

# THE LEGAL FRAMEWORK WITHIN WHICH BUSINESS IN THE PHILIPPINES OPERATES\*

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## PART II

### THE LAW ON NEGOTIABLE INSTRUMENTS

Most business transactions are carried along on good faith and on credit. Checks and bills of exchange play a very important role in facilitating business transactions. Checks and bills of exchange are negotiable instruments and are governed by a special law, the Negotiable Instruments Law.<sup>70</sup>

Not every document that can be negotiated is a "negotiable instrument." A certificate of stock is a negotiable document; so also is a bill of lading. But these documents are not negotiable instruments within the meaning of the Negotiable Instruments Law. In order that an instrument may be called a negotiable instrument, governed by the Negotiable Instruments Law, the following requisites must be present:

1. It must be in writing and must be signed by the maker or drawer;
2. Must contain an unconditional promise or order to pay a certain sum of money;
3. Must be payable on demand, or at a fixed or determinable future time;
4. Must be payable to order or to bearer; and
5. Where the instrument is addressed to a drawee, he must be named or otherwise indicated with reasonable certainty.<sup>71</sup>

Negotiable promissory notes, bills of exchange, and checks are all negotiable instruments. Of these negotiable instruments, the check is the one most commonly used.

A check is a bill of exchange drawn on a bank and payable on demand. While an ordinary bill of exchange may or may not be drawn against a bank, and may be payable on demand or at a fixed or determinable future time, a check is drawn always against a current deposit

\* Continuation of Guevara's article in the May, 1966 issue of the *Review*.

<sup>70</sup> Act No. 2031.

<sup>71</sup> Sec. 1, Act No. 2031.

in a bank and is payable on demand. A post-dated check, not being payable on demand but on some future date, is not a check but is merely a bill of exchange until the post date arrives. In the meantime, it may be treated as an evidence of indebtedness between the immediate parties.

The chief characteristic of a negotiable instrument is its negotiability. Under the law, negotiation may be made either by actual delivery or by indorsement. Negotiation by actual delivery may be done only with respect to negotiable instruments that are *payable to bearer*. Instruments *payable to order* may be negotiated either by actual delivery or by indorsement. Indorsements are of different kinds: they may be either special or in blank, restrictive, qualified, or conditional.

The legal effects of these various kinds of indorsements are as follows: An instrument indorsed with a special indorsement (such as "Pay to Juan Reyes", signed by the indorser) may be further negotiated only by the indorsee, unless the instrument is originally payable to bearer, in which case, it may be further negotiated by delivery, but the person indorsing specially is liable as indorser to only such holders as obtain title through such instruments.<sup>72</sup> An instrument indorsed in blank may be further negotiated by mere delivery.

A restrictive indorsement may either: (a) prohibit the further negotiation of the instrument (such as "Pay to Juan Reyes only", signed by the indorser); (b) constitute the indorsee the agent of the indorser (such as "Pay to the P.N.B., Cebu Branch, for collection", signed by the indorser); (c) vest the title in the indorsee in trust for, or to the use of, some other person (such as "Pay to Juan Reyes in trust for PRISM PRINTING CORPORATION, a corporation in process of incorporation", signed by the indorser).

A qualified indorsement constitutes the indorser a mere assignor of the title to the instrument, and is usually done by adding to the indorser's signature the words "without recourse", or "*sans recours*". This kind of indorsement qualifies or changes the liability of the indorser to a kind different from the liability of a general or unqualified indorser, because while a general or unqualified indorser warrants to all subsequent holders in due course that the instrument indorsed is genuine and in all respects what it purports to be, that he has a good title to it, that all prior parties had capacity to contract, that the instrument is valid and subsisting at the time of his indorsement, that on due presentment it shall be accepted or paid, as the case may be, and that if it is 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 it, yet the qualified indorser does not warrant that the instrument,

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<sup>72</sup> Sec. 40, Negotiable Instruments Law.

at the time of his indorsement, is valid and subsisting, but only warrants that he had *no knowledge* of any fact which would impair the validity of the instrument, *nor does he warrant the solvency of prior parties*.<sup>73</sup> In other words, a restrictive indorsement "restricts" the *negotiability* of the instrument, while a qualified indorsement "qualifies" the *liability* of the indorser.

The warranties of an indorser are good only in favor of holders, called "holders in due course". A holder in due course is one who has taken the instrument under the following circumstances: (a) That the instrument is complete and regular upon its face; (b) that he became the holder of it before it was overdue, and without notice that it has been previously dishonored, if such was the fact; (c) that he took it in good faith and for value; (d) that at the time it was negotiated, he had no notice of any infirmity in the instrument or defect in the title of the person negotiating it.<sup>74</sup> And, if one is a holder in due course, he holds the instrument "free from any defect of title of prior parties, and free from defenses available to prior parties among themselves, and may enforce payment of the instrument for the full amount thereof against all parties liable thereon."<sup>75</sup> In other words, a holder in due course holds the instrument free from all kinds of defenses, except from "real defenses"; while a holder who is not a holder in due course holds the instrument subject to all kinds of defenses, including "personal defenses". A "real defense" (such as an incomplete and undelivered instrument) is one available against all holders, including a holder in due course; while a "personal defense" (such as stolen check payable to bearer) is one available only against immediate parties or holders not in due course. For example, a check, signed by the drawer but not delivered to anyone, was incomplete as to the amount; even if someone should fraudulently complete the amount and negotiate it to a holder in due course, the latter cannot acquire good title thereto as against the drawer, because the check was originally incomplete and undelivered by the drawer. The drawer has a "real defense" against any holder. However, if the said check was complete in every respect, although undelivered by the drawer, and someone should steal and negotiate it to a holder in due course, the latter acquires good title, the drawer having only a "personal defense" available only against the thief or holders not in due course.

However, forgery of a negotiable instrument is governed by a special provision of the Negotiable Instruments Law.<sup>76</sup> If the signature of a party to the instrument is forged (such as that of maker or an indorser), only

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<sup>73</sup> Secs. 65 and 66, Negotiable Instruments Law.

<sup>74</sup> Sec. 52, Negotiable Instruments Law.

<sup>75</sup> Sec. 57, Negotiable Instruments Law.

<sup>76</sup> Sec. 23, Negotiable Instruments Law.

the forged signature is void or wholly inoperative. This means that the instrument itself is valid in the hands of holders in due course, and all parties liable on the instrument are liable thereon, except the parties whose signatures are forged.<sup>77</sup>

The alteration of a negotiable instrument is also governed by a special provision of the Negotiable Instruments Law. The law provides that where a negotiable instrument is materially altered without the consent of all parties liable thereon, the instrument is voided except as against a party who has himself made, authorized, or assented to the alteration, and against subsequent indorsers. But when an instrument has been materially altered and is in the hands of a holder in due course, the latter may enforce payment thereof according to its original tenor. Consequently, where the original amount in a check had been fraudulently altered by the payee from P100 to P1,000, the check, even if indorsed as altered to a holder in due course, will not entitle the holder in due course to recover from the drawer the altered amount of P1,000 but only the amount of P100, although the said holder may recover from the alterer P1,000. However, the check is voided in the hands of the alterer (payee), which means that if the check is dishonored by nonpayment, the payee or the alterer could not recover from the drawer, because according to the Negotiable Instruments Law "it is voided."<sup>78</sup>

Any alteration which changes the date, the sum payable, the time or place of payment, the relations of parties or the medium or currency in which payment is to be made, or which adds a place of payment where no place of payment is specified, or makes any other change which alters the effect of the instrument in any respect, is a material alteration.<sup>79</sup>

A brief discussion of the effect of certification of a check should be of some interest to those engaged in business. The certification of a check is equivalent to an acceptance of a bill of exchange; and acceptance of a bill of exchange must be in writing and must be signed by the acceptor. Consequently, the certification of a check must also be in writing and must be signed by the bank certifying the check. In banking practice, this is done by writing or stamping the word "Certified" and having it signed by the proper official of the bank. It was held that the sign "o.k." with the initials of a bank official is not to be regarded as a certification of a check.<sup>80</sup> Neither does mere payment of a check imply acceptance of the check, as this term is understood under the Negotiable Instruments Law.<sup>81</sup>

<sup>77</sup> *Beem v. Farrell*, 135 Iowa 670, 113 NW 509 (1907).

<sup>78</sup> See *AFP v. P.N.B.*, 56 O.G. 7458, CA-G.R. No. 16792-R (May 28, 1960).

<sup>79</sup> Sec. 125, Negotiable Instruments Law.

<sup>80</sup> *Panlilio v. David*, 50 Phil. 195 (1927).

<sup>81</sup> *P.N.B. v. N.C.B.N.Y.*, 63 Phil. 711 (1936).

And if the certification of a check is equivalent to an acceptance, then the bank that properly certifies a check will be obliged to pay it according to the tenor of its acceptance, and will have admitted the existence of the drawer, the genuineness of his signature, his capacity and authority to draw the check, the existence of the payee, and consequently his capacity to indorse.<sup>82</sup> But a bank that merely pays a check without proper certification does not admit the genuineness of the signature of the drawer, because this obligation applies only if there is due certification as this term is understood under the Negotiable Instruments Law.

What is meant by the provision that the acceptor "will pay it according to the tenor of his acceptance"? Suppose a drawer draws a check for only ₱100; the payee fraudulently raises the amount to ₱1,000 and indorses the check to A, a holder in due course. A then presents the check for certification and it is duly certified. May the drawee bank, upon discovery of the alteration, be obliged by A to pay ₱1,000? Some may answer in the affirmative, because the acceptor by accepting the instrument engages to pay "according to the tenor of his acceptance." However, it must be noted that the Negotiable Instruments Law does not say "according to the tenor of the bill as accepted" but only "according to the tenor of his acceptance." "Tenor of acceptance" means whether the acceptance is "qualified" or "general"<sup>83</sup> A qualified acceptance qualifies or varies the effects of the bill as originally drawn; such as, to pay after 60 days instead of after 30 days. A general acceptance "assents with qualifications to the order of the drawer." Hence, if the acceptance is a general acceptance, as was the case in the above problem, the obligation of the drawee-acceptor is to pay only "according to the order of the drawer", which is ₱100 and not ₱1,000. This interpretation is consistent with the effect of a material alteration as provided for in Section 124 of the Negotiable Instruments Law which says: "But when the instrument has been materially altered and is in the hands of a holder in due course, not a party to the alteration, he may enforce payment thereof according to its *original tenor*." Besides, in the case of two innocent persons who must suffer the loss caused by the fraud of a third person, let that one suffer through whose fault the fraud has succeeded. However, if the original payee first presented the check for certification and it was duly certified, and then subsequently negotiated it to A, a holder in due course, the result would be different: as in the case of the drawee bank and the holder in due course, it was through the fault of the drawee bank that the fraud had succeeded, and the holder in due course should be allowed to recover from the drawee bank the amount as altered.

Another problem regarding the effect of certification arises where the drawee bank, after certification, becomes insolvent. Is the amount covered

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<sup>82</sup> Sec. 62, Negotiable Instruments Law.

<sup>83</sup> Sec. 139, Negotiable Instruments Law.

by the certified check to be considered property of the insolvent bank or of the holder of the check? It has been alleged that, inasmuch as by certifying a check the amount of the check is immediately deducted from the current deposit of the drawer and set aside, to be paid to the holder of the check when claimed at any time, the amount of the certified check is deemed held by the drawee bank as mere deposit, and if so then title thereto belongs to the depositor, not to the depository. Hence it is claimed that in case of insolvency of the drawee bank, the amount presented by the check should not be considered assets of the insolvent bank. But the better opinion should be that a certified check merely constitutes the drawee bank the primary debtor; that the relationship between the bank and the holder of the check is still that of debtor and creditor, and that the only difference between a certified check and one that is not certified is, that in the case of the former the drawee bank is primarily liable, while in the case of the latter the bank is a mere drawee and is not liable to the holder until the bank certifies it. Hence, in case of insolvency of the drawee bank, the holder of the certified check must be regarded merely as an ordinary creditor.

## THE LAW ON INSURANCE

Businessmen usually insure their property and goods against risks of fire, perils of the sea, and other contingent events. They may also find it advisable to insure the lives of their important employees whose services are indispensable and whose death or permanent disability may adversely affect the progress of their business. In these cases, knowledge of the law of insurance is important.<sup>84</sup>

Insurance has some peculiar principles not generally found in ordinary contracts. For instance, in the case of life insurance, when a beneficiary is designated without a reservation clause, the said beneficiary acquires an absolute vested right in the policy from the issuance of the policy, and he cannot be deprived of such right without his consent. Consequently, under this "vested right" principle, the insured or the person taking the insurance may not lawfully designate a co-beneficiary during the existence of the policy without the consent of the first beneficiary.

Another peculiar principle applicable to life insurance is the so-called "incontestability of life policies." As a general rule, deceit or fraud in obtaining the consent of a party in a contract entitles the defrauded or deceived party to the rescission of the contract. But in life insurance, once the insurer agrees to insure the life of a person by an insurance policy payable upon death, and the policy has been in force during the lifetime

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<sup>84</sup> Act No. 2427, as amended.

of the insured for a period of two years, the insurer may no longer rescind the policy by reason of the fraudulent concealment or misrepresentation of the insured or his agent.<sup>85</sup> In other words, the life policy becomes incontestable after the two-year period provided by law.

However, notwithstanding the seeming absoluteness of the law on incontestability of a life policy, if the fraud or misrepresentation is of such nature as to nullify the very essence of the contract itself (such as lack of insurable interest on the part of the person taking the insurance), the policy cannot be deemed to be "in force during the lifetime of the insured for a period of two years". To validate such a policy, expressly or impliedly, is immoral, is against public policy and against the law.<sup>86</sup> As was held by one court, the "incontestable clause" cannot be used as a vehicle to sanctify that which never existed.<sup>87</sup> Neither does the "incontestability clause" apply to cases of non-payment of premiums, nor to violations of warranties, nor to conditions relating to military or naval service in time of war.<sup>88</sup>

An employer has insurable interest on the life of his manager or employee whose survival will benefit the business but whose death or permanent disability will cause direct pecuniary loss to the employer. However, where an employer insures the life of his employee and agrees to pay the premiums, with the firm designated as the beneficiary, the premiums paid are not deductible expenses on the part of the business firm;<sup>89</sup> it would be otherwise, if the beneficiary designated is the employee himself. Also, under the Workmen's Compensation Law,<sup>90</sup> an employer may insure his liability for injuries or death of his employees with an insurance company, but the premium payable thereon may not be lawfully charged against the employee.<sup>91</sup>

Fire and marine insurance contracts are commonly executed by many businessmen, insuring their property or goods against fire or marine perils. Many legal technicalities apply in connection with fire and marine insurance. There is not enough space for a detailed discussion of these legal technicalities in a work of this kind, but a few important legal concepts will be touched upon. These are: double insurance, reinsurance, and co-insurance.

"Double insurance" is the act of insuring the same property by the same insured against the same risk or peril with different insurers. In double

<sup>85</sup> Secs. 47, 184(b), Insurance Law, as amended by R.A. No. 171.

<sup>86</sup> Sec. 24, Act No. 2427.

<sup>87</sup> *Obartuch v. Security Mutual L. Ins. Co.*, 114 F.2d. 873 (1940).

<sup>88</sup> Sec. 184(b), 2427, as amended by R.A. No. 171.

<sup>89</sup> Sec. 31, Income Tax Law, C.A. No. 466.

<sup>90</sup> Act No. 3428, as amended by Act No. 2812, and C.A. No. 210, and R.A. Nos. 772, 889.

<sup>91</sup> Sec. 30, Act No. 3428.

insurance, the insured recovers not more than the actual amount of his loss from all the insurers, should there be an over-insurance. For example, X insures his property valued at P200,000 for P100,000 with Company A, for P50,000 with Company B, and P150,000 with Company C, or for a total insurance of P300,000 with the three insurance companies. This is a case of double insurance with over-insurance. In case of total loss of the property, X may recover not more than P200,000 from all the policies, and he may recover such loss in any of the following ways: (a) P100,000 from Company A, P50,000 from Company B, and only P50,000 from Company C, without prejudice to Company C being liable to his co-insurers for his pro rata share in the total indemnity paid to the insured. (b) Or, the insured may recover P100,000 from Company A and P100,000 from Company C, without prejudice to the liability of Company B and Company C to Company A for their respective pro rata share among themselves. In other words, the insured may choose to recover his loss from any one of the insurers, in any order he pleases, up to the amount for which the insurers are severally liable under their respective contracts, as long as the total amount recovered does not exceed the actual damage suffered by him, each insurer being bound, in turn, between himself and the other insurers, to contribute ratably to the loss in proportion to the amount for which each is liable on their respective contracts.<sup>92</sup>

“Reinsurance”, on the other hand, is one whereby an insurer procures a third person (called “reinsurer”) to insure him against loss or liability by reason of such original insurance. For example, Company A insures the property of X against fire for P1,000,000. Company A, in turn, may insure part of his liability with Company B for P500,000. In case of loss, assuming that the original contract, as well as the reinsurance contract, is valid, X will recover P500,000 from Company B. However, it does not necessarily follow that if X recovered from Company A the latter will also recover from Company B, because the contract of reinsurance is separate and distinct from the original contract of insurance.<sup>93</sup> This means that the original contract of insurance may be valid but the contract of reinsurance may be invalid by reason of concealment or misrepresentation on the part of Company A. But where the original contract of insurance is void, it necessarily follows that the contract of reinsurance is also void, because a contract of reinsurance is merely an insurance against liability, so that if no liability has been incurred on the original contract of insurance, there shall be no right to recover on the contract of reinsurance.<sup>94</sup>

“Co-insurance” is a term used in marine insurance, whereby the insured is required to maintain insurance to an amount equal to a speci-

<sup>92</sup> Sec. 87, Act No. 2427.

<sup>93</sup> Sec. 91, Act No. 2427.

<sup>94</sup> See Secs. 89-91, Act No. 2427.



fied percentage of the value of the insured property, under the penalty of becoming a "co-insurer" for the difference between the insurance actually taken and the true value of the property. The liability of the insurer in case of co-insurance is that part of the loss represented by a fraction the numerator of which is the amount of insurance actually taken and the denominator of which is the value of the property at the time of the loss.<sup>95</sup> In an ordinary fire policy, this principle applies only if expressly stipulated in the policy; but in marine insurance, the co-insurance automatically applies by provision of law. Thus, Article 150 of the Insurance Law provides: "A marine insurer is liable upon a partial loss, only for such proportion of the amount insured by him as the loss bears to the value of the whole interest of the insured in the property insured." It will be noticed also that co-insurance applies only in case of a partial loss in open policies; where the loss is total or where the policy is a valued policy, the insured cannot be deemed a "co-insurer" of the insurer for the loss suffered. And, as already mentioned above, in ordinary fire policies, the principle of co-insurance applies only if expressly stipulated.

In some jurisdictions, co-insurance clauses in fire policies have been outlawed by special statutes; in the Philippines, there is no law which expressly outlaws such stipulations, and their validity seems to have been taken for granted by the Supreme Court.<sup>96</sup> However, the following provision in the International Law (Sec. 163) relating to fire insurance may give food for thought regarding the validity of co-insurance clauses in fire policies:

"If there is no valuation in the policy, the measure of indemnity in an insurance against fire is the expense it would be to the insured at the time of the commencement of the fire to replace the thing lost or injured in the condition in which it was at the time of the injury; but the effect of a valuation in a policy of fire insurance is the same as in a policy of marine insurance."

In other words, in an open policy of fire insurance, "the measure of indemnity" (*whether the loss is total or partial*) in an insurance against fire is "the expense it would be to the insured at the time of the commencement of the fire to replace the thing lost."

The practice of insurance companies of including in fire policies a "co-insurance clause," making the insured a coinsurer in case of partial loss, violates the express provision of Section 163 of the Insurance Law which makes every insurer in open policies liable for the actual damage suffered by the insured, as long as this actual loss does not exceed the face value of the policy and as long as the annual premium on the policy

<sup>95</sup> *Galian v. State Assurance Co.*, 29 Phil. 413 (1915).

<sup>96</sup> *Ibid.*

had been paid. Such a stipulation printed on the policy, to which the insured is forcibly made to agree, is immoral and must be declared by the court as void. And, even if it be shown that the insured voluntarily agrees to such kind of stipulation, still the principle governing void stipulations should apply. The Civil Code (Art. 1306) provides: "The contracting parties may establish such stipulations, clauses, terms and conditions as they may deem convenient, provided they are not contrary to law, morals, good customs, public order, or public policy." Where the Insurance Law (Sec. 163) expressly obliges the insurer to indemnify the insured "the expenses it would be to the insured at the time of the commencement of the fire to replace the thing lost or injured in the condition in which it was at the time of the injury," and the law itself did not add "unless otherwise expressly stipulated," it seems that any stipulation contrary to the express legal liability of insurers would be against the law and therefore void, and there is no need for any special law to outlaw such stipulation.

In a case decided by the Court of Appeals of Kentucky,<sup>97</sup> it appeared that the Hartford Fire Insurance Co. issued to the Henderson Brewing Co. a policy which insured, in the sum of \$5,000, certain buildings belonging to the brewery company against tornadoes, windstorms, or cyclones. The following was expressly stipulated:

"It is part of the consideration of this policy, and the basis upon which the rate of premium is fixed, that the assured shall maintain insurance on each item of property insured by this policy of not less than 50% of the actual cash value thereof, and that failing so to do the assured shall be an insurer to the extent of such deficit, and in that event shall bear his, her, or their proportion of any loss."

The company's five-story building which was insured in the sum of \$3,500 was damaged to the extent of \$1,384.19. Suit was brought to recover on the policy. The insurer pleaded the co-insurance clause and alleged in substance that the loss of the damaged building was only partial; that its value was \$20,000, and 50% thereof was \$10,000; that by reason of the plaintiff's failure to take out insurance to the extent of \$10,000 he was himself a coinsurer to the extent of \$6,500 and should be required to bear 6,500/10,000 of the loss of \$1,384.19, or \$899.72; and that the insurer was only liable for 3,500/10,000 of the loss, or \$484.46. The trial court as well as the Court of Appeals held that the co-insurance clause is violative of Section 700, Kentucky Statutes. Said Section 700 of the Kentucky Statutes is as follows:

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<sup>97</sup> 182 S.W. 852 (1916).

“That (all) insurance companies that take fire or storm risks . . . in this Commonwealth shall, on all policies issued after this Act takes effect (in case of total loss thereof by fire or storm), be liable for the full estimated value of the property insured, as the value thereof is fixed in the . . . policy; and in case of partial loss of the property insured, the liability of the company shall not exceed the *actual loss* of the party insured: Provided, That the estimated value of the property insured may be diminished to the extent of any depreciation in the value of the property occurring between the dates of the policy and the loss: And provided further, That the insured shall be liable for any fraud he may practice in fixing the value of the property, if the company be misled thereby.”

It is true that the above Kentucky Statute refers to a valued policy, but its provision is similar to that of Section 163 of the Philippine Insurance Law governing open policies, in that our law makes the insurer liable to the extent of “the expense it would be to the insured at the time of the commencement of the fire to replace the thing lost or injured in the condition in which it was at the time of the injury,” or for the actual loss. In other words, an agreement which makes the insurer liable for only a part of the loss while the law makes him liable for the full actual partial loss must be deemed, as held in the Kentucky case, as violative of the statute.

## LAW ON TRANSPORTATION

Business may, in one way or another, come in contact with the law governing transportation. Transportation on land and on inland waters is governed by the Civil Code; transportation on sea is governed by maritime law contained in the Code of Commerce, and by a special law called the Carriage of Goods by Sea Act, insofar as foreign commerce is concerned. However, the general provisions of the Civil Code on overland transportation shall also apply to maritime transportation, unless these provisions are in conflict with maritime law.

For example, there is a special provision in maritime law that the civil liability of shipowners in case of collisions shall be understood as “limited to the value of the vessel with all her appurtenances and all the freightage earned during the voyage.”<sup>98</sup> Another maritime provision says that shipowners shall be civilly liable for the indemnities in favor of third persons arising from the conduct of the captain in the case of goods and of persons; “but he may exempt himself therefrom by abandoning the

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<sup>98</sup> Art. 837, Code of Commerce.

vessel with all the equipment and the freightage it may have earned during the voyage."<sup>99</sup> Still another maritime provision says that if the vessel and its freight is totally lost by reason of capture or wreck, "all rights of the crew to demand any wages shall be extinguished as well as the shipowner to recover the advances made."<sup>100</sup> And lastly, another maritime provision allows a loan on the vessel or on the cargo as security (called a "loan on bottomry" or "respondentia") but provides that "the repayment of the sum loaned and the premium stipulated depends on the safe arrival in port of the property on which it is made, or of the value that may be obtained in case of disaster."<sup>101</sup>

All these special provisions are peculiar to maritime law, and simply means that the loss of the vessel or of the cargo extinguishes the liability of the ship owner or the cargo owner. This is known as "the real and hypothecary nature of maritime law." There are, however, exceptions to this limited liability in maritime law, such as the following: "When the vessel is insured, the insurance substitutes the vessel, and the shipowner is liable to the extent of the insurance collected, notwithstanding the loss of the vessel";<sup>102</sup> or the liability of a shipowner is not extinguished by the loss of the vessel if such liability arises from the provisions of the Workmen's Compensation Law;<sup>103</sup> or where the negligence of the captain may be attributed to the shipowner himself, as where he allowed the captain to operate a vessel without license.<sup>104</sup> But, except in the cases of the few exceptions above mentioned, the liability of the shipowner in maritime law is limited to the value of his vessel so that the loss of his vessel also extinguishes his civil liability. This principle is peculiar only to maritime cases, or to cases where the subject-matter involved is a vessel. But where the property involved is not a vessel but is only a banca or a bus, the liability of the parties concerned shall be governed by the general law of transportation as provided for in the Civil Code and not by maritime law.<sup>105</sup>

However, the Civil Code provisions on common carriers in general are also very strict. While the general rule concerning obligations says that no person shall be liable for fortuitous events or *force majeure*, the rule in transportation is that the common carrier is "presumed" negligent unless he can prove that he had exercised "extraordinary diligence" in the vigilance over the goods and for the safety of the passengers transported

<sup>99</sup> Art. 587, Code of Commerce; *Yangco v. Laserna*, 73 Phil. 330 (1941).

<sup>100</sup> Art. 643, Code of Commerce.

<sup>101</sup> Art. 719, Code of Commerce.

<sup>102</sup> *Urrutia & Co. v. Baco River Plantation Co.*, 26 Phil. 632 (1913).

<sup>103</sup> *Abueg v. San Diego*, 77 Phil. 730 (1946).

<sup>104</sup> *Manila SS Co. Inc. v. Inza et al*, 52 O.G. 7587 (1956).

<sup>105</sup> See *Lopez v. Duruelo*, 52 Phil. 229 (1928).

by him;<sup>106</sup> or, unless he proves that the cause of the loss is due to natural disaster, act of the public enemy in war, act of the shipper himself, or defects in the packing, or due to an act of competent public authority.<sup>107</sup> In some cases, proof of exercise of extraordinary diligence on the part of the common carrier will not necessarily exempt him from liability for loss of goods, if such a loss is caused by the act of his employees, theft, or defective condition of the vehicle used in the transportation, even if expressly stipulated.<sup>108</sup> This is so, because of the nature of the business of common carriers and because of reasons of public policy.<sup>109</sup> "And this is a politic establishment contrived by the policy of the law, for the safety of all persons, the necessity of whose affairs oblige them to trust this sort of persons, that they may be safe in their ways of dealing; or else these carriers might have an opportunity of undoing all persons that had any dealings with them, by combining with thieves, etc., and yet doing it in such a clandestine manner as would not be possible to be discovered."<sup>110</sup>

## THE LAW ON INSOLVENCY

The primary object of every business is profit. Solvency, not insolvency, therefore, is the aim of all businessmen. But accidents do happen in all kinds of human endeavor, and if a business enterprise becomes insolvent the law on insolvency may come into operation.

Our Insolvency Law<sup>111</sup> provides for three kinds of proceedings: suspension of payments, voluntary insolvency and involuntary insolvency.

Suspension of payment proceedings takes place when the business has sufficient assets but has no cash to pay its debts when they fall due. As the term implies, the debtor may request of his creditors the suspension of the payments of the debts which, if approved by the majority vote of the creditors and by the court, may bind all creditors included in the schedule of debts submitted by the debtor. To form a majority, it is necessary that: 2/3 of the creditors voting unite upon the same proposition, and that the claims represented by said majority vote amount to at least 3/5 of the total liabilities of the debtor.<sup>112</sup> The following creditors, unless they join in the voting, are not bound by any agreement to suspend payments of debts: (a) Persons having claims for personal labor, maintenance, expenses of last illness and funeral of the wife or children of the debtor incurred

<sup>106</sup> Arts. 1733, 1735, Civil Code.

<sup>107</sup> Art. 1734, Civil Code

<sup>108</sup> Art. 1745, Nos. 5,6, and 7, Civil Code.

<sup>109</sup> Art. 1733, Civil Code.

<sup>110</sup> See Raoul P. Calinvaux, *Carver's Carriage of Goods by Sea* (10th ed.; London: Stevens & Sons, Ltd., 1957), p. 3.

<sup>111</sup> Act No. 1956, as amended.

<sup>112</sup> Sec. 8, Act No. 1956.

within 60 days immediately preceding the filing of the petition for suspension of payments; and (b) persons having legal and contractual mortgages.<sup>113</sup>

Voluntary insolvency proceedings take place when an insolvent debtor, owing debts exceeding P1,000, voluntarily files a petition in the court of first instance of the province or city where he has resided at least 6 months, annexing to his petition a schedule of his debts and an inventory of his assets and property. If his allegations are true, the court may issue an order adjudging him an insolvent within the meaning of the Insolvency Law.

Involuntary insolvency proceedings take place when 3 or more creditors, residents of the Philippines, whose credits amount to not less than P1,000 and have accrued in the Philippines, file a petition in the court of first instance of the province or city where the debtor resides, alleging and proving that the debtor has committed any of the acts of insolvency mentioned in the Insolvency Law, among which are: (a) That the debtor conceals or is removing any of his property to avoid its being attached or taken on legal process; (b) that he has suffered or procured his property to be taken on legal process with intent to give preference to one or more of his creditors; (c) that he has made any assignment, gift, sale, conveyance, or transfer of his property or credits with intent to delay, defraud, or hinder his creditors; (d) that he has, in contemplation of insolvency, made any payment, gift, sales, conveyance, or transfer of his property or credits; (e) that being a merchant, he generally defaulted in the payment of his current obligations for a period of 30 days; or (f) that an execution having been issued against him on final judgment for money, he shall have been found to be without sufficient property subject to execution to satisfy the judgment.<sup>114</sup>

When the debtor is adjudged insolvent in voluntary or involuntary insolvency proceedings, all his property (except those portions exempted by law from execution) is to be administered by an assignee or trustee in bankruptcy whose duty is to convert said assets into cash for proper distribution or payment among the creditors of the insolvent. The payment of claims of the creditors shall be determined by the legal priority of claims: the preferred creditors shall enjoy preference over the ordinary creditors.

Under the law, preferred claims are of three classes:

(a) Preferred claims with respect to specific movable property; these claims do not enjoy priority in the order of payment but are merely pref-

<sup>113</sup> Sec. 9, Act No. 1956.

<sup>114</sup> Sec. 20, Act No. 1956.

erred insofar as a particular personal property is concerned. An example of this class of preferred claim is the unpaid price of movables sold as long as said movables are in the possession of the insolvent.

(b) Preferred claims with respect to specific immovables; these claims do not enjoy priority in the order of payment either, but are merely preferred insofar as a particular immovable property is concerned. An example of this class of preferred claim is the unpaid price of real property sold, or a mortgage credit, duly recorded, upon the real property mortgaged. Credits which enjoy preference with respect to specific movables or specific immovables exclude all others to the extent of the value of the property to which the preference attaches. If there are two or more preferred credits with respect to the same property, they shall be paid *pro rata*, after the payment of taxes.<sup>115</sup>

(c) Third class of preferred claims are those which enjoy preference in the order named. These are called preferred claims with respect to the other property of the insolvent (i.e., property not subject to preferred claims on specific property). These preferred claims are payable in the following order:

1. Funeral expenses of the debtor or of his minor children, as approved by the court.

2. Credits for services rendered for one year preceding the commencement of insolvency proceedings.

3. Expenses of last illness of the debtor, or of his or her spouse and minor children.

4. Compensation due laborers in cases of labor accidents.

5. Credits and advances made to the debtor for family support, for one year preceding insolvency.

6. Support during the insolvency proceedings and for three months thereafter.

7. Fines and civil indemnity arising from a crime.

8. Legal expenses, as approved by the court.

9. Taxes due to the national government.

10. Taxes due to the provincial government.

11. Taxes due to cities and municipalities.

12. Damages for death or personal injuries caused by a quasi-delict.

13. Gifts due to charitable institutions.

14. Credits which appear in (a) public instrument, or (b) final judgment, which shall have preference among themselves in the order of priority of the dates of the instruments and of the judgments, respectively.<sup>116</sup>

<sup>115</sup> Arts. 2241, 2242, 2246, 2247, 2248, and 2249, Civil Code.

<sup>116</sup> Art. 2244, Civil Code.

After the payment of all claims, preferred and ordinary, the debtor, if entitled to a discharge, shall be granted a certificate of discharge. This certificate of discharge shall (with the exception of taxes, debts created by fraud or embezzlement of the debtor, or by his defalcation as a public officer or while acting in a fiduciary capacity) discharge the debtor from all claims or debts which are set forth in his schedule, or which were or might have been proved against his estate in insolvency.<sup>117</sup> If the insolvent is a partnership, the certificate of discharge shall be granted to every general partner. If the insolvent is a corporation, no certificate of discharge shall be granted, under the mistaken concept that the insolvency of a corporation extinguishes its juridical personality.<sup>118</sup> If no discharge shall be granted a corporation, then that corporation shall take advantage of the opportunity to file a petition for voluntary insolvency if, after all the proceedings in insolvency are over and the corporate assets duly distributed among its creditors, the corporation will continue to be liable for its unpaid debts. May not a corporation that had become insolvent be able to rehabilitate itself and reacquire property either through donation or gifts? Such a contingency is not impossible, and it is therefore not proper for the law to refuse absolutely the granting of a certificate of discharge to a corporation adjudged insolvent. In partnerships, the non-granting of a certificate of discharge to the partnership itself is proper, because under the law of partnership the insolvency of a partnership dissolves the partnership.<sup>119</sup> The insolvency of a private corporation does not of itself dissolve the corporation. Corporate dissolution takes place only in any one of the ways of dissolution expressly provided for by the Corporation Law; namely: (a) by voluntary dissolution; or by (b) involuntary dissolution, through: expiration of term, or by failure to organize and commence transaction of business within 2 years from incorporation, or by legislative enactment, or by judicial decree of forfeiture.<sup>120</sup>

## OTHER BUSINESS LAWS

*Tax laws* will surely confront every businessman doing business in the Philippines. However, one may avail himself of tax exemptions by establishing new and necessary industries;<sup>121</sup> or by importing only certain drugs and medicines and other specified articles, such as fertilizers imported by farmers directly or through their cooperatives; textbooks and supplementary readers approved by the Board of Textbooks or by public and private schools as certified by the Secretary of Education; paper and newsprint imported by publishers for their exclusive use; canned salmon

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<sup>117</sup> Secs. 68 and 69, Act No. 1956.

<sup>118</sup> Sec. 52, Act No. 1956.

<sup>119</sup> Art. 1830, Civil Code.

<sup>120</sup> Secs. 19, 62, and 190 1/7, Act No. 1459, as amended.

<sup>121</sup> R.A. No. 35, as amended by R.A. Nos. 901 and 2351.



and sardines; dynamites for mining purposes; and containers used by importers for the manufacture of local products for export;<sup>122</sup> or by taking advantage of the Basic Industries Act.<sup>123</sup>

*New and necessary industries* are exempt from all internal revenue taxes (except tax on income), up to 1958 and to a diminishing exemption, as follows:

- 90% from Jan. 1 — Dec. 31, 1959;
- 75% from Jan. 1 — Dec. 31, 1960;
- 50% from Jan. 1 — Dec. 31, 1961
- 10% from Jan. 1 — Dec. 31, 1962.

An industry shall be deemed "new" which was not existing or operating in a commercial scale prior to January 1, 1959 (except processors of oil, gasoline, and similar fuel and by-products). An industry shall be deemed "necessary" which will contribute to the attainment of a stable and balanced national economy, and where the imported raw materials represented a value not exceeding 60% (preferably much less) of the manufacturing cost.

*Basic industries include:*

1. Basic iron, nickel, aluminum and steel industries
2. Basic chemical industries, including cement manufacture and fertilizers.
3. Copper and aluminum smelting
4. Paper manufacturing.
5. Deep-sea fishing and canning of sea foods; manufacture of fish meals, nets, and fishing gear.
6. Refining of gold, silver, and other noble metals.
7. Mining and exploration of minerals and crude oil or petroleum.
8. Production of agricultural crops.
9. Ship-building and dry-docking.
10. Coal.
11. Cattle industry.
12. Logging and manufacture of veneer and plywood.
13. Vegetable oil manufacturing, processing, and refining.
14. Manufacture of irrigation equipment, farm machineries, spare parts and tools for such farm machineries, trucks, and automobiles.
15. Manufacture of textiles, cotton, ramie, synthetic fibers, and coconut coir.
16. Manufacture of cigars from both native and Virginia tobacco.

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<sup>122</sup> R.A. No. 1394, as amended by R.A. No. 2352.

<sup>123</sup> R.A. No. 3127.

17. Manufacture of gasoline and diesel engines.
18. Manufacture of ceramics, furnaces, refractories, and glass.
19. Manufacture of food products out of cereals, forest and/or agricultural products.

Those engaged in Basic Industries, as defined by law, shall be exempted from the payment of special import tax, compensating tax, foreign exchange margin fee, and tariff duties, as follows:

100% from June 17, 1961 — Dec. 31, 1966.

75% from Jan. 1 — Dec. 31, 1967.

50% from Jan. 1 — Dec. 31, 1968.

All applications for exemptions must be approved by the Board of Industries, composed of the Chairman of the National Economic Council, the Secretary of Commerce and Industry, the Secretary of Agriculture and Natural Resources, the Chairman of the Joint Legislative-Executive Tax Commission, and three private citizens representing the consumers, the producers, and the labor sectors, all appointed by the President of the Philippines, with the consent of the Commission on Appointments.

Last, but not least, every businessman must know *labor laws* such as the Minimum Wage Law,<sup>124</sup> the Industrial Peace Act,<sup>125</sup> the Workmen's Compensation Law,<sup>126</sup> the Blue Sunday Law,<sup>127</sup> the Terminal Pay Law,<sup>128</sup> the Eight-Hour Labor Law,<sup>129</sup> Women and Child Labor Law,<sup>130</sup> and the Social Security Law.<sup>131</sup>

The Minimum Wage Law obliges the industrial employer to pay his employees a minimum wage of P4.00 a day. Pending in Congress is a law seeking to increase this minimum wage to P6.00 a day. This minimum wage does not apply to retail or service enterprises that regularly employ not more than 5 employees.

The Industrial Peace Act, otherwise known as the Magna Carta of Labor, gives the employees the rights of self-organization and of collective bargaining; to interfere with or refuse to recognize these rights is considered by law as "unfair labor practice". The right to strike or lockout is directly connected with a labor dispute, and provided that "before an employer may lockout his employees, or the employees may strike, either

<sup>124</sup> R.A. No. 602, as amended by R.A. No. 812.

<sup>125</sup> R.A. No. 875.

<sup>126</sup> Act No. 3428, as amended by Act No. 3812, C.A. No. 210, R.A. Nos. 772 and 889.

<sup>127</sup> R.A. No. 946.

<sup>128</sup> R.A. No. 1052, as amended by R.A. No. 1787.

<sup>129</sup> C.A. No. 444.

<sup>130</sup> R.A. Nos. 678 and 1131.

<sup>131</sup> R.A. No. 1161, as amended by R.A. Nos. 1792 and 2658.

party as the case may be, must file with the Conciliation Service (of the Bureau of Labor) 30 days prior thereto a notice of their intention to strike or lockout the employees."<sup>132</sup>

The Workmen's Compensation Law obliges an employer to give certain sums of money to his employee by reason of death or injuries "arising out of and in the course of his employment."

The Blue Sunday Law prohibits the opening of any commercial establishment on any Sunday, Christmas Day, New Year's Day, Holy Thursday, and Good Friday, except drug stores, public utilities, and similar enterprises.

The Terminal Pay Law provides just causes for terminating an employment without a definite term, and any employee dismissed without cause or without proper notice shall be entitled to an amount equivalent to one half a month's pay for every year of service, a fraction of at least 6 months being considered as one whole year.

The Eight-Hour Labor Law provides that the legal working day for employees in private firms shall not be more than 8 hours daily, except in case of emergencies, in which case, the employees shall be entitled to receive overtime pay of at least 25% of the regular wages.

The Women and Child Labor Law grants some special privileges to women and minors employed in industrial establishments.

The Social Security Law establishes a social security system of death and sickness benefits to employees in private firms.

All these labor laws are intended to benefit the laborers and, incidentally, the business where labor is performed. However, Congress, in its zealotry to favor the laborer, may unwittingly kill the hen that lays the golden egg.

## CONCLUSION

We have made a brief survey of the entire field of Philippine business law. Due to limitation of space, some other laws which may have something to do with business transactions may have been omitted. Their omission does not mean that they are not important. To a businessman, no law that affects him, directly or indirectly, is unimportant. However, we cannot achieve completeness in our present task. The main idea is to give a broad outline of the legal framework within which business in the Philippines operates, and it is hoped that this purpose has been reasonably accomplished. If not, it is suggested that the businessman who intends to

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<sup>132</sup> Sec. 14, R.A. No. 875.

do business in the Philippines consult any annotated, up-to-date work on Philippine commercial laws.<sup>133</sup>

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<sup>133</sup> See, for example, Guevara, S., *The Philippine Commercial Laws and Code of Commerce, With Appendices, Coordinated, Integrated and Annotated*, (11th ed.; Manila: Atlas Publishing Co. 1962).