THE LEGAL FRAMEWORK WITHIN WHICH BUSINESS IN THE PHILIPPINES OPERATES

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PART I

INTRODUCTION

Law directly affects business and businessmen. A sane business promotes sound economy. An oppressive business law may lead to econo stagnancy, if not economic ruin. Law and business must know each ot

There are many laws affecting business in the Philippines. W the exception of the laws on *"sociedades anónimas"*, pledge, loans, gen law on contracts, and a few others which are of Spanish origin, all present business laws in the Philippines are of American source, with so changes or amendments to suit local requirements.

Laws on taxation, tariffs, labor, rights and liabilities of alien invest and many others cut across the business motive. More fundamental th these are the laws regulating the form of business organizations permissi under exsiting laws, the extent of the powers which may be exercised a all incidents connected therewith, as well as the different methods of d solution and liquidation when the time to quit comes. Validity of busine contracts, legal effects of credit transactions, including those arising fro sales, agency, loans, chattel and real estate mortgages, preferences of credi the use of promissory notes, checks and other negotiable instruments, th legal effects of insurance contracts, of contracts of transportation by lan sea, and air, including bills of lading, warehouse receipts, and even th legal aspects of insolvency, are matters of interest to every man of busines

In order to encourage businessmen to establish industries which wil accelerate the economic development of the country and conserve an increase its foreign exchange reserves, the Congress has enacted certai incentive laws, such as the tax-exemption laws and the Basic Industrie Act which will be discussed more fully later. Several foreign investmen bills have also been filed to attract foreign capitalists to invest in the Philippines, and the fact that up to now no such law has been passed is not indicative of general opposition to the idea but is rather due to differences of opinion as to the proper areas or field of investments which shall be open to alien investors.

All these and other related laws constitute the legal framework under which business in the Philippines may properly operate.

METHODS OF TRANSACTING BUSINESS IN THE PHILIPPINES

Ordinarily, there are three methods of doing business in the Philippines: The single proprietorship, the partnership, and the private corporation. Other types of business organizations which may be availed of are the joint-account, the joint-stock company, the business trust, and the *"sociedad anónima."*

The joint-account or *"cuentas en participación"* and the anonymous partnership or *"sociedad anónima"* are provided for in the Code of Commerce.[1] The business trust may follow the pattern of an Amercian "Massachussetts trust" or may be organized under the general provisions on "Trusts" in the Civil Code.[2] The joint-stock company is not expressly provided by Philippine law, but it may be organized under the general provisions of the law on contracts of the Civil Code.

The joint-account or *"cuentas en participación"* is neither a partnership nor a corporation; it is merely a business venture established between two or more businessmen interested in a common business transaction, without creating a juridical entity. Under the law, only the designated manager of the joint-account may sue and be sued in his personal capacity for transactions made by the said business venture. The law does not prescribe any legal formalities in organizing such kind of business association.

The anonymous partnership or *"sociedad anónima"* was formerly the common form of business association in the Philippines prior to the adoption of the present Corporation Law, Act No. 1459.[3] It is the Spanish type of private corporation which possesses the characteristics of both a partnership and a corporation. It is similar to a partnership because it is created by mere agreement of the parties; but it is also similar to a private corporation because its capital stock is represented by transferable shares. But, it is neither exactly a partnership nor a corporation as these entities are known under Philippine law.

The *"sociedad anónima"* is no longer allowed to be organized by virtue of Section 191 of the present Corporation Law. However, *"sociedades*

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[1] Our present Code of Commerce is the Spanish Code of August 22, 1885 which took effect in Spain on Jan. 1, 1886, which was extended to the Philippines by the Spanish Royal Decree of August 6, 1888 and became effective on December 1, 1888.

[2] See Arts. 1440-1457, new Civil Code, effective August 30, 1950.

[3] The Corporation Law took effect on April 1, 1906.

anónimas" already existing and duly organized at the time the Corporation Law took effect

> "which elect to continue their business as such "*sociedades anónimas*" instead of reforming and reorganizing under and by virtue of the provisions of this Act (Corporation Law) shall continue to be governed by the laws that were in force prior to the passage of this Act (Corporation Law) in relation to their organization and method of transacting business and to the rights of members thereof between themselves, but their relations to the public and public officials shall be governed by the provisions of this Act" (Corporation Law).

In the case of *Benguet Consolidated Mining Co. v. Pineda,*[4] the majority of the members of the Supreme Court held that the above provisions of the Corporation Law prohibit the extension of the term of "*sociedades anónimas*" on the alleged ground that it is a matter which affects its "relation to the public and public officials", and is therefore governed by Section 18 of the Corporation Law which prohibits the extension of terms of private corporations beyond the term as "originally stated" in the articles.

The dissenting opinion in the above-cited case seems to be more in harmony with sound business policy and with the intent and purpose of the law. "*Sociedades anónimas*" are legitimate business organizations and are at present being encouraged in many South American countries. Our fundamental law, the Constitution of the Philippines, provides that "the right to form associations or societies for purpose not contrary to law shall not be abridged."[5] The Corporation Law itself expressly authorizes an existing and lawfully organized "*sociedad anónima*" *to continue* transacting business as such, in whch case the Code of Commerce shall also continue to apply. And the Code of Commerce does not prohibit, but on the contrary impliedly allows extension of terms of "*sociedades anónimas*" inasmuch as this kind of business associations are merely created by mere agreement of the parties. Moreover, extending the term of a business enterprise is evidently a matter that concerns the "rights of members thereof as between themselves". The Supreme Court could have reasonably and legally decided that "*sociedades anónimas*" lawfully organized at the time the Corporation Law took effect could continue to do business as such and extend their term should they wish to. The opinion of the majority of the members of the Supreme Court in this regard constitutes an undue limitation on the right of citizens to choose the form of business organization they deem wise to adopt. Form of business organization is an internal affair. The state should not concern itself with mere "forms" of business organizations. So long as the association is not organized for immoral purposes, the form of business organization is of secondary importance to the State.

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[4] 52 O. G. 1961 (1956).
[5] Art. III, Sec. 1(6), Constitution of the Philippines.

THE SINGLE PROPRIETORSHIP

The simplest form of doing business is the single proprietorship. It is a business carried on and owned by a single individual, in his own name and for his own account, requiring no legal formalities or technicalities, except that if the individual would prefer to transact business by adopting a business name distinct from his own name he should register such business name in the Bureau of Commerce pursuant to the Business names Act.[5a]

If the business is to be carried on by two or more persons, combining their industry and/or capital, it may be organized in the form of a partnership or a private corporation. If a partnership, it must be established in accordance with the provisions of the Civil Code; if a private corporation, it must be organized in accordance with the provisions of the Corporation Law, Act No. 1459 as amended.

THE PARTNERSHIP

A partnership may lawfully be organized without any written contract, unless: (a) the partnership capital, in money or property, is ₱3,000 or more; or (b) where the contribution of any of the partners consists of real property; or (c) the partnership established is a limited partnership in form.

When the partnership capital, in money or property, amounts to ₱3,000 or more, the partnership contract must appear in a public instrument and duly registered in the Securities & Exchange Commission. However, failure to comply with this formal requirement "shall not affect the liability of the partnership and the members thereof to third persons."[6] This means that such partnership which failed to comply with the law regarding proper organization shall, nevertheless, be sued for its transactions, but shall have no right to sue third persons for enforcing its rights as a partnership. In other words, a partnership that failed to comply with the law regarding proper organization shall be prejudiced in the exercise of its rights against third persons, but shall not prejudice third persons in the exercise of their rights against the said partnership for transactions done in good faith. This doctrine is based on the principle that "no one shall enrich himself at the expense of another", or on the doctrine of estoppel or of actual or apparent partnership as provided for in Art. 1825 of the Civil Code.

A partnership may be established with or without a fixed term. Unlike a private corporation which may not be incorporated for more than 50 years[7], a partnership may be established indefinitely, unless it is sooner dissolved in accordance with law.

[5a] Act No. 3883, as amended by Act No. 4147 and R.A. No 863.
[6] Art. 1772, Civil Code.
[7] Except life insurance corporations which may extend its term once for another 50 years. (R.A. No. 1932).

And the *dissolution of a partnership (general)* is caused by: (a) the voluntary will of any or all of the partners; (b) the termination of the definite term or particular undertaking specified in the contract of partnership; (c) the bona fide expulsion of any partner from the partnership pursuant to a power conferred on the partners by the contract of partnership; (d) an event which makes it unlawful for the business of the partnership to be carried on or for the members to carry on in partnership; (e) the loss of any specific thing contributed or to be contributed before the partnership acquires title thereto; (f) the death of any partner; (g) the insolvency of any partner or of the partnership; (h) a judicial decree of dissolution for any of the causes provided by law.[8]

The above causes of dissolution of a general partnership equally apply to a *limited partnership,* except that the partner in a limited partnership who withdraws, dies, becomes insolvent or insane or is given a sentence of civil interdiction, must be a *general partner.*[9]

Some *legal problems regarding partnerships* may now be discussed.

As already stated, the termination of the term fixed in the contract of partnership dissolves the partnership. However, notwithstanding the termination of the term, if the partners should continue the business without any express agreement, the life of the partnership is deemed impliedly extended; this means that the partnership shall be deemed a partnership at will (i.e., a partnership without a fixed term), and the partners' rights and liabilities shall remain the same as they were at such termination.[10]

Also, the partners or some of them may expressly extend the life of the partnership and continue the business notwithstanding its dissolution by operation of law. For instance, the death of a general partner dissolves the partnership, but the remaining partners may continue the business (unless the partnership is a limited partnership and the partner who dies is the sole and only general partner in the partnership, or, unless, the dissolution is due to a legal impossibility to continue the business, as for instance a partnership established to engage in retail trade originally composed of aliens which was lawful at the time the partnership was organized but which, upon the enactment of the Nationalization Retail Trade Law[11], cannot be continued by the remaining partners).

Partnership dissolution may come under any of the following classes: (a) voluntary dissolution; (b) involuntary dissolution; (c) judicial dissolution; (d) extrajudicial dissolution.

[8] Art. 1830, Civil Code.
[9] Art. 1860, Civil Code.
[10] Art. 1785, Civil Code.
[11] R.A. No. 1180.

One of the causes for judicial dissolution is when the business of the partnership can only be carried on at a loss.[12] On application by or for a partner, the court, if such fact is proven, may decree dissolution. However, the law also provides that "if there is no agreement to the contrary, in case of an imminent loss of the business of the partnership, any partner, except an industrial partner who refuses to contribute an additional capital to save the venture, shall be obliged to sell his interest to the other partners."[13] By reason of this legal provision, the partner (who is not an industrial partner) who files a suit for judicial dissolution may, on the other hand, be challenged by the remaining partners who believe in continuing the business to contribute an additional capital equally with the other partners, and should he refuse to do so, the partner asking for dissolution on the ground that the partnership can be carried on only at a loss, may be compelled by the court to sell his interest to the remaining partners.

With respect to *partnership management,* the law allows two or more partners to be designated managers. In this connection, a problem may arise as to the correct meaning of Art. 1801 of the Civil Code which provides as follows:

> "If two or more partners have been intrusted with the management of the partnership without specification of their respective duties or without a stipulation that one of them shall not act without the consent of all the others, each one may separately execute all acts of administration, but if any one of them should oppose the acts of the others, the decision of the majority shall prevail. In case of a tie, the matter shall be decided by the partners owning the controlling interest."

The important question in connection with the above-quoted legal provision is: To what do the word "majority" and the expression "partners owning the controlling interest" refer? Do they refer to *all the partners* in the partnership or only to the *managing partners?*

In the absence of a Supreme Court decision, "majority" and "partners owning the controlling interest" should be understood to refer only to managing partners. This conclusion is justified by the legal provision itself. It must be noted that Art. 1801 of the Civil Code is speaking of "managing partners." It says: "If two or more partners have been instrusted with the management. . . ." In plain language, the subject of the article is "managing partners". Consequently, Art. 1801 should read as follows:

> *"If two or more partners have been intrusted with the management of the partnership* without specification of their respective duties or without a stipulation that one of them shall not act without the

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[12] Art. 1831, No. (5), Civil Code.
[13] Art. 1791, Civil Code.

consent of all the others, each one may separately execute all acts of administration, but if any of them should oppose the acts of the others, the decision of the majority (*of them*) shall prevail. In case of a tie, the matter shall be decided by the (*managing*) partners owning the controlling interest."

One of the fundamental principles in partnership is, that where no one has been designated manager, then all the partners individually are authorized to act as managers;[14] and the reverse is true, where someone has especially been designated manager in the articles of partnership, he alone can manage the partnership and he "may execute all acts of administration despite the opposition of his partners, unless he should act in bad faith; and his power is irrevocable without just and lawful cause."[15]

Consequently, if there are 5 partners in a partnership – A, B, C, D, and E – A and B have been designated managers without specifying their respective powers, each of the managing partners may separately execute all acts of administration, but if any of them should oppose the act of the other, then the question shall be resolved by the majority of the *managing partners;* but where, as in the instant case, there are only two managing partners, the matter shall be decided by that *managing partner owning the "controlling interest."* The words "controlling interest" should be understood to mean not the greater investment but the greater share in the profits and surplus as defined in the Civil Code.[16] It does not seem logical that management in the partnership should be made to jump from one body of persons to another. As stated heretofore, the partner or partners specially designated manager or managers in the articles of partnership shall preclude all others not so designated in the partnership management.

Another problem on partnership refers to the liability of an industrial partner and a capitalist partner for engaging in business without permission.

Article 1789 of the Civil Code provides that if an *industrial partner* engages in any business for himself without the express permission of the partnership, the capitalist partners may either: (a) exclude the industrial partner from the partnership, or (b) avail "themselves" of the benefits which the industrial partner may have obtained in violation of the law, with a right to damages in either case. The word "themselves" in this legal provision evidently refers only to the "capitalist partners"; which means, therefore, that the profits realized by an industrial partner who engages in private business for himself will be shared only between or among the *capitalist partners,* notwithstanding the fact that there may be other industrial partners in the partnership who may not be guilty of violating the law. The law on partnership unreasonably presumes that in

[14] Art. 1803, Civil Code.
[15] Art. 1800, Civil Code.
[16] Art. 1812, Civil Code.

every partnership there is only one industrial partner; but where there are two industrial partners and only one of them violated the law, why should only the "capitalist partners" share in the profits earned by the defaulting industrial partner? Article 1770 of the Civil Code expressly provides that a partnership "must be established for the common benefit or interest of the partners." Such a legal provision (Art. 1789) which favors only the capitalist partners in enjoying the benefits is contrary to the fundamental idea of a partnership.

On the other hand, when a *"capitalist partner"* engages in business of the same kind in which the partnership is engaged without the express permission of the partnership, Art. 1808 of the Civil Code provides that said capitalist partner is obliged to bring to the *common funds* any profits accruing to him from his transaction. In other words, all the partners (including even the defaulting capitalist partner) shall share in common the profits so obtained. This legal distinction sounds unfair and discriminatory. The equality of the partners is the law of partnership as may be seen from certain provisions of the Civil Code.[17]

However, the present law on partnership has improved the rules regarding the sharing by the partners in the profits and losses.

Sharing in the profit and losses in a partnership is governed by the following rules:

1. The profits and losses shall be distributed in accordance with the stipulation, if there is any.

2. In the absence of stipulation, the share of each partner in the profits and losses shall be in proportion to what each may have contributed, but the industrial partner shall not be liable for losses. As for the profits, the industrial partner shall receive a share as may be just and equitable under the circumstances.

3. The share of each partner in the profits and losses may also be made in accordance with the decision of a third person appointed by common consent.

Although sharing in the profits and losses shall be made in accordance with whatever may have been stipulated by the partners, yet any stipulation which excludes any partner from sharing in the *profits* or which exempts any capitalist partner from sharing in the *losses is void.*[18] If there is a stipulation excluding any partner from the profits or a capitalist partner from the losses, Rule No. 2 shall govern the sharing in the profits and in the losses.

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[17] See Arts. 1767, 1799, 1770.
[18] Art. 1799, Civil Code.

It is also possible that the stipulation might have been made only as to sharing in the profits but is silent as regards sharing in the *losses*. In such case, the share of each in the losses shall be in the same proportion as that agreed upon in the profits.[19]

The law did not provide any rule as to how the partners shall share in the profits if the stipulation refers only to sharing in the losses. The reason for this silence is due to the fact that partnerships are always established to obtain profits and it is rather unusual that partners should be more concerned about sharing in the losses than about sharing in the profits. But sometimes the unusual stipulation is stipulated nevertheless; then in such case, how shall the partners share in the profits? In such event, it is submitted that Rule No. 2 shall apply. Inasmuch as there is no stipulation regarding sharing in the profits, the partners shall share in the profits in proportion to their respective contributions but the industrial partner shall share in the profits as may be just and equitable and in the losses as stipulated. An industrial partner is exempt from the losses only in the absence of stipulation as to sharing in the losses.

The partner's obligation to *share in the losses* of the partnership should not be confused wth the partners' *liability for losses* of the partnership incurred in favor of third persons. The first may be governed by stipulation, but the second is always governed by law. Hence, while an industrial partner is exempt from sharing in the losses in the absence of stipulation regarding sharing in the profits and losses, the same industrial partner, insofar as the partnership debts or losses to third persons are concerned, is always liable *pro rata* for the debts of the partnership.[20] "Pro rata" liability as provided by law must be understood to mean "joint liability", as distinguished from "solidary liability."[21]

Joint liability is the general rule in partnerships. However, in the following cases, a partner is liable *"in solidum"* for partnership debts or liabilities:

1. Where, by a wrongful act of any managing partner, loss or injury is caused to any third person.

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

3. Where the partnership in the course of its business receives money or property of a third person and the money or property so received is misapplied by any partner while it is in the custody of the partnership.[22]

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[19] Art. 1797, Civil Code.
[20] Art. 1816, Civil Code.
[21] Co-Pitco v. Yulo, 8 Phil. 544 (1907).
[22] Arts. 1822, 1823, and 1824, Civil Code.

Act No. 1459, as amended, otherwise known as the Corporation Law, governs business corporations in the Philippines. Unlike a partnership, a private corporation is created not by mere agreement. While a partnership may be created by the signing of the articles of partnership by the partners, a corporation does not acquire juridical personality until a certificate of incorporation is issued to the incorporators by the Securities & Exchange Commission.[23] Again, while a partnership may be formed by two or more persons, a corporation requires at least five incorporators, a majority of whom must be residents of the Philippines.[24]

The articles of incorporation, which must be signed and sworn to by the required number of incorporators must be filed with the Securities & Exchange Commission, and must contain the following:

1. The name of the corporation.

2. The purpose or purposes for which the corporation is formed.

3. The place where the principal office is to be established, which place must be within the Philippines.

4. The names and residences of the incorporators.

5. The number of directors, not less than 5 nor more than 11 in the case of ordinary stock corporations.

6. In the case of stock corporations, the amount of its capital stock in lawful money of the Philippines, the number and classes of shares into which it is divided, the amount of capital stock actually subscribed and the names and residences of the subscribers, as well as the amount subscribed by each and the sum paid by each on his subscription.

The Securities & Exchange Commission shall not file articles of incorporation of any stock corporation unless accompanied by a sworn statement of the treasurer elected by the subscribers showing that "at least 20% of the subscription has been either paid to him in actual cash for the benefit and to the credit of the corporation, or that there has been transferred to him in trust and received by him for the benefit and to the credit of the corporation property the fair valuation of which is equal to 25% of the subscription."[25]

Contrary to the common belief and general practice, each subscriber need not pay 25% of his individual subscription; it is sufficient if 20% of the *entire capital stock* has been subscribed and at least 25% of such subscribed capital stock has been paid by any or some of the subscribers. Those subscribers who did not make any or full payment of their subscriptions

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[23] Sec. 11, Act No. 1459, as amended.
[24] Sec. 6, Act No. 1459, as amended.
[25] Sec. 9, Act No. 1459, as amended.

will be liable to pay interest on their unpaid subscriptions at the rate 6% per annum from the date of subscription, "unless otherwise provid in the by-laws." The legal provision "unless otherwise provided in t by-laws" had been erroneously interpreted in some quarters[26] to mean "unle otherwise *exempted* in the by-laws." There is a great difference betwe "unless otherwise provided" and "unless otherwise exempted." "Unle otherwise provided" means "unless a higher rate of interest than 6% prescribed in the by-laws". The law could not have intended to give t corporation the right to exempt in the by-laws the liability to pay intere on unpaid subscriptions; otherwise, there will be no incentive on the pa of the subscribers to pay their subscriptions in full at the time of subscri tion as there will be no advantage in so paying in the presence of suc a by-law. The Corporation Law also provides that unpaid subscriptio shall be subject to calls and declaration of stock delinquency, and deli quent stock shall be liable for *accrued interest* from the date of subscriptio That the accrued interest may not legally be dispensed with by the b laws may also be inferred from the following provision of the Corporatio *Law:*

> "On the day and at the place and hour of sale specified in the notices of delinquency and sale of stock for unpaid subscriptions the secretary or clerk shall, unless otherwise ordered by the board of directors, sell or cause to be sold at public auction, to the highest bidder, for cash so many shares of the stock described in the notices as may be necessary to pay the amount due on the subscription, with *interest accrued,* expenses of advertising and costs of sale."[27]

As to corporations formed for the operation of *public utilities,* the Constitution of the Philippines provides that *"no franchise, certificate, or any other form of authorization* for the operation of a public utility shall *be granted except to citizens of the Philippines* or to corporations or other entities organized under the laws of the Phlippines 60% of the capital of which is owned by citizens of the Philippines, nor shall such franchise, certificate, or authorization be exclusive in character or for a longer period than 50 years. . . ."[28]

In *People v. Quasha,*[29] the Supreme Court held that a private corporation for the purpose of engaging in the operation of a public utility may be incorporated even if 60% of its capital stock is not owned by citizens of the Philippines, so long as *at the time of operation* the requirements of the Constitution regarding the 60% capital stock ownership have been complied with. The decision makes the distinction between the right to incorporate

[26] See Velasco v. Poizat, 37 Phil. 802 (1918).
[27] See Sec. 43, Act No. 1459, as amended. See also Secs. 38, 39, 42, 44, *Ibid.*
[28] Art. XIV, Sec. 8, Constitution.
[29] 49 O.G. 2826 (1953).

and the right to operate or transact corporate business. Assuming the correctness of this decision, it must not be unnecessarily extended to cases other than the operation of a *public utility*. Thus, corporations organized for the conservation and utilization of the country's natural resources may not be legally incorporated if less than 60% of this capital are owned by citizens of the Philippines as may be clearly seen from the following constitutional provision:

> "All agricultural, timber, and mineral lands of the public domain, waters, minerals, coal, petroleum, and other mineral oils, all forces of potential energy, and other natural resources of the Philippines belong to the State, and their disposition, exploitation, development, or utilization shall be limited to citizens of the Philippines, or to corporations or associations at least 60% of the capital of which is owned by such citizens, subject to any existing right, grant, lease, or concession at the time of the inauguration of the Government established under this Constitution."[30]

The Ordinance appended to the Constitution, however, must be taken into account as regards the special privileges granted to citizens of the United States, which reads as follows:

> "Notwithstanding the provisions of Section 1, Article XIII, and Section 8, Article XIV, of the foregoing Constitution, during the effectivity of the Executive Agreement[31] entered into by the President of the Philippines with the President of the United States on the fourth of July, 1946, pursuant to the provisions of Commonwealth Act No. 733, but in no case to extend beyond the third of July, 1974, the disposition, exploitation, development, and utilization of all agricultural, timber, and mineral lands of the public domain, waters, minerals, coal, petroleum, and other mineral oils, all forces of potential energy, and other natural resources of the Philippines and the operation of public utilities, shall, if open to any person, be open to citizens of the United States in the same manner as to, and under the same conditions imposed upon, citizens of the Philippines or corporations or associations owned or controlled by citizens of the Philippines."

It must also be noted that the Constitution uses the phrase "60% of the *capital stock*" with respect to the operation of public utilities, and "60% of the capital" with respect to the conservation and utilization of natural resources. Strictly speaking, there is a distinction between "capital stock" and "capital". But, for purposes of this Constitutional provision, the above terms "capital stock" and "capital" must be understood to mean *"issued or outstanding capital stock"*, inasmuch as ownership of stock may only be determined by the issuance and registration thereof in the corporate books. Hence, corporations engaged in the exploitation, development, and utilization

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[30] Art. XIII, Sec. 1, Constitution.
[31] Otherwise known as the U.S.-P.I. Trade Agreement of 1946, as revised by the so-called Laurel-Langley Agreement of 1956.

of the country's natural resources and in the operation of public utilities must have at least 60% of their *outstanding capital stock* owned by citizens of the Philippines (except that American citizens shall enjoy in this regard the same rights and privileges of Filipino citizens until July 3, 1974.)

Subject to constitutional provisions, *foreign corporations* may transact business in the Philippines by registering with the Securities & Exchange Commission. An unregistered foreign corporation transacting business in the Philippines shall not maintain by itself or assignee any suit for the recovery of any debt, claim, or demand whatever.[32] However, the failure of a foreign corporation to register and obtain the necessary license to transact business in the Philippines shall only deprive the same corporation of juridical personality for the purpose of suing but shall not prejudice residents of the Philippines in suing the foreign corporation for transaction done while unregistered.

However, as regard violation of patents and trademarks of an unregistered foreign corporation by residents of the Philippines, the foreign corporation may sue, whether or not it has been licensed to do business in the Philippines, so long as the following requisites exist: (a) that the patent or trade-mark has been registered under the Philippine Patent and Trade-Mark Law[33]; and (b) that the country of which the foreign corporation was incorporated, by treaty, convention, or law, grants a similar privilege to juristic persons of the Philippines.[34]

As to *dissolution* of private corporations, it must be noted that these entities, being creatures of law, may only be dissolved by authority of law. Although a private corporation may be dissolved voluntarily by will of the corporators, the procedure fixed by law for voluntary dissolution must be strictly followed.

The different methods of corporate dissolution are the following:

1. *Voluntary dissolution.* — Such dissolution must first be approved by the stockholders holding at least 2/3 of all shares of stock issued or subscribed (or a majority of the members in case of non-stock corporations). A petition for voluntary dissolution, alleging such prior approval by the stockholders or members, will then be filed in the Court of First Instance of the province where the principal office of the corporation is located. However, in case dissolution of a corporation will not affect the rights of any creditor having a claim against such corporation, then such dissolution may be effected by a mere resolution duly adopted by the affirmative vote of the stockholders owning at least 2/3 of its outstanding capital stock (or by the affirmative vote of 2/3 of the members in case of non-stock corp-

[32] Sec. 69, Act No. 1459, as amended.
[33] R.A. No. 166, as amended.
[34] R.A. No. 638; Marshall-Wells Co. v. Elser, 46 Phil. 70 (1924).

orations), at a meeting duly called for the purpose, including the publication of notice of meeting for six consecutive weeks in a newspaper of general circulation. A copy of the approved resolution shall be certified by a majority of the directors, countersigned by the secretary and filed in the Securities and Exchange Commission.[35]

2. *Involuntary dissolution by failure to organize and commence transaction of business within 2 years from the date of incorporation.*[36] – A corporation that attempts to transact corporate business after the expiration of 2 years from date of incorporation would not revive the corporation because you cannot resuscitate the dead. The only remedy in such case is to file new articles of incorporation and to obtain a new certificate of incorporation.

3. *Involuntary dissolution by expiration of term as originally fixed in the articles of incorporation.*[37] – Our Corporation Law fixes the term of existence to a maximum period of 50 years (except that in case of life insurance corporations, the term may be extended once for another 50 years). Should our corporation law be revised, it would be better to grant corporations the right to incorporate for any period (or eternally as provided in most American state corporation laws) which the corporators may desire as in the case of partnerships, unless sooner dissolved by law for just causes.

4. *Involuntary dissolution by legislative enactment.*[38] – This means that Congress may at any time dissolve any corporation organized under the general incorporation law. This idea is apparently based on the philosophy that he who has the power to create has also the power to destroy. However, under a government of laws and not of men, arbitrary power should not be given to any one, even to a legislature. A more sound law in this regard is to authorize dissolution by Congress only for just and lawful causes.

5. *Involuntary dissolution by judicial decree of forfeiture.*[39] – This kind of corporate dissolution is called dissolution by "quo warranto" proceedings, and is done only in cases where the corporation is charged by the Government of having violated some provisions of the Corporation Law or of any law that justifies its dissolution.

Business corporations may desire to continue business through *mergers or consolidations* which are expressly authorized by American state corporation laws. Assuming the economic advantages of such acts, may merger or consolidation be lawfully done under Philippine law?

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[35] Sec. 62, Act No. 1459, as amended.
[36] Sec. 19, *Ibid.*
[37] Sec. 18, *Ibid.*
[38] Sec. 76, *Ibid*
[39] Sec. 190 1/7, *Ibid.*

It is a fundamental principle in mergers or consolidations that these acts can be done only by express statutory provisions, on the theory that private corporations being mere creatures of the law, all their powers must be derived from the law that created them except those acts which are considered absolutely necessary (not merely "convenient") for their corporate existence. The effect of "merger" and "consolidation" as understood under American law is automatic or by operation by law. Technically, *merger* is limited to a statutory procedure whereby one of the constituent companies takes title to the assets of the other one, which in turn, loses its existence by operation of law. If none of the constituent companies remains but instead a new entity is created into which they are merged, the process is called *consolidation*. For this reason, in the absence of a statute expressly authorizing merger or consolidation, a dissenting stockholder cannot be compelled to become a stockholder in the new corporation merely because a majority of the stockholders consented to the merger or consolidation. In order that this may lawfully be done, the law under which the corporation is incorporated must expressly authorize merger or consolidation.[40]

The Philippine law expressly authorizes merger or consolidation of railroad corporations[41] under certain conditions. Except in the case of railroad corporations, there is no Philippine statute that expressly authorizes merger or consolidation of ordinary business corporations.

However, the Supreme Court, in the case of *Blouse v. Reyes*[42] said that:

> "As to how the merger or consolidation shall be carried out, our corporation law contains ample provisions to this effect (Sections 17 1/2, 18, and 28 1/2). This law does not require that there be an express legislative authority, or a unanimous consent of all stockholders, to effect a merger or consolidation of two corporations."

Section 17 1/2, 18, 28 1/2 of the Corporation Law, cited by the Supreme Court, will reveal that these provisions do not specifically refer to merger or consolidation of corporations. Section 17 1/2 refers to the power of a private corporation to invest its corporate funds in another corporation or business with the approval of the stockholders owning at least 2/3 of the voting stock. Section 18 refers to the manner of amending the articles of incorporation with the approval also of the stockholders owning at least 2/3 of the subscribed capital stock. Section 28 1/2 refers to the power of the corporation to sell, exchange, lease, or otherwise dispose of all or substantially all of its property and assets, when approved by the stockholders owning at least 2/3 of the voting stock. Even assuming that the merging or consolidating corporations had done all these, is one of the

[40] Clearwater v. Meredith, 1 Wall. 25, 17L. Ed. 604 (1864).
[41] Act No. 2772, as amended by Act No. 2789.
[42] 91 Phil. 305 (1952).

corporations or both corporations automatically dissolved and is another entity automatically created without the issuance of a certificate of incorporation by the Securities and Exchange Commission? Are corporations dissolved without dissolving them in the manner prescribed by the Corporation Law? Is a corporation automatically created without filing any articles of incorporation? These are legal questions which should be taken into account, in the absence of specific statutory procedure on merger and consolidation. The mere compliance with the aforementioned articles without further complying with other provisions of the Corporation Law on the incorporation and dissolution of corporations will not give rise to "merger" or "consolidation" as understood under American law and practice.

However, the Philippine Supreme Court is correct in saying that there are "ample provisions" in the Philippine Corporation Law that may lead to or consummate a merger or consolidation, with the same effects as intended under American statutes. These "ample provisions" in the Philippine Corporation Law are: Sections 6, 17, 17 1/2, 28 1/2 and 62.

Let us suppose that Corporation A and Corporation B would like to effect a *merger*. (In *merger*, the juridicial personality of one is extinguished and *"merged"* with the other surviving corporation.) So, let Corporation A sell all its property and assets to Corporation B with the approval of the stockholders holding at least 2/3 of the voting stock (Sec. 28 1/2) in exchange for shares of stock issued by Corporation B to the assenting stockholders of Corporation A, after making the necessary increase of the capital stock (Sec. 17) of Corporation B to the extent of the value of the assets acquired from Corporation A. Then Corporation A voluntarily dissolves itself. (Sec. 62.)

Dissenting stockholders of Corporation A and B who did not consent to the sale or purchase of the assets of Corporation A are entitled to the return of the appraised value of their shares. (Sec. 17 1/2.)

In case of *consolidation*, a similar procedure may be done, except that before or after the sale or purchase of the assets is made but before dissolution of both corporations, a new corporation be first incorporated (Sec. 6) by the necessary number of incorporators who may be the stockholders of any or of both consolidating corporations. This is necessary because in consolidation, both corporations are dissolved, giving rise to a new corporation to which the two former corporations are consolidated.

Hence, although the Philippine Corporation Law is silent as regards merger and consolidation, it may lawfully be done by following the above specific provisions of the Corporation Law, and provided further, that the law on monopolies, illegal combinations and restraint of trade are not violated. (Act No. 3518, Sec. 20; Act No. 3247).

It will be seen that our laws on business organizations are scattered and uncoordinated. There is a good reason for codifying or combining our laws on partnerships and private corporations; when so combined, other more sound distinctions should be made between business in the partnership form and business in the corporate form. At present, there is no substantial difference between the two classes of business organizations except as to the manner of creation, the personal pro rata liability of partners for the firm's debts, the term of existence, management, and causes of dissolution, — differences or distinctions which are not very substantial. Under American law, partnerships do not have juridical personality as such, and the partner and the partnership are the same. Under our law, partnerships and private corporations are both juridical entities distinct and separate from the members composing the same, and yet this separate juridical personality is not maintained as regards partnerships. It being admitted that a partnership has also juridical personality as such, like a private corporation, the distinction that remains is a mere matter of name. A codified law on business organizations may consider all of them "corporations," and applying to some of them the characteristics of present partnerships. That is to say, in some kinds of corporations formed by less than five, each one may be held personally liable for the firm's debts and such other characteristics peculiar to partnerships. In this way, we shall have one general law on business organizations.

Upon the due incorporation of a private corporation, it shall be confronted by various laws that affect all aspects of its business operations. Principal among these laws is the general law on obligations and contracts.

THE LAW ON OBLIGATIONS AND CONTRACTS IN GENERAL

An obligation is a duty to do or not to do a certain thing. A contract is an agreement (oral or written) which gives rise to an obligation. A contract, therefore, is one of the sources of obligations. The other sources of obligations are: law, quasi-contracts, unlawful acts or omissions, and quasi-delicts or torts.[43] And all obligations are extinguished by: payment or performance, loss of the thing due, condonation or remission of the debt, merger, compensation or set off, and by novation.[44]

Obligations are of different kinds. They may be: pure and conditional obligations; obligations with a term; alternative obligations; joint and solidary obligations; divisible and indivisible obligations; and obligations with a penal clause.

[43] Art. 1156, Civil Code.
[44] Art. 1231, Civil Code.

Whether an obligation is *joint* or *solidary* is important to every businessman. An obligation is called "joint", when the person obliged to do a thing is liable only for a part of the whole obligation. Thus, a promissory note for ₱1,000 signed by two debtors will make each of them liable only for ₱500, if the obligation is merely joint. But when the obligation is "solidary", anyone of the codebtors in the example given is obliged to pay the entire debt of ₱1,000, without prejudice on the part of the payor to recover the proportionate share in the debt of his codebtor. Inasmuch as solidary liability is more onerous than a joint liability, the law provides that unless expressly agreed upon or unless the law specifies otherwise, co-debtors shall be presumed to be only liable jointly and not solidarily.[45] Thus, the Negotiable Instruments Law[46] expressly provides that the use of the pronoun "I" in a negotiable instrument, signed by two or more persons, will make them liable *in solidum.*

A contract need not be in writing to be valid or enforceable. However, there are some contracts whch must be in writing to be *valid;* and there are also some contracts which must be in writing to be *enforceable.*

The Civil Code[47] provides that "when the law requires that a contract be in some form in order that it may be valid or enforceable, or that a contract be proved in a certain way, that requirement is absolute and indispensable." Thus, the donation and acceptance of a movable property in excess of ₱5,000 must be in writing; otherwise, the donation shall be void.[48] And the donation of an immovable must not only be in writing; it must be in public instrument in order to be valid.

A contract may be valid and yet unenforceable, unless made in writing. A contract, therefore, in order to be effective for all legal purposes, must not only be validly entered into but must follow the form prescribed by law.

The following contracts are unenforceable, unless they are made to appear in writing, signed by the party charged or by his duly authorized agent:

1. An agreement that by its term is not to be performed within a year from the making thereof;

2. A special promise to answer for the debt, default, or miscarriage of another;

3. An agreement made in consideration of marriage, other than a mutual promise to marry;

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45 Art. 1207, Civil Code.
46 Sec. 17, Negotiable Instruments Law.
47 Art. 1356, Civil Code.
48 Art. 748, Civil Code.

4. An agreement for the sale of goods at a price not less than ₱500, unless the buyer accepts and receives part of such goods or pay at the time some part of the purchase price;

5. An agreement for the leasing for a longer period than one year, or for the sale of real property or of an interest therein;

6. A representation as to the credit of a third person.[49]

The above contracts are contracts which come under the so-called "Statute of Frauds". They are *valid* between the contracting parties but are *enforceable* in a court of justice, unless evidence of the agreement is produced or unless ratified by the party against whom it is sought to be enforced.

LAW ON CREDIT TRANSACTIONS

In the course of business operation, the businessman may find occasion to borrow money secured by pledge or chattel mortgage, or by real estate mortgage, and may even find it necessary to sell some of his assets to obtain the needed capital. In such event, he should know some pertinent provisions of the law of loans, usury, pledge, chattel mortgage, real estate mortgage, and sales. These laws are either provided for in the Civil Code or in special laws.

In a loan of money, as distinguished from a deposit, the borrower acquires ownership thereof and is obliged to pay to the creditor an equal amount of the same *kind* of *quality*[50]; whereas, in a deposit of money, the depositary does not acquire ownership and is obliged to return the very same thing deposited.[51] When the bailee or the person to whom the thing has been delivered has the right to spend or consume it, the transaction is not a deposit but a simple loan. Hence, deposit of money in a savings or commercial bank is not a "deposit" but is, legally speaking, a "loan". The legal effect of such a "deposit" is that when the bank fails or becomes insolvent, all the "deposits" of money held by the bank do not belong to the respective depositors but are considered assets of the insolvent bank, liable for the payment of the bank's debts and liabilities; and although the bank's depositors are considered creditors of the bank, yet their claims are not considered "preferred claims" but only "ordinary claims". This means that the money "deposited" in the bank shall be used for the payment first, of preferred claims, and, second, of ordinary claims which include the claims of depositors.

All loans with interest are governed by the *Usury Law*.[52] The maximum rates of interest that may lawfully be charged on loans of money

[50] Art. 1953, Civil Code.
[51] Art. 1962, Civil Code.
[52] Act No. 2655, as amended by Acts Nos. 3291, 3998, 4070, and C.A. No. 399.

are fixed in the Usury Law. For instance, a loan secured by real estate mortgage shall not pay more than 12% per annum. Unsecured loans and loans not secured by real estate shall not pay more than 14% per annum. Any person who shall have paid a higher rate of interest than is allowed by the Usury Law *"may recover the whole interest"*.[53] Although there is a *dictum* that what may be recovered in case of usurious loan is the "excess over the lawful rate"[54], yet the correct rule is that provided for in Section 6 of the Usury Law as quoted above. The opinion that only the "excess' over the lawful rate is recoverable is allegedly based on a provision of the Civil Code[55] which provides as follows:

> "Interest paid in excess of the interest allowed by the usury laws may be recovered by the debtor, with interest thereon from the date of the payment."

The words "interest paid in excess of the interest allowed by the usury laws" do not refer to the "excess over the lawful rate", but to the "whole interest paid which is in excess of the interest allowed by the Usury Law." The Civil Code could not have intended to change the rule provided in the Usury Law, because the Civil Code itself expressly provides: "Contracts and stipulations, under any cloak or device whatever, intended to circumvent the laws against usury shall be void. The borrower may recover *in accordance with the law on usury.*"[56]

If the stipulation to pay a usurious interest is *void,* then it is as if no such stipulation had been made; that is, no interest had been stipulated, and the fundamental rule in loans is that provided for in Art. 1956 of the Civil Code which says: *"No interest* shall be due unless it has been expressly stipulated in writing." To contend otherwise is to give the usurer an advantage of receiving the maximum rate of interest allowed by the Usury Law without need of express stipulation.

Secured transactions, like *pledge and chattel mortgage,* present no special problems to the businessman, except the technical distinction between pledge and chattel mortgage. When the security given by the debtor is personal property, the contract of security is called either a pledge or a chattel mortgage; when the security given is real property, the secured transaction is called real estate mortgage. The difficulty to a layman arises when the security given is personal property: when is it called pledge and when is it called chattel mortgage? The Civil Code answers this by saying that: "By a chattel mortgage, personal property is recorded in the Chattel Mortgage Register as a security for the performance of an obligation. If the movable, *instead of being recorded,* is *delivered* to the

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[53] Sec. 6, Usury Law, as amended by Act Nos. 3291 and 3998.
[55] Art. 1413, Civil Code.
[56] Art. 1957, Civil Code.

creditor or a third person, the contract is a pledge and not a chattel mortgage." In other words, there is a valid pledge between the parties so long as the thing pledged is actually delivered to the pledgee or a third person by common agreement;[57] whereas, to constitute a valid chattel mortgage the security need not actually be delivered to the creditor so long as the contract of chattel mortgage is registered n the Chattel Mortgage Register. But, suppose the security is actually delivered in the Chattel Mortgage Register: is it a pledge or a chattel mortgage? In such case, the transaction should properly be called a chattel mortgage.

But, is it of any consequence to call a contract a pledge or a chattel mortgage? Yes, because, if it is a pledge, the transaction shall be governed by the law of pledge as provided in the Civil Code, and if it is a chattel mortgage the transaction shall be primarily governed by the Chattel Mortgage Law[58]. The Civil Code has only two articles on Chattel Mortgage (Arts. 2140 and 2141); and Art. 2141 provides: "The provisions of this Code on pledge, insofar as they are not in conflict with the Chattel Mortgage Law, shall be applicable to chattel mortgages." This particular provision of the Civil Code has given rise to a very technical distinction between pledge and chattel mortgage, as will presently be explained.

In pledge, when the debt is not paid when due, the law gives the pledgee the right to sell the thing pledged at public auction, with due notice to the pledgor, and the law of pledge expressly provides: "The sale of the thing pledged shall extinguish the principal obligation, whether or not the proceeds of the sale are equal to the amount of the principal obligation, interest and expenses in a proper case. If the price of the sale is more than said amount, *the debtor shall not be entitled to the excess,* unless it is otherwise agreed. If the price of the sale is less, *neither shall the creditor be entitled to recover any deficiency,* notwithstanding any stipulation to the contrary."[59] In chattel mortgage, however, the Chattel Mortgage Law has a special provision regarding the disposition of the "excess", although it is silent as regards the liability for any "deficiency". The Chattel Mortgage Law expressly gives the creditor the right to any *excess,* after deducting the principal debt and accrued interests and subsequent mortgages, if any.[60]

There is a *dictum* to the effect that both in pledge and chattel mortgage, the creditor is not entitled to the excess,[61] but unless Art. 2141 of the Civil Code is amended, the provision is clear: "The provisions of this Code on pledge, *insofar as they are not in conflict with the Chattel*

[57] Art. 2093, Civil Code
[58] Act No. 1508, as amended by Act No. 2496.
[59] Art. 2115, Civil Code.
[60] Act No. 1508, Sec. 14.
[61] See Ablaza v. Ignacio, G.R. No. L-11466, May 23, 1958.

Mortgage Law, shall be applicable to chattel mortgages." There being a conflict between the provisions of the Chattel Mortgage Law and the law on pledge about the disposition of the "excess", the provisions of the Chattel Mortgage Law shall prevail, if the secured transaction is one of chattel mortgage.

Perhaps, it would be advisable to unify the law on pledge and chattel mortgage. There should only be one kind of contract of security of personal security. The dual existence of two classes of security transactions, governed by different laws, is not necessary or indispensable; on the contrary, it only creates confusion and uncertainty in business.

Another transaction with which every merchant is oftentimes confronted with is the *contract of sale,* which is governed by the law of sales. Under our law, there is a distinction between the perfection of a contract of sale and the transfer of ownership of the thing sold. The contract of sale is *perfected* at the moment there is a meeting of the minds upon the thing which is the object of the contract and upon the price.[62] But the *ownership* of the thing sold does not pass to the vendee until the actual or constructive delivery thereof.[63] The seller and the buyer might have agreed to the sale of a certain thing, but without actual delivery of the subject matter of the sale, the buyer cannot be deemed to have acquired title thereto. Consequently, the seller, before actual or constructive delivery of the thing sold, has still the power to sell and deliver the same thing to another person, without prejudice to his liability to the first buyer for any damage caused to the latter. As a consequence also of this distinction, if the thing sold should be lost while still in the possession of the seller, the latter shall bear the risk of loss, unless the parties have aggreed to constitute the seller as mere depositary before actual delivery.

However, notwithstanding the fact that the ownership of the thing sold may have passed to the buyer by reason of constructive delivery or by agreement but the price has not been paid, the seller becomes what is called an "unpaid seller", and as such has the following rights:

1. A lien on the goods or *right to retain* them for the price while he is in possession of them.

2. In case of insolvency of the buyer, a *right of stoppage in transitu* after he has parted with the possession of them.

3. A *right of resale,* where the goods are of perishable nature, or where he has expressly reserved the right of resale in case the buyer should make default or where the buyer has been in default in the pay-

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[62] Art. 1475, Civil Code.
[63] Art. 1477, Civil Code.

ment of the price for an unreasonable time, and the seller has still po- session of the goods or can exercise the right of stoppage *in transitu.*

4. A *right to rescind* the sale, where he expressly reserved the right to do so in case the buyer should make default, or where the buyer has been in default in the payment of the price for an unreasonable time and the unpaid seller has still possession of the thing sold or can exercise the right to stoppage *in transitu.*[64]

Every seller in a contract of sale has the obligation to deliver and warrant the thing sold.[65] The thing sold shall be understood as delive when it is placed in the control and possession of the vendee.[66] Warra includes warranty against eviction (that is to say, the vendor shall answ if the vendee is deprived of the whole or part of the thing sold by fin judgment), and warranty against hidden defects of the thing sold. hidden defect in such defect which renders the thing sold unfit for the use for which it is intended, or should diminish its fitness for such use to such an extent that, had the vendee been aware thereof, he would not have acquired it. But the vendor is not answerable for patent defects those which are visible, or although not visible, yet the vendee is an expe who, by reason of his trade or profession should have known them.[67]

The buyer is obliged to accept delivery and to pay the price of the thing sold at the time and place stipulated.[68] He shall also pay inte on the purchase price in the following cases: (a) should it have bee stipulated; (b) should the thing sold and delivered produce fruits or inco and (c) should he be in default, from the time of judicial or extrajudi demand, for the payment of the price.[69]

Every businessman should also be familiar with the law gover *sales of personal property in installment.*

In the first place, a sale of personal property in installments and contract of lease of personal property should be distinguished. When the title to the property is transferred, leaving only the obligation to pay the price in installments, it is a sale in installments. But when the title to the property remains in the transferor, obligating the transferee to pay fi amounts as rentals, it is a contract of lease. However, it is the prac of some merchants to sell personal property, such as radio receiving se evidenced by a contract with mortgage called "Contract of Lease", whe the "lessee" pays monthly amounts called "rentals" under the cond that upon failure to pay two or more "rentals", the "lease" may be cance

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[64] Arts. 1526, 1533, 1534, Civil Code.
[65] Art. 1495, Civil Code.
[66] Art. 1497, Civil Code.
[67] Arts. 1548, 1561, Civil Code.
[68] Art. 1582, Civil Code.
[69] Arts. 1582, 1589, Civil Code.

by the "lessor" with an express stipulation that all payments made shall be forfeited as rentals for the use of the thing "leased".

If the real intent of the parties is a contract of lease, then all the terms thereof should be consistent with such kind of contract. In a lease contract, the ownership remains with the lessor; but the moment the alleged "lessee" is permitted to execute a chattel mortgage to guarantee the payment of the unpaid balance, the contract becomes a contract of sale in installments with mortgage, inasmuch as one of the essential requisites of mortgage is that the mortgagor must be the owner of the thing mortgaged.

Consequently, the "rentals" paid must be regarded as installments in a sale. Under the installment sales law,[70] the vendor has the following remedies:

1. Exact fulfillment of the obligation, should the vendee fail to pay;

2. Cancel the sale, should the vendee fail to pay two or more installments;

3. Foreclose the chattel mortgage on the thing sold, if one has been executed, should the vendee fail to pay two or more installments. In this case, the mortgagee shall have no further action against the purchaser to recover any unpaid balance of the price, and any agreement to the contrary shall be void.

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[70] Art. 1484, Civil Code.

(To be continued)