurance policy; however, if she obtained a valued policy then she could claim an amount corresponding to the extent of the damage based on the agreed upon valuation of the house.

As for CCC Bank, it could claim an amount corresponding to the extent of the damage but not to exceed the amount of the loan it extended to X or so much thereof as may remain unpaid.

Co-Insurance vs. Re-Insurance (1994)

Distinguish co-insurance from re-insurance.

SUGGESTED ANSWER:

CO-INSURANCE is the percentage in the value of the insured property which the insured himself assumes or undertakes to act as insurer to the extent of the deficiency in the insurance of the insured property. In case of loss or damage, the insurer will be liable only for such proportion of the loss or damage as the amount of insurance bears to the designated percentage of the full value of the property insured. REINSURANCE is where the insurer procures a third party, called the reinsurer, to insure him against liability by reason of such original insurance. Basically, a reinsurance is an insurance against liability which the original insurer may incur in favor of the original insured.

Mutual Insurance Company; Nature & Definition (2006)

What is a mutual insurance company or association?

SUGGESTED ANSWER:

A mutual life insurance corporation is a cooperative that promotes the welfare of its own members, with the money collected from among themselves and solely for their own protection and not for profit. Members are both the insurer and insured. A mutual life insurance company has no capital stock and relies solely upon its contributions or premiums to meet unexpected losses, contingencies and expenses (*Republic v. Sunlife, G.R. No 158085, October 14, 2005*).

Premiums; Late Payment (2010)

Enrique obtained from Seguro Insurance Company a comprehensive motor vehicle insurance to cover his top of the line Aston martin. The policy was issued on March 31, 2010 and, on even date, Enrique paid the premium with a personal check postdated April 6, 2010.

On April 5, 2010, the car was involved in an accident that resulted in its total loss.

On April 10, 2010, the drawee bank returned Enrique's check with the notation —Insufficient funds. Upon notification, Enrique immediately deposited additional funds with the bank and asked the insurer to redeposit the check.

Enrique thereupon claimed indemnity from the insurer. Is the insurer liable under the insurance coverage? Why or why not? (3%)

SUGGESTED ANSWER:

The insurer is not liable under the insurance policy. Under Article 1249 of the Civil Code, the delivery of a check produces the effect of payment only when it is encashed. The loss occurred on April 5, 2010. When the check was deposited, it was returned on April 10, 2010, for insufficiency of funds. The check was honored only after Enrique deposited additional funds with the bank. Hence, it did not produce the effect of payment (Vitug, Commercial Laws and Jurisprudence, Vol. I, p.250).

ALTERNATIVE ANSWER:

Yes. The insurer is liable. The insurance policy was issued. In effect, there was a grant of credit for the payment of the premium. The insurer can deduct the amount of the check from the proceeds of the insurance.

Premiums; Payment by Check (2007)

Alfredo took out a policy to insure this commercial building fire. The broker for the insurance company agreed to give a 15-day credit within which pay the insurance premium. Upon delivery of the policy on May 15, 2006, Alfredo issued a postdated check payable on May 30, 2006. On May 28, 2006, a fire broke out and destroyed the building owned by Alfredo. (10%)

(A) May Alfredo recover on the insurance policy?

SUGGESTED ANSWER:

Yes, Alfredo may recover on the policy. It is valid to stipulate that the insured will be granted credit term

for payment of premium. Payment by means of a check which was accepted by the insurer, bearing a date prior to the loss, would be sufficient. The subsequent effects of encashment retroact to the date of the check (UCPB General Insurance Co., Inc. v. MasaganaTelamart, Inc., 356 SCRA 307 [2001]).

(B) Would your answer in (a) be the same if it was found that the proximate cause of the fire was an explosion and that fire was but the immediate cause of loss and there is no excepted peril under the policy?

SUGGESTED ANSWER:

Yes, recovery under the insurance contract is allowed if the cause of the loss was either the proximate or the immediate cause as long as an excepted peril, if any was not the proximate cause of the loss (Section 86, Insurance Code of the Philippines).

(C) If the fire was found to have been caused by Alfredo's own negligence, can he still recover on the policy? Reason briefly in (a), (b) and (c).

SUGGESTED ANSWER:

Yes, mere negligence on the part of the insured will not prevent recovery under the insurance policy. The law merely prevents recovery when the cause of loss is the willful act of the insured, alone or in connivance with others (Section 87, Insurance Code of The Philippines).

Premiums; Payment by Check (2014)

On September 25, 2013, Danny Marcial (Danny) procured an insurance on his life with a face value of P5,000,000.00 from RN Insurance Company (RN), with his wife Tina Marcial (Tina) as sole beneficiary. On the same day, Danny issued an undated check to RN for the full amount of the premium. On October 1, 2013, RN issued the policy covering Danny's life insurance. On October 5, 2013, Danny met a tragic accident and died. Tina claimed the insurance benefit, but RN was quick to deny the claim because at the time of Danny's death, the check was not yet encashed and therefore the premium remained unpaid.

Is RN correct? Will your answer be the same if the check is dated October 15, 2013? (4%)

SUGGESTED ANSWER:

To the first question (Is RN correct?)

RN Insurance is not correct. The facts of the case show that Danny procured insurance on his life on September 25, 2013, with his wife Tina as beneficiary, and that on the same day, i.e., September 25, 2013, he issued an undated check to RN for the full amount of the premium. Since the undated check was issued to RN for the full amount of the premium. Since the undated check was issued to RN on September 25, 2013, it will be considered dated as of the same day, i.e., September 25, 2013 pursuant to Section 17(c) of the Negotiable Instruments Law. The facts also show that RN Insurance issued the policy on Danny's life on October 1, 2013 and that Danny died in an accident on October 5, 2013.

RN Insurance denied the claim of Tina because at the time of Danny's death, the check was not yet encashed and, therefore, the premium remained unpaid. Presumably, RN Insurance is relying on the second paragraph of Article 1249 of the Civil Code which states that the "delivery of promissory notes payable to order, or bills of exchange or other mercantile documents shall produce the effect of payment only when they have been cashed, or when through the fault of the creditor they have been impaired."

Whose fault was it that the check was not encashed? Certainly not Danny or Tina. RN Insurance had the check as early as September 25, 2013 and could have encashed the check before the death of Danny on October 5, 2013. The problem did not indicate that there was any problem with the check, e.g., that it was not adequately funded. RN Insurance was at fault and Tina should not be denied the proceeds of the policy. (See the case of *Malayan Insurance Co., Inc. vs. Arnaldo, et al.*, G.R. L-67835, October 12, 1987, where the Court held that the insurer could no longer claim forfeiture of the insured's rights because it held the check used to pay the premium on a fire insurance policy for an unreasonable time; see also the comments of Justice Jose C. Vitug (ret.) in his book, *Commercial Laws and Jurisprudence*, 2006, Vol. I, p. 250, that "[p]ayment x x x by means of a check or note, accepted by the insurer, bearing a date prior to the loss, assuming an availability of funds thereof, would be sufficient even if it remains uncashed at the time of the loss. The subsequent effects of encashment (or impairment by the fault of the creditor) or of legal compensation under Articles 1278-1279, in relation to Article 1249 of the Civil Code, would retroact to the date of the mercantile instrument and its acceptance by the creditor."]

To the second question (Will your answer be the same if the check is dated October 15, 2013).

My answer would not be the same if the check were dated October 15, 2013. This answer assumes that Danny was the one who dated the check and, therefore, what he issued was a postdated check. The payment of a promissory note or a postdated check at a stated maturity subsequent to the loss, assuming that there was no estoppel (e.g., written acknowledgment of the receipt of premium), is insufficient to put the insurance into effect. (Vitug, *Commercial Laws and Jurisprudence*, 2006, Vol. I, p. 250)

If it were RN Insurance who dated the check October 15, 2013, then my answer would be the same as my answer to the first question.

Premiums; Payment by Installment (2006)

The Peninsula Insurance Company offered to insure Francis' brand new car against all risks in the sum of P1 Million for 1 year. The policy was issued with the premium fixed at 160,000.00 payable in 6 months. Francis only paid the first two months installments.

Despite demands, he failed to pay the subsequent installments. Five months after the issuance of the policy, the vehicle was carjacked. Francis filed with the insurance company a claim for its value. However, the company denied his claim on the ground that he failed to pay the premium resulting in the cancellation of the policy. Can Francis recover from the Peninsula Insurance Company? (5%)

SUGGESTED ANSWER:

Yes, when insured and insurer have agreed to the payment of premium by installments and partial payment has been made at the time of loss, then the insurer becomes liable. When the car loss happened on the 5th month, the six months agreed period of payment had not yet elapsed (*UCPB General Insurance v. Masagana Telamart, G.R. No. 137172, April 4, 2001*). Francis can recover from Peninsula Insurance Company, but the latter has the right to deduct the amount of unpaid premium from the insurance proceeds.

Premiums; Payment by Credit (2013)

Stable Insurance Co. (SIC) and St. Peter Manufacturing Co. (SPMC) have had a long-standing insurance relationship with each other; SPMC secures the comprehensive fire insurance on its plant and facilities from SIC. The standing business practice between them has been to allow SPMC a credit period of 90 days from the renewal of the policy within which to pay the premium.

Soon after the new policy was issued and before premium payments could be made, a fire gutted the covered plant and facilities to the ground. The day after the fire, SPMC issued a manager's check to SIC for the fire insurance premium, for which it was issued a receipt; a week later SPMC issued its notice of loss.

SIC responded by issuing its own manager's check for the amount of the premiums SPMC had paid, and denied SPMC's claim on the ground that under the "cash and carry" principle governing fire insurance, no coverage existed at the time the fire occurred because the insurance premium had not been paid.

Is SPMC entitled to recover from the loss from SIC? (8%)

SUGGESTED ANSWER:

St. Peter Manufacturing Company is entitled to recover from the loss from Stable Insurance Company. Stable Insurance Company granted a credit term to pay the premiums. This is not against the law, because the standing business practice of allowing St. Peter Manufacturing Company to pay the premiums after 60 or 90 days was relied upon in good faith by SPMC. Stable Insurance Company is in estoppel (*UCPB General Insurance Company, Inc. v. Masagana Telemart, Inc.*, 356 SCRA 307, 2001).

Premiums; Return of Premiums (2000)

Name at least three instances when an insured is entitled to a return of the premium paid.

SUGGESTED ANSWER:

Three instances when an insured is entitled to a return of premium paid are:

1 To the **WHOLE PREMIUM**, if no part of his interest in the thing insured be exposed to any of the perils insured against.

2 Where the insurance is made for a definite period of time and the insured surrenders his policy, to such portion of the premium as corresponds with the unexpired time at a pro rata rate, unless a short period rate has been agreed upon and appears on the face of the policy, after deducting from the whole premium any claim for loss or damage under the policy which has previously accrued.

3 When the contract is voidable on account of the fraud or misrepresentation of the insurer or of his agent or on account of facts the existence of which the insured was ignorant without his fault; or when, by any default of the insured other than actual fraud, the insurer never incurred any liability under the policy.

ALTERNATIVE INSTANCE:

In case of an over insurance by several insurers, the insured is entitled to a ratable return of the premium, proportioned to the amount by which the aggregate sum insured in all the policies exceeds the insurable value of the thing at risk.

Premium; Unpaid/Partial Payment (2015)

B. Will an insurance policy be binding even if the premium is unpaid? What if it were partially paid? (3%)

SUGGESTED ANSWER:

As a general rule, the insurance policy is not valid and binding unless the premium thereof has been paid. This is the cash-and-carry rule under the Insurance Code. Premium is the consideration for the undertaking of the insurer to indemnify the insured against a specified peril. There are exceptions, however, one of them is when there is an agreement allowing the insured to pay the premium in installments and partial payment has been made at the time of the loss (*Makati Tuscany Condominium Corporation v. Court of Appeals*, 215 SCRA 463 [1992]).

Rescission of Insurance Contract; Concealment; Material Concealment (2001)

A applied for a non-medical life insurance. The insured did not inform the insurer that one week prior to his application for insurance, he was examined and confined at St. Luke's Hospital where he was diagnosed for lung cancer. The insured soon thereafter died in a plane crash. Is the insurer liable considering that the fact concealed had no bearing with the cause of death of the insured? Why? (5%)

SUGGESTED ANSWER:

No. The concealed fact is material to the approval and issuance of the insurance policy. It is well settled that the insured need not die of the disease he failed to disclose to the insurer. It is sufficient that his nondisclosure misled the insurer in forming his estimate of the risks of the proposed insurance policy or in making inquiries.

Rescission of Insurance Contract; Concealment (2013)

Benny applied for life insurance for Php 1.5 Million. The insurance company approved his application and issued an insurance policy effective Nov. 6, 2008. Benny named his children as his beneficiaries. On April 6, 2010, Benny died of hepatoma, a liver ailment.

The insurance company denied the children's claim for the proceeds of the insurance policy on the ground that Benny failed to disclose in his application two previous consultations with his doctors for diabetes and hypertension, and that he had been diagnosed to be suffering from hepatoma. The insurance company also rescinded the policy and refunded the premiums paid.

Was the insurance company correct? (8%)

SUGGESTED ANSWER:

The insurance company correctly rescinded the policy because of concealment (*Section 27 of Insurance Code*). Benny did not disclose that he was suffering from diabetes, hypertension, and hepatoma. The concealment is material, because these are serious ailments (*Florendo v. Philam Plans, Inc.*, 666 SCRA 618, 2012). Benny died less than two years from the date of the issuance of the policy (*Section 48 of Insurance Code*).

Claims; Loss of Property Insured; Theft Clause; What Constitutes Theft (2014)

On May 26, 2014, Jess insured with Jack Insurance (Jack) his 2014 Toyota Corolla sedan under a comprehensive motor vehicle insurance policy for one year. On July 1, 2014, Jess' car was unlawfully taken. Hence, he immediately reported the theft to the Traffic Management Command (TMC) of the Philippine National Police (PNP), which made Jess accomplish a complaint sheet as part of its procedure. In the complaint sheet, Jess alleged that a certain Ric Silat(Silat) took possession of the subject vehicle to add accessories and improvements thereon. However, Silat failed to return the subject vehicle within the agreed 3-day period. As a result, Jess notified Jack of his claim for reimbursement of the value of the lost vehicle under the insurance policy. Jack refused to pay claiming that there is no theft as Jess gave Silat lawful possession of the car. Is Jack correct? (4%)

SUGGESTED ANSWER:

Jack Insurance is not correct. Ric Silat was merely given physical possession of the car. He did not have juridical possession over the same. It is also apparent that the taking by Silat of the car of Jess is without the consent or authority of the latter. Thus, the act of Silat in depriving Jess of his car, soon after the transfer of physical possession of the same to him, constitutes theft under the insurance policy that is compensable. (*Paramount Insurance v. Spouses Remondeulaz*, G.R. 173773, November 28, 2012).

Claims; In Case of Loss of Property Insured; Theft Clause vs. Malicious Damage Clause (2014)

On February 21, 2013, Barrack entered into a contract of insurance with Matino Insurance Company (Matino)

involving a motor vehicle. The policy obligates Matino to pay Barrack the amount of Six Hundred Thousand Pesos (P600,000.00) in case of loss or damage to said vehicle during the period covered, which is from February 26, 2013 to February 26, 2014.

On April 16, 2013, at about 9:00 a.m., Barrack instructed his driver, JJ, to bring the motor vehicle to a nearby auto shop for tune-up. However, JJ no longer returned and despite diligent efforts to locate the said vehicle, the efforts proved futile. Resultantly, Barrack promptly notified Matino of the said loss and demanded payment of the insurance proceeds of P600,000.00.

In a letter dated July 5, 2013, Matino denied the claim, reasoning as stated in the contract that "the company shall not be liable for any malicious damage caused by the insured, any member of his family or by a person in the insured's service. Is Matino correct in denying the claim? (4%)

SUGGESTED ANSWER:

Matino Insurance is not correct in denying the claim. The loss of the motor vehicle is not excluded under the insurance policy as the loss was due to theft, not malicious damage. The "malicious damage" clause under the policy is not applicable but rather the "theft" clause. Thus, the provision under the policy that "the company shall not be liable for any malicious damage caused by the insured, any member of his family or by a person in the insured's service" is not applicable. (Alpha Insurance and Surety Co. v. Castor, G.R. 198174, September 2, 2003).

Claims; Loss of Property Insured; Authorized Driver Clause (2003)

Rick de la Cruz insured his passenger jeepney with Asiatic Insurers, Inc. The policy provided that the authorized driver of the vehicle should have a valid and existing driver's license. The passenger jeepney of Rick de la Cruz which was at the time driven by Jay Cruz, figured in an accident resulting in the death of a passenger. At the time of the accident, Jay Cruz was licensed to drive but it was confiscated by an LTO agent who issued him a Traffic Violation Report (TVR) just minutes before the accident. Could Asiatic Insurers, Inc., be made liable under its policy? Why? (6%)

SUGGESTED ANSWER:

Asiatic Insurers, Inc., should be made liable under the policy. The fact that the driver was merely holding a TVR does not violate the condition that the driver should have a valid and existing driver's license. Besides, such a condition should be disregarded because what is involved is a passenger jeepney, and what is involved here is not own damage insurance but third party liability where the injured party is a third party not privy to the contract of insurance.

Claims; Accident Policy (2004)

CNI insure SAM under a homeowner's policy against claims for accidental injuries by neighbors. SAM's minor son, BOY, injured 3 children of POS, a neighbor, who sued SAM for damages. SAM's lawyer was ATT, who

was paid for his services by the insurer for reporting periodically on the case to CNI. In one report, ATT disclosed to CNI that after his investigations, he found the injuries to the 3 children not accidental but intentional. SAM lost the case in court, and POS was awarded one million pesos in damages which he sought to collect from the insurer. But CNI used ATT's report to deny the claim on the ground that the injuries to POS's 3 children were intentional, hence excluded from the policy's coverage. POS countered that CNI was estopped from using ATT's report because it was unethical for ATT to provide prejudicial information against his client to the insurer, CNI. Who should prevail: the claimant, POS; or the insurer, CNI? Decide with reasons briefly. (5%)

SUGGESTED ANSWER:

CNI is not estopped from using ATT's report, because CNI, in the first place, commissioned it and paid ATT for it. On the other hand, ATT has no conflict of interest because SAM and CNI are on the same side — their interests being congruent with each other, namely, to oppose POS's claim. It cannot be said that ATT has used the information to the disadvantage or prejudice of SAM. However, in *Finman General Assurance Corp. v. Court of Appeals*, 213 SCRA 493 (1992), it was explained that there is no "accident" in the context of an accident policy, if it is the natural result of the insured's voluntary act, unaccompanied by anything unforeseen except the injury. There is no accident when a deliberate act is performed, unless some additional and unforeseen happening occurs that brings about the injury.

This element of deliberateness is not clearly shown from the facts of the case, especially considering the fact that BOY is a minor, and the injured parties are also children. Accordingly, it is possible that CNI may not prosper. ATT's report is not conclusive on POS or the court.

Claims; Improper in Case Insured Violated the Terms (2014)

On May 13, 1996, PAM, Inc. obtained a P15, 000,000.00 fire insurance policy from Ilocano Insurance covering its machineries and equipment effective for one (1) year or until May 14, 1997. The policy expressly stated that the insured properties were located at "Sanyo Precision Phils. Building, Phase III, Lots 4 and 6, Block 15, PEZA, Rosario, Cavite." Before its expiration, the policy was renewed on "as is" basis for another year or until May 13, 1998. The subject properties were later transferred to Pace Factory also in PEZA. On October 12, 1997, during the effectivity of the renewed policy, a fire broke out at the Pace Factory which totally burned the insured properties.

The policy forbade the removal of the insured properties unless sanctioned by Ilocano. Condition 9(c) of the policy provides that "the insurance ceases to attach as regards the property affected unless the insured, before the occurrence of any loss or damage, obtains the sanction of the company signified by endorsement upon the policy x x x (c) if the property insured is removed to any building or place other than in that which is herein stated to be insured." PAM claims

that it has substantially complied with notifying Ilocano through its sister company, the RBC, which, in fact, referred PAM to Ilocano for the insurance coverage. Is Ilocano liable under the policy? (4%)

SUGGESTED ANSWER:

Ilocano Insurance is not liable under the policy. By the clear and express condition in the renewal policy, the removal of the insured property to any building or place required the consent of Ilocano. Any transfer effected by PAM, Inc. without Ilocano's consent (as is the case here) would free the latter from any liability. (Malayan Insurance Company, Inc. v. PAPCO, Ltd., G.R. 200784, August 7, 2013).

Insurer; 3rd Party Liability (2000)

X was riding a suburban utility vehicle (SUV) covered by a comprehensive motor vehicle liability insurance (CMVLI) underwritten by FastPay Insurance Company when it collided with a speeding bus owned by RM Travel Inc. The collision resulted in serious injuries to X; Y, a passenger of the bus; and Z, a pedestrian waiting for a ride at the scene of the collision. The police report established that the bus was the offending vehicle. The bus had CMVLI policy issued by Dragon Ins Co. X, Y, and Z jointly sued RM Travel and Dragon Ins for indemnity under the Insurance Code of the Phils (PD1460). The lower court applied the —no faultll indemnity policy of the statute, dismissed the suit against RM Travel, and ordered Dragon Ins to pay indemnity to all three plaintiffs. Do you agree with the court's judgment? Explain (2%)

SUGGESTED ANSWER:

No. The cause of action of Y is based on the contract of carriage, while that of X and Z is based on torts. The court should not have dismissed the suit against RM Travel. The court should have ordered Dragon Ins to pay each of X, Y and Z to the extent of the insurance coverage, but whatever amount is agreed upon in the policy should be answered first by RM Travel and the succeeding amount should be paid by Dragon Insurance up to the amount of the insurance coverage. The excess of the claims of X, Y, and Z, over and above such insurance coverage, if any, should be answered or paid by RM Travel.

Insurer; Group Insurance; Employer-Policy Holder (2000)

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

undertake the payment to the individual claimants of their respective shares. PJ misappropriated the settlement amount and the wives pursued their case against Y Insurance Co. Will the suit prosper? Explain (3%)

SUGGESTED ANSWER:

Yes. The suit will prosper. Y Ins Co is liable. X Co, through its executive, PJ, acted as agent of Y Ins Co. The latter is thus bound by the misconduct of its agent. It is the usual practice in the group insurance business that the employer-policy holder is the agent of the insurer.

Insurer; Right of Subrogation (2014)

ELP Insurance, Inc. issued Marine Policy No. 888 in favor of FCL Corp. to insure the shipment of 132 bundles of electric copper cathodes against all risks. Subsequently, the cargoes were shipped on board the vessel "M/V Menchu" from Leyte to Pier 10, North Harbor, Manila.

Upon arrival, FCL Corp. engaged the services of CGM, Inc. for the release and withdrawal of the cargoes from the pier and the subsequent delivery to its warehouses/plants in Valenzuela City. The goods were loaded on board twelve (12) trucks owned by CGM, Inc., driven by its employed drivers and accompanied by its employed truck helpers. Of the twelve (12) trucks en routeto Valenzuela City, only eleven (11) reached the destination. One (1) truck, loaded with eleven (11) bundles of copper cathodes, failed to deliver its cargo.

Because of this incident, FCL Corp. filed with ELP Insurance, Inc. a claim for insurance indemnity in the amount of P1, 500,000.00. After the requisite investigation and adjustment, ELP Insurance, Inc. paid FCL Corp. the amount of P1, 350,000.00 as insurance indemnity.

ELP Insurance, Inc., thereafter, filed a complaint for damages against CGM, Inc. before the Regional Trial Court (RTC), seeking reimbursement of the amount it had paid to FCL Corp. for the loss of the subject cargo. CGM, Inc. denied the claim on the basis that it is not privy to the contract entered into by and between FCL Corp. and ELP Insurance, Inc., and hence, it is not liable therefor. If you are the judge, how will you decide the case? (4%)

SUGGESTED ANSWER:

I will decide the case in favor of ELP Insurance. Even if CGM, Inc. is not privy to the contract between FCL Corp. and ELP Insurance, it is still liable for the loss of the subject cargo. Article 2207 of the Civil Code states that if the plaintiff's property has been insured and he has received indemnity from the insurance company for 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 wrong-doer or the person who has violated the contract, which in this case is CGM. Since ELP Insurance is subrogated to the rights of FCL Corp. to the extent of the amount it paid to the latter under the marine insurance contract, it has the right to seek reimbursement from CGM, Inc., for breach of contract and/or tort (Loadmasters Customs Services,

Inc. v. Glodel Brokerage Corporation and R & B Insurance Corporation, G.R. No. 179446, January 10, 2011).

Cash & Carry Basis (2003)

What is meant by "cash and carry" in the business of insurance?

SUGGESTED ANSWER:

Marine Insurance; Implied Warranties (2000)

What warranties are implied in marine insurance?

SUGGESTED ANSWER:

The following warranties are implied in marine insurance:

- 1) That the ship is seaworthy to make the voyage and/or to take in certain cargoes
- 2) That the ship shall not deviate from the voyage insured;
- 3) That the ship shall carry the necessary documents to show nationality or neutrality and that it will not carry any document which will cast reasonable suspicion thereon;
- 4) That the ship shall not carry contraband, especially if it is making a voyage through belligerent waters.

TRANSPORTATION LAWS

Common Carrier; Breach of Contract; Damages (2003)

Vivian Martin was booked by PAL, which acted as a ticketing agent of Far East Airlines, for a round trip flight on the latter's aircraft, from Manila-Hongkong-Manila. The ticket was cut by an employee of PAL. The ticket showed that Vivian was scheduled to leave Manila at 5:30 p.m. on 05 January 2002 aboard Far East's Flight F007. Vivian arrived at the Ninoy Aquino International Airport an hour before the time scheduled in her ticket, but was told that Far East's Flight F007 had left at 12:10 p.m. It turned out that the ticket was inadvertently cut and wrongly worded. PAL employees manning the airport's ground services nevertheless scheduled her to fly two hours later aboard their plane. She agreed and arrived in Hongkong safely. The aircraft used by Far East Airlines developed engine trouble, and did not make it to Hongkong but returned to Manila. Vivian sued both airlines, PAL and Far East, for damages because of her having unable to take the Far East flight. Could either or both airlines be held liable to Vivian? Why? (6%)

SUGGESTED ANSWER:

Common Carrier; Defenses (2002)

Why is the defense of due diligence in the selection and supervision of an employee not available to a common carrier? (2%)

SUGGESTED ANSWER:

The defense of due diligence in the selection and supervision of an employee is not available to a common carrier because the degree of diligence required of a common carrier is not the diligence of a good father of a family but extraordinary diligence, i.e., diligence of the greatest skill and utmost foresight.

Common Carrier; Defenses; Limitation of Liability (2001)

Suppose A was riding on an airplane of a common carrier when the accident happened and A suffered serious injuries. In an action by A against the common carrier, the latter claimed that

- 1) there was a stipulation in the ticket issued to A absolutely exempting the carrier from liability from the passenger's death or injuries ad notices were posted by the common carrier dispensing with the extraordinary diligence of the carrier, and
- 2) A was given a discount on his plane fare thereby reducing the liability of the common carrier with respect to A in particular.

a)Are those valid defenses? (1%)

SUGGESTED ANSWER:

a) No. These are not valid defenses because they are contrary to law as they are in violation of the extraordinary diligence required of common carriers. (Article 1757, 1758 New Civil Code)

b) What are the defenses available to any common carrier to limit or exempt it from liability? (4%)

SUGGESTED ANSWER:

b) The defenses available to any common carrier to limit or exempt it from liability are:

- 1 observance of extraordinary diligence,
- 2 or the proximate cause of the incident is a fortuitous event or force majeure,
- 3 act or omission of the shipper or owner of the goods,
- 4 the character of the goods or defects in the packing or in the containers, and
- 5 order or act of competent public authority, without the common carrier being guilty of even simple negligence (Article 1734, NCC).

Common vs. Private Carrier; Defenses (2002)

Name two (2) characteristics which differentiate a common carrier from a private carrier. (3%).

SUGGESTED ANSWER:

Two (2) characteristics that differentiate a common carrier from a private carrier are:

- 1 A common carrier offers its service to the public; a private carrier does not.
- 2 A common carrier is required to observe extraordinary diligence; a private carrier is not so required.

Common Carrier; Liability (2015)

C. Are common carriers liable for injuries to passengers even if they have observed ordinary diligence and care? Explain. (2%)

SUGGESTED ANSWER:

Yes, common carriers are liable for the injuries to passengers even if the carries observed ordinary diligence and care, because the obligation imposed upon them by law is to exercise extraordinary diligence.

Kabit System (2005)

Discuss the —kabit systemll in land transportation and its legal consequences. (2%)

SUGGESTED ANSWER:

The kabit system is an arrangement where a person granted a certificate of public convenience allows other persons to operate their motor vehicles under his license, for a fee or percentage of their earnings (*Lim v. Court of Appeals and Gonzalez, G.R. No. 125817, January 16, 2002, citing Baliwag Trannit v. Court of Appeals, G.R. No. 57493, January 7, 1987*) The law enjoining the kabit system aims to identify the person responsible for an accident in order to protect the riding public. The policy has no force when the public at large is neither deceived nor involved. The law does not penalize the parties to a kabit agreement. But the kabit system is contrary to

public policy and therefore void and inexistent. (Art. 1409[1], Civil Code)

Kabit System; Agent of the Registered Owner (2005)

Procopio purchased an Isuzu passenger jeepney from Enteng, a holder of a certificate of public convenience for the operation of public utility vehicle plying the Calamba-Los Baños route. While Procopio continued offering the jeepney for public transport services, he did not have the registration of the vehicle transferred in his name. Neither did he secure for himself a certificate of public convenience for its operation. Thus, per the records of the Land Transportation Franchising and Regulatory Board, Enteng remained its registered owner and operator. One day, while the jeepney was traveling southbound, it collided with a ten-wheeler truck owned by Emmanuel. The driver of the truck admitted responsibility for the accident, explaining that the truck lost its brakes. Procopio sued Emmanuel for damages, but the latter moved to dismiss the case on the ground that Procopio is not the real party in interest since he is not the registered owner of the jeepney. Resolve the motion with reasons. (3%)

SUGGESTED ANSWER:

The motion to dismiss should be denied because Procopio, as the real owner of the jeepney, is the real party in interest. Procopio falls under the Kabit system. However, the legal restriction as regards the Kabit system does not apply in this case because the public at large is not deceived nor involved. (*Lim v. Court of Appeals, G.R. No. 125817, January 16, 2002, citing Baliwag Transit v. Court of Appeals, G.R. No. 57493, January 7, 1987*) In any event, Procopio is deemed to be "the agent" of the registered owner. (*First Malayan Leasing v. Court of Appeals, G.R. No. 91378, June 9, 1992; and "F" Transit Co., Inc. v. NLRC, G.R. Nos. 88195-96, January 27, 1994*)

Prior Operator Rule (2003)

Bayan Bus Lines had been operating satisfactorily a bus service over the route Manila to Tarlac and vice versa via the McArthur Highway. With the upgrading of the new North Expressway, Bayan Bus Lines service became seemingly inadequate despite its efforts of improving the same. Pasok Transportation, Inc., now applies for the issuance to it by the Land Transportation Franchising and Regulatory Board of a certificate of public convenience for the same Manila-Tarlac-Manila route. Could Bayan Bus Lines, Inc., invoke the prior operator rules against Pasok Transportation, Inc.? Why? (6%)

SUGGESTED ANSWER:

Boundary System (2005)

Baldo is a driver of Yellow Cab Company under the boundary system. While cruising along the South Expressway, Baldo's cab figured in a collision, killing his passenger, Pietro. The heirs of Pietro sued Yellow Cab Company for damages, but the latter refused to pay the heirs, insisting that it is not liable because Baldo is not its employee. Resolve with reasons. (2%)

SUGGESTED ANSWER:

Yellow Cab Company shall be liable with Baldo, on a solidary basis, for the death of passenger Pietro. Baldo is an employee of Yellow Cab under the boundary system. As such, the death of passenger Pietro is breach of contract of carriage, making both the common carrier Yellow Cab and its employee, Baldo, solidarily liable. (Hernandez v. Dolor, G.R. No. 160286, July 30, 2004)

Contract of Carriage; Prohibited & Valid Stipulations (2002)

Discuss whether or not the following stipulations in a contract of carriage of a common carrier are valid:

1 a stipulation limiting the sum that may be recovered by the shipper or owner to 90% of the value of the goods in case of loss due to theft.

2 a stipulation that in the event of loss, destruction or deterioration of goods on account of the defective condition of the vehicle used in the contract of carriage, the carrier's liability is limited to the value of the goods appearing in the bill of lading unless the shipper or owner declares a higher value (5%)

SUGGESTED ANSWER:

1 The stipulation is considered unreasonable, unjust and contrary to public policy under Article 1745 of the Civil Code.

2 The stipulation limiting the carrier's liability to the value of the goods appearing in the bill of lading unless the shipper or owner declares a higher value, is expressly recognized in Article 1749 of the Civil Code.

Contract of Carriage; Breach of Contract (2008)

City Railways, Inc. (CRI) provides train service, for a fee, to commuters from Manila to Calamba, Laguna. Commuters are required to purchase tickets and then proceed to designated loading and unloading facilities to board the train. Ricardo Santos purchased a ticket for Calamba and entered the station. While waiting, he had an altercation with the security guard of CRI leading to a fistfight. Ricardo Santos fell on the railway just as a train was entering the station. Ricardo Santos was run over by the train. He died.

In the action for damages filed by the heirs of Ricardo Santos, CRI interposed lack of cause of action, contending that the mishap occurred before Ricardo Santos boarded the train and that it was not guilty of negligence. Decide. (5%)

SUGGESTED ANSWER:

CRI is liable for death of Ricardo Santos because it failed to exercise extraordinary diligence (LRTA v. Navidad G.R. No. 145804, 06 February 2003). The contract of carriage began when the passenger purchased his ticket and proceeded to the

designated loading facilities to board the train (Dangwa Transp. Co., Inc. v. Court of Appeals, G.R. No. 95582, 07 October 1991), CRI is also liable for all persons in its employ (Caltex Philippines, Inc. v. Sulpicio Lines, Inc., G.R. No. 131166, 30 September 1999).

Contract of Carriage; Breach of Contract; Defenses (2009)

One of the passenger buses owned by Continental Transit Corporation (CTC), plying its usual route figured in a collision with another bus owned by Universal Transport, Inc. (UTI). Among those injured inside the CTC bus were: Romeo, a stow away; Samuel, a pickpocket then in the act of robbing his seatmate when the collision occurred; Teresita, the bus driver's mistress who usually accompanied the driver on his trips for free; and Uriel, holder of a free riding pass he won in a raffle held by CTC.

(A) Will a suit for breach of contract of carriage filed by Romeo, Samuel, Teresita, and Uriel against CTC prosper? Explain. (3%)

SUGGESTED ANSWER:

Romeo cannot sue for breach of contract of carriage. A stowaway like Romeo, Who secures passage by fraud, is not a passenger (Vda. De nueva v. Manial Railroad Company, 13 C.A. R. 49(1968)).

Samuel and Teresita cannot sue for breach of contract of carriage. The Elements in the definition of a passenger are: an undertaking of a person to travel in the conveyance provided by the carrier and an acceptance by the carrier of the person as a passenger. (14 Am Jur 2d, Carriers, So. 714,p. 164). Samuel did not board the bus to be transported but to commit robbery. Teresita did not board the bus to be transported but to accompany the driver while he was performing his work.

Uriel can sue for breach of contract. He was a passenger although he was being transported gratuitously, because he won a free riding pass in a raffle held by CTC (Article 1753, New Civil Code).

(B) Do Romeo, Samuel, Teresita, and Uriel have a cause of action for damages against UTI? Explain. (3%)

SUGGESTED ANSWER:

Romeo, Samuel, Teresita and Uriel may sue UTI on the basis of quasi-delict since they have no pre-existing contractual relationship with UTI. They may allege that the collision was due to the negligence of driver of UTI and UTI was negligent in the selection and supervision of its driver (Articles 2176 and 2180, New Civil Code).

(C) What, if any, are the valid defenses that CTC and UTI can raise in the respective actions against them? Explain. (3%)

SUGGESTED ANSWER:

With respect to Romeo, Samuel and Teresita, since there was no pre-existing contractual relationship

between them and CTC, CTC can raise the defense that it exercised the due diligence of a good father of a family in the selection and supervision of its driver (Article 2180, New Civil Code).

It can raise the same defense against Uriel if there is a stipulation that exempts it from liability for simple negligence, but not for willful acts or gross negligence (Article 1758, New Civil Code).

CTC can also raise against all the plaintiffs the defense that the collision was due exclusively to the negligence of the driver of UTI, and this constitutes a fortuitous event, because there was no concurrent negligence on the part of its own driver (Ampangv. Guinoo Transportation Company, G.R. No. L-5044, April 30, 1953).

CTC can also raise against Samuel the defense that he was engaged in a seriously illegal act at the time of the collision, which can render him liable for damages on the basis of quasi-delict (Dobbs, the Law of Torts, pp.524-525).

Since UTI had no pre-existing contractual relationship with any of the plaintiffs, it can raise the defense that it exercised due diligence in the selection and supervision of its driver that the collision was due exclusively to the negligence of the driver of CTC, and that Samuel was committing a serious illegal act at the time of the collision.

Causes of Action (2013)

Fil-Asia Air Flight 916 was on a scheduled passenger flight from Manila when it crashed as it landed at the Cagayan de Oro airport; the pilot miscalculated the plane's approach and undershot the runway. Of the 150 people on board, ten (10) passengers died at the crash scene.

Of the ten who died, one was a passenger who managed to leave the plane but was run over by an ambulance coming to the rescue. Another was an airline employee who hitched a free ride to Cagayan de Oro and who was not in the passenger manifest.

It appears from the Civil Aeronautics Authority investigation that the co-pilot who had control of the plane's landing had less than the required flying and landing time experience, and should not have been in control of the plane at the time. He was allowed to fly as a co-pilot because of the scarcity of pilots - Philippine pilots have been recruited by foreign airlines under vastly improved flying terms and wages so that newer and less trained pilots are being locally deployed. The main pilot, on the other hand, had a very high level of blood alcohol at the time of the crash.

You are part of the team that the victims hired to handle the case for them as a group. In your case conference, the following questions came up:

(A) Explain the causes of action legally possible under the given facts against the airline and the pilots; whom will you specifically implead in these causes of action? (5%)

SUGGESTED ANSWER:

A complaint for breach of contract of carriage can be filed against Fil-Asia Air for failure to exercise

extraordinary diligence in transporting the passengers safely from their point of embarkation to the destination (Article 1755, Civil Code).

A complaint based on a quasi-delict can be filed against the pilots because of their fault and negligence (Article 2176, Civil Code). Fil-Asia Air can be included for negligence in the selection and supervision of the pilots (Article 2180, Civil Code).

A third cause of action may be a criminal prosecution for reckless imprudence resulting in homicide against two pilots. The airline will be subsidiarily liable for the civil liability only after the pilots are convicted and found to be insolvent.

(B) How will you handle the cases of the passenger run over by the ambulance and the airline employee allowed to hitch a free ride to Cagayan de Oro? (3%)

SUGGESTED ANSWER:

It is the driver of the ambulance and his employer who should be held liable for damages, because a passenger was run over. This is in accordance with Articles 2176 and 2180 of the Civil Code. There could also be a criminal prosecution for reckless imprudence resulting in homicide against the ambulance driver and the consequent civil liability.

Since the airline employee was being transported gratuitously, Fil-Asia Air was not required to exercise extraordinary diligence for his safety and only ordinary care. (*Lara v. Valencia*, 104 Phil. 65, 1958)

Maritime Commerce

Averages: Types (2010)

(B) What are the types of averages in marine commerce (3%)

SUGGESTED ANSWER:

The types of average are particular and general (Article 808 of the Code of Commerce). Particular averages include all expenses and damages caused to the vessel or to the cargo which did not inure to the common benefit and profit of all the persons interested in the vessel and the cargo (Article 809 of the Code of Commerce). General averages include all damages and expenses which are deliberately caused to save the vessel, its cargo, or both at the same time, from a real and known risk (Article 811 of the Code of Commerce).

Average; Particular Average vs. General Average (2003)

M/V Ilog de Manila with a cargo of 500 tons of iron ore left the Port of Zamboanga City bound for Manila. For one reason or another, M/V Ilog de Manila hit a submerged obstacle causing it to sink along with its cargo. A salvor, Salvador, Inc., was contracted to refloat the vessel for P1 Million. What kind of average was the refloating fee of P1 million, and for whose account should it be? Why? (4%)

SUGGESTED ANSWER:

Barratry (2010)

(B) What is "barratry" in marine insurance? (2%)

SUGGESTED ANSWER:

Barratry is any willful misconduct in the part of the master or crew in pursuance of some unlawful or fraudulent purpose without the consent of the owner and to the prejudice of the interest of the owner (Roque v. Intermediate Appellate Court, supra).

Bareboat (2003)

For the transportation of its cargo from the Port of Manila to the Port of Kobe, Japan Osawa & Co., chartered bareboat M/V Ilog of Karagatan Corporation. M/V Ilog met a sea accident resulting in the loss of the cargo and the death of some of the seamen manning the vessel. Who should bear the loss of the cargo and the death of the seamen? Why? (4%)

SUGGESTED ANSWER:

Charter Party (2004)

Under a charter party, XXO Trading Company shipped sugar to Coca-Cola Company through SS Negros Shipping Corp., insured by Capitol Insurance Company. The cargo arrived but with shortages. Coca-Cola demanded from Capitol Insurance Co. P500,000 in settlement for XXO Trading. The MM Regional Trial Court, where the civil suit was filed, "absolved the insurance company, declaring that under the Code of Commerce, the shipping agent is civilly liable for damages in favor of third persons due to the conduct of the carrier's captain, and the stipulation in the charter party exempting the owner from liability is not against public policy. Coca-Cola appealed. Will its appeal prosper? Reason briefly. (5%)

SUGGESTED ANSWER:

No. The appeal of Coca-Cola will not prosper. Under Article 587 of the Code of Commerce, the shipping agent is civilly liable for damages in favor of third persons due to the conduct of the carrier's captain, and the shipping agent can exempt himself therefrom only by abandoning the vessel with all his equipment and the freight he may have earned during the voyage. On the other hand, assuming there is bareboat charter, the stipulation in the charter party exempting the owner from liability is not against public policy because the public at large

is not involved (Home Insurance Co. v. American Steamship Agencies, Inc., 23 SCRA25 (1968)).

Charter Party; Jason Clause (2015)

B. What is a "Jason clause" in a charter party? (2%)

SUGGESTED ANSWER:

The Jason Clause derives its name from The Jason 225 US 32 (1912) decided by the US Supreme Court under the Harter Act. By the Jason clause, a shipowner (provided he had exercised due diligence to make the ship seaworthy and properly manned, equipped and supplied) could claim a general average contribution from cargo, even where the damage was caused by the faulty navigation of the vessel, provided that the bill of lading excluded for such faults.

[NB. This is not a familiar principle in the Philippine maritime commerce and the question is not consistent with the norm of asking questions to test the knowledge of entry level lawyers. It is respectfully submitted that the question should be given outright credit in favour of the examinees regardless of their answer].

Carriage of Goods: Deviation: Liability (2005)

On a clear weather, M/V Sundo, carrying insured cargo, left the port of Manila bound for Cebu. While at sea, the vessel encountered a strong typhoon forcing the captain to steer the vessel to the nearest island where it stayed for seven days. The vessel ran out of provisions for its passengers. Consequently, the vessel proceeded to Leyte to replenish its supplies.

Assuming that the cargo was damaged because of such deviation, who between the insurance company and the owner of the cargo bears the loss? Explain.

SUGGESTED ANSWER:

The insurance company should bear the loss to the cargo because the deviation of the vessel was proper in order to avoid a peril, which was the strong typhoon. The running out of provisions was a direct consequence of the proper deviation in order to avoid the peril of the typhoon.

ALTERNATIVE ANSWER:

The owner of the cargo bears the loss because in the case at bar, they stayed too long at the island, making it an improper deviation. Every deviation not specified in Sec. 124 is improper. (Sec. 125, Insurance Code)

Carriage of Goods; Exercise Extraordinary Diligence (2005)

Star Shipping Lines accepted 100 cartons of sardines from Master to be delivered to 555 Company in Manila. Only 88 cartons were delivered, however, these were in bad condition. 555 Company claimed from Star Shipping Lines the value of the missing goods, as well as the damaged goods. Star Shipping Lines refused because the former failed to present a bill of lading. Resolve with reasons the claim of 555 Company. (4%)

SUGGESTED ANSWER:

The claim of 555 Company is meritorious, even if it fails to present a bill of lading. Although a bill of lading is the best evidence of the contract of carriage for cargo, nevertheless such contract can exist even without a bill of lading. Like any other contract, a contract of carriage is a meeting of minds that gives rise to an obligation on the part of the carrier to transport the goods. Jurisprudence has held that the moment the carrier receives the cargo for transport, then its duty to exercise extraordinary diligence arises. (*Cia. Maritima v. Insurance Co. of North America*, G.R. No. L-18965, October 30, 1964; *Negre v. Cabahug Shipping & Co.*, G.R. No. L-19609, April 29, 1966)

ALTERNATIVE ANSWER:

Star Shipping Lines can refuse to honor 555 Company's claim for the missing and damaged goods. The Bill of Lading is the document of title that legally establishes the ownership of 555 Company over said goods. 555 needs to present the Bill of Lading to legally claim said goods. (*National Union Fire Insurance of Pittsburg v. Stolt-Nielsen*, G.R. No. 87958, April 26, 1990)

Carriage of Goods; Deviation; When Proper (2005)

Under what circumstances can a vessel properly proceed to a port other than its port of destination? Explain. (4%)

SUGGESTED ANSWER:

Deviation is proper:

- a) when caused by circumstances over which neither the master nor the owner of the ship has any control;
- b) when necessary to comply with a warranty or avoid a peril, whether or not the peril is insured against;
- c) when made in good faith, and upon reasonable grounds of belief in its necessity to avoid a peril; or
- d) when in good faith, for the purpose of saving human life, or relieving another vessel in distress. (Sec. 124, Insurance Code)

Carriage of Goods; Deviation; Liability (2009)

Global Transport Services, Inc. (GTSI) operates a fleet of cargo vessels plying interisland routes. One of its vessels, MV Dona Juana, left the port of Manila for Cebu laden with, among other goods, 10,000 television sets consigned to Romualdo, a TV retailer in Cebu.

When the vessel was about ten nautical miles away from Manila, the ship captain heard on the radio that a typhoon which, as announced by PAG-ASA, was on its way out of the country, had suddenly veered back into Philippine territory, the captain realized that MV Dona Juana would traverse the storm's path, but decided to proceed with the voyage. True enough, the vessel sailed into the storm. The captain ordered the jettison of the 10,000 television sets, along with some other cargo, in order to lighten the vessel and make it easier to steer the vessel out of the path of the typhoon. Eventually, the vessel, with its crew intact, arrived safely in Cebu.

(A) Will you characterize the jettison of Romualdo's TV sets as an average? If so, what kind of an average,

and why? If not, why not? (3%)

SUGGESTED ANSWER:

The jettison of Romualdo's TV sets resulted in a general average loss, which entitles him to compensation or indemnification from the shipowner and the owners of the cargoes saved by the jettison.

ALTERNATIVE ANSWER:

The jettison resulted to a particular average loss because the damage was due to the fault of the captain.

(B) Against whom does Romualdo have a cause of action for indemnity of his lost TV sets? Explain. (3%)

SUGGESTED ANSWER:

Romualdo has a cause of action for his lost TV sets against the shipowner and the owners of the cargoes saved by the jettison. The jettison of the TV sets resulted in a general average loss, entitling Romualdo to indemnity for the lost TV sets.

Carriage of Goods; Implied Warranty; Liability (2010)

Paolo, the owner of an ocean-going vessel, offered to transport the logs of Constantino from Manila to Nagoya. Constantino accepted the offer, not knowing that the vessel was manned by an irresponsible crew with deep-seated resentments against Paolo, their employer.

Constantino insured the cargo of logs against both perils of the sea and barratry. The logs were improperly loaded on one side, thereby causing the vessel to tilt on one side. On the way to Nagoya, the crew unbolted the sea valves of the vessel causing water to flood the ship hold. The vessel sank.

Constantino tried to collect from the insurance company which denied liability, given the unworthiness of both the vessel and its crew.

Constantino countered that he was not the owner of the vessel and he could therefore not be responsible for conditions about which he was innocent.

(A) Is the insurance company liable? Why or why not? (3%)

SUGGESTED ANSWER:

The insurance company is not liable, because there is an implied warranty in every marine insurance that the ship is seaworthy whoever is insuring the cargo, whether it be the ship-owner or not. There was a breach of warranty, because the logs were improperly loaded and the crew was irresponsible. It is the obligation of the owner of the cargo to look for a reliable common carrier which keeps its vessel in seaworthy condition (*Roque v. Intermediate Appellate Court*, 139 SCRA 596 [1985]).

Carriage of Goods; Indemnity; Jettisoned Goods (2010)

An importer of Christmas toys loaded 100 boxes of Santa Claus talking dolls aboard a ship in Korea bound for Manila. With the intention of smuggling one-half of his cargo, he took a bill of lading for only 50 boxes. On the voyage to Manila, 50 boxes were jettisoned to save the more precious cargo.

(A) Is the importer entitled to receive any indemnity for average? Explain. (2%)

SUGGESTED ANSWER:

The importer is not entitled to receive any indemnity for average. In order that the goods jettisoned may be included in the general average and the owner be entitled to indemnity, it is necessary that their existence on board be proven by means of the bill of lading (Article 816 of the Code of Commerce).

COGSA; Applicability (2014)

On December 1, 2010, Kore A Corporation shipped from South Korea to LT Corporation in Manila some 300,000 sheets of high-grade special steel. The shipment was insured against all risks by NA Insurance(NA). The carrying vessel arrived at the Port of Manila on January 10, 2011. When the shipment was discharged, it was noted that 25,000 sheets were damaged and in bad order. The entire shipment was turned over to the custody of ATI, the arrastre operator, on January 21, 2011 for storage and safekeeping, pending its withdrawal by the consignee's authorized customs broker, RVM.

On January 26 and 29, 2011, the subject shipment was withdrawn by RVM from the custody of ATI. On January 29, 2011, prior to the withdrawal of the last batch of the shipment, a joint inspection of the cargo was conducted per the Request for Bad Order Survey (RBO) dated January 28, 2011. The examination report showed that 30,000 sheets of steel were damaged and in bad order.

NA Insurance paid LT Corporation the amount of P30,000,000.00 for the 30,000 sheets that were damaged, as shown in the Subrogation Receipt dated January 13, 2013. Thereafter, NA Insurance demanded reparation against ATI for the goods damaged in its custody, in the amount of P5, 000,000.00. ATI refused to pay claiming that the claim was already barred by the statute of limitations. ATI alleged that the Carriage of Goods by Sea Act (COGSA) applies in this case since the goods were shipped from a foreign port to the Philippines. NA Insurance claims that the COGSA does not apply, since ATIs is not a shipper or carrier. Who is correct? (5%)

SUGGESTED ANSWER:

NA Insurance is correct. The Carriage of Goods by Sea Act (Act No. 521) applies only to carriers or ships. A "carrier", under Section 1 (a) of the COGSA, "includes the owner or the charterer who enters into a contract of carriage with a shipper", while a "ship" is defined under Section 1 (d) as "any vessel used for the carriage of goods by sea. " The COGSA does not apply to ATI as it is neither a "carrier" nor a "ship", much less a "shipper". It is simply an arrastre operator. Moreover, The COGSA does not mention that an arrastre operator may invoke the prescriptive period of one year; hence, it does not cover the arrastre operator. (Insurance Co. of North America v. Asian Terminals, Inc., G.R. 180784, February 15, 2012; Insurance Co. of North America v. Phil. Ports Terminal, G.R. L-6420, July 18, 1955).

COGSA; Prescription of Claims (2000)

RC imported computer motherboards from the United States and had them shipped to Manila aboard an oceangoing cargo ship owned by BC Shipping Company. When the cargo arrived at Manila seaport and delivered to RC, the crate appeared intact; but upon inspection of the contents, RC discovered that the items inside had all been badly damaged. He did not file any notice of damage or anything with anyone, least of all with BC Shipping Company. What he did was to proceed directly to your office to consult you about whether he should have given a notice of damage and how long a time he had to initiate a suit under the provisions of the Carriage of Goods by Sea Act (CA 65). What would your advice be? (2%)

SUGGESTED ANSWER:

My advice would be that RC should give notice of the damage sustained by the cargo within 3 days and that he has to file the suit to recover the damage sustained by the cargo within one year from the date of the delivery of the cargo to him.

COGSA: Prescription of Claims/Actions (2004)

AA entered into a contract with BB thru CC to transport ladies' wear from Manila to France with transshipment at Taiwan. Somehow the goods were not loaded at Taiwan on time. Hence, when the goods arrived in France, they arrived "off-season" and AA was paid only for one-half the value by the buyer. AA claimed damages from the shipping company and its agent. The defense of the respondents was prescription. Considering that the ladies' wear suffered "loss of value," as claimed by AA, should the prescriptive period be one year under the Carriage of Goods by Sea Act, or ten years under the Civil Code? Explain briefly. (5%)

SUGGESTED ANSWER:

The applicable prescriptive period is ten years under the Civil Code. The one-year prescriptive period under the Carriage of Goods by Sea Act applies in cases of loss or damages to the cargo. The term "loss" as interpreted by the Supreme Court in *Mitsui O.S.K. Lines Ltd. v. Court of Appeals*, 287 SCRA 366 (1998), contemplates a situation where no delivery at all was made by the carrier of the goods because the same had perished or gone out of commerce deteriorated or decayed while in transit. In the present case, the shipment of ladies' wear was actually delivered. The "loss of value" is not the total loss contemplated by the Carriage of Goods by Sea Act.

COGSA; Prescription of Claims/Action (2010)

AA entered into a contract with BB for the latter to transport ladies wear from Manila to France with transshipment via Taiwan. Somehow the goods were not loaded in Taiwan on time, hence, these arrived in France —off-season. AA was only paid for one half the value by the buyer.

AA claimed damages from BB. BB invoked prescription as a defense under the Carriage of Goods by Sea Act Considering the —loss of value of the ladies wear as claimed by AA, is BB's defense tenable?

Explain. (3%)

SUGGESTED ANSWER:

The defense of BB is not tenable. The one-year prescriptive period in the Carriage of Goods Sea Act applies only in case the goods were not delivered or were delivered in a damaged or deteriorated condition. It does not apply to damages as a result of delay in the delivery of the goods. The prescription of the action is governed by Article 1144 of the Civil Code, which provides for a prescriptive period of ten years in case of actions based on a written contract (*Mitsui O.S.K. Lines Ltd. v. Court of Appeals*, 287 SCRA 366 (1998)).

Liability for Loss; Fortuitous Event (2008)

On October 30, 2007, M/V Pacific, a Philippine registered vessel owned by Cebu Shipping Company (CSC), sank on her voyage from Hong Kong to Manila. Empire Assurance Company (Emprie) is the insurer of the lost cargoes loaded on board the vessel which were consigned to Debenhams Company. After it indemnified Debenhams, Empire as subrogee filed an action for damages against CSC.

(A) Assume that the vessel was seaworthy. Before departing, the vessel was advised by the Japanese Meteorological Center that it was safe to travel to its destination. But while at sea, the vessel received a report of a typhoon moving within its general path. To avoid the typhoon, the vessel changed its course. However, it was still at the fringe of the typhoon when it was repeatedly hit by huge waves, were saved three (3) who perished. Is CSC liable to empire? What principle of maritime law is applicable? Explain. (3%)

SUGGESTED ANSWER:

The common carrier incurs no liability for the loss of the cargo during a fortuitous event, because the following circumstances were present:

- (1) the typhoon was the cause of the cargo loss;
- (2) the carrier did not contribute to the loss; and
- (3) the carrier exercised extraordinary diligence in order to minimize the attendant damage before, during and after the typhoon (See *Fortune Express v. CA*, Caorong. G.R. No. 119756, 18 March 1999; *Yobido v. CA*, G.R. No. 113003, 17 October 1997; *Gathalian v. Delim*, G.R. No. L-56487, 21 October 1991).

Under Art. 587 of Code of Commerce, in case of maritime transactions, the liability of the owner of the vessel is limited to the vessel itself. Since the vessel of CSC was seaworthy at the time it sank, the CSC is not liable to Empire under the maritime principle that the obligations of the owner of a vessel are hypothecary in nature.

(B) Assume the vessel was not seaworthy as in fact its hull had leaked, causing flooding in the vessel. Will you answer be the same? Explain. (2%)

SUGGESTED ANSWER:

When the vessel is not seaworthy, it is an exception to the hypothecary principle in maritime commerce.

To limit its liability to the amount of the insurance proceeds, the carrier has the burden of proving that the unseaworthiness of its vessel was not due to its fault or negligence. The failure to discharge such a heavy burden precludes application of the limited liability rule and the carrier is liable to the full extent of the claims of the cargo owners (*Aboitiz Shipping v. New India Assurance Company*, G.R. No. 156978, 02 May 2006).

(C) Assume the facts in question (b). Can the heirs of the three (3) crew members who perished recover from CSC? Explain fully. (3%)

SUGGESTED ANSWER:

Yes, because the crew members died while performing their assigned duties, aggravated by the failure of the ship owner to ensure that the vessel is seaworthy. Workmen's compensation has been classified by jurisprudence as an exception to the hypothecary nature of maritime commerce, *Abueg v. San Diego*, 77 Phil. 730 (1948), especially in this case where the vessel was not seaworthy at the time it sank.

Liability for Loss; Constructive Total Loss (2005)

M/V Pearly Shells, a passenger and cargo vessel, was insured for P40,000,000.00 against —constructive total loss. Due to a typhoon, it sank near Palawan. Luckily, there were no casualties, only injured passengers. The ship owner sent a notice of abandonment of his interest over the vessel to the insurance company which then hired professionals to afloat the vessel for P900,000.00. When re-floated, the vessel needed repairs estimated at P2,000,000.00. The insurance company refused to pay the claim of the ship owner, stating that there was —no constructive total loss.

a) Was there —constructive total loss to entitle the ship owner to recover from the insurance company? Explain.

SUGGESTED ANSWER:

There was constructive loss. When the vessel sank, it was likely that it would be totally lost because of improbability of recovery. (*Arnold's Law of Marine Insurance and Average*, 16th ed., Vol. II, pp.954-955)

ALTERNATIVE ANSWER:

There was no constructive total loss. The loss is not more than $\frac{3}{4}$ the value of the vessel which was insured for P40million. The cost of refloating is P900,000.00 and the needed repairs amount to P2million, or a total of only P2,900,000.00 which does not constitute $\frac{3}{4}$ the value of the vessel.

b) Was it proper for the ship owner to send a notice of abandonment to the insurance company? Explain. (5%)

SUGGESTED ANSWER:

It was proper for the shipowner to send a notice of abandonment to the insurance company, because there was reliable information of the loss of the vessel (Sec. 141, Insurance Code).

Limited Liability Rule (2000)

MV Mariposa, one of five passenger ships owned by Marina Navigation Co, sank off the coast of Mindoro

while en route to Iloilo City. More than 200 passengers perished in the disaster. Evidence showed that the ship captain ignored typhoon bulletins issued by Pag-asa during the 24-hour period immediately prior to the vessel's departure from Manila. The bulletins warned all types of sea crafts to avoid the typhoon's expected path near Mindoro. To make matters worse, he took more load than was allowed for the ship's rated capacity. Sued for damages by the victim's surviving relatives, Marina Nav Co contended:

- 1) that its liability, if any, had been extinguished with the sinking of MV Mariposa; and
- 2) that assuming it had not been so extinguished, such liability should be limited to the loss of the cargo. Are these contentions meritorious in the context of applicable provisions of the Code of Commerce? (3%)

SUGGESTED ANSWER:

Yes. The contentions of Marina Nav Co are meritorious. The captain of MV Mariposa is guilty of negligence in ignoring the typhoon bulletins issued by PAGASA and in overloading the vessel. But only the captain of the vessel

MV Mariposa is guilty of negligence. The ship owner is not. Therefore, the ship owner can invoke the doctrine of limited liability.

Limited Liability Rule; Doctrine of Inscrutable Fault (1991)

In a collision between M/T Manila, a tanker, and M/V Don Claro, an inter-island vessel, Don Claro sank and many of its passengers drowned and died. All its cargoes were lost. The collision occurred at nighttime but the sea was calm, the weather fair and visibility was good. Prior to the collision and while still 4 nautical miles apart, Don Claro already sighted Manila on its radar screen. Manila had no radar equipment. As for speed, Don Claro was twice as fast as Manila. At the time of the collision, Manila failed to follow Rule 19 of the International Rules of the Road which requires 2 vessels meeting head on to change their course by each vessel steering to starboard (right) so that each vessel may pass on the port side (left) of the other. Manila signaled that it would turn to the port side and steered accordingly, thus resulting in the collision. Don Claro's captain was off-duty and was having a drink at the ship's bar at the time of the collision.

- a) Who would you hold liable for the collision?

SUGGESTED ANSWER:

I can hold the 2 vessels liable. In the problem given, whether on the basis of the factual settings or under the doctrine of inscrutable fault, both vessels can be said to have been guilty of negligence. The liability of the 2 carriers for the death or injury of passengers and for the loss of or damage to the goods arising from the collision is solidary. Neither carrier may invoke the doctrine of last clear chance which can only be relevant, if at all, between the two vessels but not on the claims made by passengers or shippers (Litonjua Shipping v National Seamen Board GR 51910 10Aug1989)

- b) If Don Claro was at fault, may the heirs of the passengers who died and the owners of the cargoes recover damages from the owner of said vessel?

SUGGESTED ANSWER:

Yes, but subject to the doctrine of limited liability. The doctrine is to the effect that the liability of the shipowners would only be to the extent of any remaining value of the vessel, proceeds of insurance, if any, and earned freightage. Given the factual settings, the shipowner himself was not guilty of negligence and, therefore, the doctrine can well apply (Amparo de los Santos v CA 186 s 69)

Limited Liability Rule; General Average Loss (2000)

X Shipping Company spent almost a fortune in refitting and repairing its luxury passenger vessel, the MV Marina, which plied the inter-island routes of the company from La Union in the north to Davao City in the south. The MV Marina met an untimely fate during its post-repair voyage. It sank off the coast of Zambales while en route to La Union from Manila. The investigation showed that the captain alone was negligent. There were no casualties in that disaster. Faced with a claim for the payment of the refitting and repair, X Shipping company asserted exemption from liability on the basis of the hypothecary or limited liability rule under Article 587 of the Code of Commerce. Is X Shipping Company's assertion valid? Explain (3%).

SUGGESTED ANSWER:

No. The assertion of X Shipping Company is not valid. The total destruction of the vessel does not affect the liability of the ship owner for repairs on the vessel completed before its loss.

Limited Liability Rule; General Average Loss (2000)

MV SuperFast, a passenger-cargo vessel owned by SF Shipping Company plying the inter-island routes, was on its way to Zamboanga City from the Manila port when it accidentally, and without fault or negligence of anyone on the ship, hit a huge floating object. The accident caused damage to the vessel and loss of an accompanying crated cargo of passenger PR. In order to lighten the vessel and save it from sinking and in order to avoid risk of damage to or loss of the rest of the shipped items (none of which was located on the deck), some had to be jettisoned. SF Shipping had the vessel repaired at its port of destination. SF Shipping thereafter filed a complaint demanding all the other cargo owners to share in the total repair costs incurred by the company and in the value of the lost and jettisoned cargoes. In answer to the complaint, the shippers' sole contention was that, under the Code of Commerce, each damaged party should bear its or his own damage and those that did not suffer any loss or damage were not obligated to make any contribution in favor of those who did. Is the shippers' contention valid? Explain (2%)

SUGGESTED ANSWER:

No. The shippers' contention is not valid. The owners of the cargo jettisoned, to save the vessel from sinking and to save the rest of the cargoes, are entitled to contribution. The jettisoning of said cargoes constitute general average loss which

entitles the owners thereof to contribution from the owner of the vessel and also from the owners of the cargoes saved. SF Shipping is not entitled to contribution/ reimbursement for the costs of repairs on the vessel from the shippers.

Maritime Protest (2007)

Two vessels figured in a collision along the Straits of Guimaras resulting in considerable loss of cargo. The damaged vessels were safely conducted to the Port of Iloilo. Passenger A failed to file a maritime protest. B, a non-passenger but a shipper who suffered damage to his cargo, likewise did not file a maritime protest at all. (10%)

(A) What is a maritime protest?

SUGGESTED ANSWER:

A maritime protest is a sworn statement made with 24 hours after a collision in which the circumstances thereof are declared or made known before a competent authority at the point of accident or the first port of arrival if in the Philippines or the Philippine consul in a foreign country (Article 835, Code of Commerce; *Goro v. William Lines, Inc.*, 3 CAR 1(1963)).

(B) Can A and B successfully maintain an action to recover losses and damages arising from the collision? Reason briefly

SUGGESTED ANSWER:

B, the shipper, can successfully maintain an action to recover losses and damages arising from the collision notwithstanding his failure to file a maritime protest since the filing thereof is required only on the part of A, who being a passenger of the vessel at the time of the collision, was expected to know the circumstances of the collision. A's failure to file a maritime protest will therefore prevent him from successfully maintaining an action to recover his losses and damages (Art. 836, Code of Commerce)

ALTERNATIVE ANSWER:

A can maintain an action to recover damages if he was not in a condition to make known his wishes. B can maintain an action to recover damages since he was not on board the vessel (Article 836, Code of Commerce).

CORPORATION CODE

Public utilities (2000)

WWW Communications Inc. is an e-commerce company whose present business activity is limited to providing its clients with all types of information technology hardware. It plans to re-focus its corporate direction of gradually converting itself into a full convergence organization. Towards this objective, the company has been aggressively acquiring telecommunications businesses and broadcast media enterprises, and consolidating their corporate structures. The ultimate plan is to have only two organizations: one to own the facilities of the combined businesses and to develop and produce content materials, and another to operate the facilities and provide mass media and commercial telecommunications services. WWW Communications will be the flagship entity which will own the facilities of the conglomerate and provide content to the other new corporation which, in turn, will operate those facilities and provide the services. WWW Communications seeks your professional advice on whether or not its reorganized business activity would be considered a public utility requiring a franchise or certificate or any other form of authorization from the government. What will be your advice? Explain (5%)

SUGGESTED ANSWER:

The reorganized business activity of WWW Communications Inc. would not be considered a public utility requiring a franchise or certificate or any other form of authorization from the government. It owns the facilities, but does not operate them.

Doctrine of Separate Juridical Personality (2000)

Marulas Creative Technology Inc., an e-business enterprise engaged in the manufacture of computer media accessories; rents an office and store space at a commercial building owned by X. Being a start-up company, Marulas enjoyed some leniency in its rent payments; but after three years, X put a stop to it and asked Marulas president and general manager, Y, who is a stockholder, to pay the back rentals amounting to a hundred thousand pesos or to vacate the premises at the end of the month. Marulas neither paid its debt nor vacated the premises. X sued Marulas and Y for collection of the unpaid rentals, plus interest and costs of litigation. Will the suit prosper against X? Against Y? (5%)

SUGGESTED ANSWER:

Yes, the suit will prosper against Marulas. It is the one renting the office and store space, as lessee, from the owner of the building, X, as lessor. But the suit against Y will not prosper. Y, as president and general manager, and also stockholder of Marulas Creative Technology, Inc., has a legal personality separate and distinct from that of the corporation. The liability of the corporation is that of the corporation and not that of its officers and stockholders who are not liable for corporate liabilities.

Doctrine of Separate Juridical Personality (2000)

Nine individuals formed a private corporation pursuant to the provisions of the Corporation Code of the Philippines (BP 68). Incorporator S was elected director and president – general manager. Part of his emolument is a Ford Expedition, which the corporation owns. After a few years, S lost his corporate positions but he refused to return the motor vehicle claiming that as a stockholder with a substantial equity share, he owns that portion of the corporate assets now in his possession. Is the contention of S valid? Explain (5%)

SUGGESTED ANSWER:

No. The contention of S is not valid. The Ford Expedition is owned by the corporation. The corporation has a legal personality separate and distinct from that of its stockholder. What the corporation owns is its own property and not the property of any stockholder even how substantial the equity share that stockholder owns.

Corporation; Creation of a Private Corporation (2008)

(A) Since February 8, 1935, the legislature has not passed even a single law creating a private corporation. What provision of the Constitution precludes the passage of such a law? (3%)

SUGGESTED ANSWER:

Under Sec. 16, Art. XII of the 1987 Constitution, Congress cannot, except by general law, provide for the formation, organization, or regulation of private corporations. It is only government owned or controlled corporations that may be created or established through special charters. Consequently, it has been held that a private corporation created pursuant to a special law is a nullity, and such special law is void for being in violation of the Constitution (NDC v. Phil. Veterans Bank, G.R. Nos. 84132-33, 10 December 1990).

(B) May the composition of the board of directors of the National Power Corporation (NPC) be validly reduced to three (3)? Explain your answer fully. (2%)

SUGGESTED ANSWER:

The NPC Board may be reduced to only three (3) members, but this would have to be affected by legislative amendment of its charter. The National Power Corporation (NPC) is a chartered government corporation, not governed by the general provisions of the Corporation Code which requires that Boards of Directors of private corporations shall not have less than 5 members. The provisions of the Corporation Code are applicable to government corporations only in a supplementary manner.

Doctrine of Piercing the Corporate Veil (2001)

Plaintiffs filed a collection action against X Corporation. Upon execution of the court's decision, X Corporation was found to be without assets. Thereafter plaintiffs filed an action against its present and past stockholder Y Corporation which owned substantially all of the stocks of X Corporation. The two corporations have the same board of directors and Y Corporation financed the

operations of X Corporation. May Y Corporation be held liable for the debts of X Corporation? Why? (5%)

SUGGESTED ANSWER:

Yes, Y Corporation may be held liable for the debts of X Corporation. The doctrine of piercing the veil of corporation fiction applies to this case. The two corporations have the same board of directors and Y Corporation owned substantially all of the stocks of X Corporation, which facts justify the conclusion that the latter is merely an extension of the personality of the former, and that the former controls the policies of the latter. Added to this is the fact that Y Corporation controls the finances of X Corporation which is merely an adjunct, business conduit or alter ego of Y Corporation (CIR v Norton & Harrison Co 11 S 714 (1964))

Doctrine of Piercing the Corporate Veil (2004)

How does one pierce the veil of corporate fiction?

SUGGESTED ANSWER:

The veil of corporate fiction may be pierced by proving in court that the notion of legal entity is being used to defeat public convenience, justify wrong, protect fraud, or defend crime or the entity is just an instrument or alter ego or adjunct of another entity or person.

Doctrine of Piercing the Corporate Veil (2006)

1. What is the doctrine of "piercing the veil of corporate entity?" Explain.

SUGGESTED ANSWER:

The doctrine of "piercing the veil of corporate entity," is the doctrine that allows the courts to look behind the separate juridical personality of a corporation and treat the corporation as an association of persons and thereby make the individual actors personally liable for corporate liabilities. The fiction of corporate identity is disregarded and the individuals comprising it can be treated identically. The stockholders can be held directly liable for corporate obligations, even to the extent of their personal assets (*Concept Builders v. NLRC, Marabe, et al, G.R. No. 108734, May 29, 1996*).

2. To what circumstances will the doctrine apply? (2.5%)

SUGGESTED ANSWER:

The doctrine is applicable when the notion of legal entity is used to:

- 1) Defeat public convenience.
- 2) Justify wrong.
- 3) Protect fraud.
- 4) Defend crime (PNB v. Andrada Electric, G.R. No. 142936, April 17, 2002).
- 5) Shield a violation of the proscription against forum shopping (First Philippine International Bank v. Court of Appeals, G.R. No. 137537, January 24, 1996).
- 6) Work inequities among members of the corporation internally, involving no rights of the public or third persons (Secosa v. Heirs of Erwin Suarez Francisco, G.R. No. 156104, June 29, 2004).

- 7) Evade the lawful obligations of the corporation like a judgment credit (*Sibagat Timber Corp. v. Garcia*, G.R. No. 112546, December 11, 1992).
- 8) Escape liability arising from a debt (*Arcilla v. Court of Appeals*, G.R. No. 88113, October 23, 1992).
- 9) Avoid inclusion of corporate assets as part of the estate of the decedent (*Cease v. Court of Appeals*, G.R. No. L-35861, October 18, 1979).
- 10) To promote or to shield unfair objectives (*Villanueva v. Adre*, G.R. No. 80863, April 27, 1989).

Doctrine of Piercing the Corporate Veil (2008)

Nelson owned and controlled Sonnel Construction Company. Acting for the company, Nelson contracted the construction of a building. Without first installing a protective net atop the sidewalks adjoining the construction site, the company proceeded with the construction work. One day a heavy piece of lumber fell from the building. It smashed a taxicab which at that time had gone offroad and onto the sidewalk in order to avoid traffic. The taxicab passenger died as a result.

(A) Assume that the company had no more account and property in its name. As counsel for the heirs of the victim, whom will you sue for damages, and what theory will you adopt? (3%)

SUGGESTED ANSWER:

I would sue Nelson, as the person who owned and controlled Sonnel Construction Company, under the doctrine of "piercing the veil of corporate fiction." Although a corporation has a juridical personality separate and distinct from that of its stockholders, when the corporation is used merely as an alter ego or controlled for the benefit of a stockholder, or when it is necessary to render justice, then the courts have the right to pierce the veil of corporate fiction to hold the controlling stockholder-officer personally liable for the corporate tort or wrong committed.

The contractor should also be held liable, since being an independent contractor it is liable for the fault or negligence of its people.

(B) If you were the counsel for Sonnel Construction, how would you defend your client? What would be your theory? (2%)

SUGGESTED ANSWER:

I would use the theory that the company cannot be held liable for damages because there was no fraud or negligence by its officers in undertaking the project for the construction of the building or the selection of a construction company. Since a contractor is not an agent of Sonnel Construction, the latter cannot be held liable for the contractor's negligence. I would also argue that piercing the veil of corporate fiction is a remedy of last resort and cannot be availed of without clear evidence showing fraud or disrespect of the separate juridical personality of the corporation. Mere control of equity has not been considered as sufficient basis for piercing the veil.

(C) Could the heirs hold the taxicab owner and driver liable? Explain. (2%)

SUGGESTED ANSWER:

Yes, the taxicab company can be liable for damages because it failed to comply with its obligation as a common carrier to use extraordinary diligence in transporting the passenger, and because at the time of death of the passenger, the cab driver was violating a traffic regulation. Under Art. 2185 of Civil Code, it is presumed that a person driving a motor vehicle has been negligent if at time of mishap he was violating a traffic regulation, such as when he was driving on the wrong side of the road (*Mallari, Sr. v. CA*, G.R. No. 128607, 31 January 2000).

Doctrine of Piercing the Corporate Veil (2014)

In an action for collection of a sum of money, the Regional Trial Court (RTC) of Makati City issued a decision finding D-Securities, Inc. liable to Rehouse Corporation for P10, 000,000.00. Subsequently, the writ of execution was issued but returned unsatisfied because D-Securities had no more assets to satisfy the judgment. Rehouse moved for an Alias Writ of Execution against Fairfield Bank (FB), the parent company of D-Securities. FB opposed the motion on the grounds that it is a separate entity and that it was never made a party to the case. The RTC granted the motion and issued the Alias Writ of Execution. In its Resolution, the RTC relied on the following facts: 499,995 out of the 500,000 outstanding shares of stocks of D-Securities are owned by FB; FB had actual knowledge of the subject matter of litigation as the lawyers who represented D-Securities are also the lawyers of FB. As an alter ego, there is no need for a finding of fraud or illegality before the doctrine of piercing the veil of corporate fiction can be applied. The RTC ratiocinated that being one and the same entity in the eyes of the law, the service of summons upon D-Securities has bestowed jurisdiction over both the parent and wholly-owned subsidiary. Is the RTC correct? (4%)

SUGGESTED ANSWER:

The RTC is not correct. As FB is a separate entity and was never made a party to the case, the judgment sought to be enforced against D-Securities cannot be made against its parent company, FB.

Piercing the corporate veil based on the alter ego theory requires the concurrence of three elements: (1) control; of the corporation by the stockholder or parent corporation, (2) fraud or fundamental unfairness imposed on the plaintiff, and (3) harm or damage caused to the plaintiff by the fraudulent or unfair act of the corporation. The absence of all these elements in the problem prevents the piercing of the corporate veil.

The absence of any one of these elements prevents piercing the corporate veil. In applying the instrumentality or alter ego doctrine, the courts are concerned with reality and not form, with how the corporation operated and the individual defendant's relationship to that operation. Hence, all three elements should concur for the alter ego doctrine to be applicable.

Mere ownership by a single stockholder or by another corporation of all or nearly all of the capital stock of a corporation is not of itself sufficient ground for disregarding the separate corporate personality. Neither is the existence of interlocking directors, corporate fiction in the absence of fraud or other public policy considerations.

To justify treating the sole stockholder or holding company as responsible, it is not enough that the subsidiary is so organized and controlled as to make it "merely an instrumentality, conduit or adjunct" of its stockholders. It must further appear that to recognize their separate entities would aid in the consummation of a wrong.

Control, by itself, does not mean that the controlled corporation is a mere instrumentality or a business conduit of the mother company. Even control over the financial and operational concerns of a subsidiary company does not by itself call for disregarding its corporate fiction. There must be a perpetuation of fraud behind the control or at least a fraudulent or illegal purpose behind the control in order to justify piercing the veil of corporate fiction. Such fraudulent intent is lacking in this case. (*Pacific Rehouse Corporation v. CA, et al.*, G.R. 199687, March 24, 2014).

Commencement; Corporate Existence (2003)

1. When does a corporation acquire corporate existence?

SUGGESTED ANSWER:

2. CBY & Co., Inc., registered with the Securities and Exchange Commission its articles of incorporation. It failed, however, for one reason or another, to have its by-laws filed with, and registered by, the Commission. It nevertheless transacted and did business as a corporation for some time. A suit was commenced by its minority stockholders assailing the continued existence of CBY & Co., Inc., because of the non-adoption and registration of its by-laws. Would the action prosper? Why? (6%)

SUGGESTED ANSWER:

Corporation; Classes; Sole Proprietorship (2004)

YKS Trading filed a complaint for specific performance with damages against PWC Corporation for failure to deliver cement ordered by plaintiff. In its answer, PWC denied liability on the ground, inter alia, that YKS has no personality to sue, not being incorporated, and that the President of PWC was not authorized to enter into a contract with plaintiff by the PWC Board of Directors, hence the contract is ultra vires. YKS Trading replied that it is a sole proprietorship owned by YKS, and that the President of PWC had made it appear in several letters presented in evidence that he had authority to sign contracts on behalf of the Board of Directors of PWC. Will the suit prosper or not? Reason briefly. (5%)

SUGGESTED ANSWER:

Yes the suit will prosper. As a sole proprietorship, the proprietor of YKS Trading has the capacity to act and the personality to sue PWC. It is not necessary for YKS Trading to be incorporated before it can sue. On the other hand, PWC is estopped from asserting that its President had no authority to enter into the contract, considering that, in several of PWC's letters, it had clothed its President with apparent authority to deal with YKS Trading.

Corporation; Classes; Corporation Sole (2004)

What is a corporation sole?

SUGGESTED ANSWER:

Section 110 of the Corporation Code defines a "corporation sole" as one formed for the purpose of administering and managing, as trustee, the affairs, property and temporalities of any religious denomination, sect or church. It is formed by the chief archbishop, bishop, priest, minister, rabbi or other presiding elder of such religious denomination, sect or church.

Corporation; Classes; Sole Proprietorship (2010)

Your client Dianne approaches you for legal advice on putting up a medium-sized restaurant business that will specialize in a novel type of cuisine. As Dianne feels that the business is a little risky, she wonders whether she should use a corporation as the business vehicle, or just run it as a single proprietorship. She already has an existing corporation that is producing meat products profitably and is also considering the alternative of simply setting up the restaurant as a branch office of the existing corporation.

(A) Briefly explain to your client what you see as the legal advantages and disadvantages of using a separate corporation, a single proprietorship, or a branch of an existing corporation for the proposed restaurant business. (3%)

SUGGESTED ANSWER:

If Dianne will set up a separate corporation, her liability for its obligations and losses will be limited to the amount of her subscription in the absence of showing that there is a ground to disregard its separate juridical personality. If she were to operate a single proprietorship, her liability for its debts and losses will be unlimited.

The formation and the operation of a

corporation require a great deal of paper work and record-keeping. This is not the situation in the case of a single proprietorship.

If Dianne will form a separate corporation, it can raise more funds for the business than if she were to set up a single proprietorship.

If she were to set up the restaurant as a branch office an existing corporation, the corporation will have more funds as capital than if she were to form a separate corporation. However, all the assets of the existing corporation will be liable for the debts and losses of the restaurant business.

(B) If you advise your client to use a corporation, what officer positions must the corporation at least have? (2%)

SUGGESTED ANSWER:

The corporation must have at least five directors (Section 14 of the Corporation Code). It must also have a president, a treasurer, and secretary (Section 25 of the Corporation Code).

(C) What particular qualifications, if any, are these officers legally required to possess under the Corporation Code? (2%)

SUGGESTED ANSWER:

Every director must own at least one share of the capital stock of the corporation, which must be recorded in his name on the books of the corporation, and a majority of the directors must be residents of the Philippines (Section 25 of the Corporation Code).

The president must also be a director. The secretary must be a resident and citizen of the Philippines (Section 25 of the Corporation Code).

Corporation; Classes: De facto Corporation vs. Corporation by Estoppel (2004)

Is there a difference between a de facto corporation and a corporation by estoppel? Explain briefly. (2%)

SUGGESTED ANSWER:

A DE FACTO CORPORATION is one which actually exists for all practical purposes as a corporation but which has no legal right to corporate existence as against the State. It is essential to the existence of a de facto corporation that there be

- (1) a valid law under which a corporation might be incorporated,
- (2) a bona fide attempt to organize as a corporation under such law, and
- (3) actual use or exercise in good faith of corporate powers conferred upon it by law.

A CORPORATION BY ESTOPPEL exists when persons assume to act as a corporation knowing it to be without authority to do so. In this case, those persons will be liable as general partners for all debts, liabilities and damages incurred or arising as a result of their actions.

Corporation; Classes: Stock vs. Non-Stock Corporation (2004)

Distinguish clearly a stock corporation from a non-stock corporation.

SUGGESTED ANSWER:

A stock corporation is one that has capital stock divided into shares and is authorized to distribute to the holders of such shares dividends or allotments of the surplus profits

on the basis of the shares held. All other corporations are non-stock corporations.

Corporation; Classes; Private vs. Public Corporation (2004)

Distinguish clearly a private corporation from a public corporation

SUGGESTED ANSWER:

A PRIVATE CORPORATION is one formed for some private purpose, benefit or end, while a PUBLIC CORPORATION is formed for the government of a portion of the State for the general good or welfare. The true test is the purpose of the corporation. If the corporation is created for political or public purpose connected with the administration of government, then it is a public corporation. If not, it is a private corporation although the whole or substantially the whole interest in the corporation belongs to the State. A public corporation is created by special legislation or act of Congress. A private corporation must be organized under the Corporation Code.

Corporation; Classes; Conversion from Stock to Non-stock Corporation (2001)

X company is a stock corporation composed of the Reyes family engaged in the real estate business. Because of the regional crisis, the stockholders decided to convert their stock corporation into a charitable non-stock and non-profit association by amending the articles of incorporation.

a) Could this be legally done? Why? (3%)

SUGGESTED ANSWER:

a) Yes, it can be legally done. In converting the stock corporation to a non-stock corporation by a mere amendment of the articles of incorporation, the stock corporation is not distributing any of its assets to the stockholders. On the contrary, the stockholders are deemed to have waived their right to share in the profits of the corporation which is a gain not a loss to the corporation.

b) Would your answer be the same if at the inception, X Company is a non-stock corporation? Why? (2%)

SUGGESTED ANSWER:

b) No, my answer will not be the same. In a non-stock corporation, the members are not entitled to share in the profits of the corporation because all present and future profits belong to the corporation. In converting the non-stock corporation to a stock corporation by a mere amendment of the Articles of Incorporation, the non-stock corporation is deemed to have distributed an asset of the corporation – i.e.

its profits, among its members, without a prior dissolution of the corporation. Under Sec 122, the non-stock corporation must be dissolved first.

(Observation: The question is rather vague more particularly question 1b. The question does not specify that the conversion is from a non-stock corporation to a stock corporation. The candidate is likely to be confused because of the words "if at the inception, X Co is a nonstick corporation." Hence, any answer along the same line should be treated with liberality)

Foreign Corporation; "Doing Business" in the Philippines; Acts or Activities (2002)

Give at least three (3) examples of the acts or activities that are specifically identified under our foreign investment laws as constituting —doing business in the Philippines (3%)

SUGGESTED ANSWER:

Any three (3) of the following acts or activities constitute

—doing business in the Philippines under our foreign investment laws:

1. Soliciting orders
2. Opening offices by whatever name
3. Participating in the management, supervision or control of any domestic entity
4. Entering into service contracts
5. Appointing representatives or distributors, operating under the control of the foreign entity, who is domiciled in the Philippines or who stays in the country for a period or periods totaling at least 180 days in any calendar year.

Foreign Corporation; "Doing Business" in the Philippines; Test (2002)

What is the legal test for determining if an unlicensed foreign corporation is doing business in the Philippines? (2%)

SUGGESTED ANSWER:

The test is whether or not the unlicensed foreign corporation has performed an act or acts that imply a continuity of commercial dealings or arrangements, and contemplate to that extent the performance of acts or works, or the exercise of some of the functions normally incident to, and in progressive prosecution of, commercial gain or of the purpose and object of the business corporation.

Foreign Corporation; "Doing Business in the Philippines (2015)

A. A foreign company has been exporting goods to a Philippine company for several years now. When the Philippine company failed to pay the latest exportation, the foreign company sued to collect in the Philippines. The Philippine company interposed the defense that the foreign company was doing business in the Philippines without a license; hence, could not sue before a Philippine court. Is this defense tenable? Explain your answer. (3%)

SUGGESTED ANSWER:

The defense is not tenable. The mere act of exporting from one's own country, without doing any specific commercial act within the territory of the importing country cannot be deemed as doing business in the importing country. Thus, the foreign company may sue in the Philippines despite the lack of license to do business in the Philippines (*B. Van Zuiden Bros Ltd. v. GTVL Manufacturing Industries* 523 SCRA 233 [2007]).

Foreign Corporation; "Doing Business" in the Philippines (2015)

B. On foreign investments:

1. A foreign company has a distributor in the Philippines. The latter acts in his own name and account. Will this distributorship be considered as doing business by the foreign company in the Philippines? (3%)

SUGGESTED ANSWER:

The appointment of a distributor in the Philippines is not sufficient to constitute doing business unless it is under the full control of the foreign corporation. Of the distributor is an independent entity doing business for its own name and account, the latter cannot be considered as doing business (*Steel Case v. Design International Selection*, 670 SCRA 64 [2012]).

2. ABC Corporation was organized in Malaysia but has a branch in the Philippines. It is entirely owned by Filipino citizens. Can you consider ABC Corporation a Philippine national? (2%)

SUGGESTED ANSWER:

Yes it is considered a Philippine national as long as it is registered as doing business in the Philippines under the Corporation Code (*Section 1 of RA 7042, as amended by Section 1 of RA 8179*).

Articles of Incorporation; To Whom Binding (2009)

Triple A Corporation (Triple A) was incorporated in 1960, with 500 founders' shares and 78 common shares as its initial capital stock subscription. However, Triple A registered its stock and transfer book only in 1978, and recorded merely 33 common shares as the corporation's issued and outstanding shares.

(A) In 1982, Juancho, the sole heir of one of the original incorporators filed a petition with the Securities and Exchange Commission (SEC) for the registration of his property rights over 120 founder's shares and 12 common shares. The petition was supported by a copy of the Articles of Incorporation indicating the incorporator's initial capital stock subscription. Will the petition be granted? Why or why not? (3%)

SUGGESTED ANSWER:

Yes. The articles of Incorporation define the charter of the corporation and the contractual relationship between the State and the Corporation, the State and the stockholders, and between the corporation and the stockholders. Its contents are thus binding upon both the corporation and the stockholders, conferring on Juancho a clear right to have his stockholding recorded (*Lanuza v. Court of Appeals*, 454 SCRA 54 (2005)).

Incorporation; Requirements (2006)

What is the minimum and maximum number of incorporators required to incorporate a stock corporation? Is this also the same minimum and maximum number of directors required in a stock corporation? (2.5%)

SUGGESTED ANSWER:

Under Section 10 of the Corporation Code, any number of natural persons not less than five (5) but not more than fifteen (15), all of legal age and a majority of whom are residents of the Philippines, may form a private corporation for any lawful purpose.

This is the same minimum and maximum number of directors required in a stock corporation under Section 14(6) of the Corporation Code.

Incorporation; Residency Requirements (2006)

Must all incorporators and directors be residents of the Philippines? (2.5%)

SUGGESTED ANSWER:

Not all directors and incorporators need to be residents of the Philippines. Under Section 10 of the Corporation Code, only a majority of the incorporators need to be residents of the Philippines. As provided in Section 23 of the same Code, only a majority of the members of the Board of Directors need to be residents of the Philippines.

Incorporation; Requisites (2002)

You have been asked to incorporate a new company to be called FSB Savings & Mortgage Bank, Inc. List the documents that you must submit to the Securities and Exchange Commission (SEC) to obtain a certificate of incorporation for FSB Savings & Mortgage Bank, Inc. (5%)

SUGGESTED ANSWER:

The documents to be submitted to the Securities and Exchange Commission (SEC) to incorporate a new company to be called FSB Savings & Mortgage Bank, Inc., to obtain the certificate of incorporation for said company, are:

- 1) Articles of Incorporation**
- 2) Treasurer's Affidavit;**
- 3) Certificate of Authority from the Monetary Board of the BSP;**
- 4) Verification slip from the records of the SEC whether or not the proposed name has already been adopted by another corporation, partnership or association;**
- 5) Letter undertaking to change the proposed name if already adopted by another corporation, partnership or association;**
- 6) Bank certificate of deposit concerning the paid-up capital;**
- 7) Letter authorizing the SEC or Monetary Board or its duly authorized representative to examine the bank records regarding the deposit of the paid-up capital;**
- 8) Registration Sheet;**

Incorporation; Qualifications of Incorporators, BOD Members & Corporate Officers (2012)

X is a Filipino immigrant residing in Sacramento, California. Y is a Filipino residing in Quezon City, Philippines. Z is a resident alien residing in Makati City. GGG Corporation is a domestic corporation - 40% owned by foreigners and 60% owned by Filipinos, with T as authorized representative. CCC Corporation is a foreign corporation registered with the Philippine Securities and Exchange Commission. KKK Corporation is a domestic corporation (100%) Filipino owned. S is a Filipino, 16 years of age, and the daughter of Y.

a. Who can be incorporators? Who can be subscribers? (2%)

SUGGESTED ANSWER:

a. X, Y, Z, and T could all be incorporators and subscribers. Note, however, that Sec. 10 of the Corporation Code requires that there must be at least five but not more than fifteen incorporators (who most all be natural persons) and that a majority of the incorporators must be residents of the Philippines. S, being a minor, could neither be an incorporator nor a subscriber. GGG Corporation, CCC Corporation, and KKK Corporation could not be incorporators as they are not natural persons. However, they could be subscribers.

b. What are the differences between an incorporator and a subscriber, if there are any? (2%)

SUGGESTED ANSWER:

b. Some of the differences are as follows: first, all the incorporators are required to sign and acknowledge the Articles of Incorporation while the subscribers, as such, are not subject to the same requirement; second, the incorporators are all required to be natural persons while the subscribers could be either natural or juridical persons; and third, the number of incorporators cannot exceed fifteen while the number of subscribers could be more than fifteen (subject to compliance, in the appropriate cases, with the requirements of the Securities Regulation Code).

c. Who are qualified to become members of the board of directors of the corporation? (2%)

SUGGESTED ANSWER:

c. X, Y, Z, and T could be directors (subject to the residency requirement mentioned in (a) above and any nationality requirement under the law governing the business of the corporation) but not GGG Corporation, CCC Corporation, and KKK Corporation as they are not natural persons. However, the aforementioned corporations could have their respective representatives nominated and possibly elected as directors by the stockholders. Each director must own at least one share of the capital stock of the corporation (Sec. 23, Corporation Code).

d. Who are qualified to act as Treasurer of the company? (2%)

SUGGESTED ANSWER:

d. The Corporation Code does not impose any nationality or residency requirement in respect of the Treasurer. Any such requirement or any other reasonable requirement may be adopted by the corporation and reflected in its by-laws, or required by the law(s) governing the business of the corporation or a law of general application (e.g., the Anti-Dummy Law which applies to all nationalized businesses). Accordingly, anybody with the qualifications required under the by-laws of the corporation or under the law(s) governing the business of the corporation, could be elected Treasurer by the Board of Directors. Note, however, that the Treasurer could not be the President at the same time (Sec. 25, Corporation Code).

e. Who can be appointed Corporate Secretary? (2%)

SUGGESTED ANSWER:

e. The Secretary is required to be both a resident and a citizen of the Philippines (Sec. 10, Corporation Code).

[Note: The problem does not state what kind of business the corporation would engage in. Neither does it state whether X, Y, Z, and T are all of legal age and otherwise have the capacity to enter into contracts. Accordingly, the suggested answers set out below assume that the corporation would not be engaging in a nationalized activity and that X, Y, Z, and T are all of legal age and otherwise have the capacity to enter into contracts.]

Incorporation; Qualifications of Incorporators & BOD Members (2014)

Guetze and his wife have three (3) children: Neymar, 25, who is now based in Rio de Janeiro, Brazil; Muelter, 23, who has migrated to Munich, Germany; and James, 21, who resides in Bogota, Colombia. Neymar and Muelter have since renounced their Philippine citizenship in favor of their country of residence. Nearing 70 years old, Guetze decided to incorporate his business in Binondo, Manila. He asked his wife and three (3) children to act as incorporators with one (1) share of stock each, while he owned 999,996 shares of the 1,000,000 shares of the capital stock. (6%)

a. Assuming all other requirements are met, should the Securities and Exchange Commission (SEC) accept or reject the Articles of Incorporation? Why?

SUGGESTED ANSWER:

The Securities and Exchange Commission (SEC) should reject the Articles of Incorporation. Only two of the incorporators are resident of the Philippines. Section 10 of the Corporation Code requires that a majority of the incorporators be residents of the Philippines.

b. Being the control freak and micro-manager that he is, Guetze asked you – his astute legal adviser – if he can serve as Chairman of the Board of Directors, as President, and as General Manager of the corporation, all at the same time. Please advise Guetze.

SUGGESTED ANSWER:

Guetze can serve as Chairman of the Board of Directors, and President and General Manager of the

corporation, all at the same time. This is allowed by, and is not covered by the prohibition in, Section 25 of the Corporation Code.

c. Assuming the corporation has been properly registered, may the Articles of Incorporation now be amended to reduce the number of directors to two (2) – Guetze and his wife – to reflect the real owners of the shares of stock?

SUGGESTED ANSWER:

The Articles of Incorporation may not be amended to reduce the number of directors to two. Under Section 14 of the Corporation Code, the number of directors shall not be less than five.

By-laws (2001)

Suppose that the by-laws of X Corp, a mining firm provides that —The directors shall be relieved from all liability for any contract entered into by the corporation with any firm in which the directors may be interested. Thus, director A acquired claims which overlapped with X's claims and were necessary for the development and operation of X's mining properties.

a) Is the by-law provision valid? Why? (3%)

b) What happens if director A is able to consummate his mining claims over and above that of the corporation's claims? (2%)

SUGGESTED ANSWER:

a) No. It is in violation of Section 32 of the Corp Code.

b) A should account to the corporation for the profits which he realized from the transaction. He grabbed the business opportunity from the corporation. (Section 34, Corp Code)

By-Laws; Validity; limiting qualifications of BOD members (2000)

At the annual stockholders' meeting of MS Corporation, the stockholders unanimously passed a resolution authorizing the Board of Directors to amend the corporate by-laws so as to disqualify any stockholder who is also a director or stockholder of a competing business from being elected to the Board of Directors of MS Corporation. The by-laws were accordingly amended. GK, a stockholder of MS Corporation and a majority stockholder of a competitor, sought election to the Board of Directors of MS Corporation. His nomination was denied on the ground that he was ineligible to run for the position. Seeking a nullification of the offending disqualification provision, GK consults you about its validity under the Corporation Code of the Phils. What would your legal advice be? (3%)

SUGGESTED ANSWER:

The provision in the amended by-laws disqualifying any stockholder who is also a director or stockholder of a competing business from being elected to the Board of Directors of MS Corp is valid. The corporation is empowered to adopt a code of by-laws for its government not inconsistent with the Corp Code. Such disqualifying provision is not inconsistent with the Corp Code.

By-Laws; Validity; limiting qualifications of BOD members (2001)

Is a by-law provision of X Corporation —rendering ineligible or if elected, subject to removal, a director if he is also a director in a corporation whose business is in competition with or is antagonistic to said corporation valid and legal? State your reasons. (5%).

SUGGESTED ANSWER:

Yes, the by-law provision is valid. It is the right of a corporation to protect itself against possible harm and prejudice that may be caused by its competitors. The position of director is highly sensitive and confidential. To say the least, to allow a person, who is a director in a corporation whose business is in competition with or is antagonistic to X Corporation, to become also a director in X Corporation would be harboring a conflict of interest which is harmful to the latter (*Gokongwei Jr v SEC 89 S 336 (1979); 97 S 78 (1980)*).

By-Laws; Validity; limiting qualifications of BOD members (2003)

To prevent the entry of Marlo Enriquez, whom it considered as one antagonistic to its interests, into its Board of Directors, Bayan Corporation amended its articles of incorporation and by-laws to add certain qualifications of stockholders to be elected as members of its Board of Directors. When presented for approval at a meeting of its stockholders duly called for the purpose, the amendments were overwhelmingly ratified. Marlo Enriquez brought suits against Bayan Corporation to question the amendments. Would the action prosper? Why? (4%)

SUGGESTED ANSWER:

Intra-Corporate Controversy (2006)

What is an intra-corporate controversy? (8%)

SUGGESTED ANSWER:

An intra-corporate controversy is a conflict between stockholders, members or partners and the corporation, association or partnership regarding the regulation of the corporation. The controversy must arise out of intra-corporate or partnership relations of the parties; or between such corporation, partnership or association and the State insofar as it concerns their individual franchises. It is further required that the dispute be intrinsically connected with the regulation of the corporation (*Speed Distributing Corp., et al. v. Court of Appeals, et al, G.R. No. 149351, March 17, 2004; Intestate Estate of Alexander T.Tyv. Court of Appeals, G.R. No. 112872, April 19, 2001*).

Is the Securities and Exchange Commission the venue for actions involving intra-corporate controversies? (2%)

SUGGESTED ANSWER:

No, pursuant to Subsection 5.2 of the Securities Regulation Code, the quasi-judicial jurisdiction of the

Securities and Exchange Commission to hear corporate cases, including intra-corporate controversies, under Section 5 of Pres. Decree No. 902-A, has been expressly transferred to the designated Regional Trial Court. Pursuant to a memorandum circular issued by the Supreme Court, only particularly designated RTC special commercial courts in each judicial region have original and exclusive jurisdiction over such cases (See *Intestate Estate of Alexander T. Ty v. Court of Appeals, G.R. No. 112872, April 19, 2001*).

Intra-corporate Controversy; Relationship Test; Nature of Controversy Test (2014)

DC is a unit owner of Medici Condominium located in Pasig City. On September 7, 2011, Medici Condominium Corp. (Medici) demanded from DC payment for alleged unpaid association dues and assessments amounting to P195,000.00. DC disputed the claim, saying that he paid all dues as shown by the fact that he was previously elected as Director and President of Medici. Medici, on the other hand, claimed that DC's obligation was a carry-over of his obligations to the condominium developer, Medici Construction Corporation. Consequently, DC was prevented from exercising his right to vote and be voted for during the 2011 election of Medici's Board of Directors. This prompted DC to file a complaint for damages before the Special Commercial Court of Pasig City. Medici filed a motion to dismiss on the ground that the court has no jurisdiction over the intra-corporate dispute which the Housing and Land Use Regulatory Board (HLURB) has exclusive jurisdiction over. Is Medici correct? (4%)

SUGGESTED ANSWER:

Medici is correct. Using the relationship test and the nature of the controversy test, it is indubitable that the controversy involves intra-corporate issues. The facts of the problem indicate that there was a dispute as to the liability of DC for condominium dues, as well as the right of DC to "to vote and be voted for during the 2011 election of Medici's Board of Directors." Accordingly, jurisdiction is with the Special Commercial Court of Pasig City, not with the Housing and Land Use Regulatory Board (*Medical Plaza Makati Condominium Corp. v. Cullen, G.R. 181416, November 11, 2013*).

Corporate Powers; Validity of Corporate Acts (2002)

Which of the following corporate acts are valid, void, or voidable? Indicate your answer by writing the paragraph number of the query, followed by your corresponding answer as —Valid,|| —Void,|| or —Voidable,|| as the case may be. If your answer is —Void,|| explain your answer. In case of a —Voidable|| answer, specify what conditions must be present or complied with to make the corporate act valid. (5%)

1) XL Foods Corporation, which is engaged in the fastfood business, entered into a contract with its President Jose Cruz, whereby the latter would supply the corporation with its meat and poultry requirements.

SUGGESTED ANSWER:

Voidable – A contract of the corporation with one or more of its directors or trustees or officers is voidable, at the option of such corporation (Sec 32, Corporation Code).

2) The Board of Directors of XL Foods Corporation declared and paid cash dividends without approval of the stockholders.

SUGGESTED ANSWER:

3) XL Foods Corporation guaranteed the loan of its sister company XL Meat Products, Inc.

ANOTHER SUGGESTED ANSWER:

Void – This is an ultra vires act on part of XL Foods Corporation, and is not one of the powers provided for in Sec. 36 of the Corporation Code.

Corporate Powers; Ultra Vires Acts (2009)

When is there an *ultra vires* act on the part of (a) the corporation; (b) the board of directors; and (c) the corporate officers? (3%)

(A) the corporation;

SUGGESTED ANSWER:

Under Section 45 of the Corporation Code, no corporation shall possess or exercise any corporate power except those conferred by the Code or by its articles of incorporation and except such as are necessary or incidental to the exercise of the powers so conferred. When a corporation does an act or engages in an activity which is outside of its express, implied or incidental powers set out in its articles of incorporation, the act is deemed to be *ultra vires*.

(B) the board of directors;

SUGGESTED ANSWER:

When the Board engages in an activity or enters into a contract without the ratificatory vote of the stockholders in those instances where the Corporation Code so Requires such ratificatory vote, such as when the corporation is made to invest in another corporation or engage in a business which is not in pursuit of its primary purpose, the board resolution not ratified by stockholders owning or representing at least two-thirds of the outstanding capital stock would make the transaction void, as being *ultravires*.

(C) the corporate officers

SUGGESTED ANSWER:

When a corporate officer enters into a contract on behalf of the corporation without having been so expressly or impliedly authorized by the Board of Directors, even when the act or contract falls within the corporation's express, implied or incidental power, then the unauthorized act of the corporate officer is deemed to be *ultra vires*.

Corporate Powers; Who are Liable for Contracts Entered Into (2012)

A, B, C, D, E are all duly elected members of the Board of Directors of XYZ Corporation. F, the general manager,

entered into a supply contract with an American firm. The contract was duly approved by the Board of Directors. However, with the knowledge and consent of F, no deliveries were made to the American firm. As a result of the non-delivery of the promised supplies, the American firm incurred damages. The American firm would like to file a suit for damages. Can the American firm sue:

a. The members of the Board of Directors individually, because they approved the transaction? (2%)

SUGGESTED ANSWER:

a.) No. In approving the transaction, the directors were not acting in their personal capacities but rather in behalf of XYZ Corporation exercising the powers of the corporation and conducting its business (Sec. 23, Corporation Code). The problem contains no facts that would indicate that the directors acted otherwise.

b. The corporation? (2%)

SUGGESTED ANSWER:

b) Yes. The Board approved the supply contract and the General Manager entered into the contract, both of them acting on behalf of the XYZ Corporation.

c. F, the general manager, personally, because the non-delivery was with his knowledge and consent? (2%)

SUGGESTED ANSWER:

c) Yes, F could be sued in his personal capacity because he knowingly consented to the non-delivery of the promised supplies contrary to the contract that was duly approved by the Board of Directors. The problem does indicate any circumstance that could excuse or favorably explain the action of F.

d. Explain the rules on liabilities of a corporation for the act of its corporate officers and the liabilities of the corporate officers and Board of Directors of a corporation acting in behalf of the corporation. (4%)

SUGGESTED ANSWERS:

d) A corporation would be liable for the acts of its Board of Directors and officers if the said acts were performed by them in accordance with the powers granted to them under the Corporation Code, the articles of incorporation and by-laws of the corporation, the laws and regulations governing the business of, or otherwise applicable to, the corporation, and, in the case of officers, the resolutions approved by the Board of Directors.

As the directors have a personality separate from that of the corporation, they would be personally liable only if they acted willfully and knowingly vote for or assent to a patently unlawful act of the corporation, or when they are guilty of gross negligence or bad faith in directing the affairs of the corporation, or when they acquire any personal or pecuniary interest in conflict with their duty as directors, which acts result in damages to the corporation, its stockholders or other persons, when

they agree to hold themselves personally and solidarily liable with the corporation, or when they are made, by a specific provision of law, to personally answer for the corporate action. (Sec. 31, Corporation Code).

Corporate Powers; Power to Increase of Capital Stock (2001)

Suppose X Corporation has an authorized capital stock of P1M divided into 100,000 shares of stock with par value of P10 each.

a) Give two ways whereby said authorized capital stock may be increased to about P1.5M. (3%)

SUGGESTED ANSWER:

a) Two ways of increasing the Authorized Capital Stock of X corporation to P1.5M are:

- 1) Increase the number of shares from 100,000 to 150,000 shares with the same par value of P10.00 each.
- 2) Increase par value of 100,000 shares to P15.00 each.

b) Give three practical reasons for a corporation to increase its capital stock (2%)

SUGGESTED ANSWER:

b) Three practical reasons for a corporation to increase its capital stock are:

- 1) to generate more working capital;
- 2) to have more shares with which to pay for the acquisition of more assets like acquisition of company car, stocks, house, machinery or business; and
- 3) to have extra share with which to cover or meet the requirement for declaration of stock dividend.

Corporate Powers; Power to Acquire Own Shares in Relation to Trust Fund Doctrine (2005)

Under what conditions may a stock corporation acquire its own shares? (2%)

SUGGESTED ANSWER:

In line with the trust fund doctrine that generally renders it unlawful for the corporation to return assets to the stockholders representing capital, a corporation may acquire its own shares *only when there exists in the books unrestricted retained earnings to cover the repurchase of shares*. The purpose of the repurchase of shares must be a legitimate business purpose of the corporation, such as to:

1. ELIMINATE fractional shares arising out of stock dividends;
2. COLLECT from or COMPROMISE an indebtedness with the corporation arising out of unpaid subscription in a delinquency sale;
3. PURCHASE delinquent shares sold during the sale; and
4. PAY dissenting or withdrawing stockholders entitled to such payment

under the Corporation Code. (Sees. 41 and 82, Corporation Code)

Corporate Powers; Trust Fund Doctrine (2007)

Discuss the trust fund doctrine. (5%)

SUGGESTED ANSWER:

The trust fund doctrine means that the capital stock, properties and other assets of a corporation are regarded as equity in trust for the payment of corporate creditors. Stated simply, the trust fund doctrine states that all funds received by the corporation in payment of the shares of stock shall be held in trust for the corporate creditors and other stockholders of the corporation. Under such doctrine, no fund shall be used to buy back the issued shares of stock except only in instances specifically allowed by the Corporation Code (*Boman Environmental Development Corporation v. Court of Appeals*, 167 SCRA 540 [1988]).

Dividends; Sources of Dividends in Relation to Trust Fund Doctrine (2005)

From what funds are cash and stock dividends sourced?

Explain why. (2%)

SUGGESTED ANSWER:

All cash and stock dividends are always paid out of the unrestricted retained earnings (also called surplus profit) of the corporation. If the corporation has no unrestricted retained earnings, the dividends would have to be sourced from the capital stock. This is illegal. It violates the "TRUST FUND DOCTRINE" that provides that the capital stock of the corporation is a trust fund to be kept intact during the life of the corporation for the benefit of the creditors of the corporation. (*Commissioner of Internal- Revenue v. Court of Appeal*®, G.R. No. 108576, January 20, 1999; *Boman Environmental Development Corp. v. Court of Appeals*, G.R. No. 77860, November 22, 1988; and *Steinberg v. Velasco*, G.R. No. 30460, March 12, 1929)

Dividends; Dividends vs. Profit; Cash Dividend vs. Stock Dividend (2005)

Distinguish dividend from profit; cash dividend from stock dividend. (2%)

SUGGESTED ANSWER:

PROFITS are residual amounts representing return of capital after deducting all corporate costs and expenses from revenues. The accumulated profits, from year to year, represent the corporate retained earnings from which the dividends can be declared.

CASH DIVIDENDS represent an actual distribution of accumulated profits to the stockholders as a return on their investments. Declaration of cash dividends requires only the approval of the majority of the Board of Directors in a proper resolution. STOCK DIVIDENDS are simply transfers of retained earnings to capital stock, thereby increasing the number of shares of stocks of each stockholder with no required cash contribution. A two-thirds vote of the stockholders, coupled with a majority vote of the

Board of Directors, is needed to declare stock dividends.

Dividends; Declaration of Dividends (2001)

For the past three years of its commercial operation, X, an oil company, has been earning tremendously in excess of 100% of the corporation's paid-in capital. All of the stockholders have been claiming that they share in the profits of the corporation by way of dividends but the Board of Directors failed to lift its finger. a) Is Corporation X guilty of violating a law? If in the affirmative, state the basis (2%)

SUGGESTED ANSWER:

Corporation X is guilty of violating Section 43 of the Corp Code. This provision prohibits stock corporations from retaining surplus profits in excess of 100% of their paid-in capital.

b) Are there instances when a corporation shall not be held liable for not declaring dividends? (3%)

SUGGESTED ANSWER:

The instances when a corporation shall not be held liable for not declaring dividends are:

Dividends: Declaration of Dividends (2005)

Under what circumstances may a corporation declare dividends? (2%)

SUGGESTED ANSWER:

No form of dividends can be declared and paid by the corporation except from unrestricted retained earnings appearing on its books. Dividends must be paid in amounts proportional to all stockholders on the basis of outstanding stock held by them. Cash or property dividends, can be declared from such unrestricted retained earnings by a proper resolution of the Board of Directors. Stock dividends, however, must be declared by a proper resolution of the Board of Directors from existing unrestricted retained earnings and ratified by stockholders representing at least two-thirds (2/3) of the outstanding capital stock of the corporation, obtained in a meeting duly called for the purpose. (Sec. 43, Corporation Code)

Dividends; Declaration of Dividends (2009)

TRUE OR FALSE.

(D) Dividends on shares of stocks can only be declared out of unrestricted retained earnings of the corporation.

SUGGESTED ANSWER:

True. Dividends on shares of stock of a corporation, whether cash dividend or stock dividend, can be validly declared only out of unrestricted retained earnings (Sec. 43, Corporation Code). It cannot be declared out of the capital. Otherwise, such declaration of dividend will violate the trust fund doctrine.

Dividends; Declaration of Dividends (2008)

Ace Cruz subscribed to 100,000 shares of stock of JP Development Corporation, which has a par value of P1 per share. He paid P25,000 and promised to pay the balance before December 31, 2008. JP Development Corporation declared a cash dividend on October 15,

2008, payable on December 1, 2008

(A) For how many shares is Ace Cruz entitled to be paid cash dividends? Explain. (2%)

SUGGESTED ANSWER:

Ace Cruz is entitled to be paid each cash dividends to the entire 100,000 shares subscribed, and not only to the paid-up portion thereof. The legal character of being a "stockholder," and therefore the entitlement to all the rights of a stockholder, are determined from the time of "subscription" and not from payment of the subscription.

Under Sec. 43 of the Corporation Code, "a stock corporation may declare dividends out of the unrestricted retained earnings which shall be payable in cash, in property, or in stock to all stockholders on the basis of outstanding stock held by them" on not on the basis on what stocks have been paid.

ALTERNATIVE ANSWER:

Under Sec. 71, only when a stockholder has been declared delinquent do his rights as stockholder become suspended. It means therefore that a stockholder who has not paid the full subscription, provided he is not declared delinquent has complete exercise of all of his rights, including the right to receive dividends. But any cash dividends due on delinquent stock shall first be applied to the unpaid balance of the subscription (Sec. 43, Corporation Code).

(B) On December 1, 2008, can Ace Cruz compel JP Development Corporation to issue to him the stock certificate corresponding to the P25,000 paid by him? (2%)

SUGGESTED ANSWER:

No, Ace Cruz cannot compel JP Development Corporation to issue him the stock certificate for the P 25,000.00. No Certificate of Stock can be issued to a subscriber until the full amount of his subscription together with interest and expense, if any is due, has been paid. A Subscription is one, entire and indivisible whole contract which cannot be divided into portions. The stockholder is not entitled to a Certificate of Stock until he has remitted the full amount of his subscription (Sec. 64, Corporation Code; SEC Opinion [January 6, 1989]).

Dividends; Declaration of Dividends (2009)

On September 15, 2007, XYZ Corporation issued to Paterno eight hundred preferred shares with the ff. terms:

—The Preferred Shares shall have the ff. rights, preferences, qualifications, and limitations, to wit:

(1) The right to receive a quarterly dividend of One per Centum cumulative and participating;

(2) These shares may be redeemed, by drawing of lots, at any time after two years from date of issue, at the option of the Corporation; xxx

Today, Paterno sues XYZ Corporation for specific

performance, for the payment of dividends on, and to compel the redemption of , the preferred shares, under the terms and conditions provided in the stock certificates. Will the suit prosper? Explain. (3%)

SUGGESTED ANSWER:

No. the suit will not prosper. Paterno cannot compel XYZ Corporation to pay dividends, which have to be declared by the Board of Directors and the latter cannot do so, unless there are sufficient unrestricted retained earnings. Otherwise, the corporation will be forced to use its capital to make said payments in violation of the trust fund doctrine. Likewise, redemption of shares cannot be compelled. While the certificate allows such redemption, the option and discretion to do so are clearly vested in the corporation (*Republic Planters Bank v. Agana*, 269 SCRA 1 [1997]).

Dividends; Declaration of Dividends (2015)

A. DEF Corporation has retained surplus profits in excess of 100% of its paid-in capital stock. However, it is unable to declare dividends, because it had entered into a loan agreement with a certain creditor wherein the declaration of dividends is not allowed without the consent of such creditor. If DEF Corporation cannot obtain this consent, will it be justified in not declaring dividends to its stockholders? Explain. (3%)

SUGGESTED ANSWER:

Yes. Stock corporations are prohibited from retaining surplus profits in excess of 100% of their paid-in capital stock except among others, when the corporation is prohibited under any loan agreement with any financial institution or creditor, whether local or foreign, from declaring dividends without the consent of the creditor and such consent as not been secured (*Section 43 of the Corporation Code*).

BOD; Manner of Filling Vacancies (2013)

In the November 2010 stockholders meeting of Greenville Corporation, eight (8) directors were elected to the board. The directors assumed their posts in January 20 11. Since no stockholders' meeting was held in November 2011, the eight directors served in a holdover capacity and thus continued discharging their powers. In June 2012, two (2) of Greenville Corporation's directors- Director A and Director B -resigned from the board. Relying on Section 29 of the Corporation Code, the remaining six (6) directors elected two (2) new directors to fill in the vacancy caused by the resignation of Directors A and B.

Stockholder X questioned the election of the new directors, initially, through a letter-complaint addressed to the board, and later (when his letter-complaint went unheeded), through a derivative suit filed with the court. He claimed that the vacancy in the board should be filled up by the vote of the stockholders of Greenville Corporation. Greenville Corporation's directors defended the legality of their action, claiming as well that Stockholder X's derivative suit was improper. Rule on the issues raised. (8%)

SUGGESTED ANSWER:

The remaining directors cannot elect new directors to fill in the two vacancies. The board of directors may fill up vacancy only if the ground is not due to expiration of term, removal or increase in the number of board seats. In this case, the term of the two directors expired after one year. They remained in office in a hold-over capacity only until their resignation. The hold-over period is not part of their term. The vacancies should be filled up by election by the stockholders (*Valle Verde Country Club, Inc. v. Africa*, 598 SCRA 202, 2009).

The derivative suit was improper. xxx

BOD: Election of Aliens as members (2005)

A Korean national joined a corporation which is engaged in the furniture manufacturing business. He was elected to the Board of Directors. To complement its furniture manufacturing business, the corporation also engaged in the logging business. With the additional logging activity, can the Korean national still be a member of the Board of Directors? Explain. (3%)

SUGGESTED ANSWER:

Yes, just as long as sixty percent (60%) of the Board of Directors are Filipinos. Corporations that are sixty percent (60%) owned by Filipinos can engage in the business of exploration, development and utilization of natural resources. (Art. XII, Sec. 2, 1987 Constitution) The election of aliens as members of the Board Of Directors engaging in partially-nationalized activities is allowed in proportion to their allowable participation or share in the capital of such entities. (Sec. 2-A, Anti-Dummy Law) Nothing in the facts shows that more than forty percent (40%) of the Board of Directors are foreigners.

BOD; Contracts by Self-dealing Directors w/ the Corporation; Requirements for Validity (2008)

Pedro was 70% of the subscribed capital stock of a company which owns an office building. Paolo and Juan own the remaining stock equally between them. Paolo also owns a security agency, a janitorial company and a catering business. In behalf of the office building company, Paolo engaged his companies to render their services to the office building. Are the service contracts valid? Explain. (4%)

SUGGESTED ANSWER:

The contracts of Paolo, who owns 15% of the Outstanding Capital Stock of the office building company is not valid if they were not approved by the Board of Directors and Paolo was not designated to execute them on behalf of said company.

On the other hand, if the contracts were duly approved by the Board of Directors of the office building company with Paolo duly designated as company representative, they would nevertheless be voided at the option of the company under Sec. 32 of the Corporation Code.

"A contract of the corporation with one or more of its directors or trustees or officers is voidable at the option of such corporation, unless all the following conditions are present," (a) if Paolo as a director in the board meeting in which the

contracts were approved was not necessary to constitute a quorum for such meeting; (b) Paolo's vote at such meeting was not necessary for the approval of the contracts; (c) Each of the contract are fair and reasonable under the circumstances.

If condition (a) or (b) is absent, Sec. 32 requires that the contracts must be ratified by the shareholders representing at least two-thirds (2/3) of outstanding capital stock, provided that there was full disclosure of the adverse interest of Paolo to Pedro.

BOD; Officers; Removal of Officers (2001)

In 1999, Corporation A passed a board resolution removing X from his position as manager of said corporation. The by-laws of A corporation provides that the officers are the president, vice-president, treasurer and secretary. Upon complaint filed with the SEC, it held that a manager could be removed by mere resolution of the board of directors. On motion for reconsideration, X alleged that he could only be removed by the affirmative vote of the stockholders representing 2/3 of the outstanding capital stock. Is X's contention legally tenable. Why? (5%)

SUGGESTED ANSWER:

No. Stockholders' approval is necessary only for the removal of the members of the BOD. For the removal of a corporate officer or employee, the vote of the BOD is sufficient for the purpose.

Executive Committee; Creation Thereof & Validity of Corporate Acts (2014)

Pursuant to its By-Laws, Soei Corporation's Board of Directors created an Executive Committee to manage the affairs of the corporation in between board meetings. The Board of Directors appointed the following members of the Executive Committee: the President, Sarah L; the Vice President, Jane L; and, a third member from the board, Juan Riles. On December 1, 2013, the Executive Committee, with Sarah L and Jane L present, met and decided on the following matters:

1. Purchase of a delivery van for use in the corporation's retail business;
2. Declaration and approval of the 13th month bonus;
3. Purchase of an office condominium unit at the Fort; and
4. Declaration of P10.00 per share cash dividend.

Are the actions of the Executive Committee valid? (4%)

SUGGESTED ANSWER:

All the actions taken by the Executive Committee in the problem are not valid. The Executive Committee was not a properly created and, therefore, its acts are invalid. Section 35 of the Corporation Code requires that at least three members of an executive Committee be directors of the corporation. In the problem, only Member Sarah L (who is a director as she is the President) and Member Juan Riles (who is clearly identified in the problem as a director) are directors of Soei Corporation. Member Jane L is not identified as a director. As the Executive Committee in the problem was not properly created it could not act at all as the

minimum quorum would be three. As stated earlier, the Executive Committee lacks one qualified member.

If the Executive Committee were properly organized and a quorum were presented, all the actions taken by the Executive Committee in the problem, except the declaration of P10.00 per share cash dividend, would have been valid. The distribution of cash dividends to the shareholders may not be delegated by the Board of Directors to the Executive Committee pursuant to Section 35 of the Corporation Code.

Stockholders; Proprietary Rights; Pre-emptive Right (2001)

Suppose that X Corporation has already issued the 1000 originally authorized shares of the corporation so that its BOD and stockholders wish to increase X's authorized capital stock. After complying with the requirements of the law on increase of capital stock, X issued an additional 1000 shares of the same value. a) Assume that the stockholder A presently holds 200 out of the 1000 original shares.

a) Would A have a pre-emptive right to 200 of the new issue of 1000 shares? Why? (3%)

SUGGESTED ANSWER:

a) Yes, A would have a pre-emptive right to 200 of the new issue of 1000 shares. A is a stockholder of record holding 200 shares in X Corpo. According to the Corp Code, each stockholder has the pre-emptive right to all issues of shares made by the corporation in proportion to the number of shares he holds on record in the corporation.

b) When should stockholder A exercise the pre-emptive right? (2%)

SUGGESTED ANSWER:

b) Pre-emptive right must be exercised in accordance with the Articles of Incorporation or the By-Laws. When the Articles of Incorporation and the By-Laws are silent, the BOD may fix a reasonable time within which the stockholders may exercise the right.

Stockholders; Proprietary Rights; Pre-emptive Right (2004)

The Board of Directors of ABC, Inc., a domestic corporation, passed a resolution authorizing additional issuance of shares of stocks without notice nor approval of the stockholders. DX, a stockholder, objected to the issuance, contending that it violated his right of preemption to the unissued shares. Is his contention tenable? Explain briefly. (5%)

SUGGESTED ANSWER:

Yes. DX's contention is tenable. Under Section 39 of the Corporation Code, all stockholders of ABC, Inc. enjoy preemptive right to subscribe to all issues of shares of any class, including the reissuance of treasury shares in proportion to their respective shareholdings.

Stockholders; Proprietary Rights; Appraisal Right (2003)

In what instances may the right of appraisal be availed of under the Corporation Code?

SUGGESTED ANSWER:

SECTION 81. Instances of Appraisal Right. — Any stockholder of a corporation shall have the right to dissent and demand payment of the fair value of his shares in the following instances:

1. In case any amendment to the articles of incorporation has the effect of changing or restricting the rights of any stockholders or class of shares, or of authorizing preferences in any respect superior to those of outstanding shares of any class, or of extending or shortening the term of corporate existence;
2. In case of sale, lease, exchange, transfer, mortgage, pledge or other disposition of all or substantially all of the corporate property and assets as provided in the Code; and
3. In case of merger or consolidation.

Stockholders; Proprietary Rights; Appraisal Right (2007)

In a stockholders meeting, S dissented from the corporate act converting preferred voting shares to non-voting shares. Thereafter, S submitted his certificates of stock for notation that his shares are dissenting. The next day, S transferred his shares to T to whom new certificates were issued. Now, T demands from the corporation the payment of the value of his shares. (10%)

(A) What is the meaning of a stockholder's appraisal right?

SUGGESTED ANSWER:

Appraisal right is the right of stockholder, who dissents from a fundamental or extraordinary corporate action, to demand payment of the fair value of his shares. It is the right of a stockholder to withdraw from the corporation and demand payment of the fair value of his shares after dissenting from certain corporate acts involving fundamental changes in the corporate structure (Section 81, Corporation Code).

(B) Can T exercise the right of appraisal? Reason briefly?

SUGGESTED ANSWER:

No, T cannot exercise the right of appraisal in this case. When S transferred his shares to T and T was issued new stock certificates, the appraisal right of S ceased, and T acquired all the rights of a regular stockholder. The transfer of shares from S to T constitutes an abandonment of the appraisal right of S. All the T acquired from the issuance of new stock certificated was the rights of a regular stockholders (Section 86, Corporation Code).

Stockholders; Meeting; Quorum (2009)

Triple a Corporation (Triple A) was incorporated in 1960, with 500 founders' shares and 78 common shares as its initial capital stock subscription. However, Triple A registered its stock and transfer book only in 1978, and

recorded merely 33 common shares as the corporation's issued and outstanding shares.

(B) On May 6, 1992, a special stockholders' meeting was held. At this meeting, what would have constituted a quorum? Explain. (3%)

SUGGESTED ANSWER:

A quorum consists of the majority of the totality of the shares which have been subscribed and issued. Thus the quorum for such meeting would be 289 shares or a majority of the 57 shares issued and outstanding as indicated in the article of incorporation. This includes the 33 common shares reflected in the stock and transfer book, there being no mention or showing of any transaction effected from the time of Triple A's incorporation in 1960 up to the said meeting (Section 52 in Relation to Section 137 of Corporation Code; *Lanuza v. court of Appeals*, 454 SCRA 54 (2005)).

Stockholders; Remedial Rights; Derivative Suit; Minority Stockholder (2003)

Gina Sevilla, a minority stockholder of Bayan Corporation, felt that various investments of the company's capital were *ultra vires* if not, indeed, made in violation of law. She filed a derivative suit seeking to nullify the questioned investments. Would her action prosper? Why?

SUGGESTED ANSWER:

Yes, she is already a stockholder at the time the alleged misappropriation of corporate funds. And that filing such action as a derivative suit even by a lone stockholder is one of the protections extended by law to minority stockholders against abuses of the majority. Nevertheless, Gina must first exhaust any administrative remedies before her suit be consider in court.

Stockholders; Remedial Rights; Derivative Suit: Requisites (2004)

AA, a minority stockholder, filed a suit against BB, CC, DD, and EE, the holders of majority shares of MOP Corporation, for alleged misappropriation of corporate funds. The complaint averred, inter alia, that MOP Corporation is the corporation in whose behalf and for whose benefit the derivative suit is brought. In their capacity as members of the Board of Directors, the majority stockholders adopted a resolution authorizing MOP Corporation to withdraw the suit. Pursuant to said resolution, the corporate counsel filed a Motion to Dismiss in the name of the MOP Corporation. Should the motion be granted or denied? Reason briefly. (5%)

SUGGESTED ANSWER:

No. All the requisites for a valid derivative suit exist in this case. First, AA was exempt from exhausting his remedies within the corporation, and did not have to make a demand on the Board of Directors for the latter to sue. Here, such a demand would be futile, since the directors who comprise the majority (namely, BB, CC, DD and EE) are the ones guilty of the wrong complained of. Second, AA appears to be stockholder at the time the alleged misappropriation of corporate funds. Third, the suit is brought on

behalf and for the benefit of MOP Corporation. In this connection, it was held in *Conmart (Phils.) Inc. v. Securities and Exchange Commission*, 198 SCRA 73 (1991) that to grant to the corporation concerned the right of withdrawing or dismissing the suit, at the instance of the majority stockholders and directors who themselves are the persons alleged to have committed the breach of trust against the interests of the corporation would be to emasculate the right of minority stockholders to seek redress for the corporation. Filing such action as a derivative suit even by a lone stockholder is one of the protections extended by law to minority stockholders against abuses of the majority.

Stockholders; Remedial Rights; Derivative Suit (2005)

Sometime in April 2004, Malyn learned about Fort Patio Cafe located in Taguig City and that its development was undertaken by a new corporation known as Fort Patio, Inc., where both Schiera and Jaz are directors. Malyn also found that Schiera and Jaz, on behalf of Patio Investments, had obtained a loan of P500,000.00 from PBCom Bank, for the purpose of opening Fort Patio Cafe. This loan was secured by the assets of Patio Investments and personally guaranteed by Schiera and Jaz. Malyn then filed a corporate derivative action before the Regional Trial Court of Makati City against Schiera and Jaz, alleging that the two directors had breached their fiduciary duties by misappropriating money and assets of Patio Investments in the operation of Fort Patio Cafe. (5%)

2) Was it proper for Malyn to file a derivative suit with a prayer for injunctive relief? Explain.

SUGGESTED ANSWER:

Although it is a close corporation, nevertheless the principles of separate juridical personality still apply. The business of the corporation is still separate and distinct

from the proprietary interests of its stockholders and directors. Consequently, since the business opportunity and the resource's used pertain to the close corporation, the standing to sue and to recover remains with the close corporation and not with Malyn. Therefore, it is still necessary to file a derivative suit on behalf of the close corporation, although the proceedings would be governed under the Interim Rules of Procedure for Intra Corporate Disputes.

3) Assuming that a derivative suit is proper; may the action continue if the corporation is dissolved during the pendency of the suit? Explain.

SUGGESTED ANSWER:

Yes, for in spite of the dissolution of any corporation, it remains a juridical person for purpose of dissolution for three years from the date of dissolution, precisely one of the purposes is to allow the winding-up of its affairs, including the termination of pending suits.

Stockholders; Remedial Rights; Derivative Suit; Jurisdiction (2009)

Atlantis Realty Corporation (ARC), a local firm engaged in real estate development, plans to sell one of its prime assets—a three-hectare land valued at about P100-million. For this purpose, the board of directors of ARC unanimously passed a resolution approving the sale of the property for P75-million to Shangrila Real Estate Ventures (SREV) a rival realty firm. The resolution also called for a special stockholders meeting at which the proposed sale would be up for ratification.

Atty. Edric, a stockholder who owns only one (1) share in ARC, wants to stop the sale. He then commences a derivative suit for and in behalf of the corporation, to enjoin the board of directors and the stockholders from approving the sale.

(A) Can Atty. Edric, who owns only one share in the company, initiate a derivative suit? Why or why not? (2%)

SUGGESTED ANSWER:

Yes, Atty. Edric can initiate a derivative suit, otherwise known as the minority stockholders' suit. It is allowed by law to enable the minority stockholder/s to protect the interest of the corporation against illegal or disadvantageous act/s of its officers or directors, the people who are supposed to protect the corporation (*Pascual v. Del Zaz Orozco*, 19 Phil. 82 (1991)).

(B) If such a suit is commenced, would it constitute an intra-corporate dispute? If so, why and where would such a suit be filed? If not, why not? (2%)

SUGGESTED ANSWER:

Yes, such suit would constitute an intra-corporate dispute as it is a suit initiated by a stockholder against other stockholders who are officers and directors of the same corporation (P.D. No. 902-A, Sec. 5(b)). Such suit should be filed in the Regional Trial Court designated by the Supreme Court as a corporate or commercial court.

(C) Will the suit prosper? Why or why not? (3%)

SUGGESTED ANSWER:

No. The suit will not prosper. There is no requisite demand on the officers and directors concerned. There is, therefore, no exhaustion of administrative remedies.

Stockholders; Remedial Rights; Derivative Suit (2013)

In the November 2010 stockholders meeting of Greenville Corporation, eight (8) directors were elected to the board. The directors assumed their posts in January 2011. Since no stockholders' meeting was held in November 2011, the eight directors served in a holdover capacity and thus continued discharging their powers.

In June 2012, two (2) of Greenville Corporation's directors- Director A and Director B -resigned from the board. Relying on Section 29 of the Corporation Code, the remaining six (6) directors elected two (2) new directors to fill in the vacancy caused by the resignation of Directors A and B.

Stockholder X questioned the election of the new directors, initially, through a letter-complaint addressed to the board, and later (when his letter-complaint went unheeded), through a derivative suit filed with the court. He claimed that the vacancy in the board should be filled up by the vote of the stockholders of Greenville Corporation. Greenville Corporation's directors defended the legality of their action, claiming as well that Stockholder X's derivative suit was improper. Rule on the issues raised. (8%)

SUGGESTED ANSWER:

The remaining directors cannot elect new directors to fill in the two vacancies.... xxx

The derivative suit was improper. In a derivative suit, the corporation, not the individual stockholder, must be the aggrieved party and that the stockholder is suing on behalf of the corporation. What stockholder X is asserting is his individual right as a stockholder to elect the two directors. The case partakes more of an election contest under the rules on intra-corporate controversy (*Legaspi Towers 300, Inc. v. Muer, 673 SCRA 453, 2012*).

Stockholders; Remedial Rights; Derivative Suit; When Improper (2014)

A, B, C, D, and E were members of the 2003-2004 Board of Directors of FLP Corporation. At the election for the 2004-2005 Board of Directors, not one of them was elected. They filed in court a derivative suit on behalf of FLP Corporation against the newly-elected members of the Board of Directors. They questioned the validity of the election as it was allegedly marred by lack of quorum, and prayed for the nullification of the said election. The 2004-2005 Board of Directors moved to dismiss the complaint because the derivative suit is not proper. Decide. (4%)

SUGGESTED ANSWER:

The position taken by the 2004-2005 Board of Directors is correct. The derivative suit is not proper. The members of the 2003-2004 Board of Directors of FLP Corporation are the injured parties, not FLP Corporation, as their rights to vote and to be voted upon were directly affected by the election of the new set of directors. (*Legaspi Towers 300, Inc., et al. v. Muer, et al., G.R. 170783, June 18, 2012*).

Doctrine of Corporate Opportunity (2005)

Briefly discuss the doctrine of corporate opportunity. (2%)

SUGGESTED ANSWER:

In brief, the doctrine disqualifies a director, trustee or officer from appropriating for his personal benefit a transaction or opportunity that pertains to the corporation, and which under the duty of loyalty he should first bring to the corporation for its use or exploitation. The doctrine of corporate opportunity is an enforcement of the duty of loyalty of corporate directors and officers. When a director, trustee or officer attempts to acquire or acquires, in violation of his duty, an interest adverse to the corporation in respect of any matter which has been reposed in him in confidence, he shall be liable as a trustee for the corporation and must account for the

profits which otherwise would have accrued to the corporation. Equity imposes liability upon him not to deal for his own benefit. (Sec. 31, Corporation Code) Under Sec. 34 of the Corporation Code where a director, by virtue of his office, acquires for himself a business opportunity which should belong to the corporation, thereby obtaining profits to the prejudice of such corporation, he must account to the latter for all such profits by refunding the same, unless his act has been ratified by a vote of the stockholders owning or representing at least two-thirds (2/3) of the outstanding capital stock.

Doctrine of Corporate Opportunity (2005)

Malyn, Schiera and Jaz are the directors of Patio Investments, a close corporation formed to run the Patio Cafe, an al fresco coffee shop in Makati City. In 2000, Patio Cafe began experiencing financial reverses, consequently, some of the checks it issued to its beverage distributors and employees bounced.

In October 2003, Schiera informed Malyn that she found a location for a second cafe in Taguig City. Malyn objected because of the dire financial condition of the corporation.

Sometime in April 2004, Malyn learned about Fort Patio Cafe located in Taguig City and that its development was undertaken by a new corporation known as Fort Patio, Inc., where both Schiera and Jaz are directors. Malyn also found that Schiera and Jaz, on behalf of Patio Investments, had obtained a loan of P500,000.00 from PBCOM Bank, for the purpose of opening Fort Patio Cafe. This loan was secured by the assets of Patio Investments and personally guaranteed by Schiera and Jaz.

Malyn then filed a corporate derivative action before the Regional Trial Court of Makati City against Schiera and Jaz, alleging that the two directors had breached their fiduciary duties by misappropriating money and assets of Patio Investments in the operation of Fort Patio Cafe. (5%)

1) Did Schiera and Jaz violate the principle of corporate opportunity? Explain.

SUGGESTED ANSWER:

Yes. Although Malyn refused the business before, nevertheless, using the resources and credit standing of the company, Schiera and Jaz clearly demonstrated that the business could have been successfully pursued in the name of the close corporation. More importantly, Schiera and Jaz are guilty of diverting the resources of the close corporation to another entity, equivalent to fraud and bad faith.

Doctrine of Apparent Authority (2015)

Define: Doctrine of apparent authority (2%)

SUGGESTED ANSWER:

By doctrine of apparent authority, the corporation will be estopped from denying the agent's authority if it knowingly permits one of its officers or any other agent to act within the scope of an apparent authority and it holds him out to the public as possessing the power to do those acts

(Advance Paper Corporation v. Arma Traders Corporation, 712 SCRA 313 [2013]).

Trust Fund Doctrine (2015)

Define: Trust fund doctrine (2%)

SUGGESTED ANSWER:

By the trust fund doctrine subscriptions to the capital stock of a corporation constitute a fund to which the creditors have the right to look for satisfactions of their claims. The scope of the doctrine encompasses not only the capital stock but also other property and assets generally regarded in equity as a trust fund for the payment of corporate debts (*Halley v. Printwell*, 649 SCRA 116 [2011]; *Ong v. Tiu* 401 SCRA 1[2003]).

Capital Structure; Stocks; Sale, Transfer of Certificates of Stock (2001)

A is the registered owner of Stock Certificate No. 000011. He entrusted the possession of said certificate to his best friend B who borrowed the said endorsed certificate to support B's application for passport (or for a purpose other than transfer). But B sold the certificate to X, a bona fide purchaser who relied on the endorsed certificates and believed him to be the owner thereof.

- a) Can A claim the shares of stock from X? Explain (3%)
- b) Would your answer be the same if A lost the stock certificate in question or if it was stolen from him? (2%)

SUGGESTED ANSWER:

a) No. Assuming that the shares were already transferred to B, A cannot claim the shares of stock from X. The certificate of stock covering said shares have been duly endorsed by A and entrusted by him to B. By his said acts, A is now estopped from claiming said shares from X, a bona fide purchaser who relied on the endorsement by A of the certificate of stock.

b) Yes. In the case where the certificate of stock was lost or stole from A, A has a right to claim the certificate of stock from the thief who has no right or title to the same. —One who has lost any movable or has been unlawfully deprived thereof, may recover it from the person in possession of the same. (Art 559 NCC)

Capital Structure; Stocks; Sale, Transfer of Certificates of Stock (2004)

Four months before his death, PX assigned 100 shares of stock registered in his name in favor of his wife and his children. They then brought the deed of assignment to the proper corporate officers for registration with the request for the transfer in the corporation's stock and transfer books of the assigned shares, the cancellation of the stock certificates in PX's name, and the issuance of new stock certificates in the names of his wife and his children as the new owners. The officers of the Corporation denied the request on the ground that another heir is contesting the validity of the deed of assignment. May the Corporation be compelled by mandamus to register the shares of stock in the names of the assignees? Explain briefly. (5%)

SUGGESTED ANSWER:

Yes. The corporation may be compelled by mandamus to register the shares of stock in the name of the assignee. The only legal limitation imposed by Section 63 of the Corporation Code is when the Corporation holds any unpaid claim against the shares intended to be transferred. The alleged claim of another heir of PX is not sufficient to deny the issuance of new certificates of stock to his wife and children. It would be otherwise if the transferee's title to the shares has no prima facie validity or is uncertain.

Capital Structure; Stock and Transfer Book (2009)

(C) What is a stock and transfer book? (1%)

SUGGESTED ANSWER:

A Stock and transfer book is a book which records all stocks in the name of the stockholders alphabetically arranged; the installments paid or unpaid on all stocks for which subscription has been made and the date of payment of any installment, a statement of every alienation, sale or transfer of stock made, the date thereof, and by and to whom made; and such other entries as the by-laws may prescribe (Section 74, Corporation Code).

Capital Structure; Shares of Stock; Issuance Thereof to Pay for Services (2005)

Janice rendered some consultancy work for XYZ Corporation. Her compensation included shares of stock therein. Can XYZ Corporation issue shares of stock to pay for the services of Janice as its consultant? Discuss your answer. (2%)

SUGGESTED ANSWER:

Yes, provided the approval of stockholders representing two-thirds (2/3) of the outstanding capital stock is obtained. Although the facts indicate that the consultancy work has already been "rendered" constituting "previously contracted debt," under Section 39 of the Corporation Code, the pre-emptive rights of existing stockholders need not be respected "in payment of a previously contracted debt," but only with the indicated stockholders' approval. Under Section 62 of the Corporation Code, consideration for the issuance of stock may include labor performed for or services actually rendered to the corporation.

Capital Structure; Shares of Stock; Preferred Shares (2013)

Bell Philippines, Inc. (BelPhil) is a public utility company, duly incorporated and registered with the Securities and Exchange Commission. Its authorized capital stock consists of voting common shares and non-voting preferred shares, with equal par values of P100.00/share. Currently, the issued and outstanding capital stock of BelPhil consists only of common shares shared between Bayani Cruz, a Filipino with 60% of the issued common shares, and Bernard Fleet, a Canadian, with 40%.

To secure additional working fund, BelPhil issued preferred shares to Bernard Fleet equivalent to the currently outstanding common shares. A suit was filed questioning the corporate action on the ground that the foreign equity holdings in the company would now

exceed the 40% foreign equity limit allowed under the Constitution for public utilities.

Rule on the legality of Bernard Fleet's current holdings. (8%)

SUGGESTED ANSWER:

The holding of Bernard Fleet equivalent to the outstanding common shares is illegal. His holdings of preferred shares should not exceed 40%. Since the constitutional requirement of 60% Filipino ownership of the capital of public utilities applies not only to voting control but also to beneficial ownership of the corporation, it should also apply to the preferred shares. Preferred shares are also entitled to vote in certain corporate matters. (*Gamboa v. Teves*, 682 SCRA 397, 2012) The State shall develop a self-reliant and independent national economy effectively controlled by Filipinos. (Article 11, Sec. 19, 1987 Constitution) The effective control here should be mirrored across the board on all kinds of shares.

Capital Structure; Shares of Stock; Watered Stock (2015)

B. What is "watered stock" and what is the legal consequence of the issuance of such stock? (3%)

SUGGESTED ANSWER:

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

Dissolution & Liquidation; Expiration of Corporate Term (2004)

XYZ Corporation entered into a contract of lease with ABC, Inc., over a piece of real estate for a term of 20 years, renewable for another 20 years, provided that XYZ's corporate term is extended in accordance with law. Four years after the term of XYZ Corporation expired, but still within the period allowed by the lease contract for the extension of the lease period, XYZ Corp. notified ABC, Inc., that it is exercising the option to extend the lease. ABC, Inc., objected to the proposed extension, arguing that since the corporate life of XYZ Corp. had expired, it could no longer opt to renew the lease. XYZ Corp. countered that withstanding the lapse of its corporate term it still has the right to renew the lease because no quo warranto proceedings for involuntary dissolution of XYZ Corp. has been instituted by the Office of the Solicitor General. Is the contention of XYZ Corp. meritorious? Explain briefly. (5%)

SUGGESTED ANSWER:

XYZ Corporation's contention is not meritorious. Based on the ruling of the Supreme Court in *Philippine National Bank vs. CFI of Rizal*, 209 SCRA (1992). XYZ Corp. was dissolved ipso facto upon the expiration of its original term. It ceased to be a body corporate for the purpose of continuing the business for which it was organized, except only for purposes connected with its winding up or liquidation. Extending the lease is not an act to wind up or liquidate XYZ Corp.'s affairs. It is contrary to the idea of winding up the affairs of the corporation.

Dissolution & Liquidation; Voluntary Dissolution (2002)

Name three (3) methods by which a stock corporation may be voluntarily dissolved. Explain each method. (5%)

SUGGESTED ANSWER:

The three (3) methods by which a stock corporation may be voluntarily dissolved are: 1) Voluntary Dissolution where no creditors are affected. This is done by a majority vote of the directors, and resolution of at least 2/3 vote of stockholders, submitted to the Securities and Exchange Commission.

2) Voluntary dissolution where creditors are affected. This is done by a petition for dissolution which must be filed with the Securities and Exchange Commission, signed by a majority of the members of the board of directors, verified by the president or secretary, and upon affirmative vote of stockholders representing at least 2/3 of the outstanding capital stock.

3) Dissolution by shortening of the corporate term. This is done by amendment of the articles of incorporation.

Dissolution & Liquidation (2012)

AAA Corporation is a bank. The operations of AAA Corporation as a bank was not doing well. So, to avert any bank run, AAA Corporation, with the approval of the Monetary Board, sold all its assets and liabilities to BBB Banking Corporation which includes all deposit accounts. In effect then, BBB Corporation will service all deposits of all depositors of AAA Corporation.

a. Will the sale of all assets and liabilities of AAA Corporation to BBB Banking Corporation automatically dissolve or terminate the corporate existence of AAA Corporation? Explain your answer. (5%)

SUGGESTED ANSWER:

a. No, the sale of all the assets and liabilities of AAA Corporation to BBB Banking Corporation will not result in the automatic dissolution or termination of the existence of the former. A decision to dissolve AAA Corporation or to terminate its corporate existence would require a separate approval by a majority of the Board of Directors of AAA Corporation and its stockholders holding at least two-thirds of the total outstanding capital stock, as well as the separate approval by the Monetary Board.

b. What are the legal requirements in order that a corporation may be dissolved? (5%)

SUGGESTED ANSWER:

b. A corporation may be dissolved voluntarily under Section 118 (where no creditors are affected) or under Section 119 (where creditors are affected), or

by shortening of the corporate term under Section 120, or involuntarily by the SEC under Section 122, all of the Corporation Code. Dissolution under Sections 118, 119, and 120 require the same corporate approvals stated in (a) above.

Note that the SEC also has the authority under Section 6 of PD 902-A to revoke the certificate of registration of a corporation upon any of the grounds provided by law, including the aforementioned Section 6-A.

Dissolution & Liquidation (2015)

Barn filed an action to enjoin SN Company's Board of Directors from selling a parcel of land registered in the corporation's name, to compel the corporation to recognize Barn as a stockholder with 50 shares, to allow him to inspect the corporate books, and to claim damages against the corporation and its officers. Subsequently, the corporation and the individual defendants moved to dismiss the complaint since the corporation's certificate of registration was revoked by the SEC during the pendency of Barn's case on the ground of non-compliance with reportorial requirements. The special commercial court granted the motion and reasoned that only an action for liquidation of assets can be maintained when a corporation has been dissolved and Barn cannot seek reliefs which in effect lead to the continuation of the corporation's business. The court also ruled that it lost jurisdiction over the intra-corporate controversy upon the dissolution of the corporation.

a.) Was the court correct? (3%)

SUGGESTED ANSWER:

The court is not correct. An action to be recognized as a stockholder and to inspect corporate documents is an intra-corporate dispute which does not constitute a continuation of business. The dissolution of the corporation simply prohibits it from continuing its business. Moreover, under Section 145 of the Corporation Code, no right or remedy in favour of or against the corporation, its stockholders, members, directors and officers shall be removed or impaired by the subsequent dissolution of the corporation.

The dissolution does not automatically convert the parties into strangers or change their intra corporate relationship. Neither does it terminate existing cause of action which arose because of the corporate ties of the parties. The cause of action involving an intra-corporate controversy remains and must be filed as an intra-corporate dispute despite the subsequent dissolution of the corporation. (*Aguirre v. FQB +7, Inc., 688 SCRA 242[2013]*).

b.) Four years later, SN Company files an action against Barn to recover corporate assets allegedly held by the latter for liquidation. Will this action prosper? (3%)

SUGGESTED ANSWER:

The action cannot prosper because the corporation has no more legal capacity to sue after 3 years from its dissolution (*Alabang Development*

Corporatio v. Alabang Hills Village Association, 724 SCRA 321 [2014]).

Dissolution & Liquidation; Methods of Liquidation (2001)

X Corporation shortened its corporate life by amending its Articles of Incorporation. It has no debts but owns a prime property located in Quezon City. How would the said property be liquidated among the five stockholders of said corporation? Discuss two methods of liquidation. (5%)

SUGGESTED ANSWER:

The prime property of X Corporation can be liquidated among the five stockholders after the property has been conveyed by the corporation to the five stockholders, by dividing or partitioning it among themselves in any two of the following ways. By:

- 1) PHYSICAL DIVISION or PARTITION based on the proportion of the values of their stockholdings; or
- 2) SELLING THE PROPERTY to a third person and dividing the proceeds among the five stockholders in proportion to their stockholdings; or
- 3) after the determination of the value of the property, by ASSIGNING or TRANSFERRING THE PROPERTY to one stockholder with the obligation on the part of said stockholder to pay the other four stockholders the amount/s in proportion to the value of the stockholding of each.

Bulk Sales Law

Bulk Sales Law (2005)

Divine Corporation is engaged in the manufacture of garments for export. In the course of its business, it was able to obtain loans from individuals and financing institutions. However, due to the drop in the demand for garments in the international market, Divine Corporation could not meet its obligations. It decided to sell all its equipment such as sewing machines, perma-press machines, high speed sewers, cutting tables, ironing tables, etc., as well as its supplies and materials to Top Grade Fashion Corporation, its competitor. (5%) 1) How would you classify the transaction?

SUGGESTED ANSWER:

The transactions would constitute a sale of "substantially all of the assets of Divine Corporation complying with the test under Sec. 40 of the Corporation Code, the transactions not being "in the ordinary course of business," and one "thereby the corporation would be rendered incapable of continuing the business or accomplishing the purpose for which it was incorporated."

ALTERNATIVE ANSWER:

It is a sale and transfer in bulk in contemplation of the Bulk Sales Law. Under Sec. 2 of the Bulk Sales Law, a bulk sale includes any sale, transfer, mortgage, or assignment of all, or substantially all, of the business or trade theretofore conducted by the vendor, mortgagor, transferor, or assignor. This is exactly what happened in the case at bar.

2) Can Divine Corporation sell the aforesaid items to its competitor, Top Grade Fashion Corporation? What are the requirements to validly sell the items? Explain.

SUGGESTED ANSWER:

For such a transaction to be valid, it requires not only the favorable resolution of the Board of Directors of Divine Corporation, but also the ratificatory vote of stockholders representing at least two-thirds (2/3) of the outstanding capital stock, as mandated under Sec. 40 of the Corporation Code. The sale would be void in case of failure to meet the twin approvals. (*Islamic Directorate of the Philippines v. Court of Appeals, G.R. No. 117897, May 14, 1997*)

ALTERNATIVE ANSWER:

Divine Corporation can sell the items to its competitor, Top Grade Fashion Corporation. However, Divine Corporation must comply with Sections 3, 4 and 5 of the Bulk Sales Law, namely:

- (1) deliver sworn statement of the names and addresses of all the creditors to whom the vendor or mortgagor may be indebted together with the amount of indebtedness due or owing to each of the said creditors;
- (2) apply the purchase or mortgage money to the pro-rata payment of bona fide claims of the creditors; and
- (3) make a full detailed inventory of the stock of goods, wares, merchandise, provisions or materials, in bulk, and notify every creditor at least ten (10) days before transferring possession.

3) How would you protect the interests of the creditors of Divine Corporation?

SUGGESTED ANSWER:

Considering that Divine Corporation has entered a de facto stage of dissolution with the ceasing of its operations, I would invoke on behalf of the creditors the protection under Sec. 122 of the Corporation Code, that the proceeds of the sale should first be applied towards the settlement of the obligations of the corporation, before any amount can be paid to the stockholders.

ALTERNATIVE ANSWER:

Under the Bulk Sales Law, if the proceeds are not applied proportionately towards the settlement of the accounts of the corporate debts, to have the sale of the subject matters to Top Grade Fashion Corp., as being "fraudulent and void" and obtain satisfaction from the properties which are deemed to still be owned by Divine Corporation in spite of delivery to the buyer. The creditors can collect on the credit against Divine Corporation, and if it cannot pay, the creditors can apply for attachment on the property fraudulently sold. (***See People v. Mapoy, G.R. No. 48836, September 21, 1942***)

4) In case Divine Corporation violated the law, what remedies are available to Top Grade Fashion Corporation against Divine Corporation?

SUGGESTED ANSWER:

If the sale by Divine Corporation did not obtain the required two-thirds (2/3) vote of the outstanding capital stock, then the transaction is void. (*Islamic Directorate of*

the Philippines v. Court of Appeals, G.R. No. 117897, May 14, 1997) Top Grade Fashion Corporation can have the purchase declared void and recover the purchase price paid, as well as damages against the directors and officers who undertook the transaction in violation of the law.

ALTERNATIVE ANSWER:

For violation of the Bulk Sales Law, the principal officers of the Divine Corporation can be held criminally liable. In addition, Top Grade can sue Divine Corporation for damages. Violation of the Bulk Sales Law would render such a sale fraudulent and void. Since Top Grade would be compelled to return the goods to Divine Corporation, Top Grade can compel Divine Corporation to return the purchase price and pay damages.

Bulk Sales Law; Covered Transactions (2000)

Company X, engaged in the business of manufacturing car parts and accessories, operates a factory with equipment, machinery and tools for this purpose. The manufactured goods are sold wholesale to distributors and dealers throughout the Philippines. Company X was among the business entities adversely hit by the 1997 Asian business crisis. Its sales dropped with the decline in car sales and its operating costs escalated, while its creditor banks and other financial institutions tightened their loan portfolios. Company X was faced with the dismal choice of either suspending its operations or selling its business. It chose the latter. Having struck a deal with Company Z, a more viable entity engaged in the same business, Company X sold its entire business to the former without much fanfare or any form of publicity. In fact, evidence exists that the transaction was furtively entered into to avoid the prying eyes of Company X's creditors. The creditor banks and other financial institutions sued Company X for violation of the Bulk Sales Law. Decide. (5%)

SUGGESTED ANSWER:

Company X violated the Bulk Sales Law when it sold its entire business to Company Z furtively to avoid the prying eyes of its creditors. Its manufactured goods are sold wholesale to distributors and dealers. The sale of all or substantially all of its stocks, not in the ordinary course of business, constitutes bulk sale. The transaction being a bulk sale, entering into such transaction without complying with the requirements of the Bulk Sales Law, Company X violated said law.

Bulk Sales Law; Covered Transactions (2006)

Pursuant to a writ of execution issued by the Regional Trial Court in "Express Bank v. Don Rubio," the sheriff levied and sold at public auction 8 photocopying machines of Don Rubio. Is the sheriff's sale covered by the Bulk Sales Law? (5%)

SUGGESTED ANSWER:

No. The sale by sheriff at public sale is not a sale by a merchant. Section 8 of the Bulk Sales Law itself provides that it has no application to executors, administrators, receivers, assignees in insolvency, or public officers, acting under process. The Bulk Sales Law only applies to the sale or encumbrance of

a merchant of goods, merchandise or commodity done "in bulk" as defined by the Law itself.

Bulk Sales Law; Obligation of the Vendor (2001)

A is a merchant engaged in the sale of a variety of goods and merchandise. Because of the economic crisis, he incurred indebtedness to X, Y and Z. Thereafter, A sold to B all the stock of goods and merchandise. a) What steps should A undertake to effect a valid sale in bulk of his goods to B. (2%)

SUGGESTED ANSWER:

A must prepare an affidavit stating the names of all his creditors, in this case, X, Y, and Z, their addresses, the amount of their credits and their maturity. A should give the affidavit to B who, in turn, should furnish a copy to each creditor and notify the creditors that there is a proposed bulk sale in order to enable the latter to protect their interests.

b) Suppose A submitted a false statement on the schedule of his creditors. What is the effect of such false statement as to Vendee B. (2%)

SUGGESTED ANSWER:

If the vendee does not have knowledge of the falsity of the schedule, the sale is valid. However, if the vendee has knowledge of such falsity, the sale is void because he is in bad faith.

c) What is the right of creditors X, Y, and Z if A failed to comply with the procedure/steps required by law under question letter (a) hereof? (1%)

SUGGESTED ANSWER:

The recourse of X, Y, and Z is to question the validity of the sale from A to B so as to recover the goods and merchandise to satisfy their credits.

Bulk Sales Law; Covered Transactions (2010)

Venezia is a famous international fashion chain with outlets in Makati, Ortigas, and Manila. It has complied with the minimum capitalization required under the Retail Trade Nationalization Act and carries on retail business worth more than S3 million for each of its outlets. As its Manila outlet is not doing very well, it decides to sell all of its business there consisting of remaining inventory, furniture and fixtures and other assets to its competitor.

(A) Venezia's Manila outlet constitutes one-third of its total business. Should it comply with the requirements of the Bulk Sales Law? Why or why not? (2%)

SUGGESTED ANSWER:

Venezia need not comply with the requirements of the Bulk Sales Law as its Manila outlet constitutes only one-third of its total business and, therefore, it would not be conducted by Venezia. Moreover, the requirements of the Bulk Sales Law reflected in Sections 3, 4, 5, and 9, by the express language of said provisions, apply only to the first type of bulk sales, i.e., to any sale, transfer, mortgage or assignment of a stock of goods, wares, merchandise, provisions or materials otherwise than in the ordinary course of trade and the regular prosecution of business of the vendor, mortgagor, transferor, or

assignor, and not to the second type (as in the sale described in the problem) or the third type (i.e., sale, etc. of all or substantially all of the fixtures and equipment used in and about the business). As the Bulk Sales Law is penal in nature, it should be interpreted strictly against the State (People v. Wong Szu Tung, CA G.R. No. 9776-R, March 26, 1954; 50 O.G. 4867; Section 2 of the Bulk Sales Law).

(B) If instead of selling its Manila outlet, Venezia merely mortgages its assets there, would it need to comply with the requirements of the Bulk Sales Law? (2%)

SUGGESTED ANSWERS:

For the same reasons stated in the answer to A above, Venezia need not comply with the requirements of the Bulk Sales Law. The second type of bulk sales also includes the mortgage of all or substantially all of the business of the mortgagor (Section 2, Bulk Sales Law).

(C) What are the legal consequences of a failure to comply with the requirements of the Bulk Sales law? (2%)

SUGGESTED ANSWER:

Failure to comply with the requirements of the Bulk Sales Law renders the Sale, transfer, mortgage, or assignment fraudulent and void (Section 4, Bulk Sales Law), and makes any person found guilty of violating any provision of the Bulk Sales Law punishable by 5 years, or a fine in an amount not exceeding P5, 000, or both such imprisonment and fine in the discretion of the court (Section 11, Bulk Sales Law).

Bulk Sales Law; Covered Transactions (2009)

XXX Corporation (XXX) and its sister company, YYY Corporation (YYY), are both under judicial receivership. The receiver has the option to sell or substantially all of the properties of YYY to XX, or simply merges the two Corporations. Under either option, the requirements under the Corporation Code have to be complied with.

The receiver seeks your advice on whether the Bulk Sales law will apply to either, or both, options. What will your advice be? Explain (4%)

SUGGESTED ANSWER:

I will advise the receiver that the Bulk Sales law does not apply to both options. Sect. 8 of the Bulk Sales Law expressly provides that it will not apply to executors, administrators, receivers, and assignees in insolvency, or public officers, acting under judicial process. In this case, the receiver is acting under judicial process.

Bulk Sales Law; Covered Transactions (2007)

Seeking to Streamline its operations and to bail out its losing ventures, the stockholders of X corporation unanimously adopted a proposal to sell substantially all of the machineries and equipment used in and about its manufacturing business and to sink the proceeds of the sale for the expansion of its cargo transport services. (5%)

(A) Would the transaction be covered by the provisions of the Bulk Sales Law?

SUGGESTED ANSWER:

No. the transaction is not covered by the provisions of the Bulk sales law, Bulk sales law applies only to retail merchants, traders and dealers. It does not apply to manufacturers. X Corporation is engaged in the manufacturing business (Development bank of the Phil. V. Judge of the Regional Trial Court of Manila 86 O.G. 1137 (1987)).

ALTERNATIVE ANSWER:

YES, the transaction is covered by the Bulk Sales Law because it involves the sale of substantially all the equipment used in the business of X corporation (Sec. 2 Bulk sales law)

(B) How would X Corporation effect a valid sale?

SUGGESTED ANSWER:

To effect a valid sale. X corporation must prepare an affidavit stating the names of all its creditors, their addresses, the amount of their credits and their maturities. X Corporation should give the affidavit to the buyer who, in turn, should furnish a copy to each creditor and notify the creditors of the proposed bulk sale to enable them to protect their interest.

Bulk Sales Law; Validity (2009)

(C) Even if the seller and the buyer in a sale in bulk violate the Bulk Sales Law, the sale would still be valid.

SUGGESTED ANSWER:

False. When the Bulk Sales Law is violated, the sale is null and void. When the provisions of the said law have not been complied with, the sale is considered as being "fraudulent and void" and even when coupled with delivery, the title over the goods does not transfer to the buyer. However, the civil liabilities arising from the transaction remain enforceable between the parties thereto.

Insolvency & Corporate Rehabilitation

Insolvency: Voluntary Insolvency (2005)

Aaron, a well-known architect, is suffering from financial reverses. He has four creditors with a total claim of P26 Million. Despite his intention to pay these obligations, his current assets are insufficient to cover all of them. His creditors are about to sue him. Consequently, he was constrained to file a petition for insolvency. (5%) a) Since Aaron was merely forced by circumstances to petition the court to declare him insolvent, can the judge properly treat the petition as one for involuntary insolvency? Explain.

SUGGESTED ANSWER:

No. This is a case for voluntary insolvency because this was filed by an insolvent debtor owing debts exceeding the amount of P1,000.00 under Section 14 of the Insolvency

Law. Under Section 20 of the Insolvency Law, the petition must be filed by three or more creditors. In

the case at bar, it is Aaron, the debtor, who filed the insolvency proceedings.

b) If Aaron is declared an insolvent by the court, what would be the effect, if any, of such declaration on his creditors? Explain.

SUGGESTED ANSWER:

A declaration by the court that the petitioner is insolvent will have the following effects:

- 1) The sheriff shall take possession of all assets of the debtor until the appointment of a receiver or assignee;
- 2) Payment to the debtor of any debts due to him and the delivery to the debtor of any property belonging to him, and the transfer of any property by him are forbidden;
- 3) All civil proceedings pending against the insolvent shall be stayed; and
- 4) Mortgages and pledges are not affected by the order declaring a person insolvent. (Sec. 59, Insolvency Law)

c) Assuming that, Aaron has guarantors for his debts, are the guarantors released from their obligations once Aaron is discharged from his debts? Explain.

SUGGESTED ANSWER:

No, precisely under the principle of excussion, the liability of the guarantors arises only after the exhaustion of the assets of the principal obligor. The effect of discharge merely confirms exhaustion of the assets of the obligor available to his creditors.

ALTERNATIVE ANSWER:

Yes. Article 2076 of the Civil Code provides: The obligation of the guarantor is extinguished at the same time as that of the debtor, and for the same causes as all other obligations.

d) What remedies are available to the guarantors in case they are made to pay the creditors? Explain.

SUGGESTED ANSWER:

Under Article 2081, the guarantor may set up against the creditor all the defenses that pertain to the principal debtor. The discharge obtained by Aaron on the principal obligation can now be used as a defense by the guarantors against the creditors. The guarantors are also entitled to indemnity under Article 2066 of the Civil Code.

Insolvency; Fraudulent Payment (2002)

As of June 1, 2002, Edzo Systems Corporation (Edzo) was indebted to the following creditors:

- a. Ace Equipment Supplies – for various personal computers and accessories sold to Edzo on credit amounting to P300,000.
- b. Handyman Garage – for mechanical repairs (parts and service) performed on Edzo's company car amounting to P10,000.
- c. Joselyn Reyes – former employee of Edzo who sued Edzo for unlawful termination of employment and was able to obtain a final judgment against Edzo for P100,000.

- d. Bureau of Internal Revenue – for unpaid
- e. value-added taxes amounting to P30,000.
- f. Integrity Bank – which granted Edzo a loan in 2001 in the amount of P500,000.

The loan was not secured by any asset of Edzo, but it was guaranteed unconditionally and solidarily by Edzo's President and controlling stockholder, Eduardo Z. Ong, as accommodation surety. The loan due to Integrity Bank fell due on June 15, 2002. Despite pleas for extension of payment by Edzo, bank demanded immediate payment. Because the bank threatened to proceed against the surety, Eduardo Z. Ong, Edzo decided to pay up all its obligations to Integrity Bank. On June 20, 2002, Edzo paid to Integrity Bank the full principal amount of P500,000, plus accrued interests amounting to P55,000. As a result, Edzo had hardly any cash left for operations and decided to close its business. After paying the unpaid salaries of its employees, Edzo filed a petition for insolvency on July 1, 2002. In the insolvency proceedings in court, the assignee in insolvency sought to invalidate the payment made by Edzo to Integrity Bank for being a fraudulent transfer because it was made within 30 days before the filing of the insolvency petition. In defense, Integrity Bank asserted that the payment to it was for a legitimate debt that was not covered by the prohibition because it was —a valuable pecuniary consideration made in good faith, thus falling within the exception specified in the Insolvency Law.

a. As judge in the pending insolvency case, how would you decide the respective contentions of the assignee in insolvency and of Integrity Bank? Explain (5%)

SUGGESTED ANSWER:

The contention of the assignee in insolvency is correct. The payment made by Edzo to Integrity Bank was a fraudulent preference or payment, being made within thirty (30) days before the filing of the insolvency petition.

b. How would you, as judge in the insolvency proceedings, rank the respective credits or claims of the five (5) creditors mentioned above in terms of preference or priority against each other? (5%)

SUGGESTED ANSWER:

The claim of Handyman Garage for P10,000 has a specific lien on the car repaired. The remaining four (4) claims have preference or priority against each other in the following order:

- (1) No. 4 – claim of the BIR for unpaid value added taxes
- (2) No. 3 – claim of Joselyn Reyes for Unlawful termination
- (3) No. 1 – claim of Ace equipment Supplies as an unpaid seller; and
- (4) No. 5 – claim of Integrity Bank.

Insolvency; Preferred Claims (2007)

(A) What are the preferred claims that shall be satisfied first from the assets of an insolvent corporation? (10%)

SUGGESTED ANSWER:

Under the Insolvency law necessary funeral expenses of the debtor is the most preferred claim.

However, this is an insolvent corporation, thus, claims shall be paid in the ff. order:

- (1) Debts due for personal services rendered the insolvent by employees, laborers, or domestic servants immediately preceding the commencement of proceeding in insolvency;
- (2) Compensation due the laborers or their dependents under the provisions of act numbered thirty-four hundred and twenty-eight, known as the workmen's

Compensation Act, as amended by Act Numbered Thirty-eight hundred and twelve, and under the provisions of Act Numbered Eighteen hundred and seventy-four, known as the Employees'

Liability Act, and of other laws providing for payment of indemnity for damages in cases of labor accidents;

(3) Legal expenses, and expenses incurred in the administration of the insolvent's estate for the common interest of the creditors, when properly authorized and approved by the court;

(4) Debts, taxes, and assessments due the Insular Government;

(5) Debts, taxes, and assessments due to any province or provinces of the Philippine Islands;

(6) Debts, taxes, and assessments due to any municipality or municipalities of the Philippine Islands (Section 50, Insolvency Law).

(B) How shall the remaining non-preferred creditors share in the estate of the insolvent corporation above?

SUGGESTED ANSWER:

The remaining non-preferred creditors, whose debts are duly proved and allowed, shall be entitled to share pro-rata in the assets, without priority or preference whatsoever (Section 49, Insolvency Law; Article 2251, Civil Code).

Law on Corporate Recovery (2003)

X Corporation applied for its rehabilitation and submitted a rehabilitation plan which called for the entry by it into a joint venture agreement with Y Corporation. Under the agreement, Y Corporation was to lend to X Corporation its credit facilities with certain banks to obtain funds not only to operate X Corporation but also for a part thereof in the amount of P1 million as initial deposit in a sinking fund to be augmented annually in amounts equivalent to 10% of the yearly income from its operation of the business of X Corporation. From this fund the creditors of X Corporation were to be paid annually, starting from the second year of operations, with the entire indebtedness to be liquidated in 15 years. The creditors of X Corporation objected to the plan because Y Corporation would be taking over the business and assets of X Corporation. Could the court approve the plan despite the objections of the creditors of X Corporation and could the creditors be compelled to follow the plan? Could Y Corporation, in managing the business of X Corporation in the meantime, be deemed to have taken-over X Corporation itself? (6%)

SUGGESTED ANSWER:

Corporate Rehabilitation; Stay Order (2006)

The Blue Star Corporation filed with the Regional Trial Court a petition for rehabilitation on the ground that it foresaw the impossibility of paying its obligations as they fall due. Finding the petition sufficient in form and substance, the court issued an Order appointing a rehabilitation receiver and staying the enforcement of all claims against the corporation. What is the rationale for the Stay Order? (5%)

SUGGESTED ANSWER:

The purpose of the stay order is intended to give the management committee or rehabilitation receiver the leeway to make the business viable again, without having to divert attention and resources to litigation . (Philippine Airlines v. Spouses Kurangking, et al, G.R. No. 146698, September 24, 2002; BF Homes, Inc. v. Court of Appeals, G.R. Nos. 76879 & 77143, October 3, 1990; Rubberworld [Phils.] Inc. v. NLRC, G.R. No. 126773, April 14, 1999; Sobrejuanite v. ASB Dev. Corp., G.R. No. 165675, September 30, 2005). **It also prevents a creditor from obtaining an advantage or preference over another with respect to actions against the corporation.** (Finasia Investments and Finance Corp v. Court of Appeals, G. R. No. 107002, October 7, 1994).

Corporate Rehabilitation; Power of the Court to Stay Enforcement Claims (2012)

ABC Company filed a Petition for Rehabilitation with the Court. An Order was issued by the Court, (1). staying enforcement of all claims, whether money or otherwise against ABC Company, its guarantors and sureties not solidarity liable with the company; and (2) prohibiting ABC Company from making payments of its liabilities, outstanding as of the date of the filing of the petition. XYZ Company is a holder of an irrevocable Standby Letter of Credit which was previously procured by ABC Company in favor of XYZ Company to secure performance of certain obligations. In the light of the Order issued by the Court,

a. Can XYZ Company still be able to draw on their irrevocable Standby Letter of Credit when due? Explain your answer. (5%)

SUGGESTED ANSWER:

Yes. As an exception to a Stay or Suspension Order included in a Commencement Order issued pursuant to Section 16(q) of the FRIA, Section 18(c) the said law provides that a Stay or Suspension Order shall not apply "to the enforcement of claims against sureties and other persons solidarity liable with the debtor, and third party or accommodation mortgagors as well as Issuers of letters of credit x

xx." Similarly, assuming that it has not been superseded by the FRIA, Section 7(b) of the Supreme Court Rules of Procedure on Corporate Rehabilitation (2008) provides that a stay order shall not cover claims against letters of credit and similar security arrangements issued by a third party to secure the payment of the debtor's obligations. This was the basis of the decision in the case of *Metropolitan Waterworks and Sewerage System v. Hon. Reynaldo B. Daway, et al.* (G.R. No. 160732, June 21, 2004).

Corporate Rehabilitation; Power of the Court to Stay Enforcement Claims (2014)

PA Assurance (PA) was incorporated in 1980 to engage in the sale of pre-need educational plans. It sold open-ended educational plans which guaranteed the payment of tuition and other fees to planholders irrespective of the cost at the time of availment. It also engaged in the sale of fixed value plans which guaranteed the payment of a pre-determined amount to planholders. In 1982, PA was among the country's top corporations. However, it subsequently suffered financial difficulties.

On September 8, 2005, PA filed a Petition for Corporate Rehabilitation before the Regional Trial Court (RTC) of Makati City. On October 17, 2005, ten (10) plan holders filed an Opposition and Motion to Exclude Planholders from Stay Order on the ground that planholders are not creditors as they (planholders) have a trust relationship with PA. Are the planholders correct? (4%)

SUGGESTED ANSWER

The plan holders are not correct. Section 6 of the Supreme Court Interim Rules of Procedure on Corporate Rehabilitation of 2000 (which was amended and replaced by the Rules of Procedure on Corporate Rehabilitation of 2009) do not provide that a claim arising from a pre-need contract is an exception to the power of the trial court to stay enforcement of all claims if the court finds the petition for rehabilitation to be sufficient in form and substance. (Abrera, et al. v. Barza, et al., G.R. 171681,

Suspension of Payments; Remedies (2003)

When is the remedy of declaration in a state of suspension of payments available to a corporation?

SUGGESTED ANSWER:

SECURITIES REGULATION

Howey Test (2009)

(C) The Howey Test states that there is an investment contract when a person invests money in a common enterprise and is led to expect profits primarily from the efforts of others.

SUGGESTED ANSWER:

The Howey Test requires a transaction, contract, or scheme whereby a person makes an investment of money in a common enterprise with the expectation of profits to be derived solely, not primarily from the efforts of others (Power Homes Unlimited Corp. v. SEC, 546 SCRA 567 (2008)).

Insider Trading (2004)

Ms. OB was employed in MAS Investment Bank. WIC, a medical drug company, retained the Bank to assess whether it is desirable to make a tender offer for DOP company, a drug manufacturer. OB overheard in the course of her work the plans of WIC. By herself and thru associates, she purchased DOP stocks available at the stock exchange priced at P20 per share. When WIC's tender offer was announced, DOP stocks jumped to P30 per share. Thus OB earned a sizable profit. Is OB liable for breach and misuse of confidential or insider information gained from her employment? Is she also liable for damages to sellers or buyers with whom she traded? If so, what is the measure of such damages? Explain briefly. (5%)

SUGGESTED ANSWER:

OB is an insider (as defined in Subsection 3.8(3) of the Securities Regulation Code) since she is an employee of the Bank, the financial adviser of DOP, and this relationship gives her access to material information about the issuer (DOP) and the latter's securities (shares), which information is not generally available to the public. Accordingly, OB is guilty of insider trading under Section 27 of the Securities Regulation Code, which requires disclosure when trading in securities.

OB is also liable for damages to sellers or buyers with whom she traded. Under Subsection 63.1 of the Securities Regulation Code, the damages awarded could be an amount not exceeding triple the amount of the transaction plus actual damages. Exemplary damages may also be awarded in case of bad faith, fraud, malevolence or wantonness in the violation of the Securities Regulation Code or its implementing rules. The court is also authorized to award attorney's fees not exceeding 30% of the award.

Insider Trading (2008)

Grand Gas Corporation, a publicly listed company, discovered after extensive drilling a rich deposit of natural gas along the coast of Antique. For five (5%) months, the company did not disclose the discovery so that it could quietly and cheaply acquire neighboring land and secure mining rights to the land. Between the discovery and its disclosure of the information to the

Securities and Exchange Commission, all the directors and key officers of the company bought shares in the company at very low prices. After the disclosure, the price of the shares went up. The directors and officers sold their shares at huge profits,

(A) What provision of the Securities Regulation Code (SRC) did they violate, if any? Explain. (4%)

SUGGESTED ANSWER:

The directors and key officers of the company violated the prohibition against insider trading under Sec. 27 of the Securities Regulation Code, which declares it unlawful for an "insider"

(which includes directors and officers of a publicly listed company) to sell or buy its securities, if they know of a fact of special significance with respect to the company or the security, that is not generally available to the public, before such material information made public through disclosure proceedings. The directors and key officers are liable to disgorge the profits earned and to pay damages.

(B) Assuming that the employees of the establishment handling the printing work of Grand Gas Corporation saw the exploration reports which were mistakenly sent to their establishment together with other materials to be printed. They too bought shares in the company at low prices and later sold them at huge profits. Will they be liable for violation of the SRC? Why? (3%)

SUGGESTED ANSWER:

The employees are liable for violation of the prohibition against insider trading. They fall within the definition of "insider". Subsection 3.8 of the Securities Regulation Code defines an insider as "a person whose relationship or former relationship to issuer gives or gave him access to a fact of special significance about issuer or the security that is not generally available."

Insider Trading (2013)

You are a member of the legal staff of a law firm doing corporate and securities work for Coco Products Inc., a company with unique products derived from coconuts and whose shares are traded in the Philippine Stock Exchange. A partner in the law firm, Atty. Buenexito, to whom you report, is the Corporate Secretary of Coco Products. You have long been investing in Coco Products stocks even before you became a lawyer.

While working with Atty. Buenexito on another file, he accidentally gave you the Coco Products file containing the company's planned corporate financial rehabilitation. While you knew you had the wrong file, your curiosity prevailed and you browsed through the file before returning it. Thus, you learned that a petition for financial rehabilitation is imminent, as the company could no longer meet its obligations as they fell due.

Soon after, your mother is rushed to the hospital for an emergency operation, and you have to raise money for her hospital bills. An immediate option for you is to sell your Coco Products shares. The sale

would be very timely because the price of the company's stocks are still high.

Would you sell the shares to raise the needed funds for your mother's hospitalization? Take into account legal (5%) and ethical (3%) considerations. (8% total points)

SUGGESTED ANSWER:

The sale of the shares does not constitute insider trading. Although Atty. Buenexito, as corporate secretary of Coco Products, Inc., was an insider, it did not obtain the information regarding the planned corporate rehabilitation by a communication from him. He just accidentally gave the wrong file (Section 3.8 of Securities Regulation Code).

It would be unethical to sell the shares. Rule 1.01 of the Code of Professional Responsibility provides, "A lawyer shall not engage in unlawful, dishonest, immoral or deceitful conduct."

A lawyer should not only refrain from performing unlawful acts. He should also desist from engaging in unfair deceitful conduct to conceal from the buyer of the shares the planned corporate rehabilitation.

Insider Trading (2015)

C. What is insider trading? (2%)

SUGGESTED ANSWER:

Insider trading is the buying or selling by securities by an insider while in the possession of a material non-public information.

Manipulative Practices; Wash Sale (2001)

Suppose A is the owner of several inactive securities. To create an appearance of active trading for such securities, A connives with B by which A will offer for sale some of his securities and B will buy them at a certain fixed price, with the understanding that although there would be an apparent sale, A will retain the beneficial ownership thereof.

a) Is the arrangement lawful? (3%)

SUGGESTED ANSWER:

a) No. The arrangement is not lawful. It is an artificial manipulation of the price of securities. This is prohibited by the Securities Regulation Code.

b) If the sale materializes, what is it called? (2%)

SUGGESTED ANSWER:

b) If the sale materializes, it is called a wash sale or simulated sale.

Investment Contract; Procedure (2010)

Andante Really, a marketing company that promotes and facilitates sales of real property through leverage marketing, solicits investors who are required to be a Business Center Owner (BCO) by paying an enrollment fee of S250. The BCO is then entitled to recruit two other investors who pay S250 each. The BCO receives S90 from the S250 paid by each of his recruits and is credited a certain amount for payments made by investors through the initial efforts of his Business Center. Once the accumulated amount reaches S5, 000, the same is used as down payment for the real property chosen by the BCO.

(A) Does this multi-level marketing scheme constitute an —investment contract under the Securities Regulation Code? Define an —investment contract. (2%)

SUGGESTED ANSWER:

Yes. The multi-level marketing constitutes an "investment contract" under the Securities Regulation Code.

An "investment contract" is a contract, transaction or scheme (1) involving an investment of money, (2) in a common enterprise, (3) with expectation of profits, (4) primarily from the efforts of others (Power Homes Unlimited Corporation v. Securities and Exchange Commission, 546 SCRA 567 (2008)).

(B) What procedure must be followed under the Securities Regulation Code to authorize the sale or offer for sale or distribution of an investment contract? (2%)

SUGGESTED ANSWER:

Before the investment contract is sold or offered for sale or distribution to the public in the Philippines, it should be registered with the Securities and Exchange Commission in accordance with Section 8 of the Securities Regulation Code (Power Homes Unlimited Corporation v. Securities and Exchange Commission, 546 SCRA 567 (2008)).

(C) What are the legal consequences of failure to follow this procedure? (2%)

SUGGESTED ANSWER:

The failure to follow the procedure has criminal consequences (i.e., upon conviction, a fine 50,000 to 5 million pesos and / or imprisonment of 7 to 21 years). It carries also civil liabilities in that the purchaser can recover from the seller (i) the consideration paid with interest thereon, less the amount of any income received on the purchased securities, upon the tender of such securities, or (ii) damages if the purchaser no longer owns such securities (Sections 57 and 73, Securities Regulation Code). Furthermore, the Securities and Exchange Commission (SEC) may issue a cease and desist order (Subsection 64.1, Securities Regulation Code).

Margin Trading Rule (2009)

Under the Securities Regulation Code, what is the margin Trading Rule? (2%)

SUGGESTED ANSWER:

Under the Margin Trading Rule, no registered broker or dealer, or member of an exchange shall extend credit on any security an amount greater than whichever is higher of:

(a) 65 percent of the current market price of the security, or

(b) 100 percent of the lowest market price of the security during the preceding 36 calendar months, but not more than 75 percent of the current market price (Section 48, Securities Regulation Code).

The purpose of the Margin Trading Rule is to prevent

excessive use of credit for the purchase of securities. It is a counter to a broker's desire to generate more sales by encouraging clients to buy securities on credit (Carolina Industries, Inc. vs. CMS Stock Brokerage, Inc. 97 SCRA 734 [1980]).

Securities; Exempt Securities (2009)

What are the so-called exempt securities under the Securities Regulation Code? (2%)

SUGGESTED ANSWER:

Under Section 9 of the Securities Regulation Code, the so-called exempt securities are:

- (A) Those issued or guaranteed by the government of the Philippines or any of its political subdivisions or agencies;**
- (B) Those issued or guaranteed by the government of any foreign country with which the Philippines has diplomatic relation, or any other state on the basis of reciprocity, although the SEC may require compliance with the form and content of disclosures;**
- (C) Those issued by the receiver or by the trustee in a bankruptcy duly approved by the proper adjudicatory board;**
- (D) Those involving the sale or transfer which is bylaw, under the regulation of the OIC, HLURB, BIR; and**
- (E) Those issued by banks, except its own shares.**

(Note: It is suggested that any two of the above exempt securities should be considered as enough answer to the question.)

Securities; Selling of Securities (2002)

Equity Online Corporation (EOL), a New York corporation, has a securities brokerage service on the Internet after obtaining all requisite U.S. licenses and permits to do so. EOL's website (www.eonline.com), which is hosted by a server in Florida, enables Internet users to trade on-line in securities listed in the various stock exchanges in the U.S. EOL buys and sells U.S.- listed securities for the accounts of its clients all over the world, who convey their buy and sell instructions to EOL through the Internet. EOL has no offices, employees or representatives outside the U.S. The website has icons for many countries, including an icon for Filipino Traders containing the day's prices of U.S. listed securities expressed in U.S. dollars and their Philippine peso equivalent. Grace Gonzales, a resident of Makati, is a regular customer of the website and has been purchasing and selling securities through EOL with the use of her American Express credit card. Grace has never traveled outside the Philippines. After a series of erroneous stock picks, she had incurred a net indebtedness of US\$30,000. with EOL, at which time she cancelled her American Express credit card.

After a number of demand letters sent to Grace, all of them unanswered, EOL, through a Makati law firm, filed a complaint for collection against Grace with the Regional Trial Court of Makati. Grace, through her lawyer, filed a motion to dismiss on the ground that EOL (a) was doing business in the Philippines without a license and

was therefore barred from bringing suit and (b) violated the Securities Regulation Code by selling or offering to sell securities within the Philippines without registering the securities with the Philippine SEC and thus came to court with unclean hands. EOL opposed the motion to dismiss, contending that it had never established a physical presence in the Philippines, and that all of the activities related to plaintiffs trading in U.S. securities all transpired outside the Philippines.

If you are the judge, decide the motion to dismiss by ruling on the respective contentions of the parties on the basis of the facts presented above. (10%)

SUGGESTED ANSWER:

The grounds of the motion to dismiss are both untenable. EOL is not doing business in the Philippines, and it did not violate the Securities Act, because it was not selling securities in the country. The contention of EOL is correct, because it never did any business in the Philippines. All its transactions in question were consummated outside the Philippines.

Securities; Selling of Securities (2009)

Philippine Palaces Realty (PPR) had been representing itself as a registered broker of securities, duly authorized by the Securities and Exchange Commission (SEC). On October 6, 1996, PPR sold to spouses Leon and Carina one timeshare of Palacio del Boracay for US \$7, 500.00. However, its Registration Statement became effective only on Feb. 11, 1998 after the SEC issued a resolution declaring that PPR was authorized to sell securities, including timeshares.

On March 30, 1998, Leon and Carina wrote PPR rescinding their purchase agreement and demanding the refund of the amount they paid because the Palacio Del Boracay timeshare was sold to them by PPR without the requisite license or authority from the SEC. PPR contended that the grant of the SEC authority had the effect of ratifying the purchase agreement (with Leon and Carina) of Oct. 6, 1996. Is the contention of PPR correct? Explain (3%)

SUGGESTED ANSWER:

The contention of PPR is not correct. It is settled that no securities shall be sold or offered for sale or distribution in the Philippines without a registration duly filed and approved by the Commission. Corporate registration is one of the requirements under Sec. 8 of batas pambansa Blg. 178 (timeshare Realty Corporation v. Lao, 544 SCRA 254 (2008)).

ALTERNATIVE ANSWER:

No. Such contention is not correct. Sale or offer to sell securities which are not exempt securities or which do not arise out of exempt transactions, and, therefore, requiring registration, is unlawful as such act is violative of the Securities Regulation Cod. Subsequent grant of authority by the SEC does not retroact to past sales or offers to sell.

Securities; Selling of Securities/ Exempt Securities/Truth in Securities Law (2015)

A. Able Corporation sold securities to 21 non-qualified buyers during a 15-month period, without registering the

securities with the Securities and Exchange Commission. Did Able Corporation violate the Securities Regulation Code? Explain. (2%)

SUGGESTED ANSWER:

Yes, because under the SRC, securities shall not be sold or offered to be sold to the public within the Philippines unless the securities are registered with and approved by the Securities and Exchange Commission. Public mean 20 or more investors. The fact that the securities were sold during a 15-month period is immaterial.

However, the sale of securities to less than 20 investors if done during a 12-month period is an exempt transaction under the Securities Regulation Code.

B. Securities issued by the Philippine government are "exempt securities" and, therefore, need not be registered with the Securities and Exchange Commission prior to their sale or offering to the public in the Philippines. What is the rationale behind this exemption? (2%)

SUGGESTED ANSWER:

The rationale for the exemption is that the public is amply protected even without the registration of the securities to be issued by the government since the government is presumed to be always solvent.

C. Why is the Securities Regulation Code called a "truth in securities law"? (2%)

SUGGESTED ANSWER:

The Securities Regulation Code is called a "truth in securities law" because it requires the issuer to make full and fair disclosure of information about securities being sold or offered to be sold within the Philippines and penalizes manipulative and fraudulent acts, devices and schemes.

Securities and Exchange Commission; Jurisdiction (2015)

Mr. and Mrs. Reyes invested their hard-earned savings in securities issued by LEAD Bank. After discovering that the securities sold to them were not registered with the SEC in violation of the Securities Regulation Code, the spouses Reyes filed a complaint for nullity of contract and for recovery of a sum of money with the RTC. LEAD Bank moved to dismiss the case on the ground that it is the SEC that has primary jurisdiction over actions involving violations of the Securities Regulation Code. If you were the judge, how would you rule on the motion to dismiss? (3%)

SUGGESTED ANSWER:

The motion should be denied. Civil suits falling under the SRC (like liability for selling unregistered securities) are under the exclusive original jurisdiction of the RTC and hence, need not be first filed before the SEC unlike criminal case, wherein the latter body exercises primary jurisdiction (*Pua v. Citibank*, 705 SCRA 677[2013]).

Tender Offer (2002)

A. What is a tender offer?

SUGGESTED ANSWER:

A. Tender offer is a publicly announced intention of a person acting alone or in concert with other persons to acquire equity securities of a public company. It may also be defined as a method of taking over a company by asking stockholders to sell their shares at a price higher than the current market price and on a particular date.

B. In what instances is a tender offer required to be made?

SUGGESTED ANSWER:

B. Instances where tender offer is required to be made:

- The person intends to acquire 15% or more of the equity share of a public company pursuant to an agreement made between or among the person and one or more sellers.
- The person intends to acquire 30% or more of the equity shares of a public company within a period of 12 months.
- The person intends to acquire equity shares of a public company that would result in ownership of more than 50% of the said shares.

Tender Offer (2010)

Union Mines, Inc. has total assets of P60 Million with 210 stockholders holding at least 100 shares each.

The company has two principal stockholders, ABC which owns 60% of the shares of stock, and XYZ; which owns 17%. ABC in turn is owned to the extent of 21.13% by Acme, Inc.; 29.69% by Golden Boy Inc.; 9% by XYZ; and the rest by individual stockholders.

None of the parties is a publicly-listed company.

XYZ now proposes to buy Acme's and Golden Boy's shares in ABC, which would give it, direct control of ABC and indirect control of Union Mines.

Is the proposal acquisition by XYZ subject to the mandatory tender offer rule? Why or why not? What is tender offer and when is it mandatory? (5%)

SUGGESTED ANSWER

Yes, the proposed acquisition is subject to mandatory tender offer rule. A tender offer is publicly announced intention by a person (acting alone or in concert with other persons) to acquire shares of a public company. A tender offer is meant to protect minority stockholders against a scheme that dilutes the share value of their investments. It gives them the chance to exit the company under the same terms offered to the majority stockholders.

Under the Securities Regulations Code and its implementing rules, a mandatory tender offer is required (i) when at least 35% of the outstanding shares of a public company is to be acquired in one transaction or a series of transaction during 12-month period, or (ii) even if any acquisition is less than 35% threshold but the result thereof is the ownership of more than 51% of the total outstanding shares of a public company. The mandatory offer rule also applies to share acquisition meeting the threshold, which is done at the level of the holding or

Parent Corporation controlling a public company (Cemco Holding, Inc. v. National Life Insurance Company of the Philippines, Inc. 529 SCRA 355 [2007]).

In this case, Union Mines is clearly a public company, since it has total assets of P60 million pesos with 210 stockholders holding at least 100 shares each. A public company is defined as a corporation listed on the stock exchange, or a corporation with assets exceeding 50 million pesos and with 200 or more stockholders at least 200 of them holding not less than 100 shares of such corporation.

BANKING LAWS

BSP; Lender of Last Resort (2015)

A. Why is the Bangko Sentral ng Pilipinas considered a lender of last resort? (2o/o)

SUGGESTED ANSWER:

It is considered the lender of last resort because it lends to banks and similar institutions under financial distress when they have no other means to raise funds.

Banks; Insolvency; Prohibited Transactions (2000)

The Monetary Board of the BSP closed Urban Bank after it encountered crippling financial difficulties that resulted in a bank run. X, one of the members of the BOD of the bank, attended and stayed throughout the entire meeting of the Board that was held well in advance of the bank run and before news had begun to trickle to the business community about the dire financial pit the bank had fallen into. Immediately after the meeting, X caused the preparation and issuance of a manager's check payable to himself in the sum of 5 million pesos equivalent to the amount placed or invested in the bank by a business acquaintance. He now claims that he is keeping the funds in trust for the owner and that he had committed no violation of the General Banking Act (RA 337, as amended) for which he should be punished. Do you agree that there has been no violation of the statute? (3%)

SUGGESTED ANSWER:

No. I do not agree that there is no violation of the statute (RA 337, as amended). X violated Sec 85 when he caused the preparation and issuance of a manager's check payable to himself in the sum of P5 million. This is paying out or permitting to be paid out funds of the bank after the latter became insolvent. This act is penalized by fine of not less than P1,000.00 nor more than P10,000.00 and by imprisonment for not less than two nor more than ten years.

Banks; Insolvency; Actions of the Monetary Board (2009)

Maharlikang Pilipino Banking Corporation (MPBC) operates several branches of Maharlikang Pilipino Rural Bank in Eastern Visayas. Almost all the branch managers are close relatives of the members of the Board of Directors of the corporation. Many undeserving relatives of the branch managers were granted loans. In time, the branches could not settle their obligations to depositors and creditors.

Receiving reports of these irregularities, the Supervising and Examining Department (SED) of the Monetary Board prepared a detailed report (SED Report) specifying the facts and the chronology of events relative to the problems that beset MPBC rural bank branches. The report concluded that the bank branches were unable to pay their liabilities as they fell due, and could not possibly continue in business without incurring substantial losses to its depositors and creditors.

(A) May the Monetary Board order the closure of the

MPBC rural banks relying only on the SED Report, without need of an examination? Explain. (3%)

SUGGESTED ANSWER:

Yes. Upon receipt of the report of the SED, the Monetary Board is authorized to take any of the actions enumerated under Sec. 30, Republic Act No. 7653, otherwise known as the New Central Bank Act, leading to the receivership and liquidation of a bank or quasi-bank. There is no requirement that an examination be first conducted before a banking institution may be placed under receivership (Rural Bank of Buhi v. Court of Appeals, 162 SCRA 288 (1988)).

(B) If MPBC hires you as lawyer because the Monetary Board has forbidden it from carrying on its business due to its imminent insolvency, what action will you institute to question the Monetary Board's order? Explain. (3%)

SUGGESTED ANSWER:

The order of the Monetary Board may be questioned on a petition for certiorari on the ground that the action taken was in excess of jurisdiction or with grave abuse of discretion amounting to lack or excess of jurisdiction. The petition of certiorari may only be filed by the stockholders of record representing the majority of the capital stock within ten (10) days from receipt by the board of directors of MPBC of the order directing receivership, liquidation or conservatorship (Sec. 30, par. (2), R.A. No. 7653).

Banks; Insolvency; Claims (2010)

When OCCIDENTAL Bank folded up due to insolvency, Manuel had the following separate deposits in his name: P200,000 in savings deposit; P250,000 in time deposit; P50,000 in current account; P1 million in a trust account and P3 million in money market placement. Under the Philippine Deposit Insurance Corporation Act, how much could Manuel recover? Explain. (2%)

SUGGESTED ANSWER:

Manuel can recover P500, 000.00, because this is the total of his savings deposit, time deposit and current account (Section 4(g) of Republic Act No. 3591, as amended). The trust account and the money market placements are not included in the insured deposits (section 4(f) of Republic Act No. 3591, as amended).

Banks; Receivership (2007)

Due to growing financial difficulties, Z Bank was unable to finish construction of its 21-storey building on a prime lot located in Makati City. Inevitably, the BangkoSentral ordered the closure of Z Bank and consequently placed it under receivership. In a bid to save the bank's property investment, the President of Z Bank entered into a financing agreement with a group of investors for the completion of the construction of the 21-storey building in exchange for a ten-year lease and the exclusive option to purchase the building. (10%)

(A) Is the act of the President valid? Why or why not?

SUGGESTED ANSWER:

No, the bank president's act is not valid.

He had no authority to enter into the financing agreement. Z Bank was ordered closed and placed under receivership. Control over the properties of Z Bank passed to the receiver. The appointment of a receiver operates to suspend the authority of the bank and its officers over the bank's assets and properties, such authority being reposed in the receiver (Abacus Real Estate Development Center, Inc. v. Manila Banking Corporation, 455 SCRA 97 (2005)).

(B) Will a suit to enforce the exclusive right of the investors to purchase the property prosper? Reason briefly.

SUGGESTED ANSWER:

No, the exclusive options granted to the investors, having been entered into by one without authority to do so, is unenforceable. The bank, therefore, cannot be compelled to sell the property. Under Section 30 of Republic Act No. 7653, New Central Bank Act, the properties of Z Bank should be administered for the benefit of its creditors. The property in question can be disposed of only for the purpose of paying the debts of Z Bank (Sec. 30, Republic Act No. 7653, and New Central Bank Act).

Banks; Receivership; Prohibited Transaction (2009)

(E) A bank under receivership can still grant new loans and accept new deposits.

SUGGESTED ANSWER:

False. During the receivership, the assets and properties of the corporation are being gathered for conversion into cash in preparation for distribution to creditors. Granting new loans and accepting new deposits would constitute doing business for the bank in the ordinary course of business which is contrary to the purpose and nature of a receivership proceeding.

Banks; Conservator vs. Receiver (2006)

Distinguish between the role of a conservator and that of a receiver of a bank. (2.5%)

SUGGESTED ANSWER:

The Conservator is appointed for a period not exceeding one (1) year, to take charge of the assets, liabilities, and the management of a bank or a quasi-bank in a state of continuing inability, or unwillingness to maintain a condition of liquidity deemed adequate to protect the interest of depositors and creditors. On the other hand, the Receiver is appointed to manage a bank or quasi-bank that is unable to pay its liabilities in the ordinary course of business, or has insufficient realizable assets to meet its liabilities, or cannot continue in business without probable losses to its depositors or creditors; or has willfully violated a final cease and desist order, involving acts or transactions amounting to fraud or a dissipation of the assets of the institution. The main purpose of the Receiver is to recommend the rehabilitation or liquidation of the bank.

Banks; Receiver vs. Conservator (2015)

B. Distinguish a conservator from a receiver of a bank. (2%)

SUGGESTED ANSWER:

A conservator is appointed if a bank or quasi bank is in state of continuing inability or unwillingness to maintain a condition of liquidity deemed adequate to protect the interest of creditors and depositors. The conservator shall take charge of the assets and liabilities of the bank and exercise management and exercise other powers to restore the banks viability. The conservatorship shall not exceed one year.

The receiver is appointed generally if the realizable value of the bank's assets as determined by BSP is less than its liabilities. The receiver shall take charge of the assets and liabilities of the institution and administer the same for the benefit of its creditors. The receiver shall determine within 90 days whether the bank can be rehabilitated, otherwise, he shall recommend the closure of the institution.

Banks; Secrecy of Bank Deposits; Exceptions (2004)

The Law on Secrecy of Bank Deposits provides that all deposits of whatever nature with banks or banking institutions are absolutely confidential in nature and may not be examined, inquired or looked into by any person, government official, bureau or office. However, the law provides exceptions in certain instances. Which of the following may not be among the exceptions:

1. In cases of impeachment.
2. In cases involving bribery
3. In cases involving BIR inquiry.
4. In cases of anti-graft and corrupt practices.
5. In cases where the money involved is the subject of litigation. Explain your answer or choice briefly. (5%)

SUGGESTED ANSWER:

Under Section 6(F) of the National Internal Revenue Code, the Commissioner of Internal

Revenue can inquire into the deposits of a decedent for the purpose of determining the gross estate of such decedent. Apart from this case, a BIR inquiry into bank deposits cannot be made. Thus, exception 3 may not always be applicable. Turning to exception 4, an inquiry into bank deposits is possible only in prosecutions for unexplained wealth under the Anti-Graft and Corrupt Practices Act, according to the Supreme Court in the cases of *Philippine National Bank v. Gancayco*, 15 SCRA 91 (1965) and *Banco Filipino Savings and Mortgage Bank v. Purisima*, 161 SCRA 576 (1988). However, all other cases of anti-graft and corrupt practices will not warrant an inquiry into bank deposits. Thus, exception 4 may not always be applicable. Like any other exception, it must be interpreted strictly. Exceptions 1, 2 and 5, on the other hand, are provided expressly in the Law on Secrecy of Bank Depositors. They are available to depositors at all times.

Banks; Secrecy of Bank Deposit; Exceptions (2006)

Under Republic Act No.1405 (The Bank Secrecy Law), bank deposits are considered absolutely confidential and may not be examined, inquired or looked into by any person, government official, bureau or office. What are the exceptions? (5%)

SUGGESTED ANSWER:

The exceptions to the Bank Secrecy Law are the following:

1. Special or general examination of a bank, authorized by the Bangko Sentral ng Pilipinas' Monetary Board, in connection with a bank fraud or serious irregularity.
2. Examination by an independent Auditor, hired by the Bank and for the Bank's exclusive use.
3. Disclosure with the Depositor's written permission. In case of Impeachment.
4. In cases of Bribery or dereliction of duty by a Public Officer, upon order of a competent court. In cases of money deposited/invested which, in turn, is the subject of Litigation, upon order of a competent Court.
5. DOSRI Loans: Loans with their Banks of Bank Directors, Officers, Stockholders and related interests. Loans in excess of 5% of the Bank's Capital & Surplus The Borrower waived his right as regards the Secrecy of Bank Deposits
6. Violation of the Anti-Graft and Corrupt Practices Act.
7. Coup d' etat Law (RA 6968, Oct 24,1990).
8. BIR Commissioner's authority to verify a decedent's Gross Estate and a taxpayer's request for a compromise agreement due to incapacity to pay his tax liability.
9. Foreign Currency Deposits by foreign lenders & investors under PDs 1034.
10. Violations of the Anti-Money Laundering Law.
11. When the State exercises/invokes its Police Power.

(NOTA BENE: It is suggested that any 6 of the above be given full credit)

Banks; Secrecy of Bank Deposits (2000)

GP is a suspected jueteng lord who is rumored to be enjoying police and military protection. The envy of many drug lords who had not escaped the dragnet of the law, GP was summoned to a hearing of the Committee on Racketeering and Other Syndicated Crimes of the House of Representatives, which was conducting a congressional investigation—in aid of legislation on the involvement of police and military personnel, and possibly even of local government officials, in the illegal activities of suspected gambling and drug lords. Subpoenaed to attend the investigation were officers of certain identified banks with a directive to them to bring the records and documents of bank deposits of individuals mentioned in the subpoenas, among them GP. GP and the banks opposed the production of the banks' records of deposits on the ground that no such inquiry is allowed under the Law on Secrecy of Bank Deposits (RA 1405 as amended). Is the opposition of GP and the banks valid? Explain.

SUGGESTED ANSWER:

Yes. The opposition is valid. GP is not a public official. The investigation does not involve one of the exceptions to the prohibition against disclosure of any information concerning bank deposits under the Law on Secrecy of Bank Deposits. The Committee conducting the investigation is not a competent court or the Ombudsman authorized under the law to issue a subpoena for the production of the bank record involving such disclosure.

Banks; Secrecy of Bank Deposits (2009)

(B) If the Ombudsman is convinced that there is a violation of law after investigating a complaint alleging illicit bank deposits of public officer, the Ombudsman may order the bank concerned to allow in camera inspection of bank records and documents.

SUGGESTED ANSWER:

False. The Bank Secrecy Law prohibits the inspection of a bank account unless the permission of the account holder is obtained, or upon lawful order of the court or when the deposit is the subject of litigation. Investigation by the Ombudsman is not considered as a pending litigation to allow the examination of the bank records and documents (*Marquez v. Desierto*, 359 SCRA 772 (2001)).

Banks; Secrecy of Bank Deposits; Garnishment (2001)

The Law on Secrecy of Bank Deposits, otherwise known as RA 1405, is intended to encourage people to deposit their money in banking institutions and also to discourage private hoarding so that the same may be properly utilized by banks to assist in the economic development of the country. Is a notice of garnishment served on a bank at the instance of a creditor of a depositor covered by the said law? State the reason(s) for your answer. (5%)

SUGGESTED ANSWER:

No. The notice of garnishment served on a bank at the instance of a creditor is not covered by the Law on Secrecy of Bank Deposits. Garnishment is just a part of the process of execution. The moment a notice of garnishment is served on a bank and there exists a deposit by the judgment debtor, the bank is directly accountable to the sheriff, for the benefit of the judgment creditor, for the whole amount of the deposit. In such event, the amount of the deposit becomes, in effect, a subject of the litigation.

Banks; Secrecy of Bank Deposits; Garnishment (2004)

CDC maintained a savings account with CBank. On orders of the MM Regional Trial Court, the Sheriff garnished P50,000 of his account, to satisfy the judgment in favor of his creditor, MO. CDC complained that the garnishment violated the Law on the Secrecy of Bank Deposits because the existence of his savings account was disclosed to the public. (5%) Is CDC's complaint meritorious or not? Reason briefly.

SUGGESTED ANSWER:

No. CDC's complaint is not meritorious. It was held in *China Banking Corporation v. Ortega*, 49 SCRA 355

(1973) that peso deposits may be garnished and the depositary bank can comply with the order of garnishment without violating the Law on the Secrecy of Bank Deposits. Execution is the goal of litigation as it is its fruit. Garnishment is part of the execution process. Upon service of the notice of garnishment on the bank where the defendant deposited funds, such funds become part of the subject matter of litigation.

Banks; Secrecy of Bank Deposits; Garnishment (2015)

A. Raymond invested his money in securities issued by the Philippine government, through his bank. Subsequently, the Bureau of Internal Revenue asked his bank to disclose his investments. His bank refused the request for disclosure on the ground that the investments are confidential under the Secrecy of Bank Deposits Law (Republic Act No. 1405, as amended). Is the bank's refusal justified? Defend your answer. (2%)

SUGGESTED ANSWER:

It is justified. Under RA 1405, investment in bonds issued by the Philippine government are also absolutely confidential and may not be examined, inquired or looked into by any person, government official, bureau or office save for the exceptions provided by law. None of the exceptions apply in the present case.

B. First Bank received an order of garnishment over a client's peso and dollar deposits in First Bank. Should First Bank comply with that order? Explain. (3%)

SUGGESTED ANSWER:

First bank should comply with the order of garnishment over a client's peso deposits because there is nothing in RA 1405 that places bank deposits beyond the reach of judgement creditor. And the disclosure of information on bank deposits pursuant to the writ of garnishment is only incidental to the execution process (*PCIB v. Court of Appeals* 193 SCRA 452[1991]).

The dollar deposits, however, are exempt from garnishment or court order under the Foreign Currency Act (RA 6426). Thus, the bank should not comply with this part of the garnishment.

Truth in Lending Act (2000)

Embassy Appliances sells home theater components that are designed and customized as entertainment centers for consumers within the medium-to-high price bracket. Most, if not all, of these packages are sold on installment basis, usually by means of credit cards allowing a maximum of 36 equal monthly payments. Preferred credit cards of this type are those issued by banks, which regularly hold mall wide sales blitzes participated in by appliance retailers like Embassy Appliances. You are a buyer of a home theater center at Embassy Appliances. The salesclerk who is attending to you simply swipes your credit card on the electronic approval machine (which momentarily prints out your charge slip since you have unlimited credit), tears the slip from the machine, hands the same over to you for your signature, and

without more, proceeds to arrange the delivery and installation of your new home theater system. You know you will receive a statement on your credit card purchases from the bank containing an option to pay only a minimum amount, which is usually 1/36 of the total price you were charged for your purchase. Did Embassy Appliances comply with the provisions of the Truth in Lending Act (RA 3765)?

SUGGESTED ANSWER:

There is no need for Embassy Appliances to comply with the Truth in Lending Act. The transaction is not a sale on

installment basis. Embassy Appliances is a seller on cash basis. It is the credit card company which allows the buyer to enjoy the privilege of paying the price on installment basis.

Truth in Lending Act (2009)

(A) A loan agreement which provides that the debtor shall pay interest at the rate determined by the bank's branch manager violates the disclosure requirement of the Truth in Lending Act.

SUGGESTED ANSWER:

True. This contrary to the duty of the creditor to disclose in detail the interests, charges and other figures indicating in detail the cost of the credit granted to the debtor (United Coconut Planters Bank v. Beluso, 530 SCRA 567 (2007)).

Legal Tender (2000)

After many years of shopping in the Metro Manila area, housewife HW has developed the sound habit of making cash purchases only, none on credit. In one shopping trip to Mega Mall, she got the shock of her shopping life for the first time, a store's smart salesgirl refused to accept her coins in payment for a purchase worth not more than one hundred pesos. HW was paying seventy pesos in 25centavo coins and twenty five pesos in 10 centavo coins. Strange as it may seem, the salesgirl told HW that her coins were not —legal tender. Do you agree with the salesgirl in respect of her understanding of —legal tender? Explain (2%)

SUGGESTED ANSWER:

No. The salesgirl's understanding that coins are not legal tender is not correct. Coins are legal tender in amounts not exceeding fifty pesos for denominations from twenty five centavos and above, and in amounts not exceeding twenty pesos for denominations ten centavos and less.

Banks; Restrictions on Loan Accommodations (2002)

As part of the safeguards against imprudent banking, the General Banking Law imposes limits or restrictions on loans and credit accommodations which may be extended by banks. Identify at least two (2) of these limits or restrictions and explain the rationale of each of them. (5%)

SUGGESTED ANSWER:

Any two (2) of the following limits or restrictions on loan and credit transactions which may be extended by banks, as part of the safeguards against imprudent banking, to

wit:

1 SBL Rules – (i.e., Single Borrower's Limit) rules are those promulgated by the Bangko Sentral ng Pilipinas, upon the authority of Section 35 of the General Banking Law of 2000, which regulate the total amount of loans, credit accommodations and guarantees that may be extended by a bank to any person, partnership, association, corporation or other entity. The rules seek to protect a bank from making excessive loans to a single borrower by prohibiting it from lending beyond a specified ceiling.

2 DOSRI Rules – These rules promulgated by the BSP, upon authority of Section 5 of the General Banking Law of 2000, which regulate the amount of credit accommodations that a bank may extend to its directors, officers, stockholders and their related interests (thus, DOSRI). Generally, a bank's credit accommodations to its DOSRI must be in the regular course of business and on terms not less favorable to the bank than those offered to non-DOSRI borrowers.

3. No commercial bank shall make any loan or discount on the security of shares of its own capital stock.

Banks; Restrictions on Loan Accommodations (2006)

Pio is the president of Western Bank. His wife applied for a loan with the said bank to finance an internet cafe. The loan officer told her that her application will not be approved because the grant of loans to related interests of bank directors, officers, and stockholders is prohibited by the General Banking Law. Explain whether the loan officer is correct. (5%)

SUGGESTED ANSWER:

Section 36 of the General Banking Law of 2000 does not entirely prohibit directors or officers of the bank, directly or indirectly, from borrowing from the bank. In this case, Pio is the president of Western Bank, which makes him an officer, director and stockholder of the said bank. The General Banking Law provides for additional restrictions to the bank before it can lend to its directors or officers. A

written approval of the majority vote of all the directors of the bank, excluding the director concerned, is required. Furthermore, such dealings must be upon terms not less favorable to the bank than those offered to others (Section 1326, Central Bank's "Manual of Regulations for Banks and Other Financial Intermediaries, cited in Ranioso v. CA, G.R. No. 117416, December 8, 2000). A violation of this provision will cause his or her position to be declared vacant and the erring director or officer subjected to the penal provisions of the New Central Bank Act.

General Banking Law of 2000; Classifications of Banks (2002)

There are six (6) classes of banks identified in the General Banking Law of 2000. Name at least four (4) of

them and explain the distinguishing characteristic or function of each one. (5%)

SUGGESTED ANSWER:

Any four (4) of the following six (6) classes of banks identified in the General Banking Law of 2002, to wit:

1 Universal Banks – These are those which used to be called expanded commercial banks and the operations of which are now primarily governed by the General Banking Law of 2002. They can exercise the powers of an investment house and invest in non-allied enterprises. They have the highest capitalization requirement.

2 Commercial Banks – These are ordinary or regular commercial banks, as distinguished from a universal bank. They have a lower capitalization requirement than universal banks and cannot exercise the powers of an investment house and invest in non-allied enterprises.

3 Thrift Banks – These banks (such as savings and mortgage banks, stock savings and loan associations, and private development banks) may exercise most of the powers and functions of a commercial bank except that they cannot, among others, open current or check accounts without prior Monetary Board approval, and they cannot issue letters of credit. Their operations are governed primarily by the Thrift Banks Act of 1995 (RA 7906).

4 Rural Banks – these are those which are organized primarily to extend loans and other credit facilities to farmers, fishermen or farm families, as well as cooperatives, merchants, and private and public employees and whose operations are primarily governed by the Rural Banks Act of 1992 (RA 7353).

5 Cooperative Banks – these are those which are organized primarily to provide financial and credit services to cooperatives and whose operations are primarily governed by the Cooperative Code of the Philippines (RA 6938).

6 Islamic Banks – these are those which are organized primarily to provide financial and credit services in a manner or transaction consistent with the Islamic Shari'ah. At present, only the Al Amanah Islamic Investment Bank of the Philippines has been organized as an Islamic Bank.

General Banking Law of 2000; Types of Banks (2010)

Briefly describe the ff. types of banks; (2% each)

(A) Universal bank

SUGGESTED ANSWER:

A universal bank is a commercial bank with 2 additional powers, namely: (1) the power of an investment house and (2) the power to invest in non-allied enterprises (Section 23, Rep. Act No. 8791, "The General Banking Law of 2000").

(B) Commercial bank

SUGGESTED ANSWER:

A commercial bank is a bank that can:

(1) accept drafts; (2) issue letters of credit; (3) discount and negotiate promissory notes, drafts, bills of exchange, and other evidence of debt; (4) accept or create demand deposits; (5) receive other types of deposits, as well as deposit substitutes; (6) buy and sell foreign exchange, as well as gold or silver bullion; (7) acquire marketable bonds and other debts securities; and (8) extend credit, subject to such rules promulgated by the Monetary Board. (Section 29, Rep. Act No. 8791, "The General Banking Law of 2000").

(C) Thrift bank

SUGGESTED ANSWER:

A thrift bank is one established as a savings and mortgage bank, a stock savings and loan association, or a private development bank, for the purpose of: (1) accumulating the savings of depositors and investing them in outlets determined by the Monetary Board as necessary in the furtherance of national economic objectives; (2) providing short-term working capital, medium and long-term financing, to business engaged in agriculture, services, industry and housing; and (3) providing diversified financial and allied services for its chosen market and constituencies specially for small and medium enterprises and individuals (Section 3 (a), Rep. Act No. 7906 "Thrift Banks Act of 1995").

(D) Rural bank

SUGGESTED ANSWER:

A rural bank is one established to provide credit facilities to farmers and merchants or their cooperatives and, in general to the people of the rural communities (Section 3, Rep. Act No. 7353, "The Rural Banks Act of 1992").

(E) Cooperative bank

SUGGESTED ANSWER:

A cooperative bank is organized under the Cooperative Code to provide financial and credit services to cooperatives. It may perform any or all the services offered by a rural bank, including the operation of a Foreign Currency Deposit Unit subject to certain conditions (Section 100, Rep. Act No. 6938, "The Cooperative Code of the Philippines").

General Banking Law of 2000; Commercial Bank (2015)

A. A commercial bank wants to acquire shares in a cement manufacturing company. Do you think it can do that? Why or why not? (2%)

SUGGESTED ANSWER:

A commercial bank cannot acquire shares in a cement manufacturing company because a commercial bank can only invest in the equity of allied undertakings, meanings, undertakings related to banking (Section 30 of RA 8791).

B. A court found the interest charged by a bank as excessive and unconscionable and struck down the contractual stipulation on interest. If you were the judge, what would you impose as the applicable interest rate? State your legal basis. (2%)

SUGGESTED ANSWER:

I will impose a legal rate of interest which currently set at 6% per annum.

General Banking Law of 2000; Single Borrower's Limit; Collateral Security (2008)

Industry Bank, which has a net worth of P1 Billion, extended a loan to Celestial Properties Inc. amounting to P270 Million. The loan was secured by a mortgage over a vast commercial lot in the Fort Bonifacio Global City, appraised at P350 Million. After audit, the Banko Sentral ng Pilipinas gave notice that the loan to Celestial Properties exceeded the single borrower's limit of 25% of the bank's net worth under a recent BSP Circular. In light of other previous similar violations of the credit limit requirement, the BSP advised Industry Bank to reduce the amount of the loan to Celestial Properties under pain of severe sanctions. When Industry Bank informed Celestial Properties that it intended to reduce the loan by P50 Million, Celestial Properties countered that the bank should first release a part of the collateral worth P50 Million. Industry Bank rejected the counter-proposal, and referred the matter to you as counsel. How would you advise Industry Bank to proceed, with its best interests in mind? (5%)

SUGGESTED ANSWER:

With a net worth of P1.0 Billion, the maximum loan exposure of the bank to Celestial Properties can reach up to P250.0 Million. The bank should proceed with to reduce the loan of Celestial properties by P20.0 Million, but should not release any part of the collateral by the amount of reduction.

The collateral is a single commercial lot in the Fort, covered by a single title and being essentially indivisible in character, the mortgage cannot be "partially released." Besides, since a real estate mortgage cannot be "partially released." Besides, since a real estate mortgage is merely a collateral contract, it can be enforced only to the amount of the loan; and the moment the loan exposure is reduced, then automatically, reduction of the collateral coverage of the real estate mortgage follows.

General Banking Law of 2000; Single Borrower's Limit (2015)

C. What is the single borrower's limit? (2%)

SUGGESTED ANSWER:

Under the single borrower's limit, the total amount of loans, credit accommodations and guarantee that the bank may extend to any person shall not exceed 25% of the bank's net worth. While the law sets the ceiling at 20% of the bank's net worth, it also empowers the BSP to modify the ceiling. The current SBL as set by BSP is 25% of the Bank's net worth.

Banks; Deposit: Safety Deposit Box; Relationship with Banks (2010)

(A) How do you characterize the legal relationship between a commercial bank and its safety deposit box client? (20%)

SUGGESTED ANSWERS:

The Relationship between a commercial bank and its safety deposit box client is that of a bailee and a bailor, the bailment being for hire and mutual benefit (*Sia v. Court of Appeals*, 222 SCRA 24 (1993); *CA Agro-Industrial Development Corp. v. Court of Appeals*, 219 SCRA 426(1993)).

ALTERNATIVE ANSWER:

The legal relationship of the bank and its safety deposit box client is that of lessor and lessee.

(B) Is a stipulation in the contract for the use of a safety deposit box relieving the bank of liability in connection with the use thereof valid? (2%).

SUGGESTED ANSWER:

The stipulation relieving the bank of liability in connection with the use of the safety deposit box is void as it is against law and public policy (*CA Agro-Industrial Development Corp. v. Court of Appeals*, supra).

Banks; Deposits; Safety Deposit Box; Liability

MN and OP rented a safety deposit box at SIBANK. The parties signed a contract of lease with the conditions that: the bank is not a depository of the contents of the safe and has neither the possession nor control of the same; the bank assumed no interest in said contents and assumes no liability in connection therewith. The safety deposit box had two keyholes: one for the guard key which remained with the bank; and the other for the renters' key. The box can be opened only with the use of both keys. The renters deposited certificates of title in the box. But later, they discovered that the certificates were gone. MN and OP now claim for damages from SIBANK. Is the bank liable?

Explain briefly. (5%)

SUGGESTED ANSWER:

The bank is liable, based on the decisions of the Supreme Court in *CA Agro-Industrial Development Corp. v. Court of Appeals*, 219 SCRA 426 (1993) and *Sia v. Court of Appeals*, 222 SCRA 24 (1993). In those cases, the Supreme Court ruled that the renting out of safety deposit boxes is a "special kind of deposit" wherein the bank is the depository. In the absence of any stipulation prescribing the degree of diligence required, that of a good father of a family is to be observed by the depository. Any stipulation exempting the depository from any liability arising from the loss of the thing deposited would be void for being contrary to law and public policy. The deposit box is located in the bank premises and is under the absolute control of the bank.

Banks; Deposits vs. Deposit Substitutes (2010)

(C) Differentiate —bank deposits— from—deposit substitutes.— (2%)

SUGGESTED ANSWER:

Bank deposits are funds obtained by a bank from the

public which are lent by such bank to its own borrowers. Deposit substitutes are alternative forms of obtaining funds from the public, other than deposits, through the issuance, endorsement, or acceptance of debt instruments for the own account of the borrower, for the purpose of relending or purchasing of receivables and other obligations. These instruments may include, but need not be limited to, banker's acceptances, promissory notes, participations, certificates of assignment and similar instruments with recourse, and repurchase agreements (Section 95, Rep. Act No. 7653, "The New Central Bank Act").

(D) Why are banks required to maintain reserves against their deposits and deposit substitutes? State one of three purposes for these reserves. (2%)

SUGGESTED ANSWER:

Any one of the following 4 purposes for requiring banks to maintain reserves against their deposits and deposit substitutes will suffice:

- (1) One of the purposes of the requirement to maintain bank reserves is to control the volume of money created by the credit operations of the banking system (Section 94 of the New Central Bank Act);
- (2) It is to enable the banks to answer any withdrawal;
- (3) To help Government to finance its operation;
- (4) To help the Government control money supply.

Banks; Mortgage; Redemption (2007)

On December 4, 2003, RED Corporation executed a real estate mortgage in favor of BLUE Bank. RED Corporation defaulted in the payment of its loan. Consequently, on June 4, 2004, BLUE Bank extra judicially foreclosed the property. Being the highest bidder in the auction sale conducted, the Bank was issued a Certificate of Sale which was registered on August 4, 2004.

Does RED Corporation still have the right to redeem the property as of September 14, 2007? Reason briefly. (5%)

SUGGESTED ANSWER:

No, RED Corporation has lost its right to redeem the property. Juridical persons whose property is sold pursuant to an extrajudicial foreclosure, shall have the right to redeem the property until registration of the certificate of sale with the Register of Deeds, which shall in no case be more than three months after foreclosure, whichever is earlier (Section 47, General Banking Law).

Banks; Collateral Security (2002)

Andrew is engaged in the business of building low-cost housing units under contracts with real estate developers. He applied for a loan of P3 Million from Ready Credit Bank (the Bank), which required Andrew to provide collateral security for it. Andrew offered to assign to the

Bank his receivables amounting to P4 million from Home Builders Development Corporation (the Obligor). The Bank accepted the offer. Accordingly, Andrew obtained the loan and he executed a promissory note undertaking to pay the loan in full in one lump sum on September 1, 2002, together with interest thereon at the rate of 20% per annum. At the same time, Andrew executed a Deed of Assignment in favor of the Bank assigning to the Bank his receivables from the Obligor. The deed of assignment read:

—I, Andrew Lee, hereby assign, transfer and convey, absolutely and unconditionally, to Ready Credit Bank (hereinafter called the Bank) all of my right, title and interest in and to my accounts receivable from Home Builders Development Corporation (hereinafter called the Obligor) arising from delivery of housing units with a total contract price of P4,000,000.00, the description and contract value of which are attached hereto as Annex A (hereinafter called the Receivables).||

—In the event that I shall be unable to pay my outstanding indebtedness owned to the Bank, the Bank shall have the right, without any further formality or act on its part, to collect the Receivables from the Obligor and to apply the proceeds thereof toward payment of my said indebtedness.||

Andrew failed to pay the loan on its due date on September 1, 2002. When the Bank attempted to collect from the Obligor, the Bank discovered that the latter had already closed operations and liquidated all its assets. The Bank sued Andrew for collection, but Andrew moved to dismiss the complaint on the ground that the debt had already been paid by reason of his execution of the aforesaid Deed of Assignment which, being absolute and unconditional, was in essence a dacion en pago. The Bank opposed the motion, contending that the Deed of Assignment was only a security for a loan. If you were the Judge, how would you resolve the motion to dismiss filed by Andrew? Explain (5%)

SUGGESTED ANSWER:

(Since the question is outside the scope of the Bar Examination, it is recommended that the candidate be given full credit of 5%, whatever may be his answer, and he be given a bonus if he made an answer in the following manner:) The motion to dismiss should be granted. The simple absolute and unconditional conveyance embodied in the deed of assignment would be operative, and the assignment would constitute essentially a mode of payment or dacion en pago.

Banks; Applicability: Foreign Currency Deposit Act & Secrecy of Bank Deposits (2005)

Hi Yielding Corporation filed a complaint against five of its officers for violation of Section 31 of the Corporation Code. The corporation claimed that the said officers were guilty of advancing their personal interests to the prejudice of the corporation, and that they were grossly negligent in handling its affairs. Aside from documents and contracts, the corporation also submitted in evidence

records of the officers' U.S. Dollar deposits in several banks overseas - Boston Bank, Bank of Switzerland, and Bank of New York.

For their part, the officers filed a criminal complaint against the directors of Hi Yielding Corporation for violation of Republic Act No. 6426, otherwise known as the Foreign Currency Deposit Act of the Philippines. The officers alleged that their bank deposits were illegally disclosed for want of a court order, and that such deposits were not even the subject of the case against them.

a) Will the complaint filed against the directors of Hi Yielding Corporation prosper? Explain.

SUGGESTED ANSWER:

No, because the Foreign Currency Deposit Act (R.A. No. 6426), including its punitive provisions, refers to foreign currency deposits accounts constituted within the Philippines. It has no application at all to accounts, even though they are banks, opened and constituted abroad.

b) Was there a violation of the Secrecy of Bank Deposits Law (Republic Act No. 1405)? Explain. (5%)

SUGGESTED ANSWER:

No, because the punitive provisions of the Secrecy of Bank Deposits Law (R.A. No. 1405), including the statutory exemptions provided therein, are not applicable to FCDU accounts, even when constituted locally. (Intengan v. Court of Appeals, G.R. No. 128996, February 15, 2002)

INTELLECTUAL PROPERTY

Patent; Non-Patentable Inventions (2006)

Supposing Albert Einstein were alive today and he filed with the Intellectual Property Office (IPO) an application for patent for his theory of relativity expressed in the formula $E=mc^2$. The IPO disapproved Einstein's application on the ground that his theory of relativity is not patentable. Is the IPO's action correct? (5%)

SUGGESTED ANSWER:

Yes, the IPO is correct because under the Intellectual Property Code, discoveries, scientific theories and mathematical methods, are classified to be as "nonpatentable inventions." Einstein's theory of relativity falls within the category of being a non-patentable "scientific theory."

Patents: Gas-Saving Device: first to file rule (2005)

Cezar works in a car manufacturing company owned by Joab. Cezar is quite innovative and loves to tinker with things. With the materials and parts of the car, he was able to invent a gas-saving device that will enable cars to consume less gas. Francis, a co-worker, saw how Cezar created the device and likewise, came up with a similar gadget, also using scrap materials and spare parts of the company. Thereafter, Francis filed an application for registration of his device with the Bureau of Patents. Eighteen months later, Cezar filed his application for the registration of his device with the Bureau of Patents.

1) Is the gas-saving device patentable? Explain.

SUGGESTED ANSWER:

Yes, the gas-saving device is patentable because it provides a technical solution to a problem in a field of human activity. It is new and involves an inventive step, and certainly industrially applicable. It therefore fulfills the requisites mandated by the Intellectual Property Code for what is patentable.

2) Assuming that it is patentable, who is entitled to the patent? What, if any, is the remedy of the losing party?

SUGGESTED ANSWER:

Cezar is entitled to the patent because he was the real inventor. Francis, copying from the work of Cezar, cannot claim the essential criteria of an inventor, who must possess essential elements of novelty, originality and precedence to be entitled to protection. Nevertheless, under the "first to file rule," Francis' application would have to be given priority. Cezar, however, has within three months from the decision, to have it cancelled as the rightful inventor; or within one year from publication, to file an action to prove his priority to the invention, which has been taken from him and fraudulently registered by Francis.

3) Supposing Joab got wind of the inventions of his employees and also laid claim to the patents, asserting that Cezar and Francis were using his materials and

company time in making the devices, will his claim prevail over those of his employees? Explain.

SUGGESTED ANSWER:

No, Joab's claim cannot prevail over those of his employees. In the first place, Joab did not commission any of the two employees to invent the device, and its invention did not fall within their regular duties. What prevails is the provision of the Intellectual Property Code that holds that the invention belongs to the employee, if the inventive activity is not a part of his regular duties, even if he uses the time, facilities and materials of the employer.

Patent: Method of Diagnosis & Treatment; Non-Patentable (2010)

Dr. Nobel discovered a new method of treating Alzheimer's involving a special method of diagnosing the disease, treating it with a new medicine that has been discovered after long experimentation and field testing, and novel mental isometric exercises. He comes to you for advice on how he can have his discoveries protected. Can he legally protect his new method of diagnosis, the new medicine, and the new method of treatment? If no, why? If yes, how? (4%)

SUGGESTED ANSWER:

Dr. Nobel can be protected by a patent for the new medicine as it falls within the scope of Sec. 21 of the Intellectual Property Code (Rep. Act No. 8293, as amended). But no protection can be legally extended to him for the method of diagnosis and method of treatment which are expressly non-patentable (Sec. 22, Intellectual Property Code).

Patent; When Importation of Patented Product Constitutes Infringement (2010)

For years, Y has been engaged in the parallel importation of famous brands, including shoes carrying the foreign brand MAGIC. Exclusive distributor X demands that Y cease importation because of his appointment as exclusive distributor of MAGIC shoes in the Philippines.

Y counters that the trademark MAGIC is not registered with the Intellectual Property Office as a trademark and therefore no one has the right to prevent its parallel importation.

(B) Suppose the shoes are covered by a Philippine patent issued to the owner, what would your answer be? Explain. (2%)

SUGGESTED ANSWER:

A patent for a product confers upon its owner the exclusive right of importing the product (Subsection 71.1 of the Intellectual Property Code). The importation of a patented product without the authorization of the owner of the patent constitutes infringement of the patent (Subsection 76.1 of the Intellectual Property Code). X can prevent the parallel importation of such shoes by Y without its authorization.

Trademark; Dominancy Test; Holistic Test (2014)

Skechers Corporation sued Inter-Pacific for trademark infringement, claiming that Inter-Pacific used Skechers' registered "S" logo mark on Inter-Pacific's shoe products without its consent. Skechers has registered the trademark "SKECHERS" and the trademark "S" (with an oval design) with the Intellectual Property Office (IPO).

In its complaint, Skechers points out the following similarities: the color scheme of the blue, white and gray utilized by Skechers. Even the design and "wave-like" pattern of the mid-sole and outer sole of Inter Pacific's shoes are very similar to Skechers' shoes, if not exact patterns thereof. On the side of Inter-Pacific's shoes, near the upper part, appears the stylized "S" placed in the exact location as that of the stylized "S" the Skechers shoes. On top of the "tongue" of both shoes, appears the stylized "S" in practically the same location and size.

In its defense, Inter-Pacific claims that under the Holistic Test, the following dissimilarities are present: the mark "S" found in Strong shoes is not enclosed in an "oval design"; the word "Strong" is conspicuously placed at the backside and insoles; the hang tags labels attached to the shoes bear the word "Strong" for Inter-Pacific and "Skechers U.S.A." for Skechers; and, Strong shoes are modestly priced compared to the costs of Skechers shoes.

Under the foregoing circumstances, which is the proper test to be applied – Holistic or Dominancy Test? Decide. (4%)

SUGGESTED ANSWER:

Considering the facts given and the arguments of the parties, the dominancy test is the proper test to apply. Thus, the appropriation and the use of the letter "S" by Inter-Pacific on its rubber shoes constitutes an infringement of the trademark of Skechers.

The essential element of infringement under the Intellectual Property Code is that the infringing mark is likely to cause confusion. In determining similarity and likelihood of confusion, jurisprudence has developed tests – the Dominancy Test and the Holistic or Totality Test. The Dominancy Test focuses on the similarity of the prevalent or dominant features of the competing trademarks that might cause confusion, mistake, and deception in the mind of the purchasing public. Duplication or imitation is not necessary; neither is it required that the mark sought to be registered suggest an effort to imitate. Given more consideration are the aural and visual impressions created by the marks on the buyers of goods, giving little weight to factors like prices, quality, sales outlets, and market segments.

In contrast, the Holistic or Totality Test necessitates a consideration of the entirety of the marks as applied to the products, including the labels and packaging, in determining confusing similarity. The discerning eye of the observer must focus not only on the predominant words, but also on the other features appearing on both labels so that the observer may draw conclusion on whether one is confusingly similar to the other.

Relative to the question on confusion of marks and trade names, jurisprudence has noted two (2) types of confusion, viz.,: (1) confusion of goods (product confusion), where the ordinarily prudent purchaser would be induced to purchase one product in the belief that he was purchasing the other; and (2) confusion of business (source or origin confusion), where, although the goods of the parties are different, the product, the mark of which registration is applied for by one party, is such as might reasonably be assumed to originate with the registrant of an earlier product, and the public would then be deceived either into that belief or into the belief that there is some connection between the two parties, though nonexistent.

Applying the Dominancy Test to the problem, we find that the use of the stylized “S” by Inter-Pacific in its Strong rubber shoes infringes on the mark already registered by Skechers with the IPO. While it is undisputed that stylized “S” of Skechers is within an oval design, the dominant feature of the trademark is the stylized “S,” as it is precisely the stylized “S” which catches the eye of the purchaser. Thus, even if Inter-Pacific did not use an oval design, the mere fact that it is used the same stylized “S”, the same being dominant feature of the trademark of Skechers, already constitutes infringement under the Dominancy Test. (*Skechers, U.S.A., Inc. v. Inter Pacific Industrial Trading Corp., et al.*, G.R. 164321, November 30, 2006 [decision reconsidering and setting aside the original decision in the case]).

Trademark; Unfair Competition (2010)

For years, Y has been engaged in the parallel importation of famous brands, including shoes carrying the foreign brand MAGIC. Exclusive distributor X demands that Y cease importation because of his appointment as exclusive distributor of MAGIC shoes in the Philippines.

Y counters that the trademark MAGIC is not registered with the Intellectual Property Office as a trademark and therefore no one has the right to prevent its parallel importation.

(A) Who is correct? Why? (2%)

SUGGESTED ANSWER:

X is correct. His rights under his exclusive distributorship agreement are property rights entitled to protection. The importation and sale by Y of MAGIC shoes constitute unfair competition (*Yu v. Court of Appeals*, 217 SCRA 328 (1993)). Registration of the trademark is not necessary in case of an action for unfair competition (*Del Monte Corporation v. Court of Appeals*, 181 SCRA 410 (1990)).

ALTERNATIVE ANSWER:

Y is correct. The rights in a trademark are acquired through registration made validly in accordance with the Intellectual Property Code (Section 122 of the Intellectual Property Code).

Trademark; Petition to Cancel Registration (2014)

Jinggy went to Kluwer University (KU) in Germany for his doctorate degree (Ph.D.). He completed his degree with the highest honors in the shortest time. When he came back, he decided to set-up his own graduate school in his hometown in Zamboanga. After seeking free legal advice from his high-flying lawyer-friends, he learned that the Philippines follow the territoriality principle in trademark law, i.e., trademark rights are acquired through valid registration in accordance with the law. Forth with, Jinggy named his school the Kluwer Graduate School of Business of Mindanao and immediately secured registration with the Bureau of Trademarks. KU did not like the unauthorized use of its name by its top alumnus no less. KU sought your help. What advice can you give KU? (4%)

SUGGESTED ANSWER:

I can advise KU to file a petition to cancel the registration of the name “Kluwer” Graduate School of Business of Mindanao” (KGSBM”) with the Bureau of Trademarks.

The petition could be anchored on the following facts: Kluwer University is the owner of the name “Kluwer.” Jinggy registered the trademark in bad faith. He came to know of the trademark because he went to Kluwer University in Germany for his doctorate degree. KU is the owner of the name “Kluwer” and has the sole right to register the same. Foreign marks that are not registered are still accorded protection against infringement and/or unfair competition under the Paris Convention for the Protection of Industrial Property. Both the Philippines and Germany are signatories to the Paris Convention. Under the said Convention, the trademark of a national signatory to the Paris Convention is entitled to its protection in other countries that are also signatories to the Convention without need of registering the trademark.

The petition could also be based on the fact, if it were proven by KU that “Kluwer” is a well-known mark and entitled to protection as KU and KGSBM belong to the same class of services, i.e., Class 41 (education and entertainment). KU must also prove that a competent authority of the Philippines has designated “Kluwer” to be well known internationally and in the Philippines.

Finally, the petition could also be based on the fact, if it were proven by KU, that “Kluwer” is a trade name that KU has adopted and used before its use and registration by Jinggy. (*Ecole de Cuisine Manille [Cordon Bleu of the Philippines], Inc. v. Renaud Cointreau & Cie and Le Cordon Bleu Int’l.*, B.V., G.R. 185830, June 5, 2013).

Trademark; Petition to Cancel Registration (2015)

CHEN, Inc., a Taiwanese company, is a manufacturer of tires with the mark Light Year. From 2009 to 2014, Clark Enterprises, a Philippine-registered corporation, imported tires from CHEN, Inc. under several sales contracts and sold them here in the Philippines. In 2015, CHEN, Inc. filed a trademark application with the Intellectual Property Office (IPO) for the mark Light Year to be used for tires. The IPO issued CHEN, Inc. a certificate of registration

(COR) for said mark. Clark Enterprises sought the cancellation of the COR and claimed it had a better right to register the mark Light Year. CHEN, Inc. asserted that it was the owner of the mark and Clark Enterprises was a mere distributor. Clark Enterprises argued that there was no evidence on record that the tires it imported from CHEN, Inc. bore the mark Light Year and Clark Enterprises was able to prove that it was the first to use the mark here in the Philippines. Decide the case. (4%)

SUGGESTED ANSWER:

While RA 8293 removed the previous requirement of proof of actual use prior to the filing of an application for registration of a mark, proof of prior and continuous use is necessary to establish ownership of trademark. Such ownership of the trademark confers the right to register the trademark. Since Chen owns the trademark as evidenced by its actual and continuous use prior to the Clark Enterprises, then it is the one entitled to the registration of the trademark. The fact that Clark was the first one to use the mark here in the Philippines will not matter. Chen's prior actual use of the trademark even in another country bars Clark from applying for the registration of the same trademark.

Also, a mere distributor does not own the trademark to the goods he distributes and his right over the trademark cannot prevail over the owner (*E.Y. Industrial Sales v. Shien Dar Electricity and Machinery*, 634 SCRA 363[2010]; *Ecole de Cuisine Manille c. Renaud Cointreau*, 697 SCRA 345 [2013]).

Trademark vs. Copyright vs. Patent (2015)

A. Differentiate trademark, copyright and patent from each other. (6%)

SUGGESTED ANSWER:

1. As to definition:

- a. Trademark is any visible sign capable of distinguishing goods
- b. Copyright is an incorporated right granted by statute to the author or creator of original literary and artistic works whereby he is invested for a limited period of time with the right to carry out, authorize and prevent the reproduction, distribution, transformation, rental, public performance and other forms of communication of his work to the public.
- c. Patent is any technical solution of any problem in any field of human activity which is new, requires an inventive step and industrially applicable.

2. As to object

- a. The object of trademark are goods
- b. The object of copyright are original literary and artistic works
- c. The object of patent is invention

3. As to term

- a. The term of trademark is 10 years
- b. The term of copyright is generally 50 years

- c. The term of patent is 20 years from application

4. As to how acquired

- a. Trademark is acquired through registration and use
- b. Copyright is acquired from the moment of creation
- c. Patent is acquired through application with the IPO

Tradename; International Affiliation (2005)

S Development Corporation sued Shangrila Corporation for using the —Sll logo and the tradename —Shangrilall. The former claims that it was the first to register the logo and the tradename in the Philippines and that it had been using the same in its restaurant business. Shangrila Corporation counters that it is an affiliate of an international organization which has been using such logo and tradename —Shangrilall for over 20 years. However, Shangrila Corporation registered the tradename and logo in the Philippines only after the suit was filed. Which of the two corporations has a better right to use the logo and the tradename? Explain.

SUGGESTED ANSWER:

S Development Corporation has a better right to use the logo and the tradename, since the protective benefits of the law are conferred by the fact of registration and not by use. Although Shangrila Corporation's parent had used the tradename and logo long before, the protection of the laws will be for S Development Corporation because it was the first entity to register the intellectual properties.

How does the international affiliation of Shangrila Corporation affect the outcome of the dispute? Explain. (5%)

SUGGESTED ANSWER:

The international affiliation of Shangrila Corporation may be critical in the event that its affiliates or parent company abroad had registered in a foreign jurisdiction the tradename and the logo. A well-known mark and tradename is subject to protection under Treaty of Paris for the Protection of Intellectual Property to which the Philippines is a member.

Copyright; Commissioned Artist (2008)

In 1999, Mocha warn, an American musician, had a bit rap single called Warm Warm Honey which he himself composed and performed. The single was produced by a California record company, Galactic Records. Many notice that some passages from Warm Warm Honey sounded eerily similar to parts of Under Hassle, a 1978 hit song by the British rock and Majesty. A copyright infringement suit was filed in the United States against Mocha Warm by Majesty. It was later settled out of court, with Majesty receiving attribution as co-author of Warm Warm Honey as well as a share in the royalties.

By 2002, Moeha Warm was nearing bankruptcy and he sold his economic rights over Warm Warm Honey to Galactic Records for

\$10,000.

In 2008, Planet Films, a Filipino movie producing company, commissioned DJ Chef Jean, a Filipino musician, to produce an original re-mix of Warm Warm Honey for use in one of its latest films, Astig!. DJ Chef Jean remixed Warm Warm Honey with a salsa beat, and interspersed as well a recital of poetic stanza by John Blake, 17th century Scottish poet. DJ Chef Jean died shortly after submitting the remixed Warm Warm Honey to Planet Films.

Prior to the release of Astig!, Mocha Warm learns of the remixed Warm Warm Honey and demands that he be publicly identified as the author of the remixed song is all the CD covers and publicity releases of Planet Films.

(A) Who are the parties or entities entitled to be credited as author of the remixed Warm Warm Honey? Reason out your answers. (3%)

SUGGESTED ANSWER:

The parties entitled to be credited as authors of the remixed Warm Warm Honey are Mocha Warm, Majesty, DJ Chef Jean and John Blake, for the segments that was the product of their respective intellectual efforts.

In the case of Mocha Warm and Majesty, who are the attributed co-authors, and in spite of the sale of the economic right to Galactic Records, they retain their moral rights to the copyrighted rap, which include the right to demand attribution to them of the authorship (Sec. 193, IPC).

Which respect to DJ Chef Jean, in spite of his death, and although he was commissioned by Planet Films for the remix, the rule is that the person who so commissioned work shall have ownership of the work, but copyright thereto shall remain with creator, unless there is a written stipulation to the contrary.

Even if no copyright exist in favor of poet John Blake, intellectual integrity requires that the authors of creative work should properly be credited.

(B) Who are the particular parties or entities who exercise copyright over the remixed Warm Warm Honey? Explain. (3%)

SUGGESTED ANSWER:

The parties who exercise copyright or economic rights over the remixed Warm Warm Honey would be Galactic Records and Planet Films. In the case of Galactic Records, it bought the economic rights of Mocha Warm. In the case of Planet Films, it commissioned the remixed work.

Copyright; Commissioned Artist (2004)

BR and CT are noted artists whose paintings are highly prized by collectors. Dr. DL commissioned them to paint a mural at the main lobby of his new hospital for children. Both agreed to collaborate on the project for a total fee of two million pesos to be equally divided between them. It was also agreed that Dr. DL had to provide all the materials for the painting and pay for the wages of technicians and laborers needed for the work on the

project. Assume that the project is completed and both BR and CT are fully paid the amount of P2M as artists' fee by DL. Under the law on intellectual property, who will own the mural? Who will own the copyright in the mural? Why? Explain. (5%)

SUGGESTED ANSWER:

Under Section 178.4 of the Intellectual Property Code, in case of commissioned work, the creator (in the absence of a written stipulation to the contrary) owns the copyright, but the work itself belongs to the person who commissioned its creation. Accordingly, the mural belongs to DL. However, BR and CT own the copyright, since there is no stipulation to the contrary.

Copyright; Commissioned Work (2008)

Eloise, an accomplished writer, was hired by Petong to write a bimonthly newspaper column for Diario de Manila, a newly-established newspaper of which Petong was the editor-in-chief. Eloise was to be paid P1,000 for each column that was published. In the course of two months, Eloise submitted three columns which, after some slight editing, were printed in the newspaper. However, Diario de Manila proved unprofitable and closed only after two months. Due to the minimal amounts involved, Eloise chose not to pursue any claim for payment from the newspaper, which was owned by New Media Enterprises.

Three years later, Eloise was planning to publish an anthology of her works, and wanted to include the three columns that appeared in the Diario de Manila in her anthology. She asks for your legal advice:

(A) Does Eloise have to secure authorization from New Media Enterprises to be able to publish her Diario de Manila columns in her own anthology? Explain fully. (4%)

SUGGESTED ANSWER:

Eloise may publish the columns without securing authorization from New Media Enterprises. Under Sec. 172 of the Intellectual Property Code, original intellectual creations in the literary and artistic domain are protected from the moment of their creation and shall include those in periodicals and newspapers. Under Sec. 178, copyright ownership shall belong to the author. In case of commissioned work, the person who so commissioned work shall have ownership of work, but copyright shall remain with creator, unless there is a written stipulation to the contrary.

(B) Assume that New Media Enterprises plans to publish Eloise's columns in its own anthology entitled, —The Best of Diario de Manila! Eloise wants to prevent the publication of her columns in that anthology since she was never paid by the newspaper. Name one irrefutable legal argument Eloise could cite to enjoin New Media Enterprises from including her columns in its anthology. (2%)

SUGGESTED ANSWER:

Under the IPC, the copyright or economic rights to the columns she authored pertains only to Eloise. She can invoke the right to either "authorize or

prevent” reproduction of the work, including the public distribution of the original and each copy of the work “bysale or other forms of transfer of ownership,” Since this would be the effect of including her column in the anthology.

Copyright; Painting (2013)

Rudy is a fine arts student in a university. He stays in a boarding house with Bernie as his roommate. During his free time, Rudy would paint and leave his finished works lying around the boarding house. One day, Rudy saw one of his works -an abstract painting entitled Manila Traffic Jam - on display at the university cafeteria. The cafeteria operator said he purchased the painting from Bernie who represented himself as its painter and owner.

Rudy and the cafeteria operator immediately confronted Bernie. While admitting that he did not do the painting, Bernie claimed ownership of its copyright since he had already registered it in his name with the National Library as provided in the Intellectual Property Code. Who owns the copyright to the painting? Explain. (8%)

SUGGESTED ANSWER:

Rody owns the copyright to the painting because he was the one who actually created it. (Section 178.1 of the Intellectual Property Code) His rights existed from, the moment of its creation (Section 172 of the Intellectual Property Code: *Unilever Philippines (PRC) v. Court of Appeals, 498 SCRA 334, 2006*). The registration of the painting by Bernie with the National Library did not confer copyright upon him. The registration is merely for the purpose of completing the records of the National Library.(Section 191 of the Intellectual Property Code).

Copyright; Infringement (2006)

In a written legal opinion for a client on the difference between apprenticeship and learnership, Liza quoted without permission a labor law expert's comment appearing in his book entitled "Annotations on the Labor Code." Can the labor law expert hold Liza liable for infringement of copyright for quoting a portion of his book without his permission? (5%)

SUGGESTED ANSWER:

Liza cannot be held liable for infringement of copyright since under the Intellectual Property Code, one of the limitations to the copyright is the making of quotations from a published work for purpose of any judicial proceedings or for giving of professorial advice by legal practitioner, provided that the source and name of the author are identified (See Section 184.1[k] of the Intellectual Property Code of the Philippines).

Copyright; Infringement (2007)

Diana and Piolo are famous personalities in showbusiness who kept their love affair secret. They use a special instant messaging service which allows them to see one another's typing on their own screen as each letter key is pressed. When Greg, the controller of the service facility, found out their identities, he kept a copy of all the messages Diana and Piolo sent each other and

published them. Is Greg liable for copyright infringement? Reason briefly. (5%)

SUGGESTED ANSWER:

Yes, Greg is liable for copyright infringement. Letter are among the works which are protected from the moment of their creation (Section 172, intellectual Property Code; *Columbia Pictures, Inc. v Court of Appeals, 261 SCRA 144 [1996]*). The publication of the letters without the consent of their writers constitutes infringement of copyright.

ALTERNATIVE ANSWER

No, Greg is not liable for copyright infringement. There is no copyright protecting electronic documents. What are involved here are text messages, not letter in their ordinary sense. Hence, the protection under the copyright law does not extend to text messages (Section 172, Intellectual Property Code).

The messages that Diana and Piolo exchanged through the use of messaging service do not constitute literary and artistic works under Section 172 of the Intellectual Property Code. They are not letter under Section 172(d).

For copyright to subsist in a “message”, it must qualify as a “work” (Section 172

Intellectual Property Code). Whether the messages are entitled or not to copyright protection would have to be resolved in the light of the provision of the Intellectual Property Code.

Note: Since the law on this matter is not clear, it is suggested that either of the above of the above suggested answers should be given full credit.

Copyright; Infringement (2014)

KKis from Bangkok, Thailand. She studies medicine in the Pontifical University of Santo Tomas (UST). She learned that the same foreign books prescribed in UST are 40-50% cheaper in Bangkok. So she ordered 50 copies of each book for herself and her classmates and sold the books at 20% less than the price in the Philippines. XX, the exclusive licensed publisher of the books in the Philippines, sued KK for copyright infringement. Decide. (4%)

SUGGESTED ANSWER:

KK is liable for infringement of copyright. XX, as exclusive licensed publisher, is entitled, within the scope of the license, to all the rights and remedies that the licensor has with respect to the copyright (Sec. 180, Intellectual Property Code, as amended by Republic Act No. 10372).

The importation by KK of 50 copies of each foreign book prescribed in UST and selling them locally at 20% less than their respective prices in the Philippines is subject to the doctrine of fair use set out in Section 185.1 of the Intellectual Property Code. The factors to be considered in determining whether the use made of a work is fair use shall include:

- a. The purpose and character of the use, including whether such use is of a commercial nature or is for non-profit educational purposes;
- b. The nature of the copyrighted work;

- c. The amount and substantiality of the portion used in relation to the copyrighted work as a whole; and
- d. The effect of the use upon the potential market for a value of the copyrighted work.

Applying the above-listed factors to the problem, KK's importation of the books and their sale locally clearly show the unfairness of her use of the books, particularly the adverse effect of her price discounting on the business of XX.

Copyright; Denicola Test (2009)

(A) The *Denicola Test* in intellectual property law states that if design elements of an article reflect a merger of aesthetic and functional considerations, the artistic aspects of the work cannot be conceptually separable from the utilitarian aspects; thus, the article cannot be copyrighted.

SUGGESTED ANSWER:

True. Applying the Denicola Test in *Brandir International, Inc. v. Cascade Pacific Lumber Co.* (834 F. 2d 1142, 1988 Copr.L.Dec. P26), the United States Court of Appeals for the Second Circuit held that if there is any aesthetic element which can be separated from the utilitarian elements, then the aesthetic element may be copyrighted.

(Note: It is suggested that the candidate be given full credit for whatever answer or lack of it. Further, it is suggested that terms or any matter originating from foreign laws or jurisprudence should not be asked.)

Infringement vs. Unfair Competition (2003)

In what way is an infringement of a trademark similar to that which pertains to unfair competition?

SUGGESTED ANSWER:

Infringement; Jurisdiction (2003)

K-9 Corporation, a foreign corporation alleging itself to be the registered owner of trademark —K-9II and logo —KII, filed an Inter Partes case with the Intellectual Property Office against Kanin Corporation for the cancellation of the latter's mark —K-9II and logo —K.II During the pendency of the case before the IPO, Kanin Corporation brought suit against K-9 Corporation before the RTC for infringement and damages. Could the action before the RTC prosper? Why?

SUGGESTED ANSWER:

Infringement; Claims (2010)

While vacationing in Boracay, Valentino surreptitiously took photographs of his girlfriend Monaliza in her skimpy bikini. Two weeks later, her photographs appeared in the Internet and in a national celebrity magazine.

Monaliza found out that Valentino had sold the photographs to the magazine, adding insult to injury, uploaded them to his personal blog on the Internet.

(A) Monaliza filed a complaint against Valentino damages based on, among other grounds, violation of her intellectual property rights. Does she have any cause of action? Explain. (2%)

SUGGESTED ANSWER:

Monaliza cannot sue Valentino for violation of her intellectual property rights, because she was not the one who took the pictures (Subsection 178.1 of the Intellectual Property Code). She may sue Valentino instead for violation of her right to privacy. He surreptitiously took photographs of her and then sold the photographs to a magazine and uploaded them to his personal blog in the Internet (Tolentino, *Commentaries and Jurisprudence on the Civil Code of the Philippines*, Vol. I, 1987 ed., p. 169).

(B) Valentino's friend Francesco stole the photographs and duplicated them and sold them to a magazine publication. Valentino sued Francesco for infringement and damages. Does Valentino have any cause of action? Explain. (2%)

SUGGESTED ANSWER:

Valentino cannot sue Francesco for infringement, because he has already sold the photographs to a magazine (*Angeles vs. Premier Productions, Inc.*, 6 CAR (2s) 159).

ALTERNATIVE ANSWER:

Yes, as the author of the photographs, Valentino has exclusive economic rights thereto, which include the rights to reproduce, to distribute, to perform, to display, and to prepare derivative works based upon the copyrighted work. He sold only the photographs to the magazine; however, he still retained some economic rights thereto. Thus, he has a cause of action against infringement against Francesco.

(C) Does Monaliza have any cause of action against Francesco? Explain. (2%)

SUGGESTED ANSWER:

Monaliza can also sue Francesco for violation of her right to privacy.

Infringement; Trademark, Copyright (2009)

After disposing of his last opponent in only two rounds in Las Vegas, the renowned Filipino boxer Sonny Bachao arrived at the Ninoy Aquino International Airport met by thousands of hero-worshipping fans and hundreds of media photographers. The following day, a colored

photograph of Sonny wearing a black polo shirt embroidered with the 2-inch Lacoste Crocodile logo appeared on the front page of every Philippine newspaper.

Lacoste International, the French firm that manufactures Lacoste apparel and owns the Lacoste trademark, decided to cash in on the universal popularity of the boxing icon. It reprinted the photographs, with the permission of the newspaper publishers, and went on a world-wide blitz of print commercials in which Sonny is shown wearing a Lacoste shirt alongside the phrase —Sonny Bachao just loves Lacoste.®

When Sonny sees the Lacoste advertisements, he hires you as lawyer and asks you to sue Lacoste International before a Philippine court:

(A) For trademark Infringement in the Philippines because Lacoste International used his image without his permission: (2%)

SUGGESTED ANSWER:

Sonny Bachao cannot sue for infringement of trademark. The photographs showing him wearing a Lacoste shirt were not registered as a trademark (*Pearl & Dean (Phil.), Inc. v. Shoemart, Inc.*, 409 SCRA 231 (2003)).

(B) For copyright infringement because of the unauthorized use of the published photographs; (2%) and

SUGGESTED ANSWER:

Sonny Bachao cannot sue for infringement of copyright for the unauthorized use of the photographs showing him wearing a Lacoste shirt. The copyright to the photographs belong to the newspapers which published them inasmuch as the photographs were the result of the performance of the regular duties of the photographers (Subsection 173.3 (b), Intellectual Property Code (IPC)). Moreover, the newspaper publishers authorized the reproduction of the photographs (Section 177, Intellectual Property Code).

(C) For injunction in order to stop Lacoste International from featuring him in their commercials. (2%)

Will these actions prosper? Explain.

SUGGESTED ANSWER:

The complaint for injunction to stop Lacoste International from featuring him in its advertisements will prosper. This is a violation of subsection 123, 4(c) of the IPC and Art. 169 in relation to Art. 170 of the IPC.

(D) Can Lacoste International validly invoke the defense that it is not a Philippine company and, therefore, Philippine courts have no jurisdiction? Explain. (2%)

SUGGESTED ANSWER:

No. Philippine courts have jurisdiction over it, if it is doing business in the Philippines. Moreover, under Section 133 of the Corporation Code, while a foreign corporation doing business in the Philippines without license to do business, cannot sue or intervene in any action, it may be sued or proceeded against

before our courts or administrative tribunal (*De Joya v. Marquez*, 481 SCRA 376 (2006)).

Infringement; Doctrine of Equivalents (2015)

B. What is the doctrine of equivalents? (2%)

SUGGESTED ANSWER:

Under the doctrine of equivalents, infringement of patent occurs when a device appropriates a prior invention by incorporating its innovative concept and albeit with some modifications and changes which performs the same function in substantially the same way to achieve the same result (*Godines v. Court of Appeals*, 226 SCRA 338 [1993]).

Infringement of Trademark vs. Unfair Competition (2015)

C. In what ways would a case for infringement of trademark be different from a case for unfair competition? (3%)

SUGGESTED ANSWER:

1. In infringement of trademark, prior registration of the trademark is a prerequisite to the action whereas in unfair competition trademark registration is not necessary.

2. Trademark infringement is the unauthorized use of the registered trademark while unfair competition is the passing off one's goods as those of another.

3. In infringement of trademark, fraudulent intent is unnecessary whereas in unfair competition fraudulent intent is essential (*Delmonte Corporation v. Court of Appeals*, 181 SCRA 410 [1990]).

Technology Transfer Agreements; Important Stipulations & Prohibitions (2010)

(A) What contractual stipulations are required in all technology transfer agreements? (2%)

SUGGESTED ANSWER:

The following stipulations are required in all technology transfer agreements:

(1) The laws of the Philippines shall govern its interpretation and in the event of litigation, the venue shall be the proper court in the place where the licensee has its principal office;

(2) Continued access to improvements in techniques and processes related to the technology shall be made available during the period of the technology transfer arrangement;

(3) In case it shall provide for arbitration, the Procedure of Arbitration of the Arbitration Law of the Philippines or the Arbitration Rules of the United Nations Commission on International Trade Law or the Rules of Arbitration of the International Chamber of Commerce (ICC) shall apply and the venue of arbitration shall be the Philippines or any neutral country;

(4) The Philippine taxes on all payments relating to the technology transfer agreement shall be borne by the licensor (Sec. 88, Intellectual Property Code).

(B) Enumerate three stipulations that are prohibited in

technology transfer agreements. (3%)

SUGGESTED ANSWER:

The following stipulations are prohibited in technology transfer agreements:

- (1) Those that contain restrictions regarding the volume and structure of production;
- (2) Those that prohibit the use of competitive technologies in a non-exclusive agreement; and
- (1) Those that establish a full or partial purchase option in favor of the licensor (Subsections 87.3, 87.4 and 87.5 of the Intellectual Property Code).

Article of Commerce; As Trademark, Patent & Copyright (2010)

(C) Can an article of commerce serve as a trademark and at the same time enjoy patent and copyright protection? Explain and give an example. (2%)

SUGGESTED ANSWER:

A stamped or marked container of goods can be registered as trademark (subsections 113.1 of the Intellectual Property Code). An original ornamental design or model for articles of manufacturer can be copyrighted (Subsection 172.1 of the Intellectual Property Code). An ornamental design cannot be patented, because aesthetic creations cannot be patented (Section 22 of the Intellectual Property Code). However, it can be registered as an industrial design (Subsections 113.1 and 172.1 of the Intellectual Code). Thus, a container of goods which has an original ornamental design can be registered as trademark, can be copyrighted, and can be registered as an industrial design.

ALTERNATIVE ANSWER:

It is entirely possible for an article of commerce to bear a registered trademark, be protected by a patent and have most, or some part of it copyrighted. A book is a good example. The name of the publisher or the colophon used in the book may be registered trademarks, the ink used in producing the book may be covered by a patent, and the text and design of the book may be covered by copyrighted.

OTHER SPECIAL LAWS

Chattel Mortgage

Chattel Mortgage vs. Levy (2003)

To pay for her loan obtained from Stela, Liza constituted in Stela's favor a chattel mortgage over an electric generator. Cecil, a creditor of Liza, levied on attachment the generator. Stela filed a third party claim. Cecil opposed the claim. Rule on their conflicting claims.

SUGGESTED ANSWER:

Chattel Mortgage; Remedies (2003)

Carmakers, Inc., sold a motor vehicle on installment basis to Chari Paredes. The transaction was reflected on a promissory note executed by Chari in favor of Carmakers. The note was secured by a mortgage over the car. Contemporaneous with the execution of the note and the mortgage deed, Carmakers, Inc., assigned the instruments sans recourse to Adelantado Finance Corporation. Chari defaulted in her obligations. Could Adelantado Finance corporation take action against both Carmakers Inc., and Chari? Why? (6%)

SUGGESTED ANSWER:

Chattel Mortgage; Foreclosure (2008)

On January 1, 2008, Al obtained a loan of P10,000 from Bob to be paid on January 30, 2008, secured by a chattel mortgage on a Toyota motor car. On February 1, 2008, Al obtained another loan of P10,000 from Bob to be paid on February 15, 2008. He secured this by executing a chattel mortgage on a Honda motorcycle. On the due date of the first loan Al failed to pay. Bob foreclosed the chattel mortgage but the car was bidden for P6,000 only. Al also failed to pay the second loan due on February 15, 2008. Bob filed an action for collection of sum of money. Al filed a motion to dismiss claiming that Bob should first foreclose the mortgage on The Honda motorcycle before

he can file the action for sum of money. Decide with reasons. (4%)

SUGGESTED ANSWER:

Bob has the legal right to file a collection suit for a sum of money in lieu of foreclosing on the chattel mortgage. It has been ruled that a chattel mortgage is a security arrangement to support a primary contract (*Serra v. Rodriguez*, G.R. no. L-25546, 22 April 1974). Since the chattel mortgage is only a collateral contract prerogative to choose which of the remedies available to pursue. However, the filing of the collection suit constitutes a waiver of the chattel mortgage (*Land Settlement and Dev. Corp. v. Carlos*, 22 SCRA 202, 1968). And even if the collection suit included the recovery of the P6,000 deficiency on the first loan, the same is valid because unlike in a pledge the lender has the legal right to recover the deficiency incurred on the foreclosure of a chattel mortgage (*PAMECA Wood Treatment v. CA*, G.R. No. 106435, 14 July 1999).

Chattel Mortgage; Foreclosure (2009)

Armando, a resident of Manila, borrowed P3-million from Bernardo, offering as security his 500 shares of stock worth P1.5-million in Xerxes Corporation, and his 2007BMW sedan, valued at P2-million. The mortgage on the shares of stock was registered in the Office of the Register of Deeds of Makati City where Xerxes Corporation has its principal office. The mortgage on the car was registered in the Office of the Register of Deeds of Manila. Armando executed a single Affidavit of Good Faith, covering both mortgages.

Armando defaulted on the payment of his obligation; thus, Bernardo foreclosed on the two chattel mortgages. Armando filed suit to nullify the foreclosure and the mortgages, raising the following issues:

(A) The execution of only one Affidavit of Good Faith for both mortgages invalidated the two mortgages; (2%) and

SUGGESTED ANSWER:

The execution of only one Affidavit of Good Faith for both mortgages is not a ground to nullify the said mortgages and the foreclosure thereof. Said mortgages are valid as between immediate parties (*Lilius v. Manila Railroad Company*, 62 Phil. 56 (1935)), although they cannot bind third parties (*Philippine Refining v. Jarque*, 61 Phil. 229 (1935)).

(B) The mortgage on the shares of stocks should have been registered in the office of the Register of Deeds of Manila where he resides, as well as in the stock and transfer book of Xerxes Corporation. (3%)

Rule on the foregoing issues with reasons.

SUGGESTED ANSWER:

The mortgage on the shares of stock should be registered in the chattel mortgage registry in the Register of Deeds of Makati City where the corporation has its principal office and also in the Register of Deeds of Manila where the mortgagor resides (*Chua Guan v. Samahang Magsasaka, Inc.*, 62 Phil. 472 (1935)). Registration of chattel mortgage in

the stock and transfer book is not required to make the chattel mortgage valid. Registration of dealings in the stock and transfer book under Section 63 of the Corporation Code applies only to sale or disposition of shares, and has no application to mortgages and other forms of encumbrances (*Monserrat v. Ceron*, 58 Phil. 469 (1933)).

(C) Assume that Bernardo extrajudicially foreclosed on the mortgages, and both the car and the shares of stocks were sold at public auction. If the proceeds from such public sale should be 1-million short of Armando's total obligation, can Bernardo recover the deficiency? Why or why not? (2%)

SUGGESTED ANSWER:

Yes. Bernardo can recover the deficiency. Chattels are given as mere security, and not as payment or pledge (*CuHada v. Drilon*, 432 SCRA 618 (2004)).

Real Estate Mortgage

Real Estate Mortgage; Extrajudicial Foreclose (2006)

A real estate mortgage may be foreclosed judicially or extrajudicially. In what instance may a mortgagee extrajudicially foreclose a real estate mortgage? (5%)

SUGGESTED ANSWER:

When a sale is made under a special power inserted or attached to any real-estate mortgage, thereafter given as security for the payment of money or the fulfillment of any other obligation, then the mortgagee may extrajudicially foreclose the real estate mortgage (Sec. 1, Act No. 3135, as amended).

Real Estate Mortgage; Foreclosure (2003)

May the sale at public auction by a bank of a property mortgaged to it be nullified because the price was extremely low? Why?

SUGGESTED ANSWER:

Real Estate Mortgage; Foreclosure (2003)

Because of failure of Janette and Jeanne to pay their loan to X Bank, the latter foreclosed on the mortgage constituted on their property which was put up by them as security for the payment of the loan. The price paid for the property at the foreclosure sale was not enough to liquidate the obligation. The bank sued for deficiency. In their answer, Janette and Jeanne did not deny the existence of the loan nor the fact of their default. They, however, interposed the defenses that the price at the auction was extremely low and that their loan, despite the loan documents, was a long-term loan which had not yet matured. If you were the judge, how would you rule on the case? Why? (6%)

SUGGESTED ANSWER:

Real Estate Mortgage; Foreclosure (2010)

Ozamis Paper Corporation secured loans from ABC Universal Bank in the aggregate principal amount of P100 million, evidenced by several promissory notes, and secured by a continuing guaranty of its principal stockholder Menandro Marquez; a pledge of Marquez's shares in the corporation valued at P45 million; and a real estate mortgage over certain parcels of land owned by Marquez.

The corporation defaulted and the bank extrajudicially foreclosed on the real estate mortgage. The bank which was the sole bidder for P75 million, won the award.

(A) Can the bank sue Marquez for the Deficiency of P25 million? Explain. (2%)

SUGGESTED ANSWER:

Yes, the bank can sue Marquez for the deficiency of P25million. In extrajudicial foreclosure of a real estate mortgage, if the proceeds of the sale are insufficient to pay the debt, the mortgagee has the right to sue for the deficiency (Suico Rattan and Buri Interiors, Inc. v. Court of Appeals, 490 SCRA 560 (2006)).

(B) If the bank opts to file an action for collection against the corporation, can it afterwards institute a real action to foreclose the mortgage? Explain (2%)

SUGGESTED ANSWER:

No, the bank can no longer file an action to foreclose the real estate mortgage. When it filed a collection case, it was deemed to have abandoned the real estate mortgage (Bank of America, NT and SA v. American Realty Corporation, 321 SCRA 659(1999)).

(C) Can the bank foreclose on the pledged shares of Marquez and recover the deficiency from the corporation? Explain. (2%)

SUGGESTED ANSWER:

If the bank forecloses the pledge, it cannot recover the deficiency because the foreclosure extinguishes the principal obligation, whether or not the proceeds from the foreclosure are equal to the amount of the principal obligation (Art. 2115, Civil Code).

Real Estate Mortgage; Foreclosure of Improvements (1999)

Borrower obtained a loan against the security of a mortgage on a parcel of land. While the mortgage was subsisting, borrower leased for fifty years the mortgaged property to Land Development Company (LDC). The mortgagee was duly advised of the lease. Thereafter,

LDC constructed on the mortgaged property an office condominium.

Borrower defaulted on his loan and mortgagee foreclosed the mortgage. At the foreclosure sale, the mortgagee was awarded the property as the highest bidder. The corresponding Certificate of Sale was executed and after the lapse of one year, title was consolidated in the name of mortgagee.

Mortgagee then applied with the RTC for the issuance of a writ of possession not only over the land but also the condominium building. The mortgagee contended that the mortgage included all accessions, improvements and accessories found on the mortgaged property. LDC countered that it had built on the mortgaged property with the prior knowledge of mortgagee which had received formal notice of the lease.

a) How would you resolve the dispute between the mortgagee and LDC? (3%)

SUGGESTED ANSWER:

a. The mortgagee has a better right than LDC. The mortgage extends to the improvements introduced on the land, with the declarations, amplifications, and limitations established by law, whether the estate remains in the possession of the mortgagor or passes into the hands of a third person (Art 2127 NCC). The notice given by LDC to the mortgagee was not enough to remove the building from coverage of the mortgage considering that the building was built after the mortgage was constituted and the notice was only as regards the lease and not as to the construction of the building. Since the mortgagee was informed of the lease and did not object to it, the mortgagee became bound by the terms of the lease when it acquired the property as the highest bidder. Hence, the mortgagee steps into the shoes of the mortgagor and acquires the rights of the lessor under Art 1768 of the NCC. This provision gives the lessor the right to appropriate the condominium building but after paying the lessee half of the value of the building at that time. Should the lessor refuse to reimburse said amount, the lessee may remove the improvement even though the land will suffer damage thereby.

1st Alternative Answer:

a. The mortgagee has a better right to the building. Under Art 2127 of the NCC, the mortgage extends to all improvements on the mortgaged property regardless of who and when the improvements were introduced. LDC cannot complain otherwise, because it knew that the property it was leasing was mortgaged when it built the condominium.

2nd alternative Answer:

a. Assuming that the office condominium was duly constituted under the Condominium Law, before LDC could validly constitute the same as a condominium, it should cause to be recorded in the register of deeds of the province or city where the land is situated an enabling or master deed showing, among others, a certificate of the registered owner and of all registered holders of any lien or encumbrance on the property that they consent to the registration of the deed. (Sec 4. RA 4726). If the mortgagee gave its

consent thereto, then LDC should prevail. If no consent was given, the condominium was included in the mortgage.

b) Is the mortgagee entitled to the lease rentals due from LDC under the lease agreement? (3%)

SUGGESTED ANSWER:

b. The lease rentals belong to the mortgagor. However, the mortgage extends to rentals not yet received when the obligation becomes due and the mortgagee may run after the said rentals for the payment of the mortgage debt.

(Recommendation: Since the subject matter of these two (2) questions is not included within the scope of the Bar Questions in Mercantile Law, as it is within Civil Law, it is suggested that whatever answer is given by the examinee, or the lack of answer should be given full credit. If the examinee gives a good answer, he should be given additional credit.)

Real Estate Mortgage; Redemption Period; Foreclosed Property (2002)

Primetime Corporation (the Borrower) obtained a P10 Million, five-year term loan from Universal Bank (the Bank) in 1996. As security for the loan and as required by the Bank, the Borrower gave the following collateral security in favor of the Bank:

- 1) a real estate mortgage over the land and building owned by the Borrower and located in Quezon City;
- 2) the joint and several promissory note of Mr. Primov Timbol, the President of the Borrower; and
- 3) a real estate mortgage over the residential house and lot owned by Mr. Timbol, also located in Quezon City.

Because of business reverses, neither the Borrower nor Mr. Timbol was able to pay the loan. In June 2001, the Bank extrajudicially foreclosed the two real estate mortgages, with the Bank as the only bidder in the foreclosure sale. On September 16, 2001, the certificates of sale of the two properties in favor of the Bank were registered with the Register of Deeds of Quezon City. Ten months later, both the Borrower and Mr. Timbol were able to raise sufficient funds to redeem their respective properties from the Bank, but the Bank refused to permit redemption on the ground that the period for redemption had already expired, so that the Bank now has absolute ownership of both properties. The Borrower and Mr. Timbol came to you today, September 15, 2002, to find out if the position of the Bank is correct. What would be your answer? State your reasons (5%).

SUGGESTED ANSWER:

1 With respect to the real estate mortgage over the land and building owned by the Borrower, Primetime Corporation, a juridical body, the period of redemption is only three (3) months, which period already expired.

2 As to the real estate mortgage over the residential house and lot owned by Mr. Timbol, the period of redemption is one (1) year from the date of registration of the certificate of sale, which period has not yet expired in this case.

Real Estate Mortgage; Foreclosure (2012)

X obtained a loan for Php50Million from SSS Bank. The collateral is his vacation house in Baguio City under a real estate mortgage. X needed more funds for his business so he again borrowed another Php10Million, this time from BBB Bank, another bank, using the same collateral. The loan secured from SSS Bank fell due and X defaulted.

a. If SSS Bank forecloses the real estate mortgage, what rights, if any, are left with 888 Bank as mortgagee also? (2%)

SUGGESTED ANSWER:

a) BBB Bank, as junior mortgagee, would have a right to redeem the foreclosed property, together with X, his successors in interest, any judicial or judgment creditor of X, or any other person or entity having a lien on the vacation house subsequent to the real estate mortgage in favor of SSS Bank (i.e., other junior mortgagees, if any). (Sec. 6, Act 3135)

b. If the value of the Baguio property is less than the amount of loan, what would be the recourse of SSS Bank? BBB Bank? (2%)

SUGGESTED ANSWER:

b) In case of a deficiency, SSS Bank could file suit to claim for the deficiency. BBB Bank could file an ordinary action to collect its loan from X. If it does so, it would be deemed to have waived its mortgage lien. If the judgment in the action to collect is favorable to BBB Bank, and it becomes final and executory, BBB Bank could enforce the said judgment by execution. It could even levy execution on the same mortgaged property, but it would not have priority over the latter. (Caltex Philippines v. IAC, et al., G.R. No. 74730, August 25, 1989)

c. If the value of the property is more than the amount of the loan, who will benefit from the excess value of the property? (2%)

SUGGESTED ANSWER:

c) If the value of the property is more than the amount of the loan, the excess could benefit and be claimed by BBB Bank, any judicial or judgment creditor of X, any other junior mortgagee, and X.

d. If X defaulted with its loan in favor of BBB Bank but fully paid his loan with SSS Bank, can BBB Bank foreclose the real mortgage executed in its favor? (2%)

SUGGESTED ANSWER:

d) If X defaulted in respect of his loan from BBB Bank but fully paid his loan from SSS Bank, BBB Bank could now foreclose the mortgaged property as it would be the only remaining mortgagee of the same.

e. Does X have any legal remedy after the foreclosure in the event that later on he has the money to pay for the loan? (1%)

SUGGESTED ANSWER:

e) Yes, X could redeem the property within one (1) year from the date of registration of the sheriff's certificate of foreclosure sale.

f. If SSS Bank and BBB Bank abandon their rights under the real estate mortgage, is there any legal recourse available to them? (1%)

SUGGESTED ANSWER:

f) SSS Bank and BBB Bank could each file an ordinary action to collect its loan from X.

Real Estate Mortgage; Foreclosure (2014)

DMP Corporation (DMP) obtained a loan of P20 million from National Bank (NB) secured by a real estate mortgage over a 63,380-square-meter land situated in Cabanatuan City. Due to the Asian Economic Crisis, DMP experienced liquidity problems disenableing it from paying its loan on time. For that reason, NB sought the extra judicial foreclosure of the said mortgage by filing a petition for sale on June 30, 2003. On September 4, 2003, the mortgaged property was sold at public auction, which was eventually awarded to NB as the highest bidder. That same day, the Sheriff executed a Certificate of Sale in favor of NB.

On October 21, 2003, DMP filed a Petition for Rehabilitation before the Regional Trial Court (RTC). Pursuant to this, a Stay Order was issued by the RTC on October 27, 2003.

On the other hand, NB caused the recording of the Sheriff's Certificate of Sale on December 3, 2003 with the Register of Deeds of Cabanatuan City. NB executed an Affidavit of Consolidation of Ownership and had the same annotated on the title of DMP. Consequently, the Register of Deeds cancelled DMP's title and issued a new title in the name of NB on December 10, 2003.

NB also filed on March 17, 2004 an Ex-Parte Petition for Issuance of Writ of Possession before the RTC of Cabanatuan City. After hearing, the RTC issued on September 6, 2004 an Order directing the Issuance of the Writ of Possession, which was issued on October 4, 2004.

DMP claims that all subsequent actions pertaining to the Cabanatuan property should have been held in abeyance after the Stay Order was issued by the rehabilitation court. Is DMP correct? (4%)

(RECOMMENDATION:

This problem is outside the coverage of the 2014 Mercantile Law Bar Examination as the 2014 Syllabus for Mercantile law prepared by the Supreme Court does not include the Supreme Court Rules of Procedure on Corporate Rehabilitation. It is recommended that all examinees be given full credit whether they gave any answer or not. In any case:)

SUGGESTED ANSWER

DMP is not correct. Since the foreclosure of DMP's mortgage and the issuance of the certificate of sale in NB's favor were done prior to the appointment of a Rehabilitation Receiver and the Stay Order, all the

actions taken with respect to the foreclosed mortgage property which were subsequent to the issuance of the Stay Order were not affected by the Stay Order. Thus, after the redemption period expired without DMP redeeming the foreclosed property, NB becomes the absolute owner of the property and it was within its right to ask for the consolidation of title and the issuance of new title in its name as a consequence of ownership; thus, it is entitled to the possession and enjoyment of the property. (Equitable PCI Bank, Inc. v. DNG Realty and Development Corporation, G.R. 168672, August 8, 2010).

Real Estate Mortgage; Extrajudicial Foreclosure (2012)

X obtained a Php10Million loan from BBB Banking Corporation. The loan is secured by Real Estate Mortgage on his vacation house in Tagaytay City. The original Deed of Real Estate Mortgage for the Php10Million was duly registered. The Deed of Real Estate Mortgage also provides that "The mortgagor also agrees that this mortgage will secure the payment of additional loans or credit accommodations that may be granted by the mortgagee ... " Subsequently, because he needed more funds, he obtained another Php5Million loan. On due dates of both loans, X failed to pay the Php5Million but fully paid the Php10Million. BBB Banking Corporation instituted extrajudicial foreclosure proceedings.

a. Will the extrajudicial foreclosure prosper considering that the additional Php5Million was not covered by the registration? (5%)

SUGGESTED ANSWER:

(a) Yes. X executed a real estate mortgage containing a "blanket mortgage clause." Mortgages given to secure future advancements are valid and legal contracts, and the amounts named as consideration in said contracts do not limit the amount for which the mortgage may stand as security if from the four corners of the instrument the intent to secure future and other indebtedness can be gathered. (Prudential Back v. Alviar, G.R. No. 150197, 28 July 2005)

Real Estate Mortgage; Dragnet Clause (2012)

b. What is the meaning of a "dragnet clause" in a Deed of Real Estate Mortgage? Under what circumstances will the "dragnet clause" be applicable? (5%)

SUGGESTED ANSWERS:

(b) Generally, a dragnet clause is a clause in a deed of real estate mortgage stating that the mortgage secures all the loans and advances that the mortgagor may at any time owe to the mortgagee. The word "dragnet" is a reference to a net drawn through a river or across ground to trap fish or game. It is also known in American jurisprudence as a "blanket mortgage clause" or an "anaconda clause." A mortgage with a dragnet clause enables the parties to provide continuous dealings, the nature or extent of which may not be known or anticipated at the time,

and they avoid the expense and inconvenience of executing a new security on each new transaction. It operates as a convenience and accommodation to the borrower as it makes available additional funds to him without his having to execute additional security documents, thereby saving time, travel, costs of extra legal services, recording fees, etc. (Prudential Bank v. Alviar, id.)

The "dragnet clause" may not apply to other loans extended, by the mortgagee to the mortgagor for which other securities were given. In the case of Prudential Bank v. Alviar, the Supreme Court adopted the "reliance on the security test" to the effect that "when the mortgagor takes another loan [from the mortgagee] for which another security was given, it could not be inferred that such loan was made in reliance solely on the original security with the "dragnet clause," but, rather, on the new security given." This means that the existence of the new security must be respected and the foreclosure of the old security should only be for the other loans not separately collateralized and for any amount not covered by the new security for the new loan.

Remedies; Available to Mortgagee-Creditor (2001)

Debtor —All issued a promissory note in the amount of P10M in favor of commercial bank Y secured by mortgage of his properties worth P30M. When A failed to pay his indebtedness, despite demands made by bank Y, the latter instituted a collection suit to enforce payment of the P10M account. Subsequently, bank Y also filed foreclosure proceedings against A for security given for the account. If you were the judge, how would you resolve the two cases? (5%)

SUGGESTED ANSWER:

The case for collection will be allowed to proceed. But the foreclosure proceedings have to be dismissed. In instituting foreclosure proceedings, after filing a collection case involving the same account or transaction, bank Y is guilty of splitting a cause of action. The loan of P10M is the principal obligation while the mortgage securing the same is merely an accessory to said loan obligation. The collection of the loan and the foreclosure of the mortgage securing said loan constitute one and the same cause of action. The filing of the collection case bars the subsequent filing of the foreclosure proceedings.

Anti-Money Laundering Act

Anti-Money Laundering (2006)

Rudy is jobless but is reputed to be a jueteng operator. He has never been charged or convicted of any crime. He maintains several bank accounts and has purchased 5 houses and lots for his children from the Luansing Realty, Inc. Since he does not have any visible job, the company reported his purchases to the Anti-Money Laundering Council (AMLC). Thereafter, AMLC charged him with violation of the Anti-Money Laundering Law. Upon request of the AMLC, the bank disclosed to it Rudy's bank deposits amounting to P100 Million.

Subsequently, he was charged in court for violation of the Anti-Money Laundering Law.

1. Can Rudy move to dismiss the case on the ground that he has no criminal record? (2.5%)

SUGGESTED ANSWER:

No. Under the Anti-Money Laundering Law, Rudy would be guilty of a "money laundering crime" committed when the proceeds of an "unlawful activity," like jueteng operations, are made to appear as having originated from legitimate sources. The money laundering crime is separate from the unlawful activity of being a jueteng operator, and requires no previous conviction for the unlawful activity (See also Sec. 3, Anti-Money Laundering Act of 2001).

2. To raise funds for his defense, Rudy sold the houses and lots to a friend. Can Luansing Realty, Inc. be compelled to transfer to the buyer ownership of the houses and lots? (2.5%)

SUGGESTED ANSWER:

Luansing Realty, Inc. is a real estate company, hence it is not a covered institution under Section 3 of the Anti-Money Laundering Act. Only banking institutions, insurance companies, securities dealers and brokers, pre-need companies and other entities administering or otherwise dealing in currency, commodities or financial derivatives are covered institutions. Hence, Luansing Realty, Inc. may not use the Anti-Money Laundering Act to refuse to transfer to the buyer ownership of the houses and lots.

3. In disclosing Rudy's bank accounts to the AMLC, did the bank violate any law? (2.5%)

SUGGESTED ANSWER:

No, the bank did not violate any law. The bank being specified as a "covered institution" under the Anti-Money Laundering Law, is obliged to report to the AMLC covered and suspicious transactions, without thereby violating any law. This is one of the exceptions to the Secrecy of Bank Deposit Act.

4. Supposing the titles of the houses and lots are in possession of the Luansing Realty, Inc., is it under obligation to deliver the titles to Rudy? (2.5%)

SUGGESTED ANSWER:

Yes, it has an obligation to deliver titles to Rudy. As Luansing Realty, Inc. is not a covered institution under Section 3 of the Anti-Money Laundering Act, it may not invoke this law to refuse delivery of the titles to Rudy.

Anti-Money Laundering (2015)

A. On the anti-money laundering laws:

1. What is the distinction between a "covered transaction report" and a "suspicious transaction report"? (2%)

SUGGESTED ANSWER:

A covered transaction report involves transaction/s in cash or other equivalent monetary instrument involving a total amount in excess of

P500,000 within one banking day while suspicious transaction report involves transactions with covered institutions regardless of the amounts involved made under any of the suspicious circumstances enumerated by law.

2. Does the Anti-Money Laundering Council have the authority to freeze deposits? Explain. (2%)

SUGGESTED ANSWER:

No. The authority to freeze deposits is lodged with and based upon the order of the Court of Appeals (Section 10 of RA 9160 as amended).

Anti-Money Laundering: Predicate Crimes (2007)

Name at least five predicate crimes to money laundering. (5%)

SUGGESTED ANSWER:

Any five of the following are predicate crimes to money laundering:

- (1) Kidnapping for ransom under Article 267 of Act No.3815, otherwise known as the Revised Penal Code, as amended;
- (2) Sections 3,4,5,7,8 and 9 of Article Two of Republic Act No. 6425, as amended, otherwise known as the Dangerous Drugs Act of 1972;
- (3) Section 3 paragraphs B,C,E,G,H and I of Republic Act No. 3019, as amended; otherwise known as the Anti-graft and Corrupt Practices Act;
- (4) Plunder under Republic Act No. 7080, as amended;
- (5) Robbery and extortion under Articles 294,295,296,299,300,301 and 302 of the Revised Penal Code, as amended;
- (6) Jueteng and Masiao punished as illegal gambling under Presidential Decree No. 1602;
- (7) Piracy on the high seas under the Revised Penal Code, as amended and Presidential Decree No. 532;
- (8) Qualified theft under Article 310 of the Revised Penal Code, as amended; (9) Swindling under Article 315 of the Revised Penal Code, as amended.
- (9) Swindling under 315 of the Revised Penal code, as amended;
- (10) Smuggling under Republic Act Nos. 455 and 1937
- (11) Violations under Republic Act No. 8792, otherwise known as the Electronic Commerce Act of 2000
- (12) Hijacking and other violations under Republic Act No 6235;destructive arson and murder, as defined under the Revised Penal Code, as amended, including those perpetrated by terrorist against non-combatant persons and similar targets;
- (13) Fraudulent practices and other violations under Republic Act No. 8799, otherwise known as the securities Regulation Code of 2000
- (14) Felonies or offenses of a similar nature those are punishable under the penal laws of other

countries. (Sec 3, Anti-Money Laundering Act of 2001).

Anti-Money Laundering; Authority to Inquire Into Bank Deposits; Freeze Order (2013)

From his first term in 2007, Congressman Abner has been endorsing his pork barrel allocations to Twin Rivers in exchange for a commission of 40% of the face value of the allocation. Twin Rivers is a non-governmental organization whose supporting papers, after audit, were found by the Commission on Audit to be fictitious. Other than to prepare and submit falsified papers to support the encashment of the pork barrel checks, Twin Rivers does not appear to have done anything on the endorsed projects and Congressman Abner likewise does not appear to have bothered to monitor the progress of the projects he endorsed. The congressman converted most of the commissions he generated into US dollars, and deposited these in a foreign currency account with Banco de Plata (BDP).

Based on amply-supported tips given by a congressman from another political party, the Anti-Money Laundering Council sent BDP an order: (1) to confirm Cong. Abner's deposits with the bank and to provide details of these deposits; and (2) to hold all withdrawals and other transactions involving the congressman's bank accounts.

As counsel for BDP, would you advise the bank to comply with the order? (8%)

SUGGESTED ANSWER:

I shall advise Banco de Plata not to comply with the order of the Anti-Money Laundering Council. It cannot inquire into the deposits of Congressman Abner, regardless of currency, without a bank inquiry order from a competent court, because crimes involved are not kidnapping for ransom, violations of the Comprehensive Dangerous Drugs Act, hijacking and other violations of Republic Act No. 6235, destructive arson, murder, and terrorism and conspiracy to commit terrorism (Section 11 of Anti-Money Laundering Act).

The Anti-Money Laundering Council cannot order Banco de Plata to hold all withdrawals and other transactions involving the accounts of Congressman Abner. It is the Court of Appeals which has the power to issue a freeze order over the accounts upon petition of the Anti-Money Laundering Council (*Anti-Money Laundering Act; Republic v. Cabrini Green Ross, 489 SCRA 644, 2006*).

MISCELLANEOUS

Energy Regulatory Commission: Jurisdiction & Power (2004)

CG, a customer, sued MERALCO in the MM Regional Trial Court to disclose the basis of the computation of the purchased power adjustment (PPA). The trial court ruled it had no jurisdiction over the case because, as contended by the defendant, the customer not only demanded a breakdown of MERALCO's bill with respect to PPA but questioned as well the imposition of the PPA, a matter to be decided by the Board of Energy, the regulatory agency which should also have jurisdiction over the instant suit. Is the trial court's ruling correct or not? Reason briefly. (5%)

SUGGESTED ANSWER:

The trial court's ruling is correct. As held in *Manila Electric Company v. Court of Appeals*, 271SCRA 417 (1997), the Board of Energy had the power to regulate and fix power rates to be charged by franchised electric utilities like MERALCO. In fact pursuant to Executive Order No. 478 (April 17, 1998), this power has been transferred to the Energy Regulatory Board (now the Energy Regulatory Commission). Under Section 43(u) of the Electric Power Industry Reform Act of 2001, the Energy Regulatory Commission has original and exclusive jurisdiction over all cases contesting power rates.

Government Deregulation vs. Privatization of an Industry (2004)

What is the difference between government deregulation and the privatization of an industry? Explain briefly. (2%)

SUGGESTED ANSWER:

Government deregulation is the relaxation or removal of regulatory constraints on firms or individuals, with a view to promoting competition and market-oriented approaches toward pricing, output, entry, and other related economic decisions. Privatization of an industry refers to the transfer of ownership and control by the government of assets, firms and operations in an industry to private investors.

Power of the State: Regulating of Domestic Trade (2004)

In its exercise of police power and business regulation, the legislature of LVM State passed a law prohibiting aliens from engaging in domestic timber trade. Violators including dummies would, after proper trial, be fined and imprisoned or deported. Mrs. BC, a citizen of LVM but married to ZC, an alien merchant of PNG, filed suit to invalidate the law or exempt from its coverage their timber business. She contended that the law is, inter alia, gravely oppressive and discriminatory. It violated the Universal Declaration of Human Rights (UDHR) passed in 1948 by the United Nations, of which LVM is a member, she said, as well as the reciprocity provisions of the World Trade Organization (WTO) Agreement of 1994, of which PNG and LVM are parties. Aside from denying them equal protection, according to BC, the law will also

deprive her family their livelihood without due process nor just compensation. Assuming that the legal system of LVM is similar to ours, would Mrs. BC's contention be tenable or not? Reason briefly. (5%)

SUGGESTED ANSWER:

Mrs. BC's contention is not tenable. First, the UDHR does not purport to limit the right of states (like LVM) to regulate domestic trade. Second, the WTO Agreement involves international trade between states or governments, not domestic trade in timber or other commodities. Third, nationality is an accepted norm for making classifications that do not run counter to the equal protection of law clause of the Constitution. Fourth, there is no impairment of due process here because violators of the law will be punished only after "proper trial." Fifth, the issue of "just compensation" does not arise, because the property of Mrs. BC is not being expropriated. On the contrary, as a citizen of LVM, Mrs. BC is freely allowed to engage in domestic timber trade in LVM.

Tariff and Customs Code: Violation of Customs Laws (2004)

The Collector of Customs ordered the seizure and forfeiture of new electronic appliances shipped by TON Corp. from Hongkong for violation of customs laws because they were falsely declared as used office equipment and then undervalued for purposes of customs duties. TON filed a complaint before the MM Regional Trial Court for replevin, alleging that the Customs officials erred in the classification and valuation of its shipment, as well as in the issuance of the warrant of seizure. The Collector moved to dismiss the suit for lack of jurisdiction on the part of the trial court. Should the Collector's motion be granted or denied? Reason briefly. (5%)

SUGGESTED ANSWER:

The Collector's motion should be granted. Under Section 602(g) of the Tariff and Customs Code, the Bureau of Customs has exclusive original jurisdiction over seizure and forfeiture cases under the tariff and customs laws. NOTE: (This question is outside the coverage of the Bar Examinations. It is therefore recommended that whatever answer made by the candidate should be given full credit.)

Four ACID Problems of Philippine Judiciary (2006)

In several policy addresses extensively covered by media since his appointment on December 21, 2005, Chief Justice Artemio V. Panganiban vowed to leave a judiciary characterized by "four Ins" and to focus in solving the "four ACID" problems that corrode the administration of justice in our country. Explain this "four Ins" and "four ACID" problems.

SUGGESTED ANSWER:

Upon assuming his office, Chief Justice Panganiban vowed to lead a judiciary characterized by the "four Ins:" Integrity, Independence, Industry and Intelligence; one that is morally courageous to resist influence, interference, indifference and insolence. He envisions a judiciary that is impervious to the

plague of undue influence brought about by kinship, relationship, friendship and fellowship. He calls on the judiciary to battle the "Four ACID" problems corroding our justice system:

(1) limited access to justice by the poor;

(2) corruption;

(3) incompetence; and

(4) delay in the delivery

of quality judgments. The judicial department should discharge its functions with transparency, accountability and dignity.

(NOTA BENE: It is respectfully suggested that all Bar Candidates receive a 2.5% bonus for the above question regardless of the answer)

2. The Chief Justice also said that the judiciary must "safeguard the liberty" and "nurture the prosperity" of our people. Explain this philosophy. Cite Decisions of the Supreme Court implementing each of these twin beacons of the Chief Justice. (2.5%)

SUGGESTED ANSWER:

The Chief Justice's philosophy "Safeguarding Liberty, Nurturing Prosperity" embodies the Supreme Court's approach in decision-making in the exercise of its constitutional power of judicial review which provides: In cases involving liberty, the scales of justice should weight heavily against government and in favor of the poor, the oppressed, the marginalized, the dispossessed and the weak; and that laws and action that restrict fundamental rights come to the court "with a heavy presumption against their constitutional validity. On the other hand, as a general rule, the Supreme Court must adopt a deferential or respectful attitude towards actions taken by the governmental agencies that have primary responsibility for the economic development of the country; and only when an act has been clearly made or executed with grave abuse of discretion does the Court get involved in policy issues. Decisions implementing the "safeguarding of liberty" include those involving the constitutionality of Presidential Proclamation No. 1017 (*David v. Arroyo*, G.R. No. 171390, May 3, 2006); the validity of *Calibrated Pre-emptive Response (CPR)* and *B.P. Big. 880* or the *Public Assembly Act* (*Bayan v. Ermita*, G.R. No. 169848, April 25, 2006); and the legality of *Executive Order No. 464* and the President's exercise of *Executive Privilege* (*Senate of the Philippines v. Ermita*, G.R. No. 169777, April 20, 2006).

On the other hand, cases that relate to "nurturing the prosperity" of the people include the question the constitutionality of the Mining Law (*La Bugal-B'Laan v. Ramos*, G.R. No. 127882, Dec. 1, 2004) and the WTO Agreement (*Tanada v. Angara*, G.R. 118295, May 2, 1997).