PREFACE

Upon first impression, the Negotiable Instruments Law may appear to be complex and abstruse. However, it is believed that the subject may be presented in a simplified and concise manner without sacrificing the proper scope, so that it may be easily understood by a wide range of readers. It is with this aim in mind that this modest work which is now on its seventh edition has been prepared.

It will be noticed that the authors did not limit themselves to merely explaining the law, giving illustrations, and citing or quoting judicial decisions and opinions of well-known writers on bills and notes. In many instances, they expressed their own opinions especially where there is a conflict of views. Needless to say, they do not pretend to speak with authority.

This book also discusses at some length the Civil Code provisions on documents of title and the Warehouse Receipts Law. The authors have deemed it fit to include as appendices important specialized laws in die mercantile field.

While this volume is intended primarily to serve as a textbook for law students, it may conveniently be used by lawyers, judges, and business executives as a handy reference.

The authors acknowledge their grateful appreciation to former Justice Catalino R. Castaneda, Jr. of the Sandiganbayan, a classmate in the U.R College of Law and co-author of "Comprehensive Review of Business Law" of the first author of this work, for his valued comments and suggestions.

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PARTI

THE NEGOTIABLE INSTRUMENTS LAW

(ACT NO. 2031.) INTRODUCTION

Historical background of our Negotiable Instruments Law.

(1) *U.S. Uniform Negotiable Instruments Act.* — Our law is patterned with very slight modifications after the Uniform Negotiable Instruments Act of the United States of 1896 drafted by the National Conference of Commissioners on Uniform State Laws.

The Conference was appointed in 1895 to revise and codify the law merchant in the United States as there was much confusion and lack of uniformity then in the court decisions on the subject resulting from the variety of statutes pertaining to commercial paper enacted by various state legislatures. This law, in turn, is based upon and largely copied from the English Bill of Exchange Act of 1882, a codification of the laws in England governing bills of exchange, promissory notes and checks. Most state legislatures adopted the Act as the main law for regulating commercial paper.

(2) *U.S. Uniform Commercial Code.* — The Uniform Negotiable Instruments Act has been replaced in part by Article 3 and in part by other articles of the Uniform Commercial Code (U.C.C.) prepared under the auspices of the National Conference of Commissioners on Uniform State Law and the American Law

Institute. Proposed for adoption by the legislatures of the states, the first draft of the Code was finished in 1952 although the Code is revised periodically, (see 11 Am. Jur. 2d 64.)

The Code seeks to simplify and modernize the law of commercial transactions. Each state has adopted part or all of the Code.

(3) *Act No. 2031.* — Our Negotiable Instruments Law was enacted as Act No. 2031 on February 3,1911. It took effect 90 days after its publication on March 4,1911 in the Official Gazette of the Philippine Islands was completed. (Sec. 198.) The Act, therefore, took effect on June 2,1911. Since then, our Congress has not seen fit to amend any of its provisions. [M]

The evident purpose of the Act is to facilitate transactions in commercial paper and to promote free flow of credit. Since then, our Congress has not seen fit to amend any of its provisions.

(4) *Code of Commerce.* — Prior to the passage of Act No. 2031, the law then existing and in force as to negotiable instruments could be found in Book II of the Code of Commerce, from Articles 443 to 556. All these articles, with the exception of those on crossed checks, have been repealed. (Sec. 197.)

Application and purpose of the Negotiable Instruments Law.

(1) The Act applies only to *negotiable* instruments (Arnold vs. Jordan, 215 Ala. 693,112 So. 305.) or to those instruments which meet the requirements laid down in Section 1 of the law. It is designed to describe fully the law of negotiable instruments. It "covers the entire subject of negotiable instruments and must be , treated as a complete body of law upon the subject and controlling in all cases to which it is applicable/' (Bank of Italy, etc. vs. Symmes, 118 Cal. App. 716,5 P. [2d] 956.) It is decisive as to all matters comprehended within its terms.

(2) Any case not provided for by the Act shall be governed by the provisions of existing legislation or in default thereof, by the rules of the law merchant. (Sec. 196.) The Civil Code has no effect on its provisions except to supply any deficiency in cases not covered by the Act. (see Art 18, Civil Code.)

(3) The law was enacted for the purpose of facilitating, not hindering or hampering transactions in commercial paper. Thus, the said statute should not be tampered with haphazardly or lightly nor should it be brushed aside in order to meet the inecessities in a single case. (State Investment House, Inc. vs. Court of Appeals, 217 SCRA 32 [1993].)

Function and importance of negotiable instruments.

Negotiable instruments play an important role in the business world.

(1) *Asa substitute for money.* — Although they do not constitute legal tender (Art. 1249, *ibid.),* and are not money, they are used as a substitute for money. One of the distinctive characteristics of a negotiable instrument is its negotiability which allows it to pass freely from hand to hand in the commercial markets and to take the place of money in commercial transactions free from all personal defenses (see Sees. 57-58.) available against the original owner.

A negotiable instrument differs from money, however, in that the former is valuable or worthless depending upon the financial ability of the parties to them. The purpose of the law is to place negotiable instruments on such footing that it would be freely accepted without question in commercial transactions and thereby facilitate trade.

(2) *As a medium of exchange Jbr most commercial transactions.* — Negotiable papers, particularly checks, constitute, at present, the media of exchange for most commercial transactions. They thus increase the purchasing medium in circulation. Without them circulating among business houses and individuals, more money either in coins or bank bills would be needed in circulation to take care of the ever increasing everyday business transactions. It would be very difficult for the economy to prosper.

(3) *As a medium of credit transactions.* — Negotiable instruments also serve as a medium of credit transactions." A man does not always have property, or valuable property rights which he can turn into cash at any moment. These tilings, however, measure his credit and he avails himself of his credit by executing

his note to his creditor who, in turn indorses this to a third person. Thus, men, in this way, without cash in hand are enabled by means of credit to conduct and carry to completion business and commercial enterprises. The *purpose of negotiability* then is to allow men of undoubted credit to carry on a business enterprise upon their promissory notes, bills of exchange and checks knowing that other businessmen will treat these promises as cash/' (Ogden, Negotiable Instruments [5th ed.], p. 50.)

The check is primarily used for immediate payment *(i:e.,* as a substitute for money), while the ordinary bill of exchange and the promissory note are intended for the circulation of credits *(i.e.,* primarily as a credit transaction). It is used more than any other instrument of credit as a means of making payment. The use of checks automatically provides a receipt for payment and serves as convenient records of financial transactions, (see Sec. 185.)

EXAMPLE:

S sells goods to B who gives a check or a promissory note payable until a future date. Since S would have to wait until maturity date to collect, this is a form of extending *credit* to a buyer. Now S may wish to sell the instrument to a bank (or a third person) for immediate cash. In order to induce the bank (indorsee) which would have to wait for the maturity before receiving payment, to buy the instrument, S accepts a discount of say, 10% of the face amount.

In the above example, the bank, in effect, pays less than the amount it will eventually collect as a way of charging S (seller) interest in advance as compensation for its role in the transaction.

Characteristics or features of negotiable instruments.

Negotiable instruments have twp important features, namely: negotiability and accumulation of secondary contracts as they pass from one person to another.

(1) *Negotiability.* — This is that quality or attribute of a bill or note whereby it may pass from hand to hand similar to money, so

as to give the holder in due course the right to hold the instrument and collect the sum payable for himself free from any infirmity in the instrument or defect in the title of any of the prior parties, or defenses available to them among themselves, (see Sees. 52,57.)

In other words, the rule that one can pass no better title to personal property thanhe himself has, does not apply to negotiable instruments, (see Sec. 30, re-distinctions between negotiation and assignment) A negotiable instrument is analogous to money, for one who honestly takes coin or currency from a thief or finder without knowledge of loss or theft, giving value for it, can hold it against the world, including the true owner. Without this rule, negotiable instruments could not perform their peculiar functions. When transferability is limited or restricted, the paper may be said to be non-negotiable.

EXAMPLE:

Suppose S sells and delivers goods to B who later refuses to pay for them as they, in fact, are not as ordered. In a suit by S against B for the price, B can successfully raise breach of contract by S as a defense. If S assigns the account to X, B can interpose the same defense against X notwithstanding the fact that X did not know of any dispute between S and B when X bought B's account. As assignee X stands in the shoes of S, his assignor.

Assume now that B had issued to S his promissory note for the price of the goods. If S sues B on the note, the defense of breach of contract is available to B. But if S negotiates the note to Y who takes the note under such circumstances as to make him a holder in due course (see Sec. 52.), B can no longer interpose such defense against Y.

A *bona fide* holder, however, while free from *personal* defenses available to prior parties among themselves, is subject to *real* defenses that might have obtained between them, (see Sec. 58.)

(2) *Accumulation of secondary contracts.* — The most important feature of negotiable instruments is the accumulation of secondary contracts as they are transferred from one person to another. Once an instrument is issued (see Sec. 191.), additional parties can become involved.

EXAMPLE:

Suppose A issues a promissory note payable to the order of B for the sum stated therein. Here, the contract is only between A and B. A is primarily liable. If B transfers his right to the instrument to C, B thereby enters into a new contract with C whereby B binds himself to pay in C in case A, the maker, does not pay the note. Here, B is secondarily liable^ The primary contract is that between A and B. The transfer of the note to C makes a secondary contract between B and C.

If D buys or discounts the note from C, a similar contract is entered into and so on as it passes from hand to hand. It is obvious that the more debts are added, the more advantageous it will be to the holder as he can pr6teed not only against the " maker but also against all transferors.

The theory of negotiable instruments.

The theory of negotiable instruments, and of their currency from hand to hand, rests upon the proposition that they appear to belong to the person having them in possession and to no one else.

By sending a negotiable instrument into the world, the maker is estopped from urging, as against a *bona fide* holder who has received it from anyone in possession, a defect of title. The holder, though without title, has capacity to give a title because he is the apparent owner of the instrument. (Manhattan Sav. Inst, v. New York Nat. Ex. Bank, 62 NE1079.)

Forms of negotiable instruments.

(1) *Common forms.* — The most common forms of negotiable instruments in commercial transactions are the promissory note (Sec. 184.), bill of exchange (Sec. 126.), and bank check. (Sec. 185.) Actually, the Negotiable Instruments Law deals only with two kinds or types of instruments, namely: (a) promissory notes or those in which the issuer has promised to pay; and (b) bills of exchange or those in which the issuer has ordered a third person topay.

Checks are also discussed in the law but they are really a special form or kind of bill of exchange.

(2) *Special types.* — There are, to be sure, many various forms of negotiable instruments. An analysis of the many variations will reveal, however, that they belong to one or the other of the types mentioned.

Some other instruments that have been held negotiable under the Negotiable Instruments Law are: certificates of deposits, bank notes, due bills, bonds, drafts, trade acceptances, and banker's acceptances. The first four are special types of promissory notes (see Sec. 184.) while the others are types of bills of exchange, (see Sec. 126.)

Doubt resolved in favor of negotiability.

Negotiable paper, representing as it does in almost all civilized nations a very large proportion of the commercial operations, and serving to a great extent as the representative of money, is justly a favorite of the law, and enjoys immunities and privilege which are extended to no other species of contracts. (Winston v. Westfeldt, 22 Ala. 760.)

Where the meaning is doubtful, the courts have thus adopted the policy of resolving in favor of the negotiability of the instrument. The purpose obviously is to encourage the free circulation of the negotiable papers because of the admittedly indispensable function they perform in mercantile business transactions in any given country and the world at large.

Contracts and negotiable instruments compared.

(1) *Assumability and negotiability.* — Bills of exchange and promissory notes in their various forms are written contracts, and the fundamental rules governing the law of contracts are applicable to the determination of the legal questions which may arise over such instruments. However, bills and notes are capable of being cast in such form as to have the quality Of negotiability, and instruments having this quality, while their nature as contracts is unimpaired, are distinguished from ordinary contracts by incidents having their foundation in the law merchant (see Sec. 196.), which, so far as it has been codified by statute, is now known as the Negotiable Instruments Law.

Between ordinary contracts and negotiable instruments there is the difference between "assignability" and "negotiability." (11 Am. Jur. 2d 29-30; see Sec. 30.)

Unlike other contracts, a negotiable instrument is not in force until it is delivered: (see Sec. 16*)

(2) *Negotiability of various types of commercial papers.* — While it has been said that there is no middle term between negotiability and non-negotiability, the courts sometimes use the term "quasi- negotiability," and "negotiability" may vary with various types of commercial papers and their various purposes and functions. An instrument may possess some, but not all, of the elements of negotiability, or be negotiable in a limited sense rather than in the true sense. True negotiability may be confined to commercial contracts which represent and, in a measure, pass as money, such as bills of exchange and promissory notes (11 Am. Jur. 2d 33-35.) and their special forms.

(3) *Rules of law applicable.* — The peculiarities of the Negotiable Instruments Law, distinguishing such instruments from other contracts, relate, of course, to a holder who has taken by negotiation, and not as an original party. (Vander Plaeg v. Van Zuuk, 112 NW 807.) Bills and notes, while usually negotiable, are not necessarily so, and non-negotiable instruments generally are governed by the rules of law applicable to ordinary contracts, except as there is applicable to them, by analogy or by express provisions, the Negotiable Instruments Law. (11 Am. Jur. 2d 30.) Instruments which are negotiable in the true sense are governed by said Law.

Commercial papers with limited negotiability.

There are certain instruments with limited negotiability which are also widely used in commercial transactions but they have been held to be non-negotiable in the technical sense because they do not have the requisites that are essential under the Negotiable Instruments Law. They are beyond the scope of the Law and are, therefore, governed by other laws.[1]

'Also not governed by the NIL are:

■ Among such commercial papers are the following:

(1) *Document of title.* — It is a receipt or order for the delivery of goods, (see Part II.) It includes any bill of lading, dock warrant, "quedan" or warehouse receipt. Although it is termed "negotiable" when the goods are deliverable to the bearer or order, it is without an unconditional promise or order to pay a sum certain in money;

(2) *Letter of credit.* — It is in favor of a specified person and not to order. (Art. 568, Code of Commerce; see Part III-A.) But drafts (see Sec. 126.) issued in connection with letters of credit are negotiable instruments. (Lee vs. Court of Appeals, 375 SCRA579 [2002].)

(3) *Trust receipt* — It is a document of security pursuant to which a bank acquires a "security interest" in the goods under trust receipt, (see Part III-C.) Under a letter of credit-trust receipt arrangement, a bank extends a loan covered by a letter of credit with the trust receipt as a security for the loan. The transaction involves a loan feature represented by a letter of credit and a security feature which is in the covering trust receipt which secures an indebtedness. (Lee vs. Court of Appeals, *supra.)*

(4) *Certificate of stock.* — It is a muniment of title to a given share in the assets of a corporation. It is also without an unconditional promise or order to pay a sum certain in money; and

(5) *Pawn ticket.* — It is not a negotiable instrument under the Negotiable Instruments Law nor a negotiable document of title under Articles 1507, *et seq.* of the Civil Code. (Part II-A.) A

(1) *Treasury warrant.* — It is a government warrant for the payment of money such as that issued in favor of a public officer or employee covering payment or replenishment of cash advances for official expenditures. It is payable out of a specific fund or appropriation (Abubakar vs. Auditor General, 81 Phil. 359 [1948]; Metropolitan Bank &

(2) *Postal money order.* — It is an order for the payment of money to the payee named therein drawn by one post office upon another under authority of law. (see 11 Am. Jur. 2d 55.) It is subject to restrictions and limitations under postal laws and regulations (only one indorsement is allowed) inconsistent with the character of negotiable instrument. (7 Am. Jur. 921.) Moreover, in establishing and operating a postal money order system, the government is not engaged in commercial transactions but merely exercises a governmental power for the public benefit. (Phil. Educ.

pawnbroker who has been notified by the owner of the thing (jewelry) pledged by another that the thing pawned to it was either stolen or involved in an embezzlement of the proceeds of the pledge, has the duty (see Art. 21, Civil Code.) to hold the thing and to give notice to the owner and the police of any effort to redeem the same. The circumstance that the pawn ticket states that the pawn is redeemable does not exempt him from that duty. (Serrano vs. Court of Appeals, 196 SCRA107 [1991].)

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TITLE I

NEGOTIABLE INSTRUMENTS
IN GENERAL

CHAPTER I

FORM AND INTERPRETATION

Section 1. ***Form of negotiable instruments.*** **— An instrument to be negotiable must conform to the following requirements:**

(a) It must be in writing and signed by the maker or drawer;

(b) Must contain an unconditional promise or order to pay a sum certain in money;

(c) Must be payable on demand, or at a fixed or determinable future time;

(d) Must be payable to order or to bearer; and

(e) Where the instrument is addressed to a drawee, he must be named or otherwise indicated therein with reasonable certainty.

Commercial paper defined.

Commercial paper, in its broadest sense, refers to written promises or obligations that arise out of commercial transactions from the use of such instruments as promissory notes and bills of exchange.

All such paper is either negotiable or non-negotiable.

Formal requirements of negotiability in general.

A negotiable instrument, briefly stated, is a contractual obligation to pay money. However, whether or not an instrument is negotiable or non-negotiable depends entirely on its form and content. In determining the negotiability of an instrument, the following must be considered:

(1) the whole of the instrument;

(2) only what appears on the face of the instrument; and

(3) the provisions of the Negotiable Instruments Law especially Section 1 thereof which gives the requirements of negotiability.

A valid instrument is not necessarily negotiable. Every negotiable instrument is presumed to be a contract but not every contract is a negotiable instrument.

Negotiable instrument defined.

Section 1, in effect, gives a definition of a *negotiable instrument.* It is an instrument which possesses all the elements of negotiability provided in Section 1 of the Negotiable Instruments Law. It does not cover other types of negotiable *documents* involving the sale or tansfer of goods, (see Part II.)

The requisites enumerated in Section 1 are deemed essential for the security of commercial transactions as they enable one to tell at a glance whether or not an instrument is negotiable and accordingly, to gauge the risks involved in taking it as security. The Negotiable Instrument Law cannot' come into operation unless the document in existence is of the character described in Section 1 of the law. (Kauffman v. National Bank, 12 Phil. 182 [1908].) ,

Formal requirements explained.

All kinds of negotiable instruments are either promises or orders to pay money which meet the formal requirements set forth in the law.

The requirements indicated in subsections (a), (b), (c), and (d) are necessary in order that a promissory note may be negotiable while all the sub sections from (a) to (e) are necessary in order that a bill of exchange may be negotiable.

Under subsection (a), the *maker* refers to the person issuing a promissory note, while the *drawer,* to the person issuing a bill of exchange.

In subsection (b), the instrument must contain an "unconditional promise" if it is a promissory note and "an unconditional order" if it is a bill of exchange.

Subsections (c) and (d). are both applicable to each of the two kinds of instruments, but subsection (e) is applicable only to bills of exchange.

(1) *The instrument must be in writing.*—The term "instrument" indicates a writing. The instrument must be in writing or reduced in tangible form; otherwise, nothing could be negotiated or passed from hand to hand.

(a) Writing includes not only that which has been written on paper and with a pen or pencil but also that which is in print. (Sec. 191.) or has been typed. The writing may be made upon leather, doth or any other substitute for paper as long as it is movable in nature. Such materials, however, are no longer used in the usual exercise of business. The usual way is to have the instrument written or printed in durable paper.

There is no such thing as an oral negotiable instrument. An oral promise can make it difficult to determine liability and create the danger of fraud.

(b) The accepted rule is that the negotiability or non- negotiability of an instrument is determined from the writing that is from the face of the instrument itself. While the writing may be read in the light of surrounding circumstances in order to more perfectly understood the intent of the parties, yet as they have constituted the writing to be the only outward expression of their meaning, no other words are to be added to it or substituted in its stead. The duty of the court in such case is to ascertain not what the parties may have secretly intended as contradistinguished from what their words express, but what is the meaning of the words they have used. (Caltex [Phils.], Inc. vs. Court of Appeals, 212 SCRA 448 [1992].)

(2) *The instrument must be signed by the maker or drawer.* — Although the signature of the maker or drawer as a general rule is placed at the lower right hand corner of the instrument, it may appear in any part thereof whether at the top, middle or bottom or at the margin.

(a) A handwritten statement on the body of the instrument, such as "I, Juan dela Cruz, promise to pay Maria dela Cruz . . ." will be considered as Juan's signature. It will be valid and binding as long as it appears that a person intended to make the instrument his own. His signature is *prima facie* evidence of his intention to be bound as either maker or drawer. However, if the signature is so placed upon the instrument that it is not clear in what capacity the person intended to sign, he is deemed an indorser (Sec. 17[f].) and not a maker or a drawer.

(b) The signature of the maker or drawer is usually written in longhand. It is preferable that the full name or at least the surname should appear. But initials or any mark will be sufficient, provided that such signature be used as a substitute and the maker or drawer intends to be bound by it. The name may be written in script or Roman letters with a pen or pencil, or made by rubber stamp by one having authority. It may be printed, type-written, engraved, photographed or lithographed.

What is important is that the signer has intended to adopt the signature on the instrument as his own and to obligate himself for its payment. However, an unusual signature may limit the acceptability of an instrument. The use of a pencil is undesirable as it is easy to tamper the writing.

(c) Where the genuineness of the signature of the maker or drawer is denied, the signature is nevertheless presumed valid. The maker or drawer must provide some evidence of the signature's invalidity.

(3) *The instrument must contain an unconditional promise or order to pay.* — See comments under Section 3.

(4) *The instrument must be payable in a sum certain in money.* — The promise or order must call for the payment of a sum certain in money.

(a) The reason for the requirement that negotiable instruments must be payable in money is that money is the one standard of value in actual business. All other commodities may rise and fall in value but in theory, at least, money always measures this rise and fall, and remains the same. The chattel which is used as means of payment may fluctuate in value. (Norton on Bills and Notes, 4th ed., p. 66.) But the promise or order may designate "a particular kind of current money in which payment is to be *made."* (Sec. 6[e].)

With the requirement, negotiable instruments acquire a uniform standard of value enabling them to pass freely in lieu of money in the business world.

(b) The term *money* properly includes all legal tender, (see Sec. 6[e].) *Legal tender* is that sort of money in which a debt, or other obligation calling for money, may be lawfully paid, if the contract does hot specify the medium of payment. (18 R.C.L. 1276-1278; Ballentine's Law Dictionary, p. 738.) Thus, gold and silver and bank notes are not money.

See comments under Sections 2 and 6.

(5) *The instrument must be payable at a fixed or determinable future time or on demand.* — See comments under Sections 4 and 7.

(6) *The instrument must be payable to order or bearer.* — See comments under Sections 8 and 9.

(7) *The drawee must be named.* — This provision applies only to bills and checks. Obviously, an order which is not addressed to any person cannot be a bill, (see Sec. 14.) A bill is an order. But the bill would be sufficient if the drawee is indicated therein with reasonable certainty though he is not named. Thus, where a bill is addressed to the "treasurer" of a corporation, the drawee is sufficiently indicated, (see Sees. 128,129,17[e].) The trade name may be used as in the case of the payee. The reason for this last

element of negotiability is to enable the payee or holder to know upon whom he is to call for acceptance or payment.

A promissory note has no drawee. Like the drawee, the payee must be named with reasonable certainty, (see Sec. 8, par. 2.)

Non-negotiable instrument defined.

A *non-negotiable instrument* is, of course, an instrument which is not negotiable, that is, an instrument which does not meet the requirements laid down to qualify an instrument as a negotiable one, or an instrument which in its inception was negotiable but has lost its quality of negotiability. (11 Am. Jur. 2d, 37.)

A typical example is a check payable only to a specified person, as when it reads merely "Pay to Pedro Cruz/' A negotiable instrument ceases to be negotiable if the indorsement prohibits the further negotiation of the instrument, (see Sec. 36[a]; also Sees. 32 and 41.)

An instrument which is non-negotiable is covered by the general provisions of the Civil Code, not by the Negotiable Instruments Law. It is merely a simple contract in writing and is evidence of such intangible rights as may have been created by the assent of the parties. (Garcia vs. Llamas, 417 SCRA 292 [2003].)

A non-negotiable instrument may not be negotiated but it may be assigned or transferred (see Sec. 30.), absent an express prohibition against assignment or transfer written on the face of the instrument. The legal consequences of negotiation, as distinguished from assignment of a negotiable instrument, are different. (Sesbreno vs. Court of Appeals, 222 SCRA 466 [1993].) Persons who transfer or assign contractual or non-negotiable rights pass only the rights that they had.

Money defined.

Specifically, *money* means what is coined or stamped by public authority and has its value fixed by public authority. In a literal sense, the term "money" means cash, (see 11 Am. Jur. 2d 40.)

It is a medium of exchange authorized or adopted by. a government as part of its currency, (see [U.S.] Uniform Commercial Code 1-201 [24].) It includes all legal tender, *{supra;* see Sec. 6[e].)

Money not governed by Act.

Paper money is, of course, a negotiable instrument, but the Negotiable Instruments Law has no application to money as such

While negotiable instruments approach money in character and use, and are a temporary substitute therefor, the question whether for any particular purpose such an instrument constitutes money, payment, or proper tender, is not governed by the Act.' (see 11 Am. Jur. 2d 40.)

Promissory note defined.

A negotiable *promissory note* is an unconditional *promise* in writing made by one person to another, signed by the maker, engaging to pay on demand, or at a fixed or determinable future time, a sum certain in money to order or to beareir. (see Sec. 184.)

A promissory note, briefly stated, is a promise to pay a sum of money. It is commonly referred to as *note.* It may be a *demand* instrument (Sec. 7.) but is normally a *time* instrument. (Sec. 4.)

A mere contract to pay money which is not a promissory note is a mere chose in action. (Steward v. Mcintosh, 9 NE 2d 407.)

Original parties to a promissory note.

This class of negotiable instrument is a *promise paper,* or two- party paper.

There are originally two parties in a promissory note. The one who makes die promise and signs the instrument is called

'Money bears no earmarks of peculiar ownership; Its primary function is to pass from hand to hand as a medium of exchange, without other evidence of its title. Money, which had passed through various transactions in the general course of banking business, even if of traceable origin, is no exception. (BPI Family Bank vs. Franco, 538 SCRA 184 [2007].)

the *maker* and the party to whom .the promise is made or the instrument is payable is called the *payee.*

The payee may be specifically designated by name or by office or title *(e.g.,* treasurer of X Corporation). It may be unspecified * *(e.g.,* "bearer"). He may seek payment personally or further . negotiate (see Sec. 30.) the instrument/Thus, the maker assumes liability to pay to the payee or to the holder.

The maker's signature must appear on the face of the note for him to be liable thereon. After an Instrument, promissory note or bill of exchange — is issued, additional parties can also become involved.

NOTE: Every person to whom an instrument is delivered, is a *holder,* (see Sec. 191.) Such holder may be the payee or any subsequent person receiving the promissory note or bill of exchange *(infra.)* by delivery or by. delivery and indorsement, (see Sec. 30.)

EXAMPLES:

The foregoing illustrations show the general outline and principal features of a negotiable promissory note:

(1) Payable to order: v

(a)

August 30,2010
Manila

P10,000.00

For value received, I promise to pay to the order of Alfredo M. Almeda the sum of Ten Thousand (P10,000.00) Pesos on or before September 30, 2010 at his house at Pateros, Metro, Manila.

(Sgd.) Arsenio F. Flores

(b)

August 30,2010
Manila
P10,000.00
Thirty days after date, I promise to pay to Alfredo M. Almeda or order the sum of Ten Thousand (P10,000.00) Pesos.
(Sgd.) Arsenio F. Flores

(2) *Payable to bearer:*

(c)

August 30,2010
Manila
P10,000.00
Two months after date, I promise to pay to Alfredo M. Almeda or bearer the sum of Ten Thousand (P10,000.00) Pesos.

(Sgd.) Arsenio F. Flores

(d)

August 30,2010
Manila
P10,000.00
Two months after date, I promise to pay to bearer the sum of Ten Thousand (P10,000.00) Pesos.

(Sgd-) Arsenio F. Flores

(1) The figures "P10,000.00" at the upper left hand corner of the instrument indicate the amount of the note. This is not essential but it is convenient because the amount in figures is more quickly grasped than if written in words, (see Sec. 17[a].)

(2) The word "Manila" at the upper right corner indicates the place where the contract is executed, while the date "August 30,2010," the date of execution.

The place and the date are not essential to the negotiability of the instrument except in certain cases when the date is necessary to determine when the note is due (see examples [b]/ [c], and [d].) or the interest is to run when the payment of interest has been stipulated or whether the holder is barred by the statute of limitations from enforcing the note, (see Sees. 144,186.)

(3) The words "for value received" indicate the consideration given for the note which may be specified. As consideration is presumed (Sec. 24.), the words "for value received" may be omitted. (Sec. 6[b].)

(4) The words "I promise to pay" signify an absolute and unconditional promise to pay the payee, or to a holder. This is essential to the riegotiabiHty of the instrument.

Instead of "promise," however, any other set of words of equivalent meaning may be substituted, "I agree to pay," "I will pay," "good to Alfredo Almeda or order" (Hussey v. Winslow, 59 Me. 170.) "due to Alfredo Almeda or order" (Smith v. Allen, 5 Day [Conn.] 337; Shimmerl v. Williams, 240 NY Suppl. 161.), "I acknowledge to be indebted to Alfredo Almeda or order" and the like.

But mere acknowledgement of a debt without the use of the words "order" and "bearer" which are usually referred to as words of negotiability does not satisfy the requirements, "Due to Alfredo M. Almeda P10,000.00," because it does not imply a promise to pay. (see Sec. 3.) Neither the words "will agree to pay" satisfy an unconditional promise to pay.

(5) The words "to the order of (example [a].) and "or order" (example [b].), indicate a promise to pay as ordered or commanded by the payee. But the instrument may be payable to bearer, (examples [c] and [d].) The above examples show four different ways usually adopted in making an instrument payable to order or bearer.

(6) The words "on or before September 30,2010" (example [a].) indicate the date of maturity or the time when the promise to pay is to be fulfilled. Not all instruments are payable at a fixed future time. They may be payable after date or after the expiration of a certain period, (examples [b], [c], and [d].) Others may be payable on demand.

Where no time for payment is expressed, an instrument is payable on demand. (Sec. 7[b].)

(7) The name "Alfredo M. Almeda" indicates the payee, the person to whom the promise is made or the instrument is payable. But the payee need not be specified if the promise is made to "bearer." (example [d].)

(8) The amount "Ten Thousand Pesos" as the figures "P10,000.00" do indicate the amount which the maker binds himself to pay. The figures "P10,000.00" are not essential, (see Sec. 17[a].)

(9) The words "at his house at Pateros, Metro Manila" indicate the place where the note is to be paid. The place of payment, however, is not essential as an instrument may be made payable at any other place agreed upon by the parties.

(10) The signature "Arsenio F. Flores" is the maker of the note. He is the one who promises to pay at the first instance. A note may be signed by several persons either jointly, or jointly and severally, (see Sec. 17[g].)

Bill of exchange defined.

A negotiable *bill of exchange* is an unconditional *order* in writing addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money to order or to bearer. (Sec. 126.)

From the foregoing, it will be seen that a bill of exchange is essentially an order made by one person to another to pay money to a third person. For brevity, a bill of exchange is usually called a "bill." If drawn on a bank *and* payable on demand, the order bill is, by definition, called *check.* (Sec. 185.) The check is the most common form of order paper, *(infra.)*

Original parties to a bill of exchange.

This class of negotiable instruments is known as *order paper,* or three-party paper.

A bill of exchange requires in its inception at least three parties — the drawer, the drawee, and the payee — to fill the legal roles involved. The holder of the instrument may be the payee or, when there has been a negotiation thereof, a party subsequent to the payee, *(supra.)*

(1) *The* person who issues and draws the order bill is called the *drawer.* He gives the order to pay money to a third party. He does not pay directly.

(2) The party upon whom the bill is drawn is called the *drawee.* He is the person to whom the bill is addressed and who is ordered to pay. He becomes an *acceptor* when he indicates a willingness to accept responsibility for the payment of the bill. (Sec. 62.) The drawee is a bank in the case of a check.

(3) The party in whose favor the bill is originally drawn or is payable is called the *payee.* Up to the time of acceptance by the drawee, the payee looks exclusively to the drawer. Again, the payee, as in a promissory note, may be specifically designated, or may be an office or title, or unspecified.

The parties need not all be distinct persons. Indeed, a bill will be valid where there is only one party to it, for one may draw on himself payable to his own order (see Sec. 8.), that is, the two parties to the bill can be the same person (drawer-drawee or drawer-payee).

EXAMPLE:

December 30,2010
Manila

P10,000.00

Thirty days after date, pay to Alfredo M. Almeda
or order the sum of Ten Thousand (P10,000.00) Pesos.
Value received and charge the same to the account of

(Sgd.) Jovencio F. Cinco

To Domingo M. Lantican
College, Los Bafios
Laguna

As may be seen from the above example, a bill of exchange has the following general characteristics not found in the promissory note:

(1) The words "pay to" indicate an unconditional order to pay instead of an unconditional promise to pay a promissory note.

(2) The name "Jovencio F. Cinco" indicates the drawer, the one who signs the bill of exchange. He corresponds to the maker in the case of a promissory note.

(3) The name "Domingo M. Lantican" indicates the drawee, the one to whom the bill is addressed. In a promissory note there is no drawee. The drawee is not really a party to the bill. He assumes liability only when he accepts the bill usually by writing the word "accepted" and signing his name on the face thereof (see Sees. 132 and 133.) in which case he ceases to be a drawee and becomes known as an *acceptor.*

By accepting, the acceptor becomes primarily liable like the maker of a note (see Sec. 62.), the drawer becoming only a surety, (see Sec. 61.)

(4) The words "charge the same to the account of' means that the amount to be paid by the drawee is to be charged against the funds of the drawer. But these may be omitted.

Idea and purpose of a bill of exchange.

(1) *Drawer's funds in hands of drawee.* — The original and fundamental idea and purpose of a bill of exchange is that the drawer has funds in the hands of the drawee of which the drawer wishes to avail himself, the drawer being the party primarily interested in, and benefited by, the transaction. By this instrument, the drawer, appropriates the fund, actual or anticipated, in the drawee's hands and receives the consideration for the appropriation from the payee to whom the instrument is delivered. The office of the instrument is to collect for the drawer from the drawee money to which the former may be entitled, (see 11 Am. Jur. 2d 42.)

(2) *Liability of drawee for non-payment.* — If the drawee refuses to accept when he has funds for the purpose, he becomes liable to the drawer for the resulting damages and the harm done to his

credit. If the drawer has no funds in the hands of the drawee, it is at least presumed that the former must have made arrangements with the latter so that he will honor the bill. In such a case, the drawee must look to the drawer for reimbursement and not to a *bona fide* holder.

In short, in order for the drawee to be liable to the drawer, there must be some kind of agreement obligating the drawee to honor the order of the drawer or an existing debtor-creditor relationship between them, that is, the drawee must owe the drawer a debt, in which case the drawer simply orders the drawee to pay the debt or a portion of it to a third party.

A drawee-bank is not liable for its refusal to pay a check on account of insufficient funds notwithstanding the fact that a deposit may be made later in the day. Where the deposit is sufficient, the failure of a bank to pay the check of the drawer entitles the drawer to substantial damages without any proof of actual damages. (Moran vs. Court of Appeals, 230 SCRA 799 [1994].)

Sec. 2. *Certainty as to sum; what constitutes.* — The sum payable is a sum certain within the meaning of this Act, although it is to be paid —

(a) With interest; or

(b) By stated installments; or

(c) By stated installments, with a provision that upon default in payment of any installment or of interest the whole shall become due; or

(d) With exchange, whether at a fixed rate or at the current rate; or

(e) With costs of collection or an attorney's fee, in case payment shall not be made at maturity.

Certainty of sum payable.

The promise or order must call for the payment of a sum certain in money. This is a requisite for the negotiability of the instrument (Sec. l[b];), to assure clarity and certainty in determining the value of the instrument. The "sum certain" requirement is met if the holder can determine from the instrument itself the amount he is entitled to receive at maturity. If the instrument calls for an act other than the payment of money, it is not negotiable because a negotiable instrument is intended as a substitute for money.

(1) *Payment of a fixed amount of money.* — Since a negotiable instrument is a device intended as a substitute for money, it is, therefore, essential that it represents a fixed amount to be paid wholly in money. The amount to be paid must be stated plainly on the face of the instrument or at least, may be ascertained upon its face by computation, independent of any extrinsic evidence.

If an instrument be for a specified sum of money, and also for the payment of something else, the value of which is not ascertained but depends upon extrinsic evidence, it would not be negotiable. Accordingly, the following do not express a sum certain:

(a) "To pay PI,000.00 or what may be due on my deposit book/' (National Savings Bank v. Cable, 79 Conn. 68,48 Atl. 428.)

(b) "To pay PI,000.00 and also all other sums which may be due to him." (Smith v. Nightingale, 2 Stardie, 375.)

(c) "To pay PI,000.00 and the value of four days labor/' (Iowe v. Bliss, 24111.168.)

(2) *Permissible clauses or stipulations.* — The sum is not rendered uncertain by a clause in the instrument that it is to be paid with interest, by stated installment, with exchange, with costs of collection, or with attorney's fees. Neither is the certainty of the sum affected by an acceleration provision in an installment note. The basic test is whether the holder can determine by calculation or computation the amount payable when the instrument is due. But a promissory note giving the maker the right to ascertain the amount rightly payable thereunder is non-negotiable.

Sum to be paid with interest.

(1) *Interest at fixed rate.* — A provision for the payment of interest is a mere incident; it does not render the instrument non- negotiable because it does not make uncertain the sum payable.

EXAMPLE:

"I promise to pay P[2] or order P10,000.00, with interest at 15% *per annum.*

The entire sum is still certain because the principal sum of P10,000.00 is certain artel the amount of interest due at any given time can easily be computed. In other words, the sum absolutely payable upon the instrument is specified as the principal of P10,000.00 and the interest of 15%.

(2) *Interest at increased or reduced rate.* — Likewise, a provision for increased interest rate if the note is not paid at maturity (Citizens Savings Bank v. Landis, 132 Dec. 1101.), or for a reduced rate if payment is made at or before maturity (Union Nat. Bank v. Mayfield, 174 Pac. 1034.), or for payment of interest on interests, does not destroy negotiability.

EXAMPLE:

"I promise to pay P or order P10,000.00 with interest at 18% *per annum* from date until paid; 15% if paid when due/'

Here, the payee wants the obligation to be paid at the due date of the contract, and to secure this, he binds the debtor to pay an increase of the rate of interest in case of delinquency. The increase (3%) is really' a penalty. Consequently, the note draws the same rate of interest before as after maturity, *i.e.,* 15%.

(3) *Accrual/rate of interest not specified.* — If the instrument provides for the payment of interest without stating the date from which interest is to run, it shall be computed from the date of the instrument, and if the instrument is not dated, from the issue thereof. (Sec. 17[b].) If there is a stipulation for the payment of interest but the rate is not specified, it shall be the legal rate of 6% (Art. 2209, Civil Code.), now 12%.

(4) *Interest usurious.* — If the interest stipulated is usurious,[3] the instrument is still negotiable because the contract remains valid as to the principal. (Sec. 7, Act No. 2655 [Usury Law].)

Unless otherwise indicated "P" refers to PAYEE.

'There is no more ceiling on the rate of interest. Usury is now legally non-existent

Sum to be paid by stated installments.

The promise or order to pay "by stated installments" does not affect negotiability.

Stated installments, within the meaning of Section 2, means that: (a) the interest of each installment, and (b) the due date of each installment must be fixed in the instrument.

EXAMPLE:

"I promise to pay P or order the sum of PI,000.00 in two installments as follows: P500.00, on or before November 1,2010 and P500.00, on or before December 1,2010."

But a promise to pay P1,000.00 in "two installments" or "in installments" does not fulfill the requirements of the law.

(1) *With an acceleration clause.* — The sum is still certain although payable by stated installments with an acceleration clause, *i.e.,* a promise that if any installment or interest is not paid as agreed, the whole shall become due. Such a clause requires full payment of an instrument immediately upon default on any installment. It does not make an instrument payable upon contingency (and so non-negotiable) since the time of payment will surely come and the exact value of the instrument can be ascertained.

(2) *Acceleration dependent on maker.* — The maker can avoid the acceleration by paying the installments on the due date.

EXAMPLE:

"I promise to pay P or order P10,000.00 with interest at 15% *per annum* in four equal monthly installments beginning luly 1, 2010.

Upon default in payment of any installment or interest, the whole sums shall become due and payable."

The payee or holder cannot accelerate the note unless the maker fails to pay an installment.

(3) *Acceleration at option of holder.* — A note providing for acceleration at the option of the holder is non-negotiable as

where the clause in the above example instead provides "or the whole amount plus interest on August 1,2010 at the option of the holder."

Extension clauses.

The extension clauses are the opposite of acceleration clauses. They appear in instruments with fixed future maturity date and provide that under certain circumstances, the date shall be further extended. An instrument is negotiable if, by its terms, it is payable at a definite time subject to extension at the option of the holder, or to extension to a further definite time at the option of the maker or acceptor or automatically upon or after a specified event.

Note that if the right is given to the holder, the time of payment need not contain a new fixed maturity date or the length of extension does not have to be specified. The reason is that the holder is free to demand payment at the maturity date or any time after said date. In fact, the holder is free to postpone the time of payment even if no extension clause appears. On the other hand, if the obligor is the one given the right to extend payment, the interest of the extension must be specified to keep the instrument negotiable, for of the right to extend is without limit, it cannot be determined with absolute certainty when the holder will have the absolute right to be paid. Thus, where the maker of the note is given the right to extend the time of payment "for no longer than a reasonable time" after maturity date, the note is non-negotiable because the definite time requirement is not met.

Sum to be paid with exchange.

Section 2(d) refers to Instruments that are payable in foreign currency. The promise or order to pay "with exchange" does not also destroy negotiability.

The *exchange* is the charge for the expense of- providing funds at the place where the instrument is payable to cover such instrument which is issued at another place. It may be at a fixed rate or at the current rate.

(1) *Payment in foreign currency.* —A provision for payment of a sum in a foreign currency does not impair negotiability

because the current rate of exchange at any given time may easily be ascertained by inquiry from the banks dealing on exchange or foreign currencies and such rate is a matter of common commercial knowledge. An instrument whether payable "at a fixed exchange rate or at the current rate" is deemed by the law to meet the "sum certain" requirement.

(2) *Payment with exchange rate.* — The provision on payment with exchange applies to instruments drawn in one country and payable in another. In other words, exchange is applicable only to foreign bills, (see Sec. 129.)

EXAMPLES:

(1) M[4] promises to pay P or order $1,000.00 with exchange at 3/4%.

(2) M promises to pay P or order the sum of $1,000.00 with exchange at the current rate (or "going rate" or "market rate").

(3) *Exchange not applicable to inland or domestic bill.* — If the instrument is both drawn and payable at the same place, there can be no exchange so that a stipulation for payment in exchange may be disregarded. (Studebaker Bros. Rfg. Go. v. Davis, 119 S.W. 532.)

Under Republic Act No. 8183,[5] every monetary obligation must be paid in Philippine currency which is legal tender in the Philippines. However, the parties may agree that the obligation or transaction shall be settled in any other currency at the time of payment.

Sum to be paid with costs of collection and/or attorney's fee.

While the law says "costs of collection or an attorney's fee," the word "or" is not material and an agreement to pay "attorney's fees *and* all costs of collection" does not impair negotiability,

[4]Unless otherwise indicated, "M" refers to MAKER.

[5]It repealed R.A. No. 529, entitled to "An Act to Assure the Uniform Value of Philippine Coin and Currency." Under this law, any provision in a contract which gives the creditor the right to require payment in a particular kind of coin currency other than Philippine currency is void.

since the two phrases mean the same thing. (Wood v. Ferguson, 71 Mont. 540,230 Pac. 392.)

(1) *Increase in amount due effective after maturity.* — Negotiability is not affected by a provision that in case payment shall not be made at maturity there shall be added to the amount due oh the note costs of collection or an attorney's fee. Such a stipulation does not affect the certainty of the amount payable at maturity since the increase in the amount due even if uncertain takes place after maturity when the instrument ceases to be negotiable in the full commercial sense.

(2) *Uncertainty of sum payable only after maturity.* — The reason for the rule that the sum to be paid must be certain is that a negotiable instrument is intended as a substitute for money, and this cannot be unless it can be ascertained from it exactly how much money it represents. Until the instrument matures the amount payable is certain, and it may, therefore, take the place of money; when it becomes overdue, the amount to which the holder is entitled becomes uncertain but in this case, it has already ceased to perform the office of money. Hence, anything which only renders the sum payable uncertain after the instrument has ceased to be a substitute for money but which in no wise affected it before such time, cannot impair its negotiability.

EXAMPLES:

(1) M promises to pay P or bearer P100,000.00 on or before December 4,2010 "with 12% attorney's fee and costs of collection if not paid at maturity."

Negotiability is not effected by the clause.

(2) A provision "to pay all costs, *charges* and *expenses* including attorney's fee incurred by the payee in any legal proceedings for the collection of the debt" renders the instrument non-negotiable. (Mussenfeld v. Smith [Conn.J, 148 Atl. 388.)

Here, it cannot be ascertained from the face of the instrument exactly how much money it represents.

(3) *Liability for attorney's fees.* — The stipulation for attorney's fees may be reduced by the courts if found unconscionable or

unreasonable. (Philippine Engineering Co. vs. Green, 48 Phil. 466 [1925].) But attorney's fees which the debtor binds himself to pay in case of litigation shall not be considered interest under the Usury Law (see note 2.) because said law is not applicable. (Bachrach vs. Golingco, 39 Phil. 912 [1919].)

If the attorney's fee is not specified, then it shall be in a reasonable sum.

Sec. 3. *When promise is unconditional.* — An unqualified order or promise to pay is unconditional within the meaning of this Act, though coupled with —

(a) An indication of a particular fund out of which reimbursement is to be made, or a particular account to be debited With the amount; or

(b) A statement of the transaction which gives rise to the instrument.

But an order or promise to pay out of a particular fund is not unconditional.

When promissory note contains a promise to pay.

In order that a promissory note (or bill of exchange) may be negotiable, it must contain an unconditional promise (or order) to pay. (Sec. l[b].) Negotiable instruments are intended to flow easily through the commercial world. A prospective holder would not be eager to accept an instrument unless its payment can be reasonably expected under every circumstance.

(1) *Implied promise to pay.* — It is not essential that the word "promise" should be used. Any words equivalent to a promise or assumption of full responsibility for the payment of the note (like "payable", "to be paid," "I agree to pay," "I guaranty to pay," "M obliges himself to pay," "Good for," "due on demand," etc.) on the face of an instrument are sufficient to constitute a "promise to pay."

(2) *Bare acknowledgment of indebtedness.* — A bare admission or acknowledgement of indebtedness (like "I.O.U.," "due PI,000.00," "for value received," etc.) alone is not a negotiable instrument as it does not import an express promise to pay or

show that the parties intend the debt to be paid. It might be that the parties, in such case, intend merely to settle, in writing, with a view to further dealings. A mere promise implied by law from the existence of an indebtedness, and not from any promissory language, is not sufficient.

An acknowledgment of debt evidences an old obligation but a promissory note imports a new obligation.

(3) *Use of words of negotiability.* — The language used must be such that the written undertaking to pay may fairly be deduced therefrom. Thus, if words of negotiability or payment are added as indicating a promise to pay (like "due P or order" or "due P or bearer," or "due P or demand," or "I.O.U. P10,000.00 to be paid on June 1."), the instrument is negotiable although it contains no express promissory words.

When bill of exchange contains an order to pay.

In the case of a bill of exchange, there must be an unconditional order to pay by one party to another; otherwise, it is non- negotiable. (Sec. l[b].)

(1) *Words equivalent to an order to pay.* — It is not also necessary to use the words "order" in a bill of exchange to satisfy the requirement. Any other words which are equivalent to an order or which show the drawer's will that the money should be paid (like "Let the bearer," or "W [drawee] will much oblige R [drawer] to pay P or order," etc.) are sufficient.

(2) *Mere request to pay.* — The language used in the law is not a request. The drawer does not merely "ask" or even "expect" the drawee to pay. He *demands* that the drawee make payment.

An *order* is a command or imperative direction and, therefore, a mere request which merely asks a favor (like "I request you to pay," or "I wish you would pay," or "I authorize you to pay," or "I hope you will pay") supplication, or authority does not constitute an order for it does not import a right to ask and a duty to obey. However, the mere use of polite words like "please" does not convert an order into a request. In such case, the request is really in the nature of a polite command.

As long as the language used expresses the drawer's will that money be paid, the bill of exchange is good.

(3) *Liability of drawer.* —It is immaterial whether the drawee obeys the order to pay or not. The negotiability of a bill depends upon the terms of the order. The drawer has his liability under the law. (see Sec. 61.)

When promise or order to pay unconditional.

Instrument payable absolutely. — It is not enough that there be a promise or order. It must be unconditional, that is, it must not be subject to any condition or contingency (see Art. 1179, Civil Code; Sec. 4, last par.) except implied conditions of presentment (Sees. 70, 143.) protests (Sees. 152, 165, 167, 170.), and notice of dishonor (Sec. 89.) as provided in the law. In other words, the note or bill must be payable absolutely.

Reason for requisite. — The fact that the liability is unconditional greatly enhances the ability of the instrument to circulate freely from one person to another. No one would accept a paper for debt if the right to recover were not absolute or unconditional in nature. Instruments which are not to be paid until a condition has happened or been fulfilled would be of little practical value in business.

Thus, an instrument is not negotiable if it contains a promise or order to pay "if X marries" for X may never marry, or "if certain property is sold" for the property may never be sold, or "if after two years I am still living" for if the maker should die within two years, no payment is to be made, or "out of the rent which may be collected from my apartment" for the rent may not be collected. The promise or order to pay is clearly conditional in nature. It constitutes a simple contract rather than a negotiable paper.

Even if the condition or event is very likely to occur, or indeed, even if, in fact, did occur subsequently, the Instruments remains non-negotiable, although it would, of course, become payable at that time.

(3) *Terms not affecting unconditional liability.* — The mere indication of the particular fund out of which reimbursement is to be made, or an indication of particular account to be debited with the amount does not render a promise or order conditional. This has reference to bills of exchange only since reimbursement and debiting can only take place where payment by another has been made. Nor is an instrument, otherwise negotiable, made non-negotiable by a statement of the transaction which gives rise thereto.

Additional terms appearing on an instrument *(e.g.,* statement of the purpose for which the instrument is issued or the collateral securing it, the consideration received in exchange for the instrument, (e.g., goods purchased), do not make the promise or order conditional if the duty to pay is unaffected by such terms.

Indication of a particular fund out of which reimbursement is to be made.

An instrument which mentions a particular fund out of which reimbursement is to be made is negotiable because the order to pay is not rendered conditional. The drawee is not limited to the money in his hands belonging to the drawer. In other words, the fund *indicated* is not the direct source of payment but only the source of reimbursement which is an act subsequent to the payment.

EXAMPLE:

"Pay to the order of P PI,000.00 and reimburse yourself from the rentals of my house."

The drawee may pay the amount out of any fund. It is only the reimbursement that is to come from the rentals.

Indication of a particular fund out of which payment is to be made.

An instrument *payable out* of a particular fund is non- negotiable (Sec. 3, par. 2.) as it is not payable "in any event" because the amount to be paid is made to depend upon the adequacy or existence of the fund designated. It is to be distinguished from an Instrument, merely containing reference to funds from which reimbursement is to be made. Here, the fund specified is the direct source of payment and the measure of liability. It is immaterial whether or not the fund is in actual existence or is yet to be created. The instrument remains non-negotiable even if the fund is found to be sufficient at maturity. But an instrument which is simply chargeable to a particular account *(infra.)* is negotiable. In this case, payment is not confined to that fund, but is to be made whether it should fail or otherwise, and it is mentioned only for the purpose of informing the drawee, as to his means of reimbursement.

The test of negotiability in every case is said to be whether or not the instrument carries the *general personal credit* of the maker or drawer. If it does, the instrument is negotiable; if it carries only the credit of a particular fund, the instrument is non-negotiable.

EXAMPLES:

(1) "I promise to pay P or order the sum of P10,000.00 out of my salary in the government," or "out of the proceeds of the sale of my shares of stocks."

(2) "Pay to bearer the sum of P10,000.00 out of the dividends which I may receive from X corporation."

(3) "Pay to bearer the sum of PI0,000.00 out of my money in your hands" or "out of my share of the profits."

In each of the above cases, the maker or drawee is limited to the fund indicated and is not supposed to pay if that fund should prove insufficient. The note, however, is not made uncollectible. The right or contract must be resolved under ordinary contract law.

The intention to limit payment to a particular fund must be made plain. If the language used is ambiguous or obscure, courts usually decide in favor of negotiability.

Indication of a particular account to be debited with the amount.

An instrument which contains a direction to debit a particular account is negotiable because the promise / order is not also made conditional. The payment does not depend upon the existence or adequacy of the particular account to be debited.

EXAMPLES:

(1) "I promise to pay P or order the sum of PI,000.00 to be debited with his current account with me/'

(2) "Pay P or order the sum of PI,000.00 and charge the same to my account" or "to my share of the profits."

(3) "Pay P or order PI,000.00 on account of my contract with you."

In the above cases, the instrument is payable absolutely and not out of a particular fund. It merely indicates a particular account out of which the holder or drawee is to reimburse himself. The instrument is to be paid first after which the particular account indicated will be debited.

Statement of transaction which gives rise to instrument.

(1) Mere recital of consideration for instrument/origin of transaction. — Instruments are issued by reason of the transaction upon which they are based. Hence, the mere recital of the consideration for which the instrument was issued or mere reference to a separate agreement out of which the instrument has arisen does not make it conditional. Such kind of reference has no adverse legal effect on the negotiability of the instrument.

Likewise, the phrase "per contract" or "in accordance with the contract," or "per memorandum of agreement" on the face of the instrument does not affect its negotiability according to the great weight of authority (see Beutel's Brannan, Neg. Inst. Law, 7th ed., p. 225.) nor do the words "the note secured by a mortgage" render the said note non-negotiable (Williamson v. Craig, 215 NW 664.) as they do not qualify the order or promise to pay, making it conditional. The instrument is to be paid whether or not the contract is performed.

If indeed the addition of the words in question makes the promise or order conditional, it is on the party making such claim to show.

EXAMPLE:

"I promise to pay to the order of P P300,000.00 being the price of a car this day sold and delivered to me."

The statement merely identifies the transaction which gives rise to the instrument. It does not qualify the order or promise to pay making it conditional. The instrument is to be paid whether or not the contract is performed.

(2) *Terms and conditions contained in another paper.* — If the promise or order is "subject to or governed by the terms and conditions of our contract executed by us on ____________________," the instrument is not negotiable because the obligation to pay is burdened with the terms and conditions of another contract, subjecting recovery on the Instrument to defenses available under the contract. Furthermore, this will require an examination of said contract to determine the rights and obligations under the instrument. Such instrument is non-negotiable regardless of what the terms of the contract actually are. As already stated, the negotiability of the instrument must be determinable from what appears on its face alone and not elsewhere, (see Sec. 1.)

In short, to destroy negotiability, the reference to a collateral contract must show that the obligation to pay is burdened with the conditions of that contract. (Powell & Powell v. Greenleaf & Currier, 104 Vt. 480,162 Atl. 377.)

The rule in Section 3 may be stated thus: "The negotiability of a bill or note is not affected by a reference which is simply: (a) a recital of the consideration for which the paper was given; or (b) a statement of the origin of the transaction; or (c) a statement that it is given in accordance with the terms of a contract between the same parties." *(ibid.)*

Sec. 4. *Determinable future time; what constitutes.* — An instrument is payable at a determinable future time, within the meaning of this Act, which is expressed to be payable —

(a) At a fixed period after date or sight; or

(b) On or before a fixed or determinable future time specified therein; or

(c) On or at a fixed period after the occurrence of a specified event, which is certain to happen, though the time of happening be uncertain.

An instrument payable upon a contingency is not negotiable, and the happening of the event does not cure the defect.

Certainty of time of payment.

(1) *Instrument payable at all events.* — It is an essential requisite of a negotiable instrument that it must be payable at all events. Hence, an instrument which is only payable upon a contingency is not negotiable because it does not appear on its face whether or not it will ever be paid. A note containing a provision that it may be renewed at maturity is non-negotiable because there is no unconditional promise to pay at maturity.

The last paragraph of Section 4 refers to a condition or an event which may or may not happen.

(2) *When time of payment certain.* — In order that an instrument may be negotiable, there must be certainty as to the time of payment, i.e., the payment will certainly become due and payable one time or other, though it may be uncertain when that time will come. And there is certainty as to the time when the instrument is payable on demand, or at a fixed or determinable future time. (Sec. l[c].)

In case of demand (or right) instrument, the holder may call for payment at any time. On the other hand, a term or time instrument is payable only upon the arrival of the time for payment. The time must be certain so that the holder will know when he may enforce the instrument; the person liable, when he may be required to pay; or the secondary parties — the drawer, indorser, or accomodation party — when his obligation will arise. Checks, by definition, must be payable on demand. (Sec. 185.)

Section 4 indicates when an instrument is payable at a determinable future time while Section 7, when it is payable on demand.

EXAMPLES:

(1) *Payable at a fixed time.*

"I promise to pay P or order the sum of P10,000.00 on September 10,2010."

Here, the future date specified is a fixed time.

(2) *Payable at a fixed period after date.*

"Sixty (60) days after date, I promise to pay P or order the sum of P10,000.00."

The date of maturity may be determined beforehand by counting sixty (60) days from the date of its issuance, (see Sees. 11,13,17[c].)

But an instrument payable "at the earliest possible time after date" is not payable at a definite time.

(3) *Payable at a fixed period after sight.*

"Sixty (60) days after sight, pay to the order of P the sum of P10,000.00."

After sight means after the instrument is seen by the drawee upon presentment for acceptance (see Sec. 143[a].), or accepted by the drawee. Hence, the date of maturity may be determined beforehand by counting sixty (60) days from the date it is presented to the drawee.

(4) *Payable on or before a fixed time.*

(a) "On or before September 10,2010,1 promise to pay P or order P10,000.00."

Here, the maker has the option to pay on September 10,2010 or before the date. The legal right of P, the payee, is clear and certain. He can demand payment only at the time fixed and not before. The maker has the mere option to pay in advance of the legal liability if he sees fit.

It is necessary that the year of maturity be stated, otherwise, the time of payment of the instrument, although payable at a certain time, is not determinable. (United Ry., *et al.* v. Liberian Commercial Co., 19 A.L.R. 506.)

(b) "On demand or at the end of the year, I promise to pay P or order P10,000.00."

Here, the payee is given unrestricted power to declare the note due at any time before maturity. The exercise of his right is "not dependent upon nor does it grow out of any act, promise, or agreement of the maker. In other words, it is a contingency over which the maker has no control." This uncontrollable option of the payee, it has been held, renders the note non-negotiable because it renders the time of payment uncertain.

May it be considered a demand note under Section 7(a)? "It is clear that the making of notes payable at a certain time, with the reserved power of the payee to declare them due before the stated time of maturity does not make them demand notes. They are non-negotiable, and, therefore, subject to defenses." (Puget Sound State Bank v. Washington Paving Co., 94 Wash. 504,162 Pac. 870.)

It is believed that such an instrument should be considered one payable on demand. The fixed maturity date is simply disregarded, (see Sec. 7[a].)

The instrument is not rendered non-negotiable where the holder's right to exercise the option depends upon the happening of a specified event or contingency over which he has no control, (see Sec. 2[c].)

(c) A provision in the instrument to the effect that the maker may extend payment from due date does not affect its negotiability as such instrument is the same as one payable "on or before." Thus:

"I promise to pay P P10,000.00 on September 30, 2010 but if I fail to collect from X on or before said date, this note shall be extended to November 30,2010."

The above note provides for an extension of time for payment on the condition named therein. The note would become due in any event, although the exact time could not be determined at the time of its execution. The time at which the note must eventually become due is, therefore, fixed and certain, (see State Bank of Halstad v. Bilsted, 136 N.W. 204,49 L.R.A. 132.)

(5) *Payable on or before a determinable future time.*

"On or before the start of the next school semester, I promised to pay P or order P10,000.00."

The determinable future time specified is "the next school semester." The maker may pay before the start of the semester if he shall so choose. The phrase "determinable future time" means a time that can be determined with certainty after the execution of the instrument.

(6) *Payable on the occurence of a specified event.*

"I promised to pay P or order the sum of P10,000.00 upon the death of his father."

The instrument is negotiable because the specified event, the death of the father of P, is absolutely certain to happen although the time of happening or occurence is not known or uncertain, (see Art. 1193, Civil Code.)

(7) *Payable after the occurrence of a specified event.*

"Thirty (30) days after the death of his father, I promise to pay P or order the sum of P10,000.00/'

But a bill or note payable several days *before* the occurrence of the specified event is not negotiable, since the date of maturity of the instrument can only be ascertained after it has become overdue and, therefore, the time for payment is uncertain. Moreover, the law says "on or at a fixed period after" and not "before."

(8) *Payable upon a contingency.*

(a) "Pay to the order of P the sum of P10,000.00 upon his reaching the age of majority."

The bill is non-negotiable because the order is conditional. The payment is not certain. P may die before reaching the age of majority in which case the bill will never mature. It makes no difference that P reaches such age because the happening of the contingent event does not cure the defect (Sec. 4, par. 2.) for the character of a negotiable instrument does not depend upon future events, but solely upon its character when created.

A *contingency* is, in law, an uncertain future event which may or may not happen.

(b) "I promise to pay P or order the sum of P10,000.00 if his father should die within five years."

The instrument is also non-negotiable. Note that if there is no length of time within which the death may take place, the maturity is a determinable future time, (see example No. 6.)

Payable "when able," etc.; within reasonable time.

A promise to pay "when able," "as soon as I can," etc., without specification of an absolute date is not so vague as to be unenforceable. However, there is a difference of opinion as to whether it is a conditional promise or an absolute promise to pay at an indefinite — that is, an unreasonable time.

Under either view, an instrument containing such a promise is not negotiable. Negotiability is destroyed under the first view both by the condition and by want of a fixed time for payment; and under the second view, by the general principle that a promise to pay within a reasonable time is not so certain as to render an instrument negotiable. (11 Am. Jur. 2d 208.)

Sec. 5. *Additional provisions not affecting negotiability.* — An instrument which contains an order or promise to do any act in addition to the payment of money is not negotiable. But the negotiable character of an instrument otherwise negotiable is not affected by a provision which

(a) Authorizes the sale of collateral securities in case the instrument be not paid at maturity; or

(b) Authorizes a confession of judgment if the instrument be not paid at maturity; or

(c) Waives the benefit of any law intended for the advantage or protection of the obligor; or

(d) Gives the holder an election to require something to be done in lieu of payment of money.

But nothing in this section shall validate any provision or stipulation otherwise illegal.

Acts in addition to payment of money.

A negotiable instrument must be payable in "a sum certain in money." (see Sec. I[b].)

(1) *General rule.* — As a general rule, the instrument is non-negotiable if it contains a promise or order to do any act in addition to the payment of money, (par. 1.) The prohibition

is based on the fact that while one could be indorsed the other would have to be assigned, (see Sec. 30.)

EXAMPLES:

"I promise to pay P or order P10,000.00 *and (or)* to deliver a horse."

The following clauses (see Beutel's Brannan, Negotiable Instruments Law, 7th ed., pp. 285-286.) have been held to render non-negotiable the instrument in which they are stipulated:

(a) "and to pay for taxes assessed upon the note or its mortgage security." (Hubard v. Robert Wallace Co., 201 la. 1143,208 N.W. 730.)

(b) "and to keep free from encumbrance property on which the value of collateral pledged for security of the instrument depends." (Streckload v. National Salt Co., 8T Atl. 828.)

(c) "and a promise to insure the property pledged as security." (First State Savings Bank v. Russel, 224 Mich. 298,221 N.W.142.)

(2) *Exceptions.* — The law, however, gives exceptions (Sec. 5 [a to d].) to the general rule.

(a) *Sale of collateral securities.*

EXAMPLES:

"I promise to pay P or order the sum of P30,000.00 on November 25,2010 secured by a ring I delivered to him by way of pledge and which he could sell should I fail to pay him at maturity."

Here, the additional act is to be performed after the date of maturity when the instrument is no longer negotiable in the full commercial sense, (see Sec. 2[e].) Until the date of maturity, the promise is to pay money only. A statement that an instrument is secured by a collateral, in fact, adds to the marketability of the instrument in commerce as a substitute for money or as a credit instrument. Note that the statement does not subject the promise or order to the terms and conditions of the pledge.

The instrument may recite that the security covers not only the debt evidenced by ihe instrument but also other liabilities. (Farmers & Merchants Bank & Davies, 144, La. 532,80 Sc. 713.)

(b) *Confession of judgment.* — A confession of judgment enables the holder to obtain a judgment wiihout the delay usually incident to a law suit, as it eliminates the necessity of a trial. It is a written statement signed by the defendant, setting forth the basis of liability and authorizing the entry of judgment thereon.

EXAMPLE:

"For value received, I promise to pay P or order the sum of P10,000.00 with interest at 15% *per annum* and I hereby authorize my attorney-at-law to appear in any court of record after the obligation becomes due and waive the issuing and service of process and confess a judgment against me in favor of the holder of the note for such amount as may appear to be unpaid thereon, together with costs of suit and 12% attorney's fees, and thereupon to waive all errors in any such proceedings and waive all rights of appeal."

Warrants of attorney to confess judgment, however, are not authorized nor contemplated by our law. Unless *expressly* authorized by statute, they are void "as against public policy because they enlarge the field for fraud, because under these instruments, the promissor bargains away his right to a day in court, and because the effect of the instrument is to strike down the right of appeal accorded by statue." (PNB vs. Manila Oil Refining & By-Products Co., 43 Phil. 444 [1922].)

Note that the second paragraph of Section 5 contains a proviso that nothing in said section "shall validate any provision or stipulation otherwise illegal." But the invalidity of die provision as to the confession of judgment does not render the instrument non-negotiable. It remains valid as to the amount.

Confession of judgment should be distinguished from *cognavit actiomen* and *relicta verificationem.*

The first literally means "he has confessed action." It is a written confession of action by the defendant acknowledging his indebtedness to the plaintiff after the action has been filed. (Cyclopedia Law Dictionary, 2nd ed., 181.) It is valid. It is given *after* the action is brought to save expenses.

The second literally means "his pleading being abandoned." It is confession of judgment by withdrawal of the defense, *(ibid,* 182.) It is also valid.

(c) *Waiver of benefit granted by law.*

EXAMPLE:

"Pay bearer P10,000.00. Notice of dishonor waived." (see Sec. 110.)

Neither does waiver of protest (Sec. 1-11.), presentment for payment (Sec. 70.), or demand *(ibid.),* or exemption from attachment or execution, destroy the negotiability of an instrument.

The following is also an illustration of an instrument containing a waiver of benefits intended by law for the advantage or protection of the obligor:

"Three months, after date, I promise to pay to the order of P P10,000.00, waiving the benefit of the homestead and all other statutory exemptions as to the debt evidenced by this note." (see Rules of Court, Rule 39, Sec. 12.)

(d) *Election of holder to require some other act.*

EXAMPLE:

"I promise to pay P or order P15,000.00 or an air conditioner at the option of the holder."

In this case, the holder has the choice. The instrument is, therefore, negotiable as it is as good as an instrument payable in money.

Similarly, the negotiability is not affected by a provision *which gives the payee the right to reposses the property sold* for which the note was given should payment not be made on time. (Sandlin v. Maury Nat. Bank, 98 So. 1901.)

If the *option is with the promissor,* the instrument is non- negotiable because the holder cannot compel him to make payment in money. Thus:

"I promise to pay P or order P12,000.00 *or* a brand new air conditioner."

A recital in the instrument that the obligor will deliver on *demand additional security to the satisfaction of a holder* deeming himself insecure because of his opinion that the collateral has depreciated, does not impair negotiability. Such provision merely aids the holder to secure payment, protects him from risks of insolvency, steadies the value of the instrument, and makes it circulate more readily. (Babb & Martin, Business Law, p. 178 [1957].)

Sec. 6. *Omissions; seal; particular money.* — The validity and negotiable character of an instrument are not affected by the fact that —

(a) It is not dated; or

(b) Does not specify the value given, or that any value has been given therefor; or

(c) Does not specify the place where it is drawn or the place where it is payable; or

(d) Bears a seal; or

(e) Designates a particular kind of current money in which payment is to be made.

But nothing in this section shall alter or repeal any statue requiring in certain cases the nature of the consideration to be stated in the instrument.

Effect of omission of date.

(1) The date in a bill or note is not necessary. Hence, the omission of the date will not make the instrument non-negotiable, (see Sec. 13 as to insertion of the date.) In such case, the instrument will be considered to be dated as of the time it was issued. (Sec. 17[c].) An instrument has no inception until delivery, (see Sec. 190, par. 6.)

(2) If there is a date stated, but there is no such date in the calendar, the law will deem the nearest date of the month the date intended. Thus, a note dated September 31 will be construed

as to have been intended for September 30. (Wagner v. Kenner, 2 Rob [La.] 120.)

. (3) There are, however, cases where the date is necessary to determine the date of maturity as:

(a) where said date is tied to the date of issue *(e.g.,* an undated note is "payable thirty days after date"); or

(b) where interest is stipulated for the purpose of determining when the interest is to run (see Sec. 17[c].); or

(c) in the case of the promissory note, the date of issue, and in the case of the bill of exchange, the date of the last negotiation thereof, for the purpose of determining whether a party acted within a reasonable time in making presentment for payment, (see Sees. 70,71,144.)

Instruments may be ante-dated or post-dated. (Sec. 12.)

EXAMPLE:

"I promise to pay P or order P10,000.00 thirty days after date."

Here, the date of issue is necessary to determine the date from which to start counting thirty days. Nevertheless, the instrument is negotiable although it is not dated. The holder may insert the true date. (Sec. 13.) The insertion of a wrong date, however, will not avoid the instrument in the hands of an innocent third party who may enforce the same notwithstanding the improper date. (Sec. 14.)

Effect of omission of value.

It is usual to state in the instrument that it is given for "value received" without specifying what that value is. But it is not even necessary to state that value has been received for the instrument because consideration is presumed. (Sec. 24; see Art. 1354, Civil Code.)

Under paragraph 2, this should not mean to alter or repeal any law which requires in certain cases the nature of the consideration to be stated in the instrument. There is no such law in the Philippines.

EXAMPLE:

"Pay to bearer P10,000.00"

The bill is negotiable although it does not specify the value given or that any value has been given therefor.

This is not to say that consideration in connection with a negotiable instrument is not essential. The law refers to the wording of the instrument not the lack of supporting consider-atipn which if proved wiil relieve the maker of the obligation to pay when presented for payment by the payee himself.

Effect of omission of place.

It will be noted that Section 1 does not require a negotiable instrument to specify the place where it is made or drawn or where it is payable. However, Section 73 specifies where presentment for payment should be made when the place of payment is not specified.

An instrument is presumed to have been made where it is dated. A note that does not specify the place of payment is presumed to be payable at the place of residence of the maker.

If the place of execution or payment is not stated, it is presumed to be the maker's or drawer's place of business or his home.

Effect of presence of seal.

At common law, a sealed instrument is non-negotiable and is subject to the rules governing contracts under seal. Under our law, there is no such distinction. The fact that the instrument bears a seal does not destroy its negotiability. There is no difference in legal effect between sealed and unsealed private writings.

It is advisable, however^ to have a bill or note appear in a public instrument so that it will be included among the preferred credits with respect to other property of the debtor, (see Art. 2244[4], Civil Code.)

Effect of designation of particular kind of current money payable.

The law does not require that payment should be made in legal tender, (see Sec. l[b].)

Money, as used in the law, is not necessarily limited to "legal tender" as defined by law. (see Sec. 1612, Rev. Adm. Code.) It includes any particular kind of current money or foreign money which has fixed value in relation to our money. It has been held that an instrument payable in "currency" or "in current funds" or "current bank notes" constitutes good commercial paper and are really payable in money. (Jones v. Overstreet, 4 T.B. Mon. [Kentucky] Ky. 547].) An instrument payable in "current coins" is also deemed payable in money. (Spencer, Commercial Law [3rd ed.], pp. 169,172.)

The instrument is still negotiable although it is payable in foreign money which is not current in the Philippines if the obligation may be discharged in pesos of equivalent amount.

EXAMPLE:

"I promise to pay to P or order the sum of PI,000.00 in Central Bank notes of fifty-peso bills."

The note is valid although it "designates a particular kind of money, in which payment is to be made."

Sec. 7. *When payable on demand.* — An instrument is payable on demand —

(a) Where it is expressed to be payable on demand, or at sight, or on presentation; or

(b) In which no time for payment is expressed.

Where an instrument is issued, accepted, or indorsed when overdue, it is, as regards the person so issuing, accepting, 6r indorsing it, payable on demand.

When instrument payable on demand.

Under the first paragraph, an instrument is payable on demand not only as between the immediate parties but also as to subsequent parties. On the other hand, the provision of the second paragraph refers only to immediate parties since between immediate parties there is no difference between a holder in due course and a person not a holder in due course.

An instrument payable on demand is due and payable immediately after delivery. It is a present debt due at once. The words "on demand" in a note do not make a demand a condition precedent to a right of action, but import that the debt is due and demandable, or at least, the commencement of a suit therefor is a sufficient element. (Dominion Trust Co. v. Hildover, 243 Pa. St. 235; Merchant's National Bank v. Lovitt, 114 Mo. 517.)

Instruments that are not payable on demand, called "time instruments," are payable at a definite time. (Sec. 4.)

(1) *Expressed to be payable on demand.*

EXAMPLES:

"I promise to pay to bearer on demand P10,000.00/'

"I promise to pay P P26,900 upon receipt by me of my share from the Estate of X or upon demand." (Pay v. Vda. de Palanca, 57 SCRA 618 [1974].)

The promissory note in the second example is payable upon a contingency or on demand because P may rely on the wording "upon demand." *(ibid.)* Note that it is not payable at a fixed or determinable future time, (see Sec. 4.)

Instead of "on demand," the words "at sight" or "or presentation" or "on call" or "at any time called for," or "at such times as the payee may require," or "at the holder's convenience," may be used. The words "on demand" are ordinarily used in promissory notes while the words "at sight," in bills of exhange. "At sight" means that the instrument is payable as soon it is seen by the party primarily liable.

An overdue instrument is necessarily a demand paper. A holder has an immediate right of payment for the money promised or ordered to be paid,

(2) *No time for payment is expressed.*

EXAMPLE:

"Pay to P or order P10,000.00."

The above (a check) is an instrument payable on demand because it does not express the time for payment, (see De Leon vs. RFC, 36 SCRA 289 [1970].) As between the maker and the payee, a demand note is payable as soon as it is executed. Parol evidence is, however, admissible to show a contemporaneous oral agreement fixing the time for payment. But an instrument payable on demand cannot be contradicted by parol proof.

It has been held that a note payable at the maker's convenience is payable on demand. (Smithers v. Junker 41 Fed. 101.) Likewise, an instrument "payable . . . after date" is payable on demand. (Mutual Bank v. Smith, 123 ATC 98.) It is, however, an incomplete instrument, (see Sees. 13, 14, and 15 regarding rights of the parties.) But an instrument payable to bearer on demand "if presented for payment after five months from the date of issue" is not payable on demand since it expresses a time for payment, (see Buencamino vs. Hernandez, 8 SCRA483 [1963].)

Similarly, a trade acceptance (see Sec. 126.) which states a day and month but omits the year of its maturity is not payable on demand and is not negotiable. (United Ry., etc. v. Siberian Commercial Co., 19 A.L.R. 506.)

(3) *Payable on demand as regards the maker.*

EXAMPLE:

A note dated July 3, 2010 and payable "thirty days after date" was issued on August 4, 2010 (when it was already overdue).

(4) *Payable on demand as regards the acceptor.*

EXAMPLE:

A bill payable on July 20,2010 was accepted by the drawee on July 21,2010.

(5) *Payable on demand as regards the indorser.*

EXAMPLE:

A note payable "thirty days" after July 1,2010 and indorsed on August 1,2010.

The indorsement after maturity, in legal effect, creates a new instrument payable on demand.

. Sec. 8. *When payable to order.* —The instrument is payable to order where it is drawn payable to the order of a specified person or to him or his order. It may be drawn payable to the order of —

(a) A payee who is not maker, drawer, or drawee; or

(b) The drawer or maker; or

(c) The drawee; or

(d) Two or more payees jointly; or

(e) One or more several payees; or

(f) The holder of an office for the time being.

Where the instrument is payable to order the payee must be named or otherwise indicated therein with reasonable certainty.

When instrument payable to order.

The words "to the order of/' "or order/' "or bearer/' and "to bearer" (see Sec. 9.) are standardized words of negotiability of an instrument. These words serve as an expression of consent that the instrument may be transferred, to whoever the payee orders, allowing further negotiation of the instrument. This consent is indispensable since a maker or drawer assumes greater risks under a negotiable instrument than under a non-negotiable one. (see Consolidated Plywood Industries, Inc. vs. IFC Leasing & Acceptance Corp., 149 SCRA 448 [1987].) Any other words may be used indicating the intention on the part of the maker or drawer to make the Instruments freely transferable to some person or persons other than the one to whom it was originally issued.

An instrument is payable to order where it is drawn payable: (1) to the order of a specified person (see Sec. 9[c].); or (2) to him or his order. Consequently, an instrument payable to a specified person *(e.g.,* "Pay to P.") is not an order instrument, and, therefore, is non-negotiable as the promise or order is limited to paying one person, (see GSIS v. Court of Appeals, 170 SCRA 533 [1989].) Any subsequent purchaser thereof will not enjoy the advantages of being a holder of a negotiable instrument, but will merely "step into the shoes of the person designated in the instrument and will thus be open to all the defenses available against the latter, *(ibid.,* see Sec. 30.)

It is not essential, however, that the words "to the order of" or "or order" be used. The words "to P and assigns," have been held to be equivalent words which will render the instrument negotiable. (Putnan v. Crymes, 1 McNull 9,36 Am. Dec. 250.)

Section 8 enumerates the persons to whose order an instrument may be made payable by the maker or drawer.

EXAMPLES:

(1) *to order of payee who is notthe maker.*

"I promise to pay PI,000.00 to the order of P (or to pay P or order PI,000.00).

(Sgd.) M"

(2) *to order of payee who is not the drawer.*

"Pay to the order of P P1,000.00.

(Sgd.) R[6]"

(3) *to order of payee who is not the drawee.*

"Pay to the order of P PI,000.00

(Sgd.) R

To W

Manila"

(4) *to order of drawer.*

"Pay to the order of myself PI,000.00.

(Sgd.) R

ToW

Manila"

When a depositor wishes to get cash from his bank over the counter, the practice is to draw a check in the form of "Pay to cash."

'Unless otherwise indicated, "R" refers to DRAWER.

"Unless otherwise indicated, "W" refers to

(5) *to order of maker.*

"I promise to pay to the order of myself PI,000.00.

(Sgd.)M"

But a note payable to the order of the maker is not complete , • until indorsed by him. (Sec. 184.)

(6) *to order of drawee.*

"Pay to the order of yourself P1,000.00.

(Sgd.) R

ToW Manila"

Being both the drawee and payee, W can pay himself on maturity from funds belonging to the drawer in his possession.

(7) *to order of two or more payees jointly.* "Pay to the order of P and A PI,000.00." In case of indorsement, see Section 41.

(8) *to order of one or some of several payees.*

"Pay to the order of P, A, or B PI,000.00" or "Pay to the order of P, A and B, or any of them or any two of them."

In this case, the instrument is payable to either one of them, and the indorsement of any one is sufficient to pass title.

(9) *to order of holder of an office for the time being.*

"Pay to the order of the Commissioner of Internal Revenue" or "Pay to the order of the Treasurer, Philippine National Bank."

Effect where payee not named or described.

It should be noted that in an order instrument, a specified person must always be named therein either before or after the word "order." If there is no payee, there is nobody who could give the order or authority to collect In other words, there would be nobody who could indorse the instrument (see Sees. 30,9[c].) and, therefore, there is no point considering it negotiable.

Thus, an instrument payable "to order" where there is no blank space for the name of the payee indicating authority to insert the payee's name is not negotiable because the payee is not "named, or otherwise indicated therein with reasonable certainty," although if it is subsequently completed by the addition of a payee's name, at that time it will normally meet the order requirement. But it is sufficient if the payee, though not named, is described with reasonable certainty (par. 2.), *e.g.,* to the order of "the administrator of the estate of P," "A" or his assigns, etc. The trade name of the payee may be used.

Sec. 9. *When payable to bearer.* — The instrument is payable to bearer —

(a) When it is expressed to be so payable; or

(b) When it is payable to a person named therein or bearer; or

(c) When it is payable to the order of a fictitious or non-existing person, and such fact was known to the person making it so payable; or

(d) When the name of the payee does not purport to be the name of any person; or

(e) When the only or last indorsement is an indorsement in blank.

When instrument payable to bearer.

Bearer means the person in possession of a bill or note which is payable to bearer. (Sec. 191, par. 4.)

Section 9 defines a bearer instrument. An instrument payable to bearer may be transferred by delivery without indorsement (Sec. 30.) and payment to any person in possession thereof (Sec. 191.) in good faith and without notice that his title is defective, at or after maturity (Sec. 88.), discharges the instrument. (Sec. 119.) Delivery alone is enough to effect negotiation of the instrument. (Sec. 30.) Whoever possesses it is the bearer. For added security, the holder may require indorsement of the Instrument, (see Sec. 34.)

An instrument that fails to qualify as an order instrument is nonetheless negotiable if it is payable to bearer. Note that only instrument under subsections (a) and (b) are bearer instruments on the face. Those under subsections (c), (d), and (e) are order instruments on the face. Both types of Instruments are bearer Instruments.

(1) Expressed to be payable to bearer.

EXAMPLE:

"I promise to pay to bearer P1,000.00."

But an instrument payable to the "bearer, P" is not negotiable, since the word "bearer" in such case merely described "P." The instrument is, therefore, payable to a definite person only.

The word "bearer" need not be used if the bearer would be sufficiently meant and designated. Thus, it has been held that "pay to holder" (Pitzer v. Wagar, 41 N.W. 210.), or "pay to P or holder," "pay to P or to any one to whom he may deliver it or to any one who might hold the same by delivery" (Putnam v. Crymes, 36 Am. Dec. 250.) is payable to bearer "holder" can be said to be equivalent to or of the same import as the word "bearer." (see Sec. 10.)

But a note payable "to the order of bearer" was held payable to order and not to bearer. (American Nat. Bank v. Kerly, [1923] 109 Ore. 155; 220 Doc. 116,32 A.L.R. 262.) This ruling, however, has been much criticized. The court presumably presumed that the specific payee was the individual to whom the note was originally delivered; but it is difficult to see how a prospective purchaser could know that he was the original recipient of the note except by the kind of inquiry into extrinsic facts which the negotiable instruments law seeks to avoid. It would seem that such a note is either a bearer note or else non-negotiable for want of sufficient description of the payee, (see Beutel's Brannan, *op. cit.,* p. 314.)

In a case, the pertinent portion of the subject paper read: "The Central Bank of the Philippines (the Bank) for value received, hereby promises to pay to bearer, or if this Certificate of Indebtedness be registered to Filriters Guaranty Assurance Corporation, the registered owner hereof, the principal sum of P500,000. x x x." It was ruled that the CBCI was not a negotiable instrument. "Very clearly, the instrument is payable only to Filriters, the registered owner, whose name is inscribed therein. It lacks the words of negotiability which should have served as an expression of consent that the instrument may be transferred by negotiation/' (Trader's Royal Bank v. Court of Appeals, 269 SCRA15 [1997].)

(2) *Payable to person named therein or bearer.*

EXAMPLES:

"Pay to P or bearer P10,000.00."

"Pay to P or holder P10,000.00."

An instrument payable to "holder or order" or "to the order of P or bearer" has been held to be payable to bearer. (83 Mich. 225.) Under the Uniform Commerce Code (UCC), an Instrument *(i.e.,* Pay to order P or bearer") is an order instrument, "unless the bearer words are handwritten or typewritten. (Sec. 3-110[3], thereof.) The assumption is that if the words "or bearer" are added by the maker or drawer, then presumably the maker or drawer intended that they should control. But an instrument payable to "bearer or P," according to a noted authority, is not negotiable, (see C. Alvendia, Neg. Inst. Law, 1948 ed., p. 23.)

(3) *Payable to order of a fictitious person.*

EXAMPLE:

"Pay to John Doe or order PI,000.00."

The bill is payable to bearer and not to order because John Doe is a fictitious person. A name is fictitious when it is feigned or pretended.

The phrase "person making it so payable" (Sec. 9[c].) refers to the maker or drawer rather than the party actually executing the instrument. (American Sash, etc., Co. v. Commerce Trust Co., 332 No. 98, 56 S.W. [2nd] 1930.) It is essential that the payee is known to the maker or drawer to be a fictitious or non-existing person, otherwise, it would not be a *bearer* instrument but an *order* instrument. The reason for treating this type of instrument as bearer paper is obvious. Since the maker or drawer knows that the payee is not capable of indorsing, he cannot expect the instrument to circulate through the indorsement of the payee, and, therefore, he must have intended the same to be transferred by mere delivery just like an instrument payable to bearer.

The word "fictitious" is not limited to a person having no real existence, as otherwise the word *"non-existing"* would have been sufficient without more. A *fictitious person* is meant to be one who, though named or specified as payee in an instrument, has no right to it because the maker or drawer so intended and it matters not, therefore, whether the name of the payee used by him be that one living or dead, or one who never existed. (Snyder v. Com. Exch. Nat. Bank 221, Pa. St. 599, 70 Afl. 876.) Thus, a check made expressly payable to a non-fictitious and existing person is not necessarily an order instrument. If the payee is not the intended recipient of the proteeds of the instrument, the payee is considered a "fictitious" payee and the check is a bearer instrument. In a fictitious-payee situation, the drawee-bank, in the absence of bad faith or gross negligence, is absolved from liability and the drawer of the check bears the loss. This rule protects the depositary bank and assigns the loss to the drawer of the check who was in a better position to prevent the loss in the first place. (Philippine National Bank v. Rodriguez, 566 SCRA 513 [2008].)

(4) *Payable to order of a non-existing person.*

EXAMPLE:

"Pay to the order of the King of the Pacific Ocean."

In this case, the payee named is one who does not exist and had never existed. Since indorsement is obviously impossible, the manifest intention of the drawer is to make the instrument a bearer paper negotiable by delivery.

An instrument payable to a person who is already dead is payable to bearer. Here, the maker or drawer intends that the payee shall have no right or interest whatsoever in the instrument so that the instrument is, in effect, payable to a nonentity.

Name of payee not name of person.

EXAMPLES: "Pay to cash/' "Pay to cash
or order." "Pay to money." "Pay to
sundries." "Pay to payroll."

In the above examples, the instrument does not purport to designate a specific payee. In making an instrument payable to an impersonal payee, the maker or drawer intends the same to be payable to bearer. Like the fictitious payee bearer instrument, the indorsement of this bearer instrument by the payee is impossible.

An instrument payable "to the order P's estate" has been held payable to bearer (Hansen v. Northwestern Nat. Bank, 221 N.W. 878.) but this decision has been severely criticized since an estate is always represented by a person. It is clear, however, that the "estate of P" is not the name of any person under subsection (d) of Section 9.

Only indorsement in blank.

EXAMPLE:

Face

Pay to P or order P10,000.00

(Sgd.) R

ToW
Manila

Back

(Sgd.)P

The instrument is indorsed in blank by P by simply writing his name on the back thereof. The blank indorsement makes the instrument payable to bearer.

(7) *Last indorsement in blank.*

EXAMPLE:

Pay to A[8]	
	(Sgd.)P
Pay to B	
	(Sgd.) A
	(Sgd.) B

The bill which is payable to the order of P, is indorsed especially by P to A (see Sec. 34.) and A further indorses it to B who merely signs his signature on the back without indorsing the bill to a specified person and delivers it to C. The instrument becomes also payable to bearer. C may negotiate the bill by delivery since the last indorsement is in blank

But a blank indorsement cannot make a non-negotiable instrument, it is negotiable as a bearer instrument payable to a specified person, otherwise, the person who last signed his name on the back of the instrument would be able to change entirely the contract as entered into between the parties and make the character of the instrument depend upon the manner of the indorsement, and not upon the terms expressed therein.

The word "indorsement/' as used in the law, refers only to negotiable instruments.

Unless otherwise indicated, "A," "B," "C," etc refer to indorsee or indorser, as the case may be.

Sec. 10. ***Terms, when sufficient.* — The instrument need not follow the language of this Act, but any terms are sufficient which clearly indicate an intention to conform to the requirements thereof.**

Substance criterion of negotiability.

It is advisable in most cases to conform to the forms prescribed by law in order to avoid uncertainty. However, it is not required to use the exact words of the law.

(1) *Clear intention of the parties.* — The substance of the transaction rather that its form is the criterion of negotiability. Thus, as previously stated, instead of "promise" the words "bind myself[7] may be used; instead of "on demand" the words "on call" may be used; instead of "bearer" the word "holder" may be used. As long as the clear intention of the parties to make the instrument negotiable can be determined, the law will give it force and effect. (Spencer, *op. cit.,* p. 174.)

(2) *Use of foreign language.* —An instrument may be negotiable though written in a foreign language, *(ibid.)*

(3) *Mere defect in language or grammatical error.* — This does not destroy negotiability Thus, the words "himself order" may be construed as "himself or order." (Coffey v. Day, 21 Fed, 2nd 661.)

Sec. 11. ***Date, presumption as to.* — Where the instrument or an acceptance or any indorsement thereon is dated, such date is deemed *prima facie* to be the true date of the making, drawing, acceptance or indorsement, as the case may be.**

Presumption as to date.

(1) *Date of Instrument, acceptance, or any indorsement.* — If the instrument bears a date, it is presumed that said date is the date when it was made or drawn.

If the acceptance in a bill is dated such as "accepted, February 10, 2010 (Sgd.) W," or the instrument is indorsed and the indorsement is dated, such as "February 10, 2010, Pay to A, (Sgd.) P," said date is considered the date of such acceptance or indorsement.

(2) *Evidence of a different date.* — He who claims that some other date is the true date has the burden to establish such claim. Thus, evidence is admissible that, the maker of an instrument inadvertently wrote the date "2009" instead of "2010" because at the beginning of the New Year he had not yet become accustomed to writing the new date. But a different date may be shown only as between the original parties but not against a holder in due course. (Sees. 14,57.)

Date in instrument payable at a fixed future date.

Generally, a date is not essential to make an instrument negotiable. (Sec. 6[a].) This is true of instruments which are payable at a fixed future date and which do not stipulate for the payment of interest.

EXAMPLE:

"I promise to pay P or bearer P10,000.00 on October 10, **. 2010."**

Since the instrument is payable on October 10, 2010, a fixed future date, and it does not stipulate for the payment of interest, there is no need to determine when the instrument was first issued.

In the following cases, however, the date is necessary to determine the maturity (but not for negotiability) of the instrument.

(1) *Where instrument is payable at a fixed period after date.* (Sec. 4[a].)

EXAMPLE:

"Thirty days after date, I promise to pay P or order of P10,000.00."

The date of issue is material to determine the date of maturity or the date from which to start counting thirty days.

(2) *Where instrument is payable at a fixed period after sight or presentment, (ibid.)*

EXAMPLE:

"Pay P or order P10,000.00 thirty days after sight (or after presentment)/'

The date of presentment is necessary to determine when the sixty-day period will commence to run. (see Sees. 1431a], 136, last sentence.)

Date in instrument payable on demand.

Ordinarily, an instrument payable on demand need not be dated since it is demandable at any time. However, it is required under Section 71 that a promissory note must be presented for payment within a reasonable time after its issue and in case of a bill of exchange, within a reasonable time after the last negotiation thereof, otherwise, persons secondarily liable may be released from their liability. (Sec. 70.)

The date of issue of the promissory note or the date of the last negotiation of the bill of exchange is, therefore, essential for the purpose of determining whether a party has acted within a reasonable time (see Sec. 144.) but not to make the instrument negotiable. What is a reasonable time is generally a question of fact and each case is to be considered, (see Sec. 193.)

Sec. 12. *Ante-dated and post-dated.* — The Instrument is not invalid for the reason only that it is ante-dated or post-dated, provided this is not done for an illegal or fraudulent purpose. The person to whom an instrument so dated is delivered acquires the title thereto as of the date of delivery.

Meaning of ante-dating and post-dating.

(1) An instrument is *ante-dated* when it contains a date earlier that the true date of its issuance. Thus, an instrument issued on July 30,2010 but is dated July 15,2010 is antedated.

(2) An instrument is *post-dated* when it contains a date later than the true date of its issuance. It is just the reverse of an antedated instrument. In the example given, if the instrument was issued on July 15,2010, but bears a date of July 30,2010, it is postdated.

Effect of ante-dating and post-dating.

Ante-dating or post-dating an instrument does not render it invalid or non-negotiable by that fact alone, provided this is not done for an illegal or fraudulent purpose. It may be negotiated before or after the date given as long as it is not negotiated after its maturity.

If the ante-dating or post-dating is done for an illegal or fraudulent purpose, the instrument is rendered invalid.

An example of illegal ante-dating is that done to conceal the charge of usurious interest. An example of illegal post-dating is to issue a post-dated check in payment of an obligation because of insufficiency of funds without bona *fide* intention to cover the amount of the check. If the payee, however, was informed that the check was hot covered by adequate funds, the drawer would not be guilty of bad faith or estafa in issuing it because there was no deceit.[9] (Firestone lire & Rubber Co. of the Philippines vs. Ines Chavez & Co., Ltd., 18 SCRA 356 [1966].)

'Article 315(2d) of the Revised Penal Code, as amended by R.A. No. 4885, provides: "Art. 315 Swindling (estafa). — Any person who shall defraud another by any of the means mentioned herein below shall be published by: x x x , provided that in the four cases mentioned, the fraud be committed by any of the following means: x x x x x x

2. By means of any of the following false pretenses or fraudulent acts executed prior to or simultaneously with the commission of die fraud: x x x x x x

(d) By post-dating a check, or issuing a check in payment of an obligation when the offender had no funds in the bank, or his funds deposited therein were not sufficient to cover the amount of the check. The failure of the drawer of the check to deposit the amount necessary to cover his check within three (3) days from receipt of notice from the bank and/or the payee or holder that said check has been dishonored for lack or insufficiency of funds shall be *prima facie* evidence of deceit constituting false pretense or fraudulent act."

The following are the elements of this kind of estafa: (1) post-dating or issuance of a check in payment of an obligation contracted at the time the check was issued; (2) lack or insufficiency of funds to cover the check; and (3) damage to the payee thereof. R.A. No. 4885 eliminated die requirement under die old provision for the drawer to inform the payee that he holds no funds in the bank or the funds deposited by him were not sufficient to cover the amount of the check. (People vs. Ong, 204 SCRA 942 [1991].) The post-dating of a check simply means that on the date indicated, the check would be properly funded, not that the check

Date when instrument takes effect.

Section 12 seems to contemplate instruments which are antedated or post-dated by the parties in accordance with a mutual agreement to that effect (Bank of Houston v. Day, 122 S.W. 756.) The person to whom the instrument so dated is delivered acquires title or ownership over it, not as of the date it bears, but as of the date it is delivered.

Sec. 13. *When date may be inserted.* — Where an instrument expressed to be payable at a fixed period after date is issued undated, or where the acceptance of an instrument payable at a fixed period after sight is undated, any holder may insert therein the true date of issue or acceptance, and the instrument shall be payable accordingly. The insertion of a wrong date does not avoid the instrument in the hands of a subsequent holder in due course; but as to,him, the date so inserted is to be regarded as the true date.

When date may be inserted.

(1) *Two cases.* — This section which authorizes the holder to put a date on an instrument, refers to two cases, namely:

(a) where an instrument is payable at a fixed period after date but is issued undated; and

(b) where an instrument is payable at a fixed period after sight but the acceptance is undated.

(2) *Date of issue or acceptance to be specified.* — Any holder may insert therein the true date of issue or acceptance and the instrument shall be payable accordingly. It is necessary that the date of issue or acceptance, as the case may be, be specified so as to determine the date of maturity. Unless the true date is inserted, one will not know when the instrument will be due.

(3) *Application to other cases.* — It is obvious that this section does not apply to an instrument payable on demand although undated, for its maturity is already fixed, being due immediately. Neither does it authorize the insertion of the date of issue in an undated bill of exchange payable at a fixed period after *sight,*

say, "thirty days after sight." In such a case, the date of issue is not necessary to fix the maturity of the bill (it is, however, necessary, as already pointed put to determine whether or not the holder acted with reasonable diligence; see Sec. 144.) but if the acceptance is undated the insertion of the true date of such acceptance is necessary because the "thirty days" is to be counted not from the date of issue but from "sight" or acceptance. (Sec. 13; see Sees. 136,138, last sentence.)

EXAMPLES:

(1) "I promise to pay P (no date) or order P10,000.00 thirty days after date.

(Sgd.) M"

In this case, the date of maturity cannot be determined unless we know the true date of issue of the note. The true date may be inserted not only by P but also by any holder after him.

(2) "Pay to P or order P10,000.00 thirty days after sight.

(Sgd.)R

ToW."

The bill is accepted by W who writes the word "accepted" across the instrument but the acceptance (see Sec. 132.) was made undated. Under Section 13, P or any holder may insert the true date of acceptance. The date of acceptance must be the date when it was actually accepted by him. (see Sees. 136,138.)

Effect of insertion of wrong date.

The insertion of a. wrong date in an undated instrument by one having knowledge of the true date of issue or acceptance will avoid the instrument as to him or any one claiming under him but not as to a subsequent holder in due course who may enforce the same notwithstanding the improper date. In the hands of a holder in due course, the date inserted, even if wrong, is to be regarded as the true date. (Sec. 13.)

The reason for the rule is that "one who signs such an instrument furnishes the means of fraud and is estopped to deny his liability thereon." (Bank of Houston v. Day, 122 S.W. 756; see

Sec. 14.) The insertion of a wrong date constitutes a material alteration. (Sec. 125[a].)

EXAMPLE:

Suppose the true date of the note in the preceding example is May 20, 2010 and, therefore, the date of maturity is June 19, 2010.

If P dates it May 15, 2010 to hasten the day of maturity, then the note is avoided insofar as P is concerned because the instrument is ante-dated for a fraudulent purpose. (Sec. 12.)

However, if P, after inserting the wrong date, indorses the instrument to A who acquires it in good faith for value without notice arid before maturity, then, A, as a holder in due course, has the right to enforce payment on June 14, 2010 and not on June 19, 2010, because as to him, the date so inserted, May 15, 2010, will be regarded as the true date.

Sec. 14. *Blanks, when may be filled.* — Where the instrument is wanting in any material particular, the person in possession thereof has a *prima facie* authority to complete it by filling up the blanks therein. And a signature on a blank paper delivered by the person making the signature in order that the paper may be converted into a negotiable instrument operates as a *prima facie* authority to fill it up as such for any amount. In order, however, that any such instrument when completed may be enforced against any person who became a party thereto prior to its completion, it must be filled up strictly in accordance with the authority given and within a reasonable time. But if any such instrument, after completion, is negotiated to a holder in due course, it is valid and effectual for all purposes in his hands, and he may enforce it as if it had been filled up strictly in accordance with the authority given and within a reasonable time.

Steps in issuance of negotiable instrument.

There are always two steps involved in the issuance of every negotiable instrument, namely:

(1) the mechanical act of writing the instrument completely and in accordance with the requirements of Section 1; and

(2) the delivery of the complete instrument by the maker or the drawer to the payee or holder with the intention of giving effect to it.

Such instrument, complete and delivered, is negotiable and may be enforced accordingly.

Application of Sections 14,15, and 16.

Section 14 applies only to an incomplete instrument which has been delivered by the maker or the drawer to the payee or holder; Section 15, to an incomplete instrument and undelivered; and Section 16, to a complete instrument but undelivered.

When considering Section 14, it is important to bear in mind the distinction between the two classes of instruments:

(1) Those in which obvious blanks are left at the time they are made or indorsed, of such a character as manifestly to indicate that the instruments are incomplete until such blanks shall be filled up; and

(2) Those which are apparently complete, containing blanks only because the written matter does not so fully occupy the entire paper as to preclude the insertion of additional words or figures, or both.

With respect to the first class, one who signs or indorses is liable to *bona fide* holders thereof on the doctrine of implied authority, while with respect to the second class, the liability for the amount of the instrument which has been increased by filling up unoccupied spaces therein is placed upon the doctrine of negligence. (Canon v. Gregslay, 116 111. 151; National Exchange Bank v. Lester, 194 N.Y. 464.)

Rules where instrument incomplete but delivered.

(1) *Authority to fill up the blanks.* — The holder or the person in possession has *prima facie* authority to complete an incomplete instrument by filling up the blanks therein. •

(a) The law speaks of *material particular.* It may be defined as any particular proper to be inserted in a negotiable instrument to make it complete; and the power to fill in blanks extends, therefore, to every incomplete feature or the instrument. (Linthlicum v. Bagby, 102 AtL 997.)

The word "material," as used in Section 14, is not synonymous with "necessary" so as to restrict the right of filling a blank to something essential to a complete negotiable instrument. (Johnson v. Hoover, 117 N.W. 277.) Thus, blanks for date, due date, name of payee, amount, or rate of interest may be filled in. It has been held that even the blank for the name of the drawer may be filled in. (Commercial Investment Co. v. Whitlock, 247 S.W. 833.) Also, a blank for the place of payment (Johnson v. Hoover, 117 S.W. 277.) for the amount of attorney's fees where it supplies a manifest omission and is in accord with the character and object of the blank. (Kramer v. Schmitzer, 109, S.W. 695.)

EXAMPLE:

Suppose M issues a note to P with the space for the date left blank in payment for goods purchased by M from P. This gives *prima facie* authority to fill up the blanks.

(b) The authority to complete is not an authority to alter, (see Section 124; Hoffman v. Plasters Nat. Bank, 39 S.E. 134.) So the holder has no authority to change the amount after it has been filled in or to insert the words "or order" or "or bearer" after the name of the payee. Neither may authority be presumed, unless the character of the instrument directly indicates it, to add at die end of the instrument the words "with interest." (Dunbrew v. Golb, 130, N.Y.S. 182)

(2) *Authority to put any amount.* — A signature on a blank paper delivered in order that it may be converted into a negotiable instrument operates as a *prima facie* authority to fill it up as such for any amount.

EXAMPLE:

Suppose that in the same example, M just delivered a blank paper containing his signature to P.

In order that P may have authority to fill it up for any amount, it must be shown by him that the purpose of M was to convert the said blank paper into a negotiable instrument. In the absence of such a showing, there cannot arise a *prima facie* authority on the part of P to fill it up for any amount.

Thus, if M signs his name on a piece of paper and delivers it to P for the purpose of identifying or comparing it with M's other signatures. M will not be liable even to a holder in due course after it is converted into a negotiable instrument.

(3) *Right against party prior to completion.* — The instrument may be enforced only against a party prior to completion if filled up strictly in accordance with the authority given and within a reasonable time.

(a) If an instrument is incomplete when delivered, the holder has *prima facie* authority to fill up the blanks thereon. If a blank paper is delivered by the person making the signature, the holder has *prima facie* authority to fill it up for any amount if the person making the signature intended to convert it into a negotiable instrument. In either case, the presumption is that the blank was filled up in accordance with the authority given and within a reasonable time, (see Sec. 193.)

(b) The person who signed his name has the burden to rebut the presumption of agency by contrary proof of want of authority, or proving that the authority granted was exceeded. Such "reasonable time" for filling up the Instrument is to be reckoned from the time of the issuance of the instrument because the interest involved is that of the issuer, and! not from the time of each successive negotiation.

EXAMPLE:

Suppose that in the first example, M authorized P to put in the blank only P10,000.00. However, P inserts the sum of P2,000.00 and then indorses the note to A, from A to B, and from B to C who is not a holder in due course.

It is believed that C, not being a holder in due course, can collect nothing on the note from M The implication of the law is that when one or both requisites are absent, the holder not in due course cannot recover. Such a holder is to be treated the same way as a holder not in due course of a materially altered instrument, (see Sec. 124.)

(4) *Right of holder in due course.* — The defense that the instrument had not been filled up in accordance with the authority given and within a reasonable time is not available as against a holder in due course.

EXAMPLE:

Let us now assume that C is a holder in due course. The defense that P exceeded his authority will not avail against C for in such case, the note "is valid and effective for all purpose in his hands and he may enforce it as if it has been filled up strictly in accordance with the authority given and within a reasonable time."

In other words, Section 14 merely raises a personal defense, (see Sec. 58.) The rule is founded upon the principle that where one of two persons must suffer by the bad faith of another, the loss must fall upon the one who first reposed confidence and made it possible for the loss to occur. (Philips v. Hensley, 175 N.W. 23.)

Sec. 15. *Incomplete instrument not delivered.* — Where an incomplete instrument has not been delivered it will not, if completed and negotiated, without authority, be a valid contract in the hands of any holder, as against any person whose signature was placed thereon before delivery.

Rules where instrument incomplete and undelivered.

(1) *Defense even against a holder in due course.* — The fact that an incomplete instrument, completed without authority, has not been delivered, is a defense even against a holder in due course.

EXAMPLE:

Suppose M makes a note for PI,000.00 with the name of the payee in blank and keeps it in his drawer. P steals the note and inserts his name as payee and then indorses the note to A, A to B, B to C, and C to D, a holder in due course. (Sec. 52.) Can D enforce the note against M?

No, because the law is specific that the instrument is not a valid contract in the hands of any holder. And the phrase "any holder" includes a holder in due course. As the signature of M was placed thereon before delivery, he does not assume any responsibility whatsoever.

In this case, a real defense exists, (see Sec. 58.) The instrument may be considered a forgery insofar as M is concerned (see Sec. 23.) since both the two steps in the execution of a negotiable instrument are not complied with. There is, however, a *prima facie* presumption of delivery, which M must rebut by proof to the contrary.

Under certain circumstances, negligence on the part of M may render him liable to a holder in due course.

(2) *Defense available to parties prior to delivery*.—The invalidity of the above instrument is only with reference to the parties whose signatures appear on the instrument before and not after delivery.

EXAMPLE:

In the same example, the instrument can be enforced against P, A, B, and C because, as indorsers, they warrant that the instrument is genuine and in all respects what it purports to be, etc. (see Sees. 65-66.) As their signatures appear on the instrument after delivery, the instrument is valid as to them.

In the case of P, he is liable not merely because he is an indorser but also because he is the one responsible for the theft, and the completion and negotiation of the instrument.

Sec. 16. *Delivery; when effectual; when presumed.* — Every contract on a negotiable instrument is incomplete and revocable until delivery of the instrument for the purpose of giving effect thereto. As between immediate parties, and as regards a remote party other than a holder in due course, the delivery in order to be effectual, must be made either by or under the authority of the party making, drawing, accepting, or indorsing as the case may be; and in such case the delivery may be shown to have been conditional, or for a special purpose only, and not for the purpose of transferring the property in the instrument. But where the instrument is in the hands of a holder in due course, a valid delivery thereof by all parties prior to him

so as to make them liable to him is conclusively presumed. And where the instrument is no longer in the possession of a party whose signature appears thereon, a valid and intentional delivery by him is presumed until the contrary is proved.

Rules where instrument mechanically complete.

(1) *Undelivered.* — Every contract on negotiable instrument even if it is completely written is incomplete and revocable until its delivery for die purpose of giving it effect.

As a general rule, a negotiable instrument like any other written contract, has no legal inception or existence, as such, until it has been delivered in accordance with the purpose and intent of the parties. Without the initial delivery of the instrument, there can be no liability thereon. Moreover, such delivery must be intended to give effect to the instrument.[10]

(a) *Delivery* means transfer of possession, actual or constructive, from one person to another (Sec. 191, par. 6.) with intent to transfer title thereto.

(b) *Issue* is defined as the first delivery of the instrument, complete in form, to a person who takes it as holder, *(ibid.,* par. 10.)

"Issue" and "delivery" are used interchangeably. As ordinarily understood and as used in the same sense as the term "issue," " delivery" means the transfer of the possession of the instrument by the maker or drawer with intent to transfer title to the payee and recognize him as the holder thereof.

(c) *Holder* means the payee or indorsee of a bill or note who is in possession of it, or the bearer thereof, *(ibid.,* par. 7.)

[10]The salary check of a public officer or employee does not belong to him before it is physically delivered to him; until that time, it still has the character of public funds. (De la Victoria vs. Burgos, 245 SCRA 374 [1995].)

EXAMPLE:

M makes a note payable to the order of P and keeps it in his drawer.

In the absence of delivery, the instrument though complete in all its particulars, there is no contract. M does not assume any liability. P does not acquire any right against M who may revoke, cancel or tear it up with or without any reason.

(2) *Delivered.* — The place where the instrument was written, signed, or dated does not necessarily fix or determine the place where it was executed. What is of decisive importance is the delivery thereof. The delivery of the instrument is the final act essential to its consummation as an obligation. (People v. Yaibut, 76 SCRA 624 [1977]; Lim v. Court of Appeals, 251 SCRA 408 [1995].)

Delivery may be made either by the maker or drawer himself or through a duly authorized agent. It has been held that mailing a negotiable instrument with intent to transmit it to the payee constitutes (constructive) delivery. (Mclntire v. Raskin, 161 S.E. 363.) But a note drawn by a testator and found among his effects after his death is not enforceable, no delivery being shown. (Shriner v. Danby, 113 Atl. 612.)

It has been held that the receipt of checks by the collector of the payee is not the issuance and delivery to the payee in contemplation of law. The collector cannot take the checks as a holder as defined above; neither can he be deemed an agent where he appears to be a mere employee (i.e., messenger) of the payee. (Lim v. Court of Appeals, *supra.)*

(3) *In possession of party other than a holder in due course.*—If a complete instrument is found in the possession of an immediate party or a remote party other than a holder in due course, there is a *prima facie* presumption of delivery but subject to rebuttal.

An undelivered instrument is inoperative because delivery is a prerequisite to liability. However, if the instrument is no longer in the possession of the person who signed it and it is complete in its terms, "a valid and intentional delivery by him is presumed until the contrary is proved/' (Sec. 16, last sentence.)

(a) The phrase *immediate parties,* as used in this section, has a broader meaning than its literal signification. It "refers to those who are 'immediate' in the sense of having or being held to know of the conditions or limitations placed upon the delivery of the instrument." In other words, it contemplates privity not proximity, (see Sec. 58.)

Accordingly, a payee who is a holder in due course (see Sec. 52.) is not an immediate party in the sense of Section 16. (Liberty Trust Co. v. Tilton, 105 N.E. 605.)

(b) *Remote parties* are parties who are not in direct contractual relation to each other, (see Sec. 58.) But if they are chargeable, for example, with knowledge or notice of any infirmities in the instrument or defect in the title of the person negotiating the same (see Sec. 56.), they will be considered as immediate parties for purposes of Section 16.

EXAMPLE:

Suppose in the preceding example, P steals the note and then indorses it to A, A to B, B to C, and C to D. D has knowledge that the note was stolen by P.

In this case, P and D are immediate parties. D is also an immediate party, although he is physically remote from M because he is not a holder in due course. As against them, M may prove that no delivery was made or that it was not authorized. But D can recover from P, A, B, and C as they are indorsers. (see Sees. 65 and 66.)

But suppose M delivers the note to X, his agent, with instruction to deliver it to P only for safekeeping.

If X does not tell P that the delivery is only for safekeeping, P can enforce the instrument as he is not an immediate party within the meaning of Section 16.

(4) *Delivered conditionally or for a special purpose.* — If delivery was made or authorized, it may be shown to have been conditional, or for a special purpose only, and not for the purpose of transfering the property (title) to the instrument.

When delivery is made, it is presumed to be made with the intention to transfer ownership of the instrument to the payee.

However, it may be shown between immediate parties that the delivery was conditional or for a special purpose only.

EXAMPLE:

Suppose again in the same example, M delivers the note to P on condition that it will not be binding on him until a comaker has been procured, or for safekeeping, or for collection only.

P cannot enforce the instrument against M because the latter can set up the defense that the delivery was conditional or for a special purpose only and not for the purpose of transfering title to the instrument.

(5) *In the hands of a holder in due course.*—If a complete instrument is in the hands of a holder in due course, a valid delivery thereof by all parties prior to him is conclusively presumed.

A presumption is said to be conclusive when it admits of no evidence to the contrary. It would seem that this conclusive presumption exists as well when the instruments taken from a thief as in any other case. It falls within the general principle that when one of two persons must suffer by the acts of a third, he who has enabled such third person to occasion the loss must bear it. This is a principle of manifest justice where it is confined to cases where the party who is made to suffer the loss has reposed confidence in the third person whose acts have occasioned the loss.

EXAMPLE:

In the two preceding examples, if the note were negotiated to D, tinder circumstances which make him a holder in due course, M cannot prove that the note was stolen by P or was delivered conditionally or for a special purpose only because once an instrument is in the hands of D, a valid and intentional delivery by M, a prior party to D, as to make him liable, is conclusively presumed. The defense is, therefore, only a personal defense not a real defense, (see Sec. 58.) Of course, this conclusive presumption does not apply to an instrument which is incomplete, (see Sec. 15.)

But in a case, for example, where there was no actual delivery to anyone for any purpose by the maker of a promissory note who was a victim of theft or robbery committed in his house and there was nothing to show any fault or negligence on his part, it would be unreasonable to hold him liable even to an innocent holder for value. A note in the hands of the maker, albeit complete, is, in law, but a blank piece of paper. Its wrongful seizure cannot create against his will a valid contract where none existed before.

Sec. 17. ***Construction where instrument is ambiguous.*** **— Where the language of the instrument is ambiguous, or there are omissions therein, the following rules of construction apply:**

(a) Where the sum payable is expressed in words and also in figures and there is a discrepancy between the two, the sum denoted by the words is the sum payable; but if the words are ambiguous or uncertain, reference may be had to the figures to fix the amount;

(b) Where the instrument provides for the payment of interest, without specifying the date from which interest is to run, the interest runs from the date of the instrument, and if the instrument is undated, from the issue thereof;

(c) Where the instrument is not dated, it will be considered to be dated as if the time it was issued;

(d) Where there is a conflict between the written and printed provisions of the instrument, the written provisions prevail;

(e) Where the instrument is so ambiguous that there is doubt whether it is a bill or note, the holder may treat it as either at his election;

(f) Where a signature is so placed upon the instrument that it is not clear in what capacity the person making the same intended to sign, he is to be deemed an indorser;

(g) Where an instrument containing the words "I promise to pay" is signed by two or more persons, they are deemed to be jointly and severally liable thereon.

Rules of construction in case of ambiguity or omission.

It must be emphasized that the rules in this section are applicable only when the instrument in question is ambiguous or uncertain or when there are omissions therein. If the terms are clear, the instrument must be enforced as it reads.

(1) *Sums expressed in words and in figures different.* — When there is a discrepancy between the sum expressed in words and the sum expressed in figures, the former controls.

EXAMPLE:

A promissory note reading "One hundred pesos" in its body and PI,000.00 in the margin is good only for P100.00.

The reasons for the rule are: first, the figures in the margin form no part of the instrument and are simply an abridgement of the amount payable for convenience or reference; second, it is easier to change the figures or to commit a mistake on them than when the amount is written in words.

The theory of inserting the figures in addition to the written amount in the body of the instrument is that the amount might strike the eye immediately.

(2) *Words ambiguous or uncertain.* — Words outweigh figures. However, when the words are ambiguous or uncertain, reference may be had to the figures to determine the true amount.

EXAMPLE:

If a check bears the figures "P365.00" and the amount written is "three sixty five pesos," the marginal figures control.

If the ambiguity is between words and numbers, the words control, if they are clear. In the above example, the words are ambiguous; hence, the figures control. When the amount in words has been wholly omitted in the body of the instrument, the marginal figures may be referred to for the purpose of supplying the amount for which it was given.

(3) *Date when stipulated interest to run not specified.* — If the date when the stipulated interest is to run is not specified, the

interest runs from the date of the instrument or if undated, from the date of issue.

EXAMPLE:

A promissory note payable "with interest at 16% *per annum* from..." will earn interest from the date of the note, or the date - of its issue.

If no rate of interest is mentioned, it will draw interest at the legal rate.

(4) *Instrument undated.* — An undated instrument is considered dated as of the date of its issue.

Issue means the first delivery of the instrument complete in form, to a person who takes it as holder. (Sec. 191, par. 10.) The date appearing in the instrument is deemed *prima facie* the true date of its issue acceptance, or indorsement, (see Sec. 11.) Under Section 17(c), the instrument is not dated.

EXAMPLE:

A promissory note is dated October 15, 2010. This date is *prima facie* the true date of its issue. However, proof may be adduced as between the immediate parties (but not against a holder in due course) to show a different date.

If the promissory note has no date but it was delivered to the payee on October 15,2010, then the note will be considered dated as of the same time.

(5) *Written and printed provisions in conflict.* — In case of conflict between the written and printed provisions, the former prevail. -

EXAMPLE:

Suppose a printed form of a check reads as follows:

Pau to the order of	P
Pesos	
Philippine Commercial Bank Manila	

LAW

Pay to the order of _______ *only*	*P10,000.00*
*Pesos*___________________________	____________
Philippine Commercial Bank	
Manila	
	R _____
	Authorized Signature

Under subsection (d), the written word "only" after the name of P will prevail over the printed words "to the order of and will render the check non-negotiable.

The reason for the rule is that the written words are deemed to express the true intention of the maker or drawer because they are placed there by himself. On the other hand, printed forms are prepared without any particular contract in view.

(6) *Whether instrument bill or note in doubt.* — In case of doubt as to whether an instrument is a bill or note, the holder may treat either at his election.

EXAMPLE:

"I promise to pay P or order P10,000.00

(Sgd.) R

ToW"

The instrument is ambiguous. The promise to pay indicates that it is a promissory note. However, it is addressed to W which indicates that it is a bill of exchange. In this case, P may treat the instrument either as a bill or a note at his discretion.

Another illustration is the bill of exchange where the drawer and the drawee are one and the same person, (see Sec. 130.)

(7) *Capacity in which person signed in doubt.*—In case of dtiubt as to what capacity the person making the instrument intended to sign, he is to be deemed an indorser.

(a) The signature of the maker of a note or the drawer of a bill is usually affixed at the lower right-hand corner of the instrument. Ilie drawee's name is usually written on the lower left-hand corner. The holder negotiates the instrument by signing on the back thereof.

(b) Section 17(f) applies only when there is 'doubt due to the *ambiguous* location of the signature. (Germania Nat. Bank v. Marinco, 109 N.W. 574.) In such case, the party who signs is considered as an indorser (Sec. 10.) who assumes the least liability, and not as a maker or drawer. He is not altogether exempted from liability since he is presumed to have intended to assume a certain responsibility by signing the instrument.

EXAMPLE:

A promissory note payable to the order of P is signed by M as maker.

If P writes his name across the face of the note, P will be deemed an indorser. P cannot be an acceptor because the instrument is not a bill of exchange.

(c) One who signed in the place of the maker's name is not an indorser. The provision applies only to cases of doubt arising out of the location of the signature. (Germania Bank v. Mariner, 109 N.W. 574.) Parol evidence is not admissible to show that he intended to be an indorser, not a maker. (Lumbermens Nat. Bank v. Campbell, 121 P. 427.)

(8) *Instrument signed by two or more persons.* — An instrument with the words "I promise to pay" signed by two or more persons gives rise to solidary liability.

(a) This means that anyone of the signers may be held liable for the whole amount of the instrument. (Philippine National Bank vs. Conception Mining Co., 5 SCRA 705 [1962].) And the reason is that each of them is deemed to utter the words "I promise to pay."

(b) Similarly a note reading: "I, we, or either or us promise to pay." (Powell v. Mobley, 142 S.E. 678.) or "I or we promise to pay" (Churchill v. Miller, 156 Pac. 851.) signed by two or more persons creates a joint and several (or solidary) liability. The fact that the singular pronoun is used indicates that the promise is individual as to each other, that is, each of the co-signers is deemed to have made an independent " sinjgular promise to pay the instrument in full. (Republic Planters Bank v. Court of Appeals, 216 SCRA 738 [1992]; see Astro Electronics Corp. v. Philippine Export and Foreign Loan Guarantee Corp., 411 SCRA 462 [2003].)

(c) But "we promise to pay" signed by two makers imparts only joint liability. In a joint obligation, there are as many debts as there are debtors, each debt being considered distinct and separate from each other, (see Arts. 1207, 1208, Civil Code.) Thus, if the amount of the instrument is P4,000.00 and there are four makers, there are four separate debts. Hence, each is liable only for PI,000.00 to the holder. *Note:* A joint and several obligation in common law corresponds to solidary obligation in civil law.

Sec. 18. *Liability of person signing in trade or assumed name.* — No person is liable on the instrument whose signature does not appear thereon, except as herein otherwise expressly provided. But one who signs in a trade assumed name will be liable to the same extent as if he had signed in his own name.

Persons liable on an instrument.

(1) *General rule.* — As a general rule, only persons whose signatures appear on an instrument are liable thereon. Thus, a drawee is not liable where his signature does not appear on the bill. Neither is one bound by a promissory note executed by another because part of the consideration for which the note was given was received by him. (Kalk v. Salerio, 146 Sec. 103.)

(2) *Exceptions.* — The following are the exceptions to the general rule:

(a) Where a person signs in a trade or assumed name (Sec. 18, par. 2.);

(b) The principal is liable if a duly authorized agent signs on his own behalf (Sec. 19.);

(c) In case of forgery (Sec. 23.), the forger is liable even if his signature does not appear on the instrument;

(d) Where the acceptor makes his acceptance of a bill on a separate paper (Sec. 134.); and

(e) Where a person makes a written promise to accept a bill before it is drawn. (Sec. 135.)

(3) *Signing in a trade or assumed name.* — One who signs in a trade or assumed name is liable as if he signed his own name. It is necessary, however, that the party who signed intended to be bound by his signature. Thus:

A promissory note signed in the business name by the proprietor of the business is governed by the 2nd paragraph of Section 18 making the person so signing liable to the same extent as if he had signed his name. This case is not really an exception to the general rule but rather it is an instance where a person's business name serves die same purpose that would be served by his signature.

In an action on a promissory note which was made payable to ABC Company which had no legal existence; the payee was held estopped from alleging that it was made payable to a fictitious payee where the company was an assumed name used by the payee. (Jones v. Home Furnishing Co., 9 App. Div. [N.Y.] 103.)

Sec. 19. *Signature by agent; authority; how shown.* — The signature of any party may be made by a duly authorized agent. No particular form of appointment is necessary for this purpose; and the authority of the agent may be established as in other cases of agency.

Signature by an authorized agent.

The maker or drawer may sign the instrument personally or by another duly authorized by him.

(1) *Authority of agent to sign principal's name.* — The authority of the agent may be shown, as in Other cases of agency, to have

been given orally or in writing subject to the provisions of the Statute of Frauds. It has been held competent for the agent to sign simply the principal's name and to show his authority to do so by other evidence. (First Nat. Bank v. Bank of Columbia, 5 Wheat 326.) The purpose of a written power of attorney is not to define the authority of the agent, as between himself and the principal, but to evidence the authority of the agent to third parties dealing with the agent (Reyes v. Metropolitan Trust Co., 220 N.Y. 237.)

(2) *Authority of agent to indorse instrument payable to principal — The* right of an agent to indorse commercial papers is a very responsible power and will not be lightly inferred. A salesman with authority to collect money belonging to his principal does not have the implied authority to indorse checks received in payment. (Insular Drug Co. vs. Phil. National Bank, 58 Phil. 634 [1933].)

(3) *Corporations act only by agents.* — Any person who accepts for cash checks made payable to a corporation, which can act only by agents, without making any inquiry as to the authority of the individual to exchange checks belonging to said payee-corporation, does so at his peril, and must abide by the consequences if the supposed agent who indorses the same is without authority. (Jai-Alai Corp. of the Phil. vs. Bank of P.I., 66 SCRA 29 [1975].)

(4) *Drawer as agent of drawee.* — The fact that the drawer was a commission agent of the drawee in the purchase of merchandise covered by the bill does not necessarily make him an agent of the drawee in the latter's obligations arising from the drawing of the bill by him. His (drawer's) acts in negotiating the bill constitute a different contract distinct from that made by his having purchased the merchandise on behalf of the drawee, unless at the time of signing the bill he should have added to his signature some expression to indicate it. (Phil. National Bank vs. Picornell, 46 Phil. 716 [1924].)

Sec. 20. *Liability of person signing as agent, and so forth.* — Where the instrument contains or a person adds to his signature words indicating that he signs for or on behalf of a principal, or in a representative capacity, he is

not liable on the instrument if he was duly authorized; but the mere addition of words describing him as an agent, or as filling a representative character, without disclosing his principal, does not exempt him from personal liability.

When agent may escape personal liability.

(1) In order that an agent who signs a negotiable instrument may escape personal liability, the following are the requisites:

(a) He is duly authorized;

(b) He adds words to his signature indicating that he signs as an agent, that is, for or on behalf of a principal, or in a representative capacity; and

(c) He discloses his principal.

EXAMPLES:

(1) The best mode for an agent to sign or indorse an instrument for his principal so that it may clearly appear that he is acting as a mere agent of another, is as follows:

(a) "Jovencio F. Cinco

By:

(Sgd.) Catalino R. Castaneda, Jr.

or Agent/'

(b) "(Sgd.) Catalino R. Castaneda, Jr.

or As agent of Jovencio F. Cinco;"

(c) "(Sgd.) Catalino R. Castaneda, Jr.

For Jovencio F. Cinco/'

In all the foregoing, it is clear that Catalino R. Castaneda, Jr., is merely acting as an agent of Jovencio F. Cinco, and, therefore, is not personally liable unless he is not duly authorized, in which case, he alone is liable on the instrument.

(2) "Dante Q. Pantaleon, Principal

(Sgd.) Catalino R. Castaneda, Jr.,"

Here, the instrument names the principal but does not show that the agent signed in a representative capacity by adding the word, "agent," "president," or some other title indicating an agency status.

(3) "(Sgd.) Catalino R. Castaneda, Jr., agent."

In this example, the instrument does not name the principal but does show the agent signed in a representative capacity.

The agent on both examples is personally liable on the instrument by a third-party holder. However, if the agent is being sued by the payee, the agent may introduce evidence that he signed only in a representative capacity and that the payee knew this to be the case.

Disclosure by agent of principal.

If the agent signs a note or bill in his own name and discloses no principal, he is personally bound, and evidence to the contrary may not be admitted to relieve him from personal liability, (see Granada v. Phil. National Bank, 18 SCRA 1 [1966]; see The Phil. Bank of Commerce v. Aruego, 102 SCRA 530 [1981].) As has been said: "It is better that a careless or ignorant agent shall sometimes pay for his principal, than to subject the construction of valid written contracts to the manifold perversions, misapprehensions, and uncertainties of oral testimony." (Stockpole v. Arnold, 6 Am. Dec. 150.)

It is, however, not necessary to exempt the agent from liability that the disclosure of the principal be in signature.

EXAMPLES:

(1) Pay to P or order P10,000.00.

National Manufacturing Co., Inc.

(Sgd.) Catalino R. Castaneda, Jr. President

(2) For value received by National Manufacturing Co., Inc., pay P or order P10,000.00.

(Sgd.) Catalino R. Castaneda, Jr. President

(3) National Manufacturing Go., Inc. Pasig, Metro Manila Pay
to P or order P10,000.00.

(Sgd.) Catalino R. Castaneda, Jr.
President

In all the foregoing, Catalino R Castaneda, Jr. is not personally liable as there is a sufficient disclosure of the principal. If not authorized, he will, of course, be personally liable.

Use of descriptive words without disclosure of principal.

(1) *Signer personally liable.* — The mere addition of descriptive words without disclosing the principal will not relieve the signer from personal liability. Therefore, one who signs an instrument in a representative capacity but without disclosing his principal will still be personally liable although he adds to his signature the word "agent" or "trustee," or "administrator," or "guardian," or "director," or "treasurer" etc.

In all these cases, the words added are regarded as mere *de- scriptio personae, i.e.,* describing the person who signed the instrument and do not of themselves make third persons chargeable with notice of any representative relation of the signer.

(2) *Evidence admissible to prove contract actually entered into.* — The rule is not absolute. As between immediate parties, extrinsic evidence may be admitted to show the real character of the transaction.

Thus, if the signer be in fact a mere agent and the payee knew that the former was authorized by his principal, and it was the understanding of all the parties that the instrument was given as the obligation of the principal, particularly where the agent never received any consideration or benefit for said instrument, it would be contrary to truth and justice to construe the instrument as the personal obligation of the agent contrary to the intent of the parties. He is entitled to give evidence to prove the contract actually entered into.

Sec. 21. *Signature by procuration; effect of.* — A signature by "procuration" operates as notice that the agent has but a limited authority to sign, and the principal is bound only in case the agent in so signing acted within the actual limits of his authority.

Meaning of procuration.

Procuration is defined as "the act by which a principal gives power to another to act in his place as he could himself." (Fink v. Scott, 143 S.E. 305.) It is ordinarily understood in the same sense as agency or proxy for the one who signs in merely acting as agent for another.

The term is seldom used even in the United States but is frequently used in England. Section 21 is taken from the English Bill of Exchange Act. (Daniel on Negotiable Instruments, Sec. **280.)**

EXAMPLE:

A signature by procuration may be made as follows:

Jovencio F. Cinco

Per Procuration: Domingo M. Navarro

Instead of "per procuration/' it may also be expressed thus: "per pro.," "per proc.," "P.P." or "PP."

Effect of signature by procuration.

The term "procuration" has a special and technical meaning. It gives a warning that the agent has but a limited authority, so that it is the duty of the person dealing with him to inquire into the extent of his authority.

(1) *Where agent exceeded his authority.* — The principal is not bound if the agent has exceeded the actual limits of his authority, although he may have acted within the general scope of the agency, *(ibid.)* Thus, the general authority bestowed upon an agent to transact the business of his principal does not imply an authority to accept or indorse bills so as to charge the principal. The power to make or indorse negotiable paper must be expressly granted; it is subject to strict interpretation and

must be perfomed in strict conformity with the terms thereof. (Handyside v. Cameron, 74 Am. Dec. 119; Temple v. Pomeroy, 4 Greg 128; Humpreys v. Wilson, 43 Miss. 328.)

Where P who carries on business for himself, and is also in partnership with A, gives A authority to accept bills in his name, in respect to his private business, but A accepts a bill in P's name in respect to his partnership business signing it "per pro.,"and the bill is negotiated, *held:* P is not liable on his acceptance. (Athwood v. Munnings, 7 B and C 28; Stagg v. Elliot, 12 C.B.N.S. 373.)

(2) *Where agent acted with abuse of authority given*•—But where the agent has authority to do the particular act in question, his abuse of such authority is not a defense against a *bona fide* holder for value. (Bryant, Powis & Bryant v. Quebec Bank [1893], A.C. 170,179.)

Where by resolution of the board of directors, A, the chairman of the corporation, is authorized to accept bills drawn by R against the deposit of securities and A accepts a bill drawn by P signing "per pro," and without requiring the deposit of security and the bill is negotiated to a *bona fide* holder, *held:* the company is liable. *(Re* Land Credit Co., L.R.A. Ch. 460.)

Sec. 22. *Effect of indorsement by infant or corporation.* — The indorsement or assignment of the instrument by a corporation or by an infant passes the property therein, notwithstanding that from want of capacity the corporation or infant may incur no liability thereon.

Effect of indorsement by incapacitated persons.

(1) *Minors*. —As a general rule, contracts entered into by a minor are voidable (Arts. 1327,1329,1390, Civil Code.) at his instance or at the instance of his guardian.

(a) A minor is not bound by his indorsement for lack of capacity. He is, however, not incapacitated to transfer certain rights. Section 22 merely provides that the indorsement of an infant is not void and that his incapacity is not a defense in favor of prior parties, and does not take away the infant[7] s right to disaffirm his indorsement and recover the instrument even against an innocent indorsee or subsequent holder for value. (Murray v. Thompson, 188 S.W. 578.)

Minority is not even a personal defense which may be set up by parties other than the minor; but it is real defense available to the minor. Hence, he may also disaffirm and recover the instrument from a holder in due course, (see Sees. 57,58.)

EXAMPLES:

(1) M issues a negotiable promissory note payable to the order of P, a minor. P indorses the instrument to A.

M becomes liable to A because the indorsement by P passes title to A. But if M cannot pay and A sues P, the latter may raise the defense of minority to escape liability. P may even disaffirm his indorsement and recover the instrument from A.

(2) In the same example, after P indorses the note to A, the latter negotiates the same to B. Now P seeks to disaffirm his indorsement and recover the note from B. If B qualifies as a holder in due course (see Sec. 52.) of the note, P cannot set aside the negotiation. P can rescind his indorsement before the instrument is negotiated to a party who qualifies as a holder in due course.

(b) Aminor, however, may be held bound by his signature in an instrument where he is guilty of actual fraud (see 43 C.J.S. 206.) committed by specifically stating that he is of age when, in fact, he is not. (see Mercado v. Espiritu, 37 Phil. 215 [1917].)

(2) *Other incapacitated persons.* — The rule in Section 22 applies to other incapacitated persons as well. Other persons, besides minors, who have no capacity to give consent are insane or demented persons and deaf-mutes who do not know how to write. (Art. 1327, Civil Code.) As far as the incapacitated person himself is concerned, his incapacity is a real defense that is, it is available even against a holder in due course, (see Sees. 57, 58.) He is not even bound to restore anything he has received by

virtue of his contract, except to the extent to which he has been benefited thereby. (Art. 1399, Civil Code.)

Effect of indorsement by a corporation.

As regards corporations, Section 22 applies to cases where the corporation has committed *ultra vires* acts or acts beyond its powers. It has been held that a corporation is not liable on notes in a suit thereon by an indorsee, where the corporation is without capacity to make the contract in fulfillment of which they were executed. (Pearce vs. Madison & I.R. Co., 21 How [US] 441.) One who deals with the officers or agents of a corporation is bound to know their powers and the extent of their authority. (Alexander v. Cauldwell, 83 N.Y. 480.)

If the act or obligation under the law is merely voidable at the election of the obligor, and not entirely null and void, the defense is cut off. (see Uniform Commercial Code, 3-305[b]; Sioux City Terminal & Warehouse Co. v. Trust Co. of N.A., 173 US 99.)

> **Sec. 23.** ***Forged signature; effect of.*****—When a signature is forged or made without authority of the person whose signature it purports to be, it is wholly inoperative, and no right to retain the instrument, or to give a discharge therefor, or to enforce payment thereof against any party thereto, can be acquired through or under such signature, unless the party against whom it is sought to enforce such right is precluded from setting up the forgery or want of authority.**

Forgery explained.

By *forgery* is meant the counterfeit-making or fraudulent alteration of a writing, and may consist in the signing of another's name or the alteration of an instrument in the name, amount, description of the person and the like,, with intent thereby to defraud."

"Mere variance of signatures cannot be considered conclusive proof that the same were forged. Forgery and convincing evidence, the burden of proof lies on

The intent to defraud distinguishes forgery from innocent alteration and spoliation. (Ogden, op. *cit.,* p. 318.)

Application of Section 23.

(1) *Two cases.* — This provision consists of two (2) parts. The first part states the general rule while the second piart states the exception to the general rule. It applies only to two cases:

(a) Where the *signature* on the instrument is affixed by one who does not claim to act as an agent and who has no authority to bind the person whose signature he has forged; and

(b) Where the *signature* is affixed by one who purports to be an agent but has no authority to bind the alleged principal.

(2) *Effect of forged signature.* — In both cases, the signature is wholly inoperative and so no right can be acquired through the forged signature. Payment made "through or under such forged signature" is ineffectual and does not discharge the Instrument. A person whose signature was forged as maker, drawer, payee or indorsee of a note or check was never a party or never gave his consent to the contract which gave rise to the instrument. Since his signature does not appear in the instrument, he cannot be held liable thereon by anyone. (Gempesaw v. Court of Appeals, 218 SCRA 682 [1993].)

Forgery is, therefore, a real or absolute defense even against a holder in due course, (see Sec. 58.)

(3) *Proof of forgery.* — Forgery, as any other mechanism of fraud, must be proven clearly and convincingly, and the burden of proof lies on the party alleging forgery. It cannot be presumed. A person who denies issuing a note or check puts into question the genuineness and authenticity of the. signature appearing thereon; it is he who has the burden of proving the signature is a forgery. Mere variance of signatures cannot be considered conclusive proof that the same were forged. (Chiang Yia Min v. Court of Appeals, 355 SCRA 608 [2001].). (JN Development Corp. v. Philippine Export and Foreign Loan Guarantee Corp., 468 SCRA 555 [2005].)

EXAMPLES:

(1) P makes a promissory note payable to his own order, forging M's signature as maker.

The signature is inoperative and, therefore, it did not operate to make M a party to the instrument. M is not liable even to an innocent purchaser for value.

(2) X issues a promissory note payable to the order of P. X signs M's name indicating that he signs for and on behalf of M. However, X has no authority to bind M.

The signature is also inoperative and M is not liable to any holder.

Cases of forgery in general.

The cases of forgery may be divided as follows:

(1) Forgery of promissory notes which may be subdivided into:

(a) Forgery of an indorsement on the note; and
(b) Forgery of the maker's signature.

(2) Forgery of bills of exchange which may be subdivided into:

(a) Forgery of an indorsement on the bill; and

(b) Forgery of the drawer's signature; either

1) with acceptance by the drawee; or
2) without such acceptance but the bill is paid by the drawee.

Extent of the effect of forgery.

Section 23 does not purport to declare the instrument totally void nor the genuine signatures thereon inoperative. It is only the forged or unauthorized signature that is declared to be inoperative. In other words, rights may still exist and be enforced by virtue of such instrument as to those whose signatures thereto are found to be genuine.

A forged indorsement prevents any subsequent party from acquiring any right as against any party whose name appears prior to the forgery. Although rights may exist between and among parties subsequent to the forged indorsement, not one of them can acquire rights against parties prior to the forgery. Such an indorsement cuts off the rights of all subsequent parties as against parties prior to the forgery. However, the law makes an exception to these rules where a party is precluded from setting forgery as a defense. (Gempesaw v. Court of Appeals, *supra.)*

EXAMPLE:

M makes a note payable to the order of P. P indorses it to A. X obtains possession of the note fraudulently and indorses it to B, by forging A's signature. B indorses to C. Thus, the indorsements are as follows:

Pay to

(Sgd.)P

A Pay

(Sgd.) A (forged by X)

to B

(Sgd.)B

(a) C cannot enforce the instrument against M and P because C's rights against them are cut off by the forged signature of A which is wholly inoperative. C could acquire rights against M or P to the instrument only through the forged signature of A.

(b) Neither can C enforce the note against A because A's signature is wholly inoperative. A has no privity with C. Under Section 23, C acquired no right to retain, discharge, or enforce payment of the note under the forged signature of A.

(c) But C may go against B whose signature is genuine and, therefore, operative. B is a general indorser who warranted to C that the instrument is genuine and was valid and subsisting at the time of B's indorsement, (see Sees. 65 and 66.)

(d) Of course, B or C has a right of recourse against X, the forger.

(e) A can recover from M and P because his rights against them were not affected by the forgery. The signatures of M and P are genuine and they are liable to A on their contract.

Exceptions to the general rule.

There are actually two (2) exceptions to the general rule that no right or title can be acquired to a negotiable instrument through or under a forged or unauthorized signature, namely:

(1) If the party against whom it is sought to enforce such right is precluded from setting up the forgery or want of authority (Sec. 23.); and

(2) Where the forged signature is not necessary to the holder's title in which case the forgery may be disregarded, (see Sec. 48.)

There is seldom any practical distinction in the negotiable instrument field between a case where there has been no forgery or want of authority and a case where a party against whom it is sought to enforce a right is precluded from setting up the forgery or want of authority. (Cohen v. Lincoln Sav. Bank, 10 NE 2d 457; see 11 Am. Jur. 2d 789-791.)

Persons precluded from setting up the defense of forgery.

"Precluded," as used in Section 23, is synonymous with "estopped," and does not include ratification or adoption in their strict primary meaning but only when they involve some of the elements of estoppel. (Olsgard v. Lemke, 156 N.W. 102.)

(1) *Divided into two general classes.* — Those precluded from setting up the defense of forgery may be divided into two general classes. They are:

(a) Those who by their acts, silence, or negligence, are estopped from setting up the defense of forgery; and

(b) Those who warrant or admit the genuineness of the signatures in question, namely:

1) indorsers;

2) acceptors; and

3) persons negotiating by delivery, (see Sec. 65.)

(2) *Right to recover damages.* — A party precluded from raising the defense of forgery such as by reason of negligence may still recover damages under the Civil Code provisions on quasi-delicts. (Gempesaw v. Court of Appeals, *supra;* see Sec. 196.)

EXAMPLES:

(1) P makes a promissory note payable to his own order, forging M's signature thereto as maker. When P attempts to indorse the note to A, the latter asks M if his signature is genuine and M says "It is all right."

In this case, M is estopped from setting up that his signature is a forgery. This is an example of estoppel arising from declaration.

(2) M, whose name was forged by X, her husband, upon notes also signed by him and given for a loan to him, who failed to inform A, the payee, of the forgery for many months after she discovered it, thus preventing A from taking steps to protect himself against loss was: estopped by her silence from setting up the forgery (First Nat. Bank v. Wolfe, 117 AtL 898.) on the theory, "He who is silent when conscience requires him to speak shall be debarred from speaking when conscience requires him to be silent." (Tobias v. Morris, 126 Ala. 535; Rothechild v. Tile, 204 N.Y. 458.)

(3) Where the drawer negligently failed to examine checks returned to him, it was held that he was precluded from holding the bank for paying forged checks after the time he should have given them notice. (Deer Island Fish & Oyster Co. v. First Nat. Bank of Biloxi, 166 Mass. 162,146 So. 116.)

(4) R is authorized to draw on W (a bank) for any amount not exceeding P5,000.00. P makes a bill of exchange payable to his own order for P6,000.00 by forging R's signature. P indorsed the bill to A, a holder in due course, who presented it for payment. After the bill had been cleared thru W's clearing office, W paid the bill. Can W recover the amount paid to A?

No, because W was guilty of gross negligence considering that the irregularity was apparent on the face of the bill. W is, therefore, precluded from setting up the question of forgery, (see Republic of the Phil. v. Equitable Banking Corporation, 10 SCRA 8 [1964].)

(5) M, maker, P, payee. X indorses the note to A by forging P's signature. A indorses the note to B, B to C, C to D, the present holder.

D can enforce the note against A, B, and C who are indorsers subsequent to the forgery. As indorsers, they warrant that the instrument is genuine and in all respects what it purports to be. (see Sees. 65 and 66.)

(6) P makes a bill of exchange payable to his own order by forging R's signature thereto as a drawer. The bill is addressed to W as drawee. On presentation for acceptance, W accepts the bill, (see Sec. 143.) P then indorses the bill to A, A to B, B to C, C to D, the present holder.

In this case, W cannot refuse to pay D on the ground that the signature of R was a forgery because by accepting the bill, he admits the genuineness of the drawer's signature, (see Sec. **62.)**

Of course, W is not liable to P, the forger, and he can recover from him the money paid to D. Neither is W liable to D if the latter had knowledge of the forgery or was guilty of negligence at the time he acquired the bill in not making inquiries which if made might have revealed the fact of forgery.

ILLUSTRATIVE CASES:

1. Drawee bank paid a check with name of drawer forged, although amount of check exceeds authorized limit.

Facts: R is authorized to draw on W (a bank) for any amount not exceeding P5,000.00. P makes a bill of exchange payable to his own order for P6,000.00 by forging R's signature. P indorsed the bill to A, a holder in due course, who presented it for payment.

After the bill had been cleared thru W's clearing office, W paid the bill.

Issue: Can W recover the amount paid to A?

Held: No, because W was guilty of gross negligence considering that the irregularity was apparent on the face of the bill. W is, therefore, precluded from setting up the question of forgery. *(Republic of the Phils, v. Equitable Banking Corporation, 10 SCRA 8 [1964].)*

2. Drawer's negligence facilitated the encashment of forged checks and prevented the discovery of the fraud.

Facts: During the months of March, April, and May 1969, 23 checks payable to various payees were prepared, processed, issued and released by R (MWSS), all of which were paid and cleared by W (PNB) and debited by W against R's account. During the same period of time, 23 checks bearing the same numbers as the aforementioned checks were likewise paid and cleared by W and debited against R's account.

Investigation conducted by the NBI shows that the second 23 checks were deposited by three (3) fictitious payees and the fraudulent encashment was an "inside job."

Issue: Is R barred from setting up the defense of forgery under Section 23?

Held: Yes. R was guilty of negligence not only before the questioned checks were negotiated but even after the same were already negotiated as shown by the following:

It used its own personalized checks, instead of the official PNB commercial blank checks without providing the needed security measures in the exercise of its special privilege in the printing of the same *(e.g.,* relative to the safekeeping and disposition of excess forms and spoiled check forms, paper used in printing said checks, supervision of the printing) and furnishing W with the print used by the printer, inks and pens in signing the checks, and other information regarding the same; and

It failed to reconcile the bank statements with its own records which failure facilitated the fraudulent encashment.

This negligence was the proximate cause of the failure to discover the fraud. *(Metropolitan Waterworks and Sewerage System v. Court of Appeals, 143 SCRA 20 [1986].)*

3. *Drawee bank allowed* 27 *days to elapse after clearing before notifying collecting bank as to forgery of payee's name.*

Facts: R drew a check on W (a bank) and in favor of P as payee. The check fell into the hands of A who erased the name of P and put his name instead. A deposited the altered check in his name with B (a bank) which presented the check to W for clearing. The check was duly cleared by W and A, the forger, was credited the amount of the check.

The alteration was discovered 27 days later and B was notified on the same day.

Issue: Is B liable to refund the amount of the check?

Held: No. The court, relying on the doctrine announced in *Republic of the Philippines v. Equitable Banking Corporation (supra.),* held as decisive the fact that W allowed 27 days to elapse after clearing before notifying B as to such alteration. The applicable Central Bank regulation (Circular No. 9, Feb. 17, 1949, as amended by Circulars No. 138, Jan. 30, 1962 and No. 169, March 30,1964.) provides for a 24-hour period only within which the drawee-bank must return a check to the collecting bank if the check is defective for any reason. *(Hongkong & Shanghai Banking Corporation v. People's Bank & Trust Company, 35 SCRA 140 [1970];* see *Phil National Bank v. Court of Appeals,* 25 SCRA 693 [1968].)

Note: The validity of the 24-hour clearing hours regulation has been upheld in *Republic vs. Equitable Banking Corporation, supra.* The remedy of the drawee bank is against the party responsible for the alteration. It is true that when an indorsement is forged, the collecting bank or last indorser, as a general rule, bears the loss (*Banco de Oro Savings & Mortgage Bank v. Equitable Banking Corporation,* 157 SCRA 158 [1985].), but the unqualified indorsement of the collecting bank on the check should be read together with the 24-hour regulation on clearing house operations. Once that 24-hour period is over, the liability of the collecting bank in such an indorsement has ceased. (*Metropolitan Bank & Trust Co. v. the First National City Bank,* 118 SCRA 537 [1982]; *Republic Bank v. Court of Appeals,* 196 SCRA 100 [1991].)

The clearing regulation in force when the dispute in *Bank of the Phil. Islands v. Court of Appeals (infra.)* occurred in November 12,1981 (forging of payees' indorsement) under Gearing House Rules and Regulations Philippine Clearing House Corporation (PCHC) as revised on September 19,1980 provides:

> "Items which have been the subject of material alteration or items bearing a forged endorsement when such endorsement is necessary for negotiation shall be returned within twenty-four (24) hours after discovery of the altera

tion or the forgery, but in no event beyond the period prescribed by law for the filing of a legal action by the returning bank/branch, institution or entity against the bank/branch, institution or entity sending the same." (Sec. 23 thereof.)

In the case of *Banco De Oro Savings and Mortgage Bank vs. Equitable Banking Corporation* (157 SCRA 188 [1988], *infra.),* the clearing regulation (this is the present clearing regulation) at the time the parties' dispute occurred was as follows:

"Sec. 21. x x x x x x x x x

Items which have been the subject of material alteration or items bearing forged endorsement when such endorsement is necessary for negotiation shall be returned by direct presentation or demand to the Presenting Bank and not through the regular clearing house facilities within the period prescribed by law for the filing of a legal action by the returning bank/branch, institution or entity sending the same."

The above-cited clearing regulations are substantially the same in that it allows a return of a check "bearing forged endorsement when such endorsement is necessary for negotiation" even beyond the next regular clearing although not beyond the prescriptive period "for the filing of a legal action by the returning bank." *(Bank of the Phil. Islands vs. Court of Appeals, 216 SCRA 51 [1992], infra.)*

4. *Depositor entrusted to his secretary who was able to encash and deposit to her personal account several checks against account of the depositor, his credit cards and check books with blank checks.*

Facts: Petitioner RI was a depositor of good standing of respondent bank, MBC. As he was then running about 20 corporations, and was going out of the country a number of times, he entrusted to his security KE, his credit cards and his checkbooks with blank checks. It was also KE who verified and reconciled the statements of said checking account.

KE was able to encash and deposit to her personal account 17 checks drawn against the account of petitioner RI at the respondent bank. RI did not bother to check his statement of account until a business partner apprised him he saw KE use RI's credit cards.

RI requested MBC to credit back and restore to his account the value of the checks which were wrongfully encashed but MBC refused.

Issue: Is MBC liable for damages for its negligence in failing to detect the discrepant checks?

Held: (1) *Petitioner has no cause of action.* — "To be entitled to damages, petitioner has the burden of proving negligence on the part of the bank for failure to detect the discrepancy in the signatures on the checks. It is incumbent upon petitioner to establish the fact of forgery, i.e., by submitting his specimen signatures and comparing them with those on the questioned checks. Curiously though, petitioner failed to submit additional specimen signatures as requested by the National Bureau of Investigation from which to draw a conclusive finding regarding forgery.

The Court of Appeals found that petitioner, by his own inaction, was precluded from setting up forgery."

(2) *MBC employees exercised due diligence.* — "Petitioner's contention that Manila Bank [MBC] was remiss in the exercise of its duty as drawee lacks factual basis. Consistently, the CA and the RTC found that Manila Bank employees exercised due diligence in cashing the checks. The bank's employees in the present case did not have a hint as to Eugenio's [KE's] *modus operandi* because she was a regular customer of the bank, having been designated by petitioner himself to transact in his behalf.

According to the appellate court, the employees of the bank exercised due diligence in the performance of their duties."

(3) *Petitioner negligent.* — "As borne by the records, it was petitioner, not the bank, who was negligent. *Negligence* is the omission to do something which a reasonable man, guided by those considerations which ordinarily regulate the conduct of human affairs, would do, or the doing of something which a prudent and reasonable man would do. In the present case, it appears that petitioner accorded his secretary unusual degree of trust and unrestricted access to his credit cards, passbooks, check books, bank statements, including custody and possession of cancelled checks and reconciliation of accounts."

(4) *Petitioner failed to examine his bank statements.* — "Petitioner's failure to examine his bank statements appears as the proximate cause of his own damage. *Proximate cause* is that

cause, which, in natural and continuous sequence, unbroken by any efficient intervening cause, produces the injury, and without which the result would not have occurred. In the instant case, the bank was not shown to be remiss in its duty of sending monthly bank statements to petitioner so that any error or discrepancy in the entries therein could be brought to the bank's attention at the earliest opportunity. But, petitioner failed to examine these bank statements not because he was prevented by some cause in not doing so, but because he did not pay sufficient attention to the matter. Had he done so, he could have been alerted to any anomaly committed against him.

In other words, petitioner had sufficient opportunity to prevent or detect any misappropriation by his secretary had he only reviewed the status of his accounts based on the bank statements sent to him regularly. In view of Article 2179 of the New Civil Code, when the plaintiff's own negligence was the immediate and proximate cause of his injury, no recovery could be had for damages."

(5) *Petitioner precluded from setting up forgery.* — "The rule [in Section 23] does provide for an exception, namely: *'unless the party against whom it is sought to enforce such right is precluded from setting up the forgery or want of authority.'* In the instant case, it is the exception that applies. In our view, petitioner is precluded from setting up the forgery, assuming there is forgery, due to his own negligence in entrusting to his secretary his credit cards and checkbook including the verification of his statements of account."

(6) *Fact of forgery not proved.* — "Petitioner's reliance on *Associated Bank vs. Court of Appeals* (252 SCRA 620,633 [1996].) and *Philippine Bank of Commerce vs. Court of Appeals* (269 SCRA 695,703-710 [1997].) to buttress his contention that respondent Manila Bank as the collecting or last endorser generally suffers the loss because it has the duty to ascertain the genuineness of all prior endorsements is misplaced. In the cited cases, the fact of forgery was not in issue. In the present case, the fact of forgery was not established with certainty. In those cited cases, the collecting banks were held to be negligent for failing to observe precautionary measures to detect the forgery.

In the case before us, both courts below uniformly found that Manila Bank's personnel diligently performed their duties, having compared the signature in the checks from the specimen signatures on record and satisfied themselves that it was petitioner's/' *(Ilusorio vs. Court of Appeals, 393 SCRA 89 [2002].)*

5. *Bank paid P950,000 upon a forged check payable to cash.*

Facts. Plaintiff Samsung Construction Company Philippines, Inc. ("Samsung Construction"), while based in Binan, Laguna, maintained a current account with defendant Far East Bank and Trust Company ("FEBTC") at the latter's Bel-Air, Makati branch. The sole signatory to Samsung Construction's account was Jong Kyu Lee ("Jong"), its Project Manager, while the checks remained in the custody of the company's accountant, Kyu Yong Lee ("Kyu").

On 19 March 1992, a certain Roberto Gonzaga presented for payment FEBTC Check to the bank's branch in Bel- Air, Makati. The check, *payable to cash* and drawn against Samsung Construction's current account, was in the amount of P999,500.00. The bank teller, CJ first checked the balance of Samsung Construction's account. After ascertaining there were enough funds to cover the check, she compared the signature appearing on the check with the specimen signature of Jong as contained in the specimen signature card with the bank. After comparing the two signatures, CJ was satisfied as to the authenticity of the signature appearing on the check. She then asked Gonzaga to submit proof of his identity, and the latter presented three (3) identification cards.

At the same time, CJ forwarded the check to the branch Senior Assistant Cashier GV, as it was bank policy that two bank branch officers approve checks exceeding P100, 000. 00 for payment or encashment. GV likewise counterchecked the signature on the check as against that on the signature card. He too concluded that the check was indeed signed by Jong. GV then forwarded the check and signature card to SS, another bank officer, for approval. SS then noticed that Jose Sempio IE ("Sempio"), the assistant accountant of Samsung Construction, was also in the bank. Sempio was well-known to SS and the other bank officers, he being the assistant accountant of Samsung Construction. SS showed the check to Sempio, who vouched for the genuineness of Jong's signature. Confirming the identity of Gonzaga, Sempio said that the check was for the purchase of equipment for Samsung Construction. Satisfied with the genuineness of the signature of Jong, SS authorized the bank's encashment of the check to Gonzaga.

The following day, the accountant of Samsung Construction, Kyu, examined the balance of the bank account and discovered that a check in the amount of P999,500.00 had been encashed. Aware that he had not prepared such a check for Jong's signature, Kyu perused the checkbook and found that the last blank check was missing. He reported the matter to Jong, who then proceeded to the bank. Jong learned of the encashment of the check, and realized that his signature had been forged. The Bank Manager reputedly told Jong that he would be reimbursed for the amount of the check. Jong proceeded to the police station and consulted with his lawyers. Subsequently, a criminal case for qualified theft was filed against Sempio before the Laguna Regional Trial court.

During the trial, both sides presented their respective expert witnesses to testify on the claim that Jong's signature was forged. Samsung Corporation, which had referred the check for investigation to the NBI, presented Senior NBI Document Examiner Roda B. Flores. She testified that based on her examination, she concluded that Jong's signature had been forged on the check. On the other hand, FEBTC, which had sought the assistance of the Philippine National Police (PNP), presented Rosario C. Perez, a document examiner from the PNP Crime Laboratory. She testified that her findings showed that Jong's signature on the check was genuine.

Confronted with conflicting handwriting expert testimony of the NBI and the PNP, the RTC chose to believe the findings of the NBI expert that Jong's signature had been forged on the check and accordingly directed the bank to pay or credit back to Samsung Construction's account the amount of P999,500.00, together with interest tolled from the time the complaint was filed, and attorney's fees in the amount of P15,000.00.

The Court of Appeals reversed the RTC Decision and absolved FEBTC from any liability.

Issue: Who shall bear the loss? The drawee bank or the drawer?

(1) *Generally, a forged signature is wholly inoperative* — The general rule is to the effect that a forged signature is "wholly inoperative," and payment made "through or under such

signature" is ineffectual or does not discharge the instrument. If payment is made, the drawee cannot charge it to the drawer's account. The traditional justification for the result is that the drawee is in a superior position to detect a forgery because he has the maker's signature and is expected to know and compare it. The rule has a healthy cautionary effect on banks by encouraging care in the comparison of the signatures against those on the signature cards they have on file. Moreover, the very opportunity of the drawee to insure and to distribute the cost among its customers who use checks makes the drawee an ideal party to spread the risk to insurance.

Brady, in his treatise The Law of Forged and Altered Checks, elucidates:

> 'When a person deposits money in a general account in a bank, against which he has the privilege of drawing checks in the ordinary course of business, the relationship between the bank and the depositor is that of debtor and creditor. So far as the legal relationship between the two is concerned, the situation is the same as though the bank had borrowed money from the depositor, agreeing to repay it on demand, or had bought goods from the depositor, agreeing to pay for them on demand. The bank owes the depositor money in the same sense that any debtor owes money to his creditor. Added to this, in the case of bank and depositor, there is, of course, the bank's obligation to pay checks drawn by the depositor in proper form and presented in due course. When the bank receives the deposit, it impliedly agrees to pay only upon the depositor's order. When the bank pays a check, on which the depositor's signature is a forgery, it has failed to comply with its contract in this respect. Therefore, the bank is held liable.
>
> The fact that the forgery is a clever one is immaterial. The forged signature may so closely resemble the genuine as to defy detection by the depositor himself. And yet, if a bank pays the check, it is paying out its own money and not the depositor's.
>
> The forgery may be committed by a trusted employee or confidential agent. The bank still must bear the loss. Even in a case where the forged check was drawn by the depositor's partner, the loss was placed upon the bank. The case referred to is *Robinson v. Security Bank,* Ark., 216 S. W. Rep. 717. In this case, the plaintiff brought suit against

the defendant bank for money which had been deposited to the plaintiff's credit and which the bank had paid out on checks bearing forgeries of the plaintiff's signature, xxx

It was held that the bank was liable. It was further held that the fact that the plaintiff waited eight or nine months after discovering the forgery, before notifying the bank, did not, as a matter of law, constitute a ratification of the payment, so as to preclude the plaintiff from holding the bank liable, xxx

This rule of liability can be stated briefly in these words: 'A bank is bound to know its depositors' signature." The rule is variously expressed in the many decisions in which the question has been considered. But they all sum up to the proposition that a bank must know the signatures of those whose general deposits it carries.'

By no means is the principle rendered obsolete with the advent of modern commercial transactions. Contemporary texts still affirm this well-entrenched standard. Nickles, in his book Negotiable Instruments and Other Related Commercial Paper wrote, thus:

"The deposit contract between a payor bank and its customer determines who can draw against the customer's account by specifying whose signature is necessary on checks that are chargeable against the customer's account. Therefore, a check drawn against the account of an individual customer that is signed by someone other than the customer, and without authority from her, is not properly payable and is not chargeable to the customer's account, inasmuch as any 'unauthorized signature on an instrument is ineffective' as the signature of the person whose name is signed.'"

(2) *Forgery is a real or absolute defuse.* - "Under Section 23 of the Negotiable Instruments Law, forgery is a real or absolute defense by the party whose signature is forged. On the premise that Jong's signature was indeed forged, FEBTC is liable for the loss since it authorized the discharge of the forged check. Such liability attaches even if the bank exerts due diligence and care in preventing such faulty discharge. Forgeries often deceive the eye of the most cautious experts; and when a bank has been so deceived, it is a harsh rule which compels it to suffer although

no one has suffered by its being deceived. The forgery may be so near like the genuine as to defy detection by the depositor himself, and yet the bank is liable to the depositor if it pays the check"

3. *Forgery duly proved.* — In ruling that forgery was not duly proven, the Court of Appeals held:

> ' [There] is ground to doubt the findings of the trial court sustaining the alleged forgery in view of the conflicting conclusions made by handwriting experts from the NBI and the PNP, both agencies of the government, xxx These contradictory findings create doubt on whether there was indeed a forgery/

This reasoning is pure sophistry. Xxx Any litigator worth his or her salt would never allow an opponent's expert witness to stand uncontradicted, thus the spectacle of competing expert witnesses is not unusual. The trier of fact will have to decide which version to believe, and explain why or why not such version is more credible than the other. Reliance therefore cannot be placed merely on the fact that there are colliding opinions of two experts, both clothed with the presumption of official duty, in order to draw a conclusion, especially one which is extremely crucial, xxx'

Much is expected from the Court of Appeals as it occupies the penultimate tier in the judicial hierarchy. This Court has long deferred to the appellate court as to its findings of fact in the understanding that it has the appropriate skill and competence to plough through the minutiae that scatters the factual field. In failing to thoroughly evaluate the evidence before it, and relying instead on presumptions haphazardly drawn, die Court of Appeals was sadly remiss, xxx

On the other hand, the RTC did adjudge the testimony of the NBI expert as more credible than that of the PNP, and explained its reason behind the conclusion: xxx

The RTC was sufficiently convinced by the NBI examiner's testimony, and explained her reasons in its Decisions. While the Court of Appeals disagreed and upheld the findings of the PNP, it failed to convincingly demonstrate why such findings were more credible than those of the NBI expert. As a throwaway, the assailed Decision noted that the PNP, not the NBI, had the opportunity to examine the specimen signature card signed by

Jong, which was relied upon by the employees of FEBTC in authenticating Jong's signature. The distinction is irrelevant in establishing forgery. Forgery can be established comparing the contested signatures as against those of any sample signature duly established as that of the persons whose signature was forged.

FEBTC lays undue emphasis on the fact that the PNP examiner did compare the questioned signature against the bank signature cards. The crucial fact in question is whether or not the check was forged, not whether the bank could have detected the forgery. The latter issue becomes relevant only if there is need to weigh the comparative negligence between the bank and the party whose signature was forged."

(4) *Petitioner's sole signatory disowned signature on check.* - "At the same time, the Court of Appeals failed to assess die effect of Jong's testimony that the signature on the check was not his. The assertion may seem self-serving at first blush, yet it cannot be ignored that Jong was in the best position to know whether or not the signature on the check was his. While his claim should not be taken at face value, any averments he would have on the matter, if adjudged as truthful, deserve primacy in consideration.

Jong's testimony is supported by the findings of the NBI examiner. They are also backed by factual circumstances that support the conclusion that the assailed check was indeed forged. Judicial notice can be taken that is highly unusual in practice for a business establishment to draw a check for close to a million pesos and make it payable to cash or bearer, and not to order. Jong immediately reported the forgery upon its discovery. He filed the appropriate criminal charges against Sempio, the putative forger.

(5) *Bank paid a forged check payable to cash.* - "Petitioner is not precluded from setting up defense of forgery. The bare fact that the forgery was committed by an employee of the party whose signature was forged cannot necessarily imply that such party's negligence was the cause for the forgery. Employers do not possess the preternatural gift of cognition as to the evil that may lurk within the hearts and minds of their employees. The Court's pronouncement in *PCI Bank v. Court of Appeals* applies in this case, to wit:

> '[T]he mere fact that the forgery was committed by a drawer-payor's confidential employee or agent, who by virtue of his position had unusual facilities for perpetrating the fraud and imposing the forged paper upon the bank, does not entitle the bank to shift the loss to the drawer- payor, in the absence of some circumstance raising estoppel against the drawer.'

Admittedly, the record does not clearly establish what measures Samsung Construction employed to safeguard its blank checks. Jong did testify that his accountant, Kyu, kept the checks inside a 'safety box/ and no contrary version was presented by FEBTC. However, such testimony cannot prove that the checks were indeed kept in a safety box, as Jong's testimony on that point is hearsay, since Kyu, and not Jong, would have the personal knowledge as to how the checks were kept.

Still, in the absence of evidence to the contrary, we can conclude that there was no negligence on Samsung Construction's part. The presumption remains that every person takes ordinary care of his concerns, and that the ordinary course of business has been followed. Negligence is not presumed, but must be proven by him who alleges it. While the complaint was lodged at the instance of Samsung Construction, the matter it had to prove was the claim it had alleged - whether the check was forged. It cannot be required as well to prove that it was not negligent, because the legal presumption remains that ordinary care was employed.

Thus, it was incumbent upon FEBTC, in defense, to prove the negative fact that Samsung Construction was negligent. While the payee, as in this case, may not have the personal knowledge as to the standard procedures observed by the drawer, it well has the means of disputing the presumption Of regularity. Proving a negative fact may be "a difficult office," but necessarily so, as it seeks to overcome a presumption in law. FEBTC was unable to dispute the presumption of ordinary care exercised by Samsung Construction, hence we cannot agree with the Court of Appeals' finding of negligence."

(6) *Generally, drawee bears loss from payment of forged check.* - "The assailed Decision replicated the extensive efforts which FEBTC devoted to establish that there was no negligence on the part of the bank in its acceptance and payment of the forged check. However, the degree of diligence exercised by the bank would be irrelevant if the drawer is not precluded from setting up the defense of forgery under Section 23 by his own negligence. The rule of equity enunciated in *PNB v. National City Bank of New York,* as relied upon by the Court of Appeals, deserves careful examination.

'The point in issue has sometimes been said to be that of negligence. *The drawee who has paid upon forged signature is held to bear the loss, because he has been negUigent in failing to recognize that the handwriting is not that of his customer.* But it follows obviously that if the payee, holder, or presenter of the forged paper has himself been in default, if he has himself been guilty of a negligence prior to that of the banker, or if by any act of his own he has at all contributed to induce the banker's negligence, then he may lose his right to cast the loss upon the banker. (Emphasis supplied)

Quite palpably, the general rule remains that the drawee who has paid upon the forged signature bears the loss. The exception to this rule arises only when negligence can be traced on the part of the drawer whose signature was forged, and the need arises to weigh the comparative negligence between the drawer and the drawee to determine who should bear the burden of loss. The Court finds no basis to conclude that Samsung Construction was negligent in the safekeeping of its checks. For one, the settled rule is that the mere fact that the depositor leaves his check book lying around does not constitute such negligence as will free the bank from liability to him, where a clerk of die depositor or other persons, taking advantage of the opportunity, abstract some of the check blanks, forges the depositor's signature and collect on the checks from the bank. [62] And for another, in point of fact Samsung Construction was not negligent at all since it reported the forgery almost immediately upon discovery."

(7) *Distinction between forgery of signature of drawer and of indorser. -* "It is also worth noting that the forged signatures in *PNB v. National City Bank of New York* (63 Phil. 711 [1936].) were not of the drawer, but of indorsers. The same circumstance attends *PNB v. Court of Appeals,* (25 SCRA 693 [1968].), which was also cited by the Court of Appeals. It is accepted that a forged signature of the drawer differs in treatment than a forged signature of the indorser.

The justification for the distinction between forgery of the signature of the drawer and forgery of an indorsement is that the drawee is in a position to verify the drawer's signature by comparison with one in his hands, but has ordinarily no opportunity to verify an indorsement.

Thus, a drawee bank is generally liable to its depositor in paying a check which bears either a forgery of the drawer's signature or a forged indorsement. But the bank may, as a general rule, recover back the money which it has paid on a check bearing a forged indorsement, whereas it has not this right to the same extent with reference to a check bearing a forgery of the drawer's signature.

The general rule imputing liability on the drawee who paid out on the forgery holds in this case."

(8) *Bank itself remiss in its duty.* - "Since FEBTC puts into issue the degree of care it exercised before paying out on the forged check, we might as well comment on the bank's performance of its duty. It might be so that the bank complied with its own internal rules prior to paying out on the questionable check. Yet, there are several troubling circumstances that lead us to believe that the bank itself was remiss in its duty.

The fact that the check was made out in the amount of nearly one million pesos is unusual enough to require a higher degree of caution on the part of the bank. Indeed, FEBTC confirms this through its own internal procedures. Checks below P25,000.00 require only the approval of the teller; those between P25,000.00 to P100,000.00 necessitate the approval of one bank officer; and should the amount exceed P100,000.00the concurrence of two bank officers is required.

In this case, not only did the amount in the check nearly total one million pesos, it was also payable to cash. That latter circumstance should have aroused the suspicion of the bank, as it is not ordinary business practice for a check for such large amount to be made payable to cash or to bearer, instead of to the order of a specified person. Moreover, the check was presented for payment by one Roberto Gonzaga, who was not designated as the payee of the check, and who did not carry with him any written proof that he was authorized by Samsung Construction to encash the check. Gonzaga, a stranger to FEBTC, was not even an employee of Samsung Construction. These circumstances are already suspicious if taken independently, much more so if they are evaluated in concurrence.

Given the shadiness attending Gonzaga's presentment of the check, it was not sufficient for FEBTC to have merely complied with its internal procedures, but mandatory that all earnest efforts be undertaken to ensure the validity of the check, and of the authority of Gonzaga to collect payment therefor.

According to FEBTC Senior Assistant Cashier Gemma Velez, the bank tried, but failed, to contact Jong over the phone to verify the check. She added that calling the issuer or drawer of the check to verify the same was not part of the standard procedure of the bank, but an "extra effort." Even assuming that such personal verification is tantamount to extraordinary diligence, it cannot be denied that FEBTC still paid out the check despite the absence of any proof of verification from the drawer. Instead, the bank seems to have relied heavily on the say-so of Sempio, who was present at the bank at the time the check was presented, xxx

Even assuming that FEBTC had a standing habit of dealing with Sempio, acting in behalf of Samsung Construction, the irregular circumstances attending the presentment of the forged check should have put the bank on the highest degree of alert. The Court recently emphasized that the highest degree of care and diligence is required of banks."

(9) *Bank's business impressed with public interest.* - "Banks are engaged in a business impressed with public interest, and it is their duty to protect in return their many clients and depositors who transact business with them. They have the obligation to treat their client's account meticulously and with the highest degree of care, considering the fiduciary nature of their relationship. The diligence required of banks, therefore, is more than that of a good father of a family.

Given the circumstances, extraordinary diligence dictates that FEBTC should have ascertained from Jong personally that the signature in the questionable check was his. xxx

Since the drawer, Samsung Construction, is not precluded by negligence from setting up the forgery, the general rule should apply. Consequently, if a bank pays a forged check, it must be considered as paying out of its funds and cannot charge the amount so paid to the account of the depositor. A bank is liable, irrespective of its good faith, in paying a forged check." (*Samsung Construction Company Philippines, Inc. vs. Far East Bank and Trust Company, 436 SCRA 402 [2004].)*

Right of drawee to recover payment made where drawer's signature was forged.

Has the drawee of a bill of exchange the right to recover a payment which he has made to a holder in due course of a bill on which the signature of the drawer was forged?

The rule adopted and followed in almost all American jurisdictions as the doctrine of *Price v. Neal* (3 Burr 1354, 97 Eng. Rep. 871.) is that as between equally innocent persons, the drawee who pays money on a check or draft the signature on which was forged cannot recover the money from the one who received it. Acceptance prior to payment is not a prerequisite to the rule; and the rule applies alike where payment is received without prior acceptance and where it is paid after acceptance. (Kansas Bankers Surety Co. v. Ford Country State Bank, 338 Pd. 309.)

(1) *Rule founded on estoppel and principle of natural justice.* — The grounds given for the rule include estoppel, actual or presumed negligence of the drawee of not detecting the forgery, and the principle of natural justice that as between two persons, one of whom must suffer, the legal title shall prevail. At any rate, the rule is based upon the obligation of the drawee to know the signature of the drawer and the presumption is that he does. It is impracticable for the indorsee or holder of a bill or check to know or learn whether the signature of the drawer is genuine but the drawee (particularly a bank as it keeps a record in which are preserved the genuine signatures of its depositors, customers, and correspondents) has the best means of knowing or learning the fact.

This inequality of footing between the drawee and the holder furnishes the justification for the rule placing the *onus* on the drawee, (see 11 Am. Jur. 2d 1059-1064.)

(2) *Rule founded on ground of public policy.*—It is also declared that the rule is one of policy of maintaining confidence in the security of negotiable paper by making the time and place of acceptance or payment the time and place for the final settlement, as between the drawer and the holder, of the question of the genuineness of the drawer's signature. (United States v. Northwestern Nat. Bank & T. Co., 35 E. Supp. 484.)

(3) *Responsibility of drawee bank.* — It is a fundamental rule of banking that when a bank receives money to be checked out by a depositor, it is to be paid only as the depositor shall order. The bank assumes this duty in receiving the deposit. If, therefore, it pays out money otherwise than according to such order it is liable to the depositor for the amount so paid. The bank thus assumes the responsibility of seeing that the money gets to the party authorized to receive it. Hence, if it pays money out on forged signature the depositor being free from blame or negligence, it must bear the loss. (Tolman v. American National Bank, 48 AtL 480.)

But where the payee was not a client of the respondent bank, *i.e.,* did not maintain an account in said bank, and the latter, therefore, had no way of ascertaining the authenticity of the payee's indorsements on all checks which were deposited in the accounts of the defendants in said bank, the bank cannot be held negligent where, in accordance with banking practice, it caused the checks to pass through the clearing house before it allowed their proceeds to be withdrawn by the defendants. (Manila Lighter Transportation, Inc. vs. Court of Appeals, 182 SCRA 251 [1990].)

(4) *Allocation of loss between drawee bank and collecting bank.* — In a case where both the drawee bank and the representing or collecting bank were guilty of negligence resulting in the encashment of forged checks, the Supreme Court allocated the loss and the costs of arbitration proceedings and litigation on a 60-40 ratio considering the comparative negligence of the two (2) banks. (Bank of the Phil. Islands vs. Court of Appeals, 216 SCRA 51 [1992].)

ILLUSTRATIVE CASES:

1. Drawee bank seeks a refund of the amount of check with signatures of drawer's officers forged, from collecting bank which guaranteed all prior indorsements.

Facts: A check, purporting to have been drawn by the GSIS upon PNB (bank), named P as payee who purportedly indorsed it to A and from A to B, who, in turn, deposited it with

PCIB (bank) which stamped the following on the back of the check: "AH prior indorsements and /or lack of indorsements guaranteed, PCIB." On the same date, PCIB sent the check to PNB for clearance. PNB retained the check and paid its amount to PCIB, as well as debited it against the account of GSIS.

Subsequently, upon demand by GSIS, PNB re-credited the former's account for the reason that the signatures of the GSIS's officers were forged.

Issue: Is PNB entitled to a refund of the amount of the check from PCIB?

Held: No. (1) *Forgery immaterial to PNB's liability.* — "Even assuming that the indorsements of the supposed indorsers are forged, the forgery is immaterial to PNB's liability as drawee or to its right to recover from PCIB, for, as against the drawee, the indorsement of an intermediate bank does not guarantee the signature of the drawer, since the forgery of the indorsement is not the cause of the loss."

(2) *Guarantee of PCIB not as to signatures on check.* — "PCIB guaranteed *"all prior indorsements,"* not the authenticity of the signatures of the officers of the GSIS who signed on its behalf, because GSIS is not the indorser of the check but its drawer. Said warranty is irrelevant, therefore, to PNB's alleged right to recover from PCIB. It could have been availed of by a subsequent indorsee, or a holder in due course subsequent to PCIB. Neither is PNB. Indeed, upon payment by the PNB, as drawee, the check ceased to be a negotiable instrument, and became a mere voucher or proof of payment."

(3) *PNB proximate cause of the loss.* — "Furthermore, by not returning the check to PCIB, thereby indicating that PNB had found nothing wrong with the check, and honoring the same, and by actually paying its amount to PCIB, PNB induced the latter to believe that the check was genuine and good in every respect and to pay its amount to B. In other words, PNB was the primary or proximate cause of the loss, and hence, may not recover from PCIB. Then, again, the rule is that where the collecting (PCIB) and the drawee (PNB) banks are equally at fault, the court will leave the parties where it finds them." *(Phil. National Bank vs. Court of Appeals, 25 SCRA 693 [1968].)*

2. *Depositor seeks the return by a bank to his account of amount debited under a stolen check as his signature on the check was forged.*

Facts: R brought X, a classmate and friend whom he trusted, along in his car to a bank (PNB) and he left his personal belongings in the car. X* removed and stole a check from R's check book without the knowledge and consent of the latter. X filled up the check up to the amount of P5,000.00, forged the signature of R and encashed the check in the bank on the same day.

The account of R was debited the same amount. R asked the bank the said amount should be returned to his account as his signature on the check was forged.

Issue: Under the circumstances of the case, was R negligent?

Held: No. He could not have been expected to know that X would remove a check from, his check book. .

The prime duty of a bank is to ascertain the genuineness of the signature of the drawer or depositor of the check being encashed. It is expected to use reasonable business prudence in accepting and cashing a check presented to it. This rule is absolutely necessary to the circulation of drafts and checks, and is based on the presumed negligence of the drawee in failing to meet its obligation to know the signature of its depositor.

There is nothing inequitable in such a rule. If the paper comes to the drawee in the regular course of business, and he, having the opportunity of ascertaining its character, pronounces it to be valid and pays it, it is not only a question of payment under mistake, but payment in neglect of duty which the law places upon him, and the result of his negligence must rest upon him.

It is not a defense that the check in question had to pass scrutiny by a signature verifier as well as an officer of the bank. In the case at bar, the trial court found that a comparison of the signature on the forged check and the sample signatures of R showed marked differences. *(Philippine National Bank vs. Quimpo, 159 SCRA 582 [1988].)*

Note: A drawee is not precluded from recovery of a payment which was conditional only (see Sec. 62.), that is, if an instrument is paid subject to later examination which discloses the forgery. *(Allen vs. Fourth Nat. Bank*, 59 NY 12,11 Am. Jur. 2d 1062.)

3. *Bank allowed a depositor to withdraw from the proceeds of the treasury warrants deposited with the former, even before the said warrants had been cleared.*

Facts: G opened an account with GSAL (a savings and loan association) and deposited over a period of two months 38 treasury warrants drawn by a government agency with a total value of more than PI .7 million. Six of these were directly payable to G while the others appear to have been indorsed by their respective payees, followed by G as second indorser. The warrants were subsequently indorsed by C, cashier of GSAL, and deposited to GSAL's savings account with a branch of MBTC (bank) which forwarded them to the Bureau of Treasury for special clearing.

In the meantime, G was not allowed to withdraw from his account. After more than two weeks, "exasperated" over C's repeated inquiries as to whether the warrants had been cleared and also as an accommodation for a "valued client," MBTC finally decided to allow GSAL to withdraw from the proceeds of the warrants. In turn, GSAL subsequently allowed G to make withdrawals from his own account.

Later, MBTC informed GSAL that 32 of the warrants had been dishonored by the Bureau of Treasury and demanded the refund of the amount GSAL has previously withdrawn, to make up the deficit in its account.

Issue: Was MBTC negligent in giving GSAL the impression that the treasury warrants had been cleared and that consequently, it was safer to allow G to withdraw the proceeds thereof from his account with it?

Held: (1) *MBTC guilty of negligence.* — "A MBTC was indeed negligent in giving GSAL the impression that the treasury warrants had been cleared and that, consequently, it was safe to allow G to withdraw the proceeds thereof from his account with it. Without such assurance, GSAL would not have allowed the withdrawals; with such assurance, there was no reason not to allow the withdrawal. Indeed, GSAL might even have incurred liability for its refusal to return the money that to all appearances belonged to the depositor, who could, therefore, withdraw it any time and for any reason he saw fit.

It was, in fact, to secure the clearance of the treasury warrants that GSAL deposited them to its account with MBTC.

GSAL had no clearing facilities of its own. It relied on MBTC to determine the validity of the warrants through its own services. The proceeds of the warrants were withheld from G until MBTC allowed GSAL itself to withdraw them from its own deposit. It was only when MBTC gave the go-signal that G was finally allowed by GSAL to withdraw them from his own account"

(2) *GSAL acted with due care and diligence.* — "The argument of MBTC that GSAL should have exercised more care in checking the personal circumstances of G before accepting his deposit does not hold water. It was G who was entrusting the warrants, not GSAL that was extending him a loan; and moreover, the treasury warrants were subject to clearing, pending which the depositor could not withdraw its proceeds. There was no question of G's identity or of the genuineness of his signature as checked by GSAL. In fact, the treasury warrants were dishonored allegedly because of the forgery of the signatures of the drawers, not of G as payee or indorser.

Under the circumstances, it is clear that GSAL acted with due care and diligence and cannot be faulted for the withdrawals it allowed G to make/'

(3) *MBTC liable as agent.* — "To gloss over its carelessness, MBTC would invoke the conditions printed on the dorsal side of the deposit slips through which the treasury warrants were deposited by GSAL with its Calapan branch. The conditions read as follows:

> *'Kindly note that in receiving items on deposit, the bank obligates itself only as the depositor's collecting agent, assuming no responsibility beyond care in selecting correspondents, and* until such time as actual payment shall have come into possession of this bank, *the right is reserved to charge back to the depositor's account any amount previously credited, whether or not such item is returned. This also applies to checks* drawn on local banks and bankers and their branches as well as on this bank, *which are unpaid due to* insufficiency of funds, forgery, unauthorized overdraft or *any other reason.' (Italics supplied.)*

According to MBTC, the said conditions clearly show that it was acting only as a collecting agent for GSAL and give it the right to 'charge back to the depositor's account any amount previously credited, whether or not such item is returned. This also applies to checks'... which are unpaid due to insufficiency of funds, forgery, unauthorized overdraft of any other reason." It is claimed that the said conditions are in the nature of contractual stipulations and became binding on GSAL when C, as its cashier, signed the deposit slips.

In stressing that it was acting only as a collecting agent for GSAL, MBTC seems to be suggesting that as a mere agent it cannot be liable to the principal. This is not exactly true. On the contrary, Article 1909 of the Civil Code clearly provides that —

> 'Art. 1909. The agent is responsible not only for fraud, but also for negligence, which shall be judged with more or less rigor by the courts, according to whether the agency was or was for a compensation.'

The negligence of MBTC has been sufficiently established. To repeat for emphasis, it was the clearance given by it that assured GSAL it was already safe to allow G to withdraw the proceeds of the treasury warrants he had deposited. MBTC *misled* GSAL. It allowed GSAL to withdraw from its account not only once or even twice but *three times.* The total withdrawal was in excess of its original balance before the treasury warrants were deposited, which only added to its belief that the treasury warrants had indeed been cleared.

MBTC's argument that it may recover the disputed amount if the warrants are not paid *for any reason* is not acceptable. Any reason does not mean no reason at all. Otherwise, there would have been no need at all for GSAL to deposit the treasury warrants with it for clearance. There would have been no need for it to wait until the warrants had been cleared before paying the proceeds thereof to G. Such a condition, if interpreted in the way the MBTC suggests, is not binding for being arbitrary and unconscionable. And it becomes more so in the case at bar when it is considered that the supposed dishonor of the warrants was not communicated to GSAL before it made its own payment to G."

(4) *Treasury warrants in question not negotiable instruments.* — "A no less important consideration is the circumstance that the treasury warrants in question are not negotiable instruments. Clearly stamped on their face is the word 'non- negotiable.' Moreover, and this is of equal significance, it is indicated that they are payable from a particular fund, to wit, Fund 501. (see Sees. l[b], 3, last par.)

. The indication of Fund 501 as the source of the payment to be made on the treasury warrants makes the order or promise to pay 'not unconditional' and the warrants themselves non- negotiable.

MBTC cannot contend that by indorsing the warrants in general, GSAL assumed that they were "genuine and in all respects what they purport to be," in accordance with Section 66. The simple reason is that this law is not applicable to the non-negotiable treasury warrants. The indorsement was made by C not for the purpose of guaranteeing the genuineness of the warrants but merely to deposit them with MBTC for clearing. It was in fact MBTC that made the guarantee when it stamped on the back of the warrants: 'All prior indorsements and/or lack of indorsements guaranteed, MBTC, Calapan Branch.'

MBTC lays heavy stress on *Jai Alai Corporation vs. Bank of the Philippine Islands.* (66 SCRA29 [1975].) This case is inapplicable. That case involved checks whereas this case involves treasury warrants. GSAL never represented that the warrants were negotiable but signed them only for the purpose of depositing them for clearance. Also, the fact of forgery was proved in that case but not in this case. Finally, the Court found the Jai Alai Corporation negligent in accepting the checks without question from one Antonio Ramirez notwithstanding that the payee was the Inter-Island Gas Services, Inc. and it did not appear that he was authorized to indorse it. No similar negligence can be imputed to GSAL.

The total value of the 32 treasury warrants dishonored was PI,754,089.00 from which G was allowed to withdraw PI,167,500.00 before GSAL was notified of the dishonor.

The amount G has withdrawn must be charged not to GSAL but MBTC, which must bear the consequences of its own negligence." *(Metropolitan Bank & Trust Company vs. Court of Appeals, 194 SCRA 169 [1991].)*

Right of drawee to recover payment where payee's or indorsees signature was forged.

(1) *From the encasher or last indorser.* —It is not supposed to be the duty of the drawee bank of a check to ascertain whether the signatures of the payee or indorsers are genuine or not. This is because the indorser is supposed to warrant to the drawee that

the signatures of the payee and previous indorsers are genuine, warranty not extending only to holders in due course.

One who purchases a check or draft is bound to satisfy himself that the paper is genuine and that by indorsing it or presenting it for payment or putting it into circulation before presentation, he impliedly asserts that he has performed his duty and the drawee who has paid the forged check, without actual negligence of his part, may recover the money from such negligent purchasers. In such case, the recovery is permitted because although the drawee was in a way negligent in failing to detect the forgery, yet, if the encasher of the check had performed his duty, the forgery would, in all probability, have been detected and the fraud defeated.

The reason for allowing the drawee bank to recover from the encasher is:

> "Every one with even the least experience in business knows that no businessman would accept a check in exchange for money or goods unless he is satisfied that the check is genuine. He accepts it only because he has proofs that it is genuine, or because he has sufficient confidence in the honesty and financial responsibility of the person who vouches for it. If he is deceived, he has suffered a loss of his cash or goods through his own mistake. His own credulity or recklessness, or misplaced confidence was the sole cause of the loss. Why should he be permitted to shift the loss due to his own fault in assuming the risk, upon the drawee, simply because of the accidental circumstance that the drawee afterwards failed to detect the forgery when the check was presented?" (Republic Bank vs. Ebrada, 65 SCRA 680 [1975], citing American cases.)

(2) *From the drawer or depositor.* — As a rule, a drawee bank who has paid a check on which an indorsement has been forged cannot debit or charge the drawer's account for the amount of said check and is not entitled to indemnification from the drawer. The risk of loss must perforce fall on the drawee bank. (Associated Bank vs. Court of Appeals, 67 SCAD 487,252 SCRA 620 [1996].) An exception to this rule is where the drawer is guilty of such negligence which causes the bank to honor such a check or checks. If a check is stolen from the payee, it is quite obvious

that the drawer cannot possibly discover the forged indorsement by mere examination of his cancelled check. This accounts for the rule that although a depositor owes a duty to his drawee bank to examine his cancelled checks for forgery of his own signature, he has no similar duty as to forged indorsements.

A different situation arises where the indorsement was forged by an employee or agent of the drawer, or done with the active participation of the latter.

Most of the cases involving forgery by an agent or employee deal with the payee's indorsement. The drawer and the payee oftentimes have business relations of long standing. The continued occurrence of business transactions of the same nature provides the opportunity for the agent/employee to commit the fraud after having developed familiarity with the signatures of the parties. However, sooner or later, some leak will show on the drawer's books. It will then be just a question of time until the fraud is discovered. This is especially true when the agent perpetrates a series of forgeries. The negligence of a depositor which will prevent recovery of an unauthorized payment is based on failure of the depositpr to act as a prudent businessman would under the circumstances. (Gempesaw vs. Court of Appeals, 218 SCRA 682 [1993].)

In the above-cited case, "the petitioner relied implicitly upon the honesty and loyalty of her bookkeeper, and did not even verify the accuracy of the amounts of the checks she signed against the invoices attached thereto. Furthermore, although she regularly received her bank statements, she apparently did not carefully examine the same nor the check stubs and the returned checks, and did not compare them with the sales invoices. Otherwise, she could have easily discovered the discrepancies between the checks and the documents serving as bases for the checks. With such discovery, the subsequent forgeries would not have been accomplished. It was not until two years after her bookkeeper commenced her fraudulent scheme that petitioner discovered that eighty-two (82) checks were wrongfully charged to her account, at which time she notified the respondent drawee bank. A depositor may not sit idly by, after knowledge has come to her that her funds seem to be disappearing or that there may be a leak in her business, and refrain from taking the steps that a careful and prudent businessman would take in such circumstances and if taken, would result in stopping the continuance of the fraudulent scheme. If she fails to take such steps, the facts may establish her negligence and in that event, she would be estopped from recovering from the bank."

If at the same time the drawee bank was also negligent to the point of substantially contributing to the loss, then such loss from the forgery can be apportioned between the drawer and the drawee. (Associated Bank vs. Court of Appeals, *supra.)*

Rights of parties in cases of forged indorsements.

(1) *Where note payable to order.* — Where the note is payable to order, the party whose indorsement is forged is not liable to any holder ever a holder in due course. The indorsement, being forged, is inoperative.

The other parties, including the maker, prior to the party whose signature is forged are also not liable to any holder. The instrument being payable to order, it can be negotiated only by indorsement completed by delivery. But since the indorsement is forged, it is inoperative and, therefore, it cannot operate to transfer any right or title over the instrument.

EXAMPLE:

M makes a note payable to P or order. P indorses the note to A. X finds it. X indorses the note to B forging A's signature thereto.

(a) A, whose indorsement is forged, is not liable to B, whether B is a holder in due course or not. Being forged, the indorsement is wholly inoperative.

(b) M and P, parties prior to A, whose signature is forged, are not also liable to B. The indorsement of the note by A together with the delivery of the same, is the only means through which B could acquire any right against M and P under the instrument. But since the indorsement is forged, it is inoperative. Consequently, no rights can be enforced by virtue of such instrument.

(2) *Where note payable to bearer.* — Where the note, mechanically complete, is originally payable to bearer, the party whose indorsement is forged is liable to a holder in due course, but not to one who is not a holder in due course. The other parties, including the maker, prior to the party whose signature is forged, may also be held liable by one who is not a holder in due course.

The reason is that the instrument being originally payable to bearer, it can be negotiated by mere delivery. (Sec. 30.) In other words, indorsement is not necessary to the title of the holder. Hence, even if the indorsement is forged, the forgery may be disregarded. The forged indorsement does not prevent the transfer of title since the holder may just strike out the forged indorsement. (Sec. 48.) The only defense available is want of delivery but this defense can be raised only against a holder not in due course. (Sec. 16.)

EXAMPLE:

Suppose in the preceding example, the note is payable to bearer on its face and it is delivered by M to P, who indorsed it to A. The note is found by X and is indorsed by him to B by forging A's signature. B indorses the note to C who, in turn, delivers without indorsement the note to D, a holder in due course.

In this case, the indorsement of P, A, and B are not necessary to vest ownership in the note to D. Being originally payable to bearer, mere delivery is sufficient. Hence, even if the indorsement of A is forged, A can be held liable to D.

For the same reason, M, the maker, and P, a party prior to A, whose signatures is forged, can also be held liable to D. D may just strike out the forged indorsement of A Of course, D can enforce the note against B and C who are liable tinder their warranties as indorsers.

(3) *Where bill payable to order.* — Where the bill is payable to order, the party whose indorsement is forged, is not liable to any holder even a holder in due course. The forged indorsement is wholly inoperative.

(a) Where the signature of the payee was forged, the collecting bank is liable to the payee and must bear the loss because it is its legal duty to ascertain that the payee's endorsement was genuine before cashing the check. As a general rule, a bank or corporation who has obtained possession of a check upon an unauthorized or forged indorsement of the payee's signature and who collects the amount of the check from the drawee, is liable for the proceeds thereof to the payee or other owner, notwithstanding that the amount has been paid to the person from whom the check was obtained. (Westmont Bank vs. Ong, 375 SCRA 212 [2002].) |

The theory of the rule is that the possession of a check on a forged or unauthorized indorsement is wrongful, and when the money is collected on the check, the bank can be held liable for the amount had and received. The proceeds are held for the rightful owner of the payment and may be recovered by him. The position of the bank taking the check is the same as if it had taken the check and collected without indorsement at all. The act of the bank amounts to conversion of the check. The liability of the bank to the payee for the value of the check attaches whether or not the bank was aware of the forged or unauthorized indorsement. (Associated Bank vs. Court of Appeals, 208 SCRA 465 [1992].)

In *Westmont Bank*, petitioner claims that "since there was no delivery yet and respondent has never acquired possession of the checks, respondent's remedy is with the drawer and not with petitioner bank. Petitioner relies on the view to the effect that where there is no delivery to the payee and no title vests in him, he ought not to be allowed to recover on the ground that he lost nothing because he never became the owner of the check and still retained his claim of debt against the drawer. However, another view in certain cases holds that even if the absence of delivery is considered, such consideration is not material. The rationale for this view is that in said cases the plaintiff uses one action to reach, by a desirable short cut, the person who ought in any event to be ultimately liable as among the innocent persons involved in the transaction. In other words, the payee ought to be allowed to recover directly from the collecting bank, regardless of whether the check was delivered to the payee or not. x x x Petitioner could not escape liability for its negligent *act."*

(b) If the drawee pays under a forged indorsement, the drawer is not liable on the bill and the drawee may not debit [1] the drawer's account. If it does, it shall have to recredit the amount of the check to the account of the drawer. A bank is bound to know the signature of its customers (drawers), and if it pays a forged check it must be considered as making the payment out of its own funds and cannot ordinarily charge the amount so paid to the account of the depositor (see Sec. 189.) whose name was forged. (San Carlos Milling Co., Ltd. vs. Bank of P.I. & China Banking Corporation, 59 Phil. 59 [1933].) In a checking transaction, the drawee bank has the duty to verify the genuineness of the drawer's signature and to pay the check strictly in accordance with the drawer's instructions. (Phil. National Bank vs. Rodriguez, 566 SCRA 513 [2008].)

While the drawee-bank may not debit the account of the drawer, it may generally pass liability back through the collection chain to the party who took from the forger and, of course, to the forger himself. (Associated Bank vs. Court of Appeals, 252 SCRA 820 [1996].)

(c) Where, however, the checks are received merely for collection and deposit, the bank, *as agent*, cannot be expected to know or ascertain the genuineness of all prior indorsements. (Jai-Alai Corp. vs. Bank of P.I., 66 SCRA 29 [1975].) But by stamping on checks accepted by it for deposit its guarantee that "all prior endorsements and /or lack of endorsements guaranteed," a collecting/presenting bank thereby makes the assurance that it has ascertained the genuineness of all prior indorsements. (Associated Bank vs. Court of Appeals, *supra.)*

(d) So even if the indorsement on the check deposited by the collecting bank's client is forged, the collecting bank is bound by its warranties as an indorser and cannot set up the defense of forgery as against the drawee-bank. (Associated Bank vs. Court of Appeals, *supra.)*

The principle of estoppel prevents the collecting bank from denying liability. The drawee of a check can recover from the holder the money paid to him on a forged indorsement. (Republic Bank vs. Ebrada, 65 SCRA 680 [1975].)

(e) *Apropos* the matter of forgery in indorsements, the collecting bank, or last indorser generally suffers the loss because it has the duty to ascertain the genuineness of all prior indorsements considering that the act of presenting the check for payment to the drawee is an assertion that the party making the presentment has done its duty to ascertain the genuineness of the indorsements, (see Philippine National Bank vs. National City Bank, 63 Phil. 711 [1936].)

(f) The collecting bank has privity with its depositors who are its clients. Furthermore, it is also in a better position to detect forgery, fraud or irregularity in the indorsement. If the drawee-bank discovers that the signature of the payee was forged after it has cleared the check and paid the amount of the check to the holder thereof, it can recover the amount paid from the collecting bank (Republic Bank vs. Ebrada, *supra*; Banco de Oro Savings & Mortgage Bank vs. Equitable Banking Corp., 157 SCRA 188 [1988].), as it has no right to be paid, without prejudice to the latter proceeding against the forger.

Even if the collecting bank was not negligent, it would still be liable to the drawee-bank because of its indorsement. The drawee-bank is not similarly situated as the collecting bank because the former makes no warranty as to the genuineness of any indorsement. Its duty is but to verify the genuineness of the drawer's signature and not of the indorsement because the drawer is its client. (Associated Bank vs. Court of Appeals, *supra.)*

(g) The drawee-bank must be free of any negligence in failing to discover the alteration or forgery in order that it may claim reimbursement from the collecting bank. It has the duty to promptly inform the presentor of the forgery upon discovery, otherwise, it forfeits its right to reimbursement if the delay deprives the drawee-bank of the opportunity to go after the forger. *(Ibid.)*

(h) Where the drawer of a check delivers it to an impostor mistakenly believing him to be the payee named in the check, the indorsement of the check by the impostor is not a forgery, and the drawer is liable to a *bona fide* holder or any subsequent indorser who may be compelled to pay it. (Burrows v. Western Union Tel. Co., 86 Minn. 499, 90 N.W. 1111; see Sec. 61.)

EXAMPLES:

(1) An insurance company drew a check for P2,000.00 on H & S bank payable to the order of P. X fraudulently obtained possession of the check and forged P's signature as an indorser and then personally indorsed and deposited the check with P.N. bank which honored the check and placed the amount thereof to his credit.

The next day, P.N. bank indorsed the check to H & S bank, the drawee bank, which paid it and charged the amount of the check to the account of the insurance company, the drawer.

The rights and liabilities of the parties are as follows:

(a) H & S bank, drawee, is liable to the insurance company, drawer, for the amount of the check and its account may not be debited with the said amount for the reason that the indorsement of P, the payee, being forged, it is wholly inoperative and H & S bank has no right to pay it.

(b) The P.N. bank is liable to H & S bank under the warranties of an *indorser.* (Sec. 66.) The P.N. bank with which the check was deposited has no right to pay the sum stated therein to the forger (X) or anyone else upon a forged signature. It was its legal duty to know "that P's indorsement was genuine before cashing the check." It shall, therefore, suffer the loss.

(c) The P.N. bank's remedy is against X, forger, to whom it paid the money.

(d) X, the forger, is liable both criminally and civilly for the forgery.

(e) P, the payee, is not liable on the check His indorsement being forged, it is wholly inoperative. He can demand another check from the drawer and demand payment from the drawee.

(f) The insurance company is not liable on the check because its order is to pay the amount thereof to P or his order and not to any oiher persons, (see Great Eastern Life Insurance Co. vs. Hongkong & Shanghai Bank and P.N.B., 43 PhiL 678 [1922].)

Note: The doctrine in this case is not applicable to the *Gempesaw* case *(supra.)* because in said case, the check was fraudulently taken and the signature of the payee was forged not by an agent or employee of the drawer. The drawer was not found to be negligent in the handling of its business affairs and the theft of the check by a total stranger was not attributable to negligence of the drawer; neither was the forging of the payee's indorsement due to the drawer's negligence. Since the drawer was not negligent, the drawee was duty-bound to restore to the drawer's account the amount theretofore paid under the check With a forged payee's indorsement because the drawee did not pay as ordered by the drawer.

(2) R issued 10 checks (two of three crossed checks (see Sec. 185.) are bearer checks and one uncrossed bearer check payable to P, Inc. X, a sales agent of P, Inc., indorsed all the checks to A Corp. which deposited the same in its current amount with Bank of P.I. After temporarily crediting the amount thereof to A Corp.'s account Bank of P. I. debited the amount against the account of A Corp. upon being informed by P, Inc. that the indorsements by X were forgeries.

Has Bank of P.I. the right to debit A Corp.'s current account in the amount corresponding to the total value of the checks in question? Yes.

(a) As *indorser* (considering that it indorsed the checks when it deposited them), A Corp. warrants that every single one of those checks is "genuine and in all aspects what it purports to be." (Sees. 65,66,67.)

(b) As a mere *agent* for collection and deposit, Bank of P.I. "cannot be expected to know or ascertain the genuineness of all prior indorsements on the paid checks." (see Jai-Alai Corp. vs. Bank of P.I., 66 SCRA 29 [1975].)

Note: In the *Jai-Alai Corp.* case, the Supreme Court cited the ruling in the *Great Eastern Life Ins. Co.* case (see 1, b.) in holding that "A Corp. must in turn shoulder the loss of the amounts which Bank of P.I., as its collecting agent, had to reimburse to the drawee-banks." The qualification made in the Jai-Alai Corp. case with respect to the liability of a bank acting as a mere agent for collection (see 2, b.) does not apply as regards the drawee-banks to which Bank of P.I. voluntarily paid the value of the checks returned by them to it. Bank of P.I. is liable as indorser to the drawee-banks, and A Corp. is, in turn, liable to Bank of P.I.

(3) A backpay check was issued by the Bureau of Treasury payable to P. Indorsements are from P to A, then to B, next to C, the last indorser, who encashed the check at W bank. The indorsement of P was forged.

(a) The negotiation from P to A is of no effect, but the indorsements from A to B and from B to C are valid and enforceable as the signatures thereto are genuine. (Sec. 23.)

(b) The drawee-bank can recover from C the money he received for the check As indorser, C warrants to W bank that the previous indorsements were genuine. (Republic Bank vs. Ebrada, 65 SCRA 680 [1975].)

(4) *Where bill payable to bearer.* — In case the bill is originally payable to bearer, die drawee may debit the drawer's account in spite of the forged indorsement. The reason is that the forged indorsement is not necessary to the title of the holder. The drawee cannot recover from the holder.

EXAMPLE:

Supposing that the check drawn by the insurance company is originally a bearer one, H & S bank may charge the amount thereof to the account of the insurance company. In this case, the drawee (H & S bank) would not be able to recover from the holder (P.N. bank) of the bearer bill since the forged indorsement of P by X did not prevent the transfer of title.

The remedy of the drawer insurance company is against X, the forger. Of course, P, the payee, is not bound not having received the amount of the check and not having indorsed the same.

It must be remembered that all the foregoing are qualified in those cases where there is estoppel against the party desiring to set up the defense of forgery.

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CHAPTER II CONSIDERATION

Sec. 24. *Presumption of consideration.* — Every negotiable instrument is deemed *prima facie* to have been issued for a valuable consideration; and every person whose signature appears thereon to have become a party thereto for value.

Meaning of consideration in general.

Consideration means an inducement to a contract, that is, the cause, price or impelling influence which induces a contracting party to enter into the contract. (Ogden, *op. cit.,* p. 125.) It is the essential or more proximate purpose a party has in view at the time of entering into the contract.

It is different from *motive* which is the personal or private reasons of a party in entering into a contract, (see Art. 1351, Civil Code.)

Presumption of consideration.

Like all other contracts, a negotiable instrument must have a consideration or cause. It is not necessary, however, that the consideration be expressly stated in the instrument. The presumption is that it has been issued for a valuable consideration and that every person whose signature appears thereon has become a party thereto for value, whether the words "value received" appear in it or not.

Consideration being presumed, it need not be alleged and proved, (see Art. 1354, *ibid.)* But the presumption is only *prima facie.* It may, therefore, be rebutted by evidence to the contrary. (Pineda vs. De La Rama, 121 SCRA 671 [1983]; see Yang vs.

Court of Appeals, 409 SCRA 159 [2003].) The evidence must be convincing to overthrow the presumption. It is not overcome by a mere denial of receipt of the consideration. (Bayani vs. People, 436 SCRA 113 [2004].)

EXAMPLE:

M issued in favor of P a promissory note which recites:

"Thirty days after date, I promise to pay P or order the amount of P1,000.00. (Sgd.) M."

On the back of the note the following indorsement appears:

"Pay to A. (Sgd.) P."

Although the promissory note does not mention the consideration, the law presumes that M must have received a consideration for the note and that the same is lawful, (see Art. 1354, Civil Code.) If M claims otherwise, then, he has the burden to rebut the presumption.

Similarly, it is presumed that P, as an indorser, received some valuable consideration from A. A need not prove that he paid for the note. If P claims otherwise, he must prove his allegation.

Sec. 25. *Value, what constitutes.* — Value Is any consideration sufficient to support a simple contract. An antecedent or pre-existing debt constitutes value; and is deemed such whether the instrument is payable on demand or at a future time.

Valuable consideration in general.

(1) *Value* means valuable consideration. (Sec. 191.)

(2) *Valuable consideration* may "in general terms be said to consist either in some right, interest, profit or benefit accruing to the party who makes the contract, or some forbearance, detriment, loss, responsibility, act, labor or service, on the other side. And if any of these exists, it will furnish a sufficient consideration to sustain the making or indorsing of a promissory note in favor of the payee or other holder." (Story, on Promissory Notes, Sec. 186; see Walker Rubber Corp. v. Nederlandsch Indishe & Handlesbank, 105 Phil. 934 [1959].)

"It is no defense to an action on a promissory note for the maker to say that there was no consideration which was beneficial to him personally. It is sufficient if the consideration was a benefit conferred upon a third person or a detriment suffered by the promisee, at the instance of the promissor. It is enough that the obligee foregoes some right or privilege, or suffers some detriment/' (Ty vs. People, 439 SCRA 220 [2004].) But a check issued to a person who was not authorized to collect and receive the same is without valuable consideration and is also considered issued for a non-existing account (Carino vs. De Castro, 553 SCRA 688 [2008].)

(3) Simply defined, *consideration* means any prestation sufficient to support any contract in favor of the party to an instrument, such as the maker or indorser, and it may consist in giving, doing, or not doing, (see Art. 1156, Civil Code.) Therefore, a consideration, founded on mere love, affection, or gratitude is not sufficient to sustain an action on a note or bill, as for example, when an instrument is made or accepted by a parent in favor of a child, the same cannot be enforced as between the original parties. (Maynard v. Maynard, 105 Me. 570; Sullivan v. Sullivan, 92 S.W. 966.)

In an exchange of notes or bills, each note or bill is a good consideration for the other. (Mehlinger v. Harriman, 185 Mass. 245; Franklin National Bank v. Robert Bros., 168 N.C. 413.)

Adequacy of consideration.

A valuable consideration need not be adequate. It is sufficient if it is a valuable one.

EXAMPLE:

Where P sells and delivers to M a piano worth P9,000.00 and M issues to P a promissory note for P10,000.00, there is a valuable consideration for the note, which is the piano.

In an action on the note, M cannot allege as a defense that the value of the piano is not adequate for the amount of the note. The law presumes that M is capable of managing his affairs and the mere inadequacy of the consideration is not a sufficient ground for relief Unless there is fraud, mistake or undue influence, (see Art. 1355, Civil Code.)

Antecedent or pre-existing debt.

An antecedent or pre-existing debt is a valuable consideration. The debt may be that of a third person and the discharge of such debt is a valuable consideration for a negotiable instrument, whether such instrument is payable on demand or at a future time. It must be shown that the holder has given up the preexisting debt or the right to sue.

The transfer of negotiable instruments not only as security for new purchases and advances, made upon the transfer thereof but also as security for antecedent debts has become very common in the commercial world. Such transactions contribute largely to the benefit and convenience both of debtors and creditors. The creditor is thereby enabled to realize or to secure his debt, and thus may safely give a prolonged credit, or forbear from taking any legal steps to enforce his rights. The debtor has also the advantage of making his negotiable paper of equivalent value to cash.

Were the rule otherwise, that negotiable papers cannot be applied in payment of, or as a security for pre-existing debts, without letting in all the defenses between the original and antecedent parties — the value and circulation of such securities must be essentially diminished, and the debtor driven to the embarassment of making a sale thereof, often at a ruinous discount, to some third person, and then by circuity to apply the proceeds to the payment of his debts. (Brooklyn City & N.R. Co. v. National Bank of the Republic, 102 U.S. 14; Swift v. Tyson, 10 L. Ed., 865.)

EXAMPLES:

(1) M owes P PI,000.00 payable today. M fails to pay in cash. He issues a check for that amount to P who accepts the check. Here, the consideration for the check is the pre-existing debt of M.

(2) If X is the debtor and he fails to pay P the amount of PI,000.00, the check issued by M in favor of P for the benefit of X rests on a sufficient consideration, *i.e.,* the pre-existing debt of X.

Sec. 26. ***What constitutes holder for value.*** **— Where value has at any time been given for the instrument, the holder is deemed a holder for value in respect to all parties who become such prior to that time.**

What constitutes a holder for value.

Aholderfor value is one who has given a valuable consideration for the instrument issued or negotiated to him. The holder is deemed as such not only as regards the party to whom value has been given by him but also in respect to all those who became parties prior to the time when value was given.

A holder of a negotiable instrument is presumed to be a holder for value until the contrary is shown. A holder who has not given value for an instrument obviously will suffer no loss by being unable to recover from the primary party in the event that the latter has a personal defense assertable by him. (see Sec. 58.)

EXAMPLES:

(1) M issues a note to P, the payee, without consideration. P, also without consideration, indorses it to A who, with value, indorses it to B.

Under Section 26, B is deemed a holder for value not only as regards A but also as regards M and P. If B is a holder in due course (Sec. 52.), he may enforce payment for the full amount of the note against M, P and A. (Sec. 57.) If B is not a holder in due course, M can set up the defense of absence of consideration. (Sec. 58.)

(2) Now suppose in the same example, B negotiates the note to C by way of a gift.

C is a holder for value within the meaning of Section 26 as against M, P, and A because they became parties prior to the time when value was given on the note by B.

(3) P is the payee of a check drawn by R against E bank. He deposits the check with W bank, his bank, which credits the amount thereof to his account. Is W bank a holder for value under Sections 25 and 26?

No, because W has parted with nothing and crediting the amount involves a mere bookeeping entry, (see Merchant's

National Bank of St. Paul v. Sta. Maria Sugar Co., 147 N.Y. Supp. 498,162 App. Div. 248.) It does not constitute the giving of value. Therefore, E is not entitled to recover from R assuming that R has a personal defense against C. However, if P, after depositing the check, withdrew from his account to such an • extent that the particular credited item was exhausted, E, is a holder for value.

If the sum had subsequently been checked out, then value would have passed. But how shall one determine whether or not the funds represented by the particular check have been withdrawn where there has been a continuous flow of deposits and drawings by the depositor? Under the rule, that "the first money in is the first money out," the first debits are to be charged against the first credits.

A different rule states that as long as the balance of the depositor of P is equal to or exceeds the amount of the check paid, said balance cannot be considered as withdrawn and, therefore, W bank, at this stage, is not a holder for value, (see Nat. Bank of Commerce v. Morgan, 24 A.L.R. 897.)

The second is the better rule. Under our law, bank deposits are governed by the provisions on simple loan. (Art. 1980, Civil Code.) As creditor, the depositor does not expect to receive the identical money in return but an equivalent sum. (see Art. 1953, *ibid.)* His money becomes the money of the bank and is mingled with the other money, the entire amount forming a single fund from which all deposits are paid, (see 2 C.J. 628.)

Sec. 27. ***When Hen on instrument constitutes holder for value*****. — Where the holder has a lien on the instrument, arising either from contract or by implication of law, he is deemed a holder for value to the extent of his lien.**

Where a holder has lien on instrument.

One who has taken a negotiable instrument as collateral security for a debt has a lien on the instrument. As such holder of collateral security, he would be a pledgee but the requirements therefor and the effects thereof, not being provided for by the

Negotiable Instruments Law, shall be governed by the provisions of the Civil Code on pledge of incorporeal rights.[1] (Caltex [Phils.], Inc. vs. Court of Appeals, 212 SCRA 458 [1992].)

If the amount of the instrument is more than the debt secured by such instrument, the pledgee is a holder for value to the extent of his lien. He can collect the full value of the instrument, and apply the same to the payment of the debt but he must deliver the surplus to the pledgor, (see Art. 2118, Civil Code.)

If, between the pledgor and the party liable on the instrument, there are existing defenses, then die pledgee can collect on the instrument only to the extent of the amount of the debt.

If the amount of the instrument is less than or the same as the debt secured by such instrument, the pledgee is a holder for value for the full amount and may, therefore, recover all.

If the defenses of the party liable on the instrument are real defenses, then the pledgee can recover nothing upon the instrument.

EXAMPLES:

(1) M makes a promissory note for PI,000.00 to the order of P who pledges it to A to secure the payment of P's debt of P800.00. The note is indorsed and delivered by P to A. (see Art. 2095, *ibid.)*

In this case, A is a holder for value to the extent of P800.00 which is also the extent of his lien. On the maturity of the note, even if the debt of P800.00 is not yet due (see Art. 2118, *ibid.), A* may recover the full amount of P1,000.00, holding the surplus for P, the pledgor.

(2) If M has defenses against P, indorser, such as absence or failure of consideration (Sec. 28.), A can collect only P800.00

[1] **Art. 2095. Incorporeal rights, evidenced by negotiable instruments, bills of lading, shares of stock, bonds, warehouse receipts and similar documents may also be pledged. The instrument proving the right pledged shall be delivered to the creditor, and if negotiable, must be indorsed.**

Art. 2096. A pledge shall not take effect against third persons if a

on the note even if he is a holder in due course. As the note in the hands of M is void, all that ought to be recovered by A is the amount due on the loan.

(3) Supposing that the amount of the instrument is P700.00 then A is a holder for value for the full amount of P700.00 and is entitled to recover to that extent.

(4) If the signature of M is a forgery, A can collect nothing from M because M's signature is inoperative. As against M, A acquired no right to enforce payment of the note. (Sec. 23.) Forgery is a real defense, (see Sec. 57.)

Sec. 28. ***Effect of want of consideration.*** **— Absence or failure of consideration is a matter of defense as against any person not a holder in due course; and partial failure of consideration is a defense *pro tanto,* whether the failure is an ascertained and liquidated amount or otherwise.**

Meaning of absence or want of consideration.

Absence of consideration means a total lack of any valid consideration for the contract, in consequence of which the alleged contract must fall. (Klein v. Roteman, 6 Ohio App. 145.)

EXAMPLE:

M makes a promissory note to P in payment for a parcel of land which does not exist.

As between the parties, there can be no recovery on the note as there is absence of consideration. But if P indorses the note to A, a holder in due course, A can recover from M because absence of consideration is only a personal defense not available against a holder in due course.

Meaning of failure of consideration.

Failure of consideration means the failure or refusal of one of the parties to do, perform or comply with the consideration agreed upon. In other words, something was agreed upon as consideration but for some cause, such agreed consideration failed to materialize.

EXAMPLES:

(1) In the example given, if there is really a land owned by P which was sold, but P failed to deliver it to M because he sold it again to X who in good faith registered the sale, there is a failure of consideration so that P cannot recover from M.

If only 2/3 portion of the land was delivered, there would be a partial failure of consideration which would bar recovery Only *pro tanto.* Hence, P could recover only 2/3 of the note as M is not liable to the extent of 1/3 which is the price of the undelivered portion.

(2) R issued a check in the name of P under an agreement that the amount of the check was to be given to X in payment of textiles and that profits to be derived from the investment was to be divided equally between R and P. P indorsed and cashed the check and turned over the proceeds to X. The latter, however, failed to deliver the textiles to R. The account was carried in R's books as P's indebtedness and notice thereof was given to him every year for his confirmation.

In view of this, the claim of P that he signed the check only as a witness and that the long period of time that elapsed before the suit was filed created a presumption against his liability was held untenable. Hence, R could recover from P the face value of the check, (see Tbn Hong Tick vs. Philippine Manufacturing Corp., 10 SCRA 416 [1964].)

Sec. 29. *Liability of accommodation party.* — An accommodation party is one who has signed the instrument as maker, drawer, acceptor, or indorser, without receiving value therefor, and for the purpose of lending his name to some other person. Such a person is liable on the instrument to a holder for value, notwithstanding such holder at the time of taking the instrument knew him to be only an accommodation party.

Definition of terms.

(1) *Accommodation bill* or *note* is one to which the accommodation party has put his name, without consideration, for the purpose of accommodating some other party who is to use it, and is expected to pay it. (Brown Carriage Co. v. Dowd, 71 S.E.

721.) In other words, it is a loan of one's credit. (Burr vs. Beckler, 106 N.E. 206.)

An accommodation paper creates no obligation upon delivery to the accommodated party and is of no legal efficacy and creates no obligation until delivered or negotiated to a holder for value.

(2) *Accommodation party* is one who has signed the instrument (a) as maker, drawer, acceptor, or indorser, (b) without receiving value for the signature and (c) for the purpose of lending his name to some other person. (Sec. 29.) He usually expects that not he, but the accommodated party, will provide payment of the bill or note when it falls due. He actually lends his credit to the party to whom the accomodation is made. He is classified according to the accommodated party's status. If the accommodated party is a maker, for example, he is liable on the instrument to subsequent parties as if he were the maker.

In lending his name to the accommodated party, the accommodation party is, in effect, a surety for the former. (Phil. Bank of Commerce vs. Aruego, 102 SCRA 530 [1981].)

(3) *Accommodated party* is one in whose favor a person, without receiving value therefor, signs an instrument for the purpose of lending his credit and enabling said party to raise money upon it. (Sec. 29.) He impliedly agrees to take up the instrument at maturity and to indemnify the accommodation party against the consequences of non-payment.

EXAMPLE:

P is in immediate need of P30,000.00 but he cannot find anybody to lend him the sum he needs. No one trusts him because he has no credit He goes to M, a rich relative, who is willing to accommodate him by letting him borrow on his (M's) credit. So M signs a promissory note payable to P, receiving no consideration therefor. P then indorses the note to the PNB (bank) which discounts the note because of M's credit.

In this case, the promissory note is an accommodation note, and P is the accommodated party. P cannot enforce the note against M should P pay PNB because P gave no consideration to M and he was merely accommodated by M.

M may simply sign the promissory note payable to PNB to accommodate P in order that P can borrow from PNB.[2] (see Town Savings and Loan Bank, Inc. vs. Court of Appeals, 223 SCRA 459 [1993].)

Parol evidence to prove accommodation.

The trouble with an accommodation paper lies in the fact that it is impossible to tell from an inspection of the instrument whether the signature was placed on the instrument for accommodation or otherwise. The accommodation party, however, is permitted to show by parol evidence which party he accommodated. If this were not so, an accommodated party could enforce payment of the instrument against the accommodation party. (Wyatt & Wyatt, Business Law: Principles and Cases [1963 ed.], p. 452.)

In the absence of concrete evidence showing when one issued the subject check and in what capacity, it cannot be assumed that he intended to lend his name as an accomodation party. (Bautista vs. Auto Plus Traders, Inc., 561 SCRA 223 [2005].)

Liability of accommodation party to a holder.

(1) *Absence of consideration not a defense.* — Section 29, by clear mandate makes the accommodation party "liable on the instrument to a holder for value notwithstanding such holder at the time of taking the instrument knew him [the signatory] to be only an accommodation party/[7] in whatever capacity he signed the instrument, whether primarily or secondarily. This means that absence of consideration between the accommodation party and the accommodated party does not of itself constitute a valid defense against a holder for value even though he knew of it

ʻIn *Maulini vs. Serrano* (28 Phil. 640 [1914].) cited in Towns Savings, the evidence showed that the indorser (the loan broker Serrano), in making the indorsement to the lender, Maulini, was acting as agent for the latter or, as a mere vehicle for the transference of the naked title from the borrower or maker of the note (Moreno). Furthermore, his indorsement was wholly without consideration. It was ruled that Serrano was not an accommodation indorser; he was not liable on the note. The indorsement was made as a favor to the indorsee, who requested it, not to secure payment, but to relieve himself from a distasteful situation and the only consideration for such indorsement passed from the indorser to

when he became a holder, (see Ang Hong vs. Lorenzo ling, 22 SCRA 713 [1968]; Republic Bank vs. Ebrada, 65 SCRA 680 [1975]; Ang vs. Associated Bank, 532 SCRA 244 [2007].)

(2) *Accommodation party in effect a surety.* — In lending his name to an accommodated party, the accommodation party is, in effect, a surety. (Philippine Bank of Commerce vs. Aruego, 102 SCRA530 [1981].) However, unlike in a contract of suretyship, the liability of the accommodation party remains not only primary but also unconditional to a holder for value such that even if the accommodated party receives an extension of the period for payment without the consent of the accommodation party, the latter is still liable for the whole obligation and such extension does not release him because as far as a holder for value is concerned, he is a solidary co-debtor.[3] (Prudencio vs. Court of Appeals, 103 SCRA 7 [1986]; see People vs. Maniego, 148 SCRA 30 [1987].)

It will then be noted that Section 29 is an exception to Section 28. But Section 29 should not be construed as to allow a holder for value, not otherwise a holder in due course, to recover against an accommodation party in the light of other sections (Sees. 16,55, 58.) of the Negotiable Instruments Law. In other words, except the defense of absence of consideration between the accommodation party and the accommodated party, the accommodation party is liable to a holder in due course.

(3) *Rule not applicable to corporations.* — Section 29 does not include nor apply to corporations which are accommodation parties. This is because the issue or indorsement of negotiable paper by a corporation without consideration and for the accommodation of another is *ultra vires.* The fact that for lack of capacity the corporation is not bound by an accommodation paper does not thereby absolve, but should render personally liable the signatories of said instrument where the facts show that the accommodation involved was for their personal account,

[3]Art. 1216. The creditor may proceed against any one of the solidary debtors or some or all of diem simultaneously. The demand made against one of them shall not be an obstacle to those which may subsequently be directed against the others, so long as the debt has not been fully collected. (Civil Code)

undertaking or purpose and the creditor was aware thereof. (Crisologo Jose vs. Court of Appeals, 177 SCRA 594 [1989].)

EXAMPLE:

In the preceding example, the fact that M did not receive any consideration for the note would not be a defense in an action brought against him by PNB. This would still be true even if PNB knew that M's signature was made for P's accommodation. If M were not to be held liable, then the accommodation would not serve any purpose.

Suppose, after signing the promissory note, M keeps it in his safe but P steals it. P then indorses the note to PNB which knows that P has stolen the note. In this case, PNB is not a holder in due course because it knows of the lack of delivery and tinder Sections 16 and 58, M is not liable.

ILLUSTRATIVE CASE:

Payee of a promissory note violated deed of assignment without notice to accommodation makers who then claimed release from their obligation.

Facts: As accommodation makers, X and Y executed a deed of real estate mortgage on their property and signed a promissory note issued by the CTC Company in favor of PNB which extended a loan to CTC. CTC likewise executed a Deed of Assignment whereby it assigned to PNB all payments to be received by it (CTC) from BPW (Bureau of Public Works) on account of a contract for the construction of a building.

PNB knew that X and Y signed as accommodation makers because of the Deed of Assignment. X and Y were made to believe, and on that belief, entered into the agreement, that no other conditions would alter the terms thereof. This notwithstanding, PNB approved the release by the BPW of three (3) payments directly to CTC instead of paying the same to PNB, without notice to X and Y.

X and Y now claim that the violation of the Deed of Assignment released them from their obligation as sureties, and, therefore, the real estate mortgage executed by them should be cancelled.

Issue: May PNB be considered a holder for value under Section 29?

Held: No. Although as a general rule a payee may be considered a holder in due course, such rule cannot apply with respect to PNB. Not only was PNB an immediate party or in privy to the promissory note, that is, it had dealt directly withX and Y knowing fully well that the latter signed only as accom- r .modation makers, but more importantly, because of their full reliance on the Deed of Assignment executed by CTC in favor of PNB. In effect, PNB waived payments of the first three (3) releases.

From the foregoing circumstances, PNB cannot be regarded as having acted in good faith which is out of the requisites of a holder in due course under Section 52. Thus, X and Y can validly set up their personal defense of release from the recil estate mortgage against PNB because of the violation of the Deed of Assignment. *(Prudencio vs. Court of Appeals, 143 SCRA 7 [1986].)*

(4) *Where instrument vitiated by an illegality of cause.* — A holder for value under Section 29 may be a payee, (see Sec. 191.) There can be no recovery by a payee against an accommodation party on an instrument vitiated by an illegality of cause. Thus, where the principal debtor bought a T.V. set and as security, executed a chattel mortgage over it, did not pay for it, and even sold the set without the written consent of the seller-mortgagee who accordingly filed an estafa case against the buyer-mortgagor, and to settle extrajudicially the criminal case, the mortgagor and another accommodation party executed in favor of the mortgagee a promissory note, there can be no recovery against the accommodation party as the promissory note is vitiated by the illegality of the cause — promise not to prosecute estafa case, if the promissory note is executed — but the mortgagor has an obligation to the mortgagee independently of the promissory note because for him to escape from the payment of a just obligation will result in unjust enrichment at the expense of another. (United General Industries, Inc. vs. Paler, 112 SCRA 404 [1982].)

(5) *Liability of solidary accommodation makers.* — In a case where three accommodation makers executed a promissory note "jointly and severally" in favor of a bank, it has been held that anyone of the solidary accommodation makers may be held liable when the principal debtor who received from the bank the

full value of the note failed to pay the same. (Sadaya vs. Sevilla, 19 SCRA 924 [1967].)

Rights of accommodation party.

(1) *Right to revoke accommodation.* — Since a signature for accommodation is gratuitous, it may be revoked or rescinded by cancellation or by notice to those interested at any time before the instrument has been negotiated for value. But once the instrument has been negotiated for value, the accommodation party is liable according to the face of his undertaking, the same as if he were financially interested in the transaction.

(2) *Right to reimbursement from accommodated party.* — After making payment to the holder, the accommodation party has a right to obtain reimbursement from the accommodated party. The relation between them is, in effect, that of principal and surety, the accommodation party being the surety. (Phil. National Bank vs. Maza and Macenas, 48 Phil. 207 [1915]; People vs. Maniego, 148 SCRA 31 [1987]; Caneda, Jr. vs. Court of Appeals, 181 SCRA 762 [1990].) As between the accommodation party and the accommodated party, the latter is expected to pay the instrument directly to the holder. The accommodated party is the real debtor. Hence, the cause of action is not on the instrument but on an implied contract of reimbursement.

(3) *Right to contribution from other solidary accommodation maker.* — Where the solidary accommodation maker paid to the bank, the balance due on a promissory note, he may seek contribution from the other solidary accommodation makers in the absence of a contrary agreement between them, and subject to the conditions imposed by law. This right springs from an implied promise between the accommodation makers to share equally the burden resulting from the execution of the note. They are joint guarantors of the principal debtor. (Sadaya vs. Sevilla, *supra;* see Art. 2073, Civil Code; Sec. 196.)

Meaning of "without receiving value therefor."

The law uses the words "without receiving value therefor" as one of the requisites in order that a person may be considered an accommodation party. This does not mean, however, that one cannot be an accommodation party merely because he has received some consideration for the use of his name. The last word "therefor" refers to the instrument itself and not to the use of the name by way of accommodation.

' "As stated by our Supreme Court, the expression, "without receiving value therefor" only means that no value has been received for the negotiable instrument and not "without receiving payment for lending his name." (Clark vs. Sellner, 42 Phil. 384 [1921].) Thus, if in the same example, M is given PI,000.00 in consideration of lending his name but not for the promissory note he signs, M does not lose his status as an accommodation party.

Kinds of accommodation party.

"An accommodation party is one who has signed the instrument as maker, drawer, acceptor, or indorser." (Sec. 29.)

EXAMPLES:

(1) *Accommodation maker.* — M, as accommodation party, issues a promissory note payable to P who may then negotiate it to A.

(2) *Accommodation drawer.* — M, as accommodation party, signs a bill of exchange with P as payee, and P may indorse the same to A.

(3) *Accommodation acceptor.*—M, as accommodation party, accepts a bill drawn on him by P in favor of himself and P may indorse the same to A.

(4) *Accommodation indorser.*—M, as accommodation party, simply signs as an indorser in blank, the bill or note made by P in favor of A, before it is delivered to A. (see Sec 63.)

Accommodation party and regular party distinguished.

The following are the differences:

(1) An accommodation party signs an instrument without receiving value therefor, while a regular party signs the instrument for value (Sec. 24.);

(2) An accommodation party signs an instrument for the purpose of lending his name to some other person (Sec. 29.), while a regular party does not sign for that purpose;

(3) An accommodation party may always show by parol evidence that he is only such, while a regular party cannot disclaim or limit his personal liability as appearing on the instrument by parol evidence (see Maulini vs. Serrano, 28 Phil. 640 [1914]; Velasco vs. Liuan & Co., 43 Phil. 195 [1922].);

(4) An accommodation party cannot avail of the defense of absence or failure of consideration against a holder not in due course, while a regular party may avail of said defense against a holder not in due course; and

(5) An accommodation party, after paying the holder, may sue for reimbursement the accommodated party, although a subsequent party, while a regular party may not sue any subsequent party for reimbursement. (Phil. National Bank vs. Maza & Macenas, 48 Phil. 207 [1925].)

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CHAPTER III

NEGOTIATION

Sec. 30. *What constitutes negotiation.* — An instrument is negotiated when it is transferred from one person to another in such manner as to constitute the transferee the holder thereof. If payable to bearer, it is negotiated by delivery; if payable to order, it is negotiated by the indorsement of the holder completed by delivery.

Modes of transfer of bill or note, in general.

Transfer is the process by which property is delivered by one person to another.

A bill of exchange or promissory note may be transferred from one person to another in several different ways, and for different purposes, and with different types of indorsement which result or may result in the acquisition of different rights or interests and the incurrence of different liabilities. The law does not prescribe an exclusive method of transferring negotiable instruments but only the manner in which their independence of equities or defenses that might obtain between the original parties may be preserved, (see 11 Am. Jur. 2d 334.)

Three methods of transferring a negotiable instrument.

They are the following:

(1) *Issue.* — It is the first delivery of the instrument, complete in form, to a person who takes it as holder (Sec. 191.); it is the first transfer of an instrument to a payee. A negotiable instrument's legal life does not begin until it is issued by the maker or drawer to the first holder;

(2) *Negotiation.* — It ordinarily involves indorsement (in regard to other than bearer paper) so that "negotiation" and "indorsement" are often used interchangeably. Negotiation makes it possible for the transferee to acquire a better right to a negotiable instrument that the transferor had. Whether the holder is a holder in due course depends upon factors other than the fact of negotiation (see Sec. 52.); and

(3) *Assignment.* — It is the less usual method/ which may or may not involve an indorsement in the sense of a writing on the back of the instrument. A bill or note, whether negotiable or non-negotiable, may be transferred by assignment. By its nature, there can be no "negotiation" of a non-negotiable instrument. Although it may be transferred by indorsement and delivery, the assignee acquired the instrument subject to the rules applicable to non-negotiable paper, (see 11 Am. Jur. 2d 335-336.)

Absent an express prohibition against assignment or transfer written on the face of a non-negotiable instrument, the same may be assigned or transferred. Thus, a promissory note marked "non- negotiable" but not at the same time stamped "non-transferrable" or "non-assignable" may be assigned or transferred. (Sesbreno vs. Court of Appeals, 222 SCRA 466 [1993].)

Both negotiation and assignment require delivery to effect a transfer of the instrument.

Meaning of negotiation.

Negotiation is the transfer of a negotiable instrument from one person to another made in such a manner as to constitute the transferee the holder thereof. The term expresses, at least primarily, the mode and effect of the transfer of a negotiable instrument.

There is no negotiation if the transfer does not make the transferee the holder of the instrument. If the instrument is payable to order, it is negotiable by delivery with the necesary indorsement; if payable to bearer, it is negotiable by delivery alone. Thus, if M makes a note payable to P or order and P delivers it without indorsement to A, negotiation is not effected because A, by such transfer, does not become the holder of the note. If the instrument is a bearer instrument (see Sec. 9.), P can negotiate it without indorsement of any kind simply by handing or mailing the instrument to a subsequent purchaser. Under Section 191 (par. 7.), a *holder* is "the payee or indorsee of a bill or note, who is in possession of it, or the bearer thereof/'

Methods of negotiation.

The method by which an instrument is negotiated depends upon whether the instrument is payable to order or to bearer.

(1) *Instrument payable to order.* — Where the instrument is payable to order, there are two steps required for its negotiation: *first,* an indorsement by the payee of present holder, and *secondly,* its delivery to the next holder. An instrument payable to order (Sec. 8.) is payable to the payee named therein or to the indorsee or the person ordered or authorized by the payee to collect. This order or authority is made by means of indorsement (Sec. 31.) followed by delivery of the instrument to the indorsee.

Under Section 74, the instrument must be exhibited when presented for payment to the person from whom payment is demanded. The party paying may thus judge the genuineness of the indorsements and of the right of the holder to receive payment.

(2) *Instrument payable to bearer.*—If the instrument is payable to bearer (Sec. 9.), it is negotiated by mere delivery without indorsement. Section 191, paragraph 4 defines "bearer" as the person in possession of a bill or note which is payable to bearer. Hence, any person in possession of an instrument payable to bearer is always the bearer thereof, although he may have no legal right thereto. This means that if the instrument is negotiated to a holder in due course, the latter may acquire a better title than that of the transferor.

Delivery means "transfer of possession actual or constructive, from one person to another. (Sec. 191, par. 6.)

EXAMPLE:

M issues a note "payable to bearer." The note was stolen from M's home by T who delivered the note to P.

Ts acquisition of the note does not constitute delivery. . There is no negotiation to X because delivery must be voluntary. However, the delivery to P (who acted in good faith) constitutes negotiation. While a thief (or finder) cannot acquire title to the instrument, by virtue of the theft, he can transfer title to a subsequent innocent purchaser.

Payment of instrument by drawee not negotiation.

The payment of a check (or other bill) by the drawee bank is not a negotiation and does not make the bank a holder within Section 30.

The bank is neither the payee nor indorsee, (see Sec. 191, par. 7.) The check is extinguished and cannot be put in circulation again so as to bind the drawer or indorser. (Beutel's Brannan, *op. tit.,* p. 592.)

The writing of the name of the holder on the back of the check before surrendering it for payment to the drawee-bank is not an indorsement. Such signature merely serves as a receipt for the money. Upon payment, the check becomes merely a voucher. Payment effects a discharge of the instrument, not a transfer of title thereto, (see Sec. 119[a].)

Meaning of assignment.

An *assignment* of a bill or note merely means a transfer of the title to the instrument, with the assignee generally taking only such title as his assignor has, subject to all defenses available against his assignor, (see 11 Am. Jun 2d 338.)

Assignment involves a transfer of rights under a contract. Note the transfer of a non-negotiable Instrument always constitutes an assignment. The word "transfer" is also used when referring to "assignment." When negotiation takes place, the transferee becomes a holder.

Effect of delivery of order instrument without indorsement.

A transfer of a negotiable instrument is effected otherwise than by negotiation when an order instrument is delivered without indorsement. In this case, the transfer operates as an ordinary assignment and the assignee is merely placed in the position of the assignor, the former acquiring the instrument subject to all defenses, real and personal, available against the latter.

Without the indorsement, the transferee would not be the holder of the instrument, he not being the payee, indorsee, or the bearer thereof. However, the assignee acquires the right to have the indorsement of the assignor. When indorsement is subsequently obtained, the transfer operates as a negotiation only as of the time the indorsement is actually made. (Sec. 49.)

Negotiation and assignment distinguished.

The former is strictly the transfer of a negotiable instrument to a *holder,* (see Sec. 58.) While a negotiable instrument may be either negotiated or assigned, a non-negotiable instrument can only be assigned or transferred, not negotiated. The other distinctions are:

(1) Negotiation refers only to negotiable instruments, while assignment refers generally to an ordinary contract;

(2) In negotiation, the transferee is a holder, while in assignment, the transferee is an assignee;

(3) A holder in due course is subject only to real defenses, while an assignee is subject to both real and personal defenses (see Sec. 57-59.);

(4) A holder in due course may acquire a better title or greater rights under the instrument than those possessed by the transferor or a prior party, while generally an assignee merely steps into the shoes of the assignor;

(5) A general indorser warrants the solvency of prior parties, while an assignor does not warrant the solvency of prior parties unless expressly stipulated or the insolvency is known to him;

(6) An indorser is not liable unless there be presentment and notice of dishonor, while an assignor is liable even without notice of dishonor; and

(7) Negotiation is governed by the Negotiable Instruments Law, while assignment is governed by Articles 1624 to 1635 (on assignment of credits) of the Civil Code.

When distinction not material.

The difference between negotiation and assignment may be of no material significance, if there is no defense to the obligation and only the maker is sought to be held. But whether the transfer of a bill or note is by negotiation or assignment, the transfer may constitute a sale, exchange, pledge, or gift, (see 11 Am. Jur. 2d 337.)

Payment by means of instrument merely conditional.

Whether the act involved is negotiation or assignment, payment by means of promissory notes, bills of exchange, and other negotiable instruments is merely conditional, *i.e.,* subject to the condition that they be converted into cash at maturity, (see Art. 1249, Civil Code.)

The rule is different in insurance. Acceptance of a promissory note or check in payment of the premium by the insurer renders the policy immediately operative where the policy is silent as to the mode of payment, although one of its conditions is that "it shall not be valid or binding until the first premium is paid." The acceptance, in effect, waives this provision. (Capital Ins. & Surety Co., Inc. vs. Plastic Era Co., Inc., 65 SCRA 134 [1975].)

Can there be a negotiation to a payee?

One school of thought claims that the delivery to the payee by the maker or drawer does not constitute negotiation because delivery is part of the creation of a negotiable instrument, (see Sec. 14.) Before the writing is delivered there is no negotiable instrument, no contract as yet. Negotiation, on the other hand, refers to an existing negotiable instrument.

The second school maintains that there can be such negotiation. Under Section 30 and Section 191, paragraph 7, an instrument is negotiated when it is delivered to the payee or to an indorsee or to the bearer thereof. Hence, "negotiated" is not confined to transfer after delivery to the payee (see Beutel's Brannan, *op. cit.,* p. 591.) because a holder may be a payee in possession of the instrument. Moreover, there are American cases where courts have supported this second view.

Both arguments are logical and convincing. They may, however, be reconciled.

(1) *First delivery of instrument to payee.* — It is believed that the payee, as the first holder, acquires title to the instrument not by negotiation but by issue or issuance, (see Sec. 191, par. 10.) If negotiation refers to an instrument already completely executed or issued, then only the holders subsequent to the payee can acquire title by negotiation. This should be the rule in case the first delivery of the instrument is made by the maker or drawer directly to the payee.

(2) *First delivery of instrument to other than payee.* — If the delivery is not so made, such delivery, as a qualification of Section 191, paragraph 10 ("issue"), may constitute negotiation under Section 30 in relation to Section 191, paragraph 7 ("holder"). Thus, where the delivery by the maker or drawer is made to a person other than the payee such as an agent of the maker or drawer, the payee acquired title by negotiation, (see Vicente B. de Ocampo & Co. vs. Gatchalian, 3 SCRA 596 [1961]; Sec. 52[c].)

(3) *Delivery of instrument to payee by last holder.* — There may also be negotiation to the payee when the instrument is delivered back to him by the last holder. In such case, the indorsement of the last holder is not necessary because the payee is remitted to his former rights (Sec. 121.) and all intervening parties are discharged from liability. (Sees. 48,50.)

Delivery of negotiable instrument.

(1) *Kinds.* — Delivery is the transfer of possession, actual or constructive, from one person to another. (Sec. 191, par. 6.) An example of constructive delivery is where A, without B's knowledge, indorses an instrument to B and ! puts it into an envelop containing other papers of B. (Babb & Martin, *op. cit.,* p. 188.)

(2) *Necessity.* — Delivery is an essential part of every negotiation. *Indorsement*, as defined by the Act, means an indorsement completed by delivery. (Sec. 191, par. 8.) An intent to be bound is necessary to the creation of an obligation, and delivery of the negotiable instrument is the operative fact that evidences the intention of the maker or drawer to become bound by it.

(3) *Presumption.* — Delivery is presumed from possession. Except as against a holder in due course, the maker or drawer may overcome this *prima facie* presumption by proof that the instrument was lost or stolen. (Babb & Martin, *op. cit.,* p. 188.)

Where delivery conditional.

The delivery may be conditional.

(1) *Condition precedent.* — Parol evidence is admissible to show that (notwithstanding delivery) the instrument was to become operative as a contract only upon the happening of a future, contingent event, since this is a *condition precedent* to the attaching of any obligation under the written instrument.

EXAMPLE:

M delivers his promissory note to P stating orally that the note is not to take effect until P delivers to M a deed to certain property. P fails to deliver the deed.

Evidence of the oral agreement is admissible to show that the note which purports to be a contract is in fact no contract at all.

(2) *Condition subsequent.* — Where an instrument is *unconditionally* delivered as an operative contract, parol evidence is not admissible to show a parol condition (not expressed in the writing) attached to the obligation of the contract.

EXAMPLE:

M is sued by P on a promissory note given by M in part payment of his tuition fee. M testifies that P promised orally that M would be released on the note if M should decide to discontinue with his course and should so notify P before he had received more than five lessons, and that M did so decided and notify P in accordance with the oral agreement.

The testimony of M is not admissible as it is in direct contradiction of the written contract (as to the existence and validity of which there is no controversy) and its admission ' i would violate the parol evidence rule. (Babb & Martin, *op. tit.,* pp. 188-189.)

Sec. 31. *Indorsement; how made.* — The indorsement must be written on the instrument itself or upon a paper attached thereto. The signature of the indorser, without additional words, is a sufficient indorsement

Meaning and nature of indorsement.

(1) *Indorsement* is the writing of the name of the payee on the instrument with the intent either to transfer the title to the same, or to strengthen the security of the holder by assuming a contingent liability for its future payment, or both, (see Norton, *op. cit.,* 4th ed., p. 148.) The payee by signing (indorsing) the instrument and delivering it to another person (in payment of debt payee owes him or for any other reason) becomes an *indorser.* The person who receives the indorsed instrument is the *indorsee.* He can indorse the Instrument to some else and thus become an indorser as well.

Indorsement alone without delivery conveys no title and creates no holder. Indorsement in accordance with Section 191, paragraph 8 means an indorsement completed by delivery. It applies to both bills and notes.

(2) An indorsement is not only a mode of transfer. It involves also a new contract and an obligation on the part of the indorser — an implied guaranty that the instrument will be duly paid according to the terms thereof. By his indorsement, the indorser becomes a party to the instrument, and may be held liable for its payment even without receiving any consideration therefor, (see Sec. 29.) Each indorsement generates an additional contract between the indorser and aU subsequent Holders.

(3) It involves the certainty of two things:

(a) the identity of the indorser (as being the payee or true owner); and

(b) the genuineness of his signature.

It is the duty of a person cashing or paying on an instrument to ascertain both before paying. (American Express Co. v. People's Sav. Bank, 181 NW 701; see Sec. 23.) But the acceptor does not admit the genuineness of the indorsees signature, (see Sec. 62.)

Indorsement and assignment distinguished.

The two terms are to be distinguished in that the latter is broader, and sometimes include the former. It is, however, a common practice to speak of the indorsement of negotiable, and the assignment of non-negotiable, instrument in blank, (see Hughes v. Kaw, Invest. Co., 31ALR 727.)

Necessity of indorsement.

(1) Indorsement is essential to the execution of an instrument payable to the order of the maker or drawer, (see Sees. 8[b], 184.)

(2) It is also essential to the negotiation of an order instrument, not of a bearer instrument. (Sec. 30.)

(3) It is not necessary to a mere assignment of a negotiable or non-negotiable instrument, *(supra.)* Thus, one may acquire title to such instrument without indorsement but without indorsement of an order instrument, he cannot be a holder in due course thereof even though he is entitled to have the indorsement made, (see Sec. 49.)

(4) Under proper circumstances, an estoppel may take the place of an indorsement to uphold the transfer of a bill or note such as where the indorsement is forged or unauthorized and the party against whom the instrument is sought to be enforced is precluded from setting up the defense of forgery or want of authority, (see Sec. 23; see 11 Am. Jur. 2d 371.)

Form of indorsement.

The law does not require an exclusive form by which an indorsement may be accomplished. But it "must be written" or in writing. As "writing" includes "print" (Sec. 191, par. 13.), the indorsement made by rubber stamp or typewritten on the instrument complies with the requirement. The use of the word "assign" does not make a negotiation a mere assignment. For example: "I hereby assign all my rights and interests in this note. (Sgd.) P." Clearly, it cannot be said that P intends to limit the rights of the person to whom he transfers the Instrument.

According to Section 31, the signature of the indorser, without additional words, is a sufficient indorsement. Such indorsement is called "blank indorsement." (Sec. 34.) Where the name of the indorsee is specified, it is called "special indorsement." *(ibid.)* The indorser, however, may add words which prohibit or limit the further negotiation of the instrument, (see Sec. 36.)

ILLUSTRATIVE CASE:

Guaranty by payee at the back of the note is followed by his signature.

Facts: At the back of a promissory note payable to order issued by M, the following notation appears: "For value received I hereby guarantee payment of the within note including interest and costs at maturity or at any time thereafter demanded." (Sgd.) P (payee)

Before maturity of the note, A became the *bona fide* purchaser thereof, for value and without notice of any defense thereto. A brought suit to recover upon the note. M argued that the guaranty provision on the back standing alone was not an indorsement and the note was not thereby negotiated but merely transferred or assigned subject to defenses existing in favor of the maker against the original payee.

Issue: Did the guaranty followed by the signature of P amount to an indorsement?

Held: There are two conflicting lines of authority. The reasoning of authorities which support the position of M is that the indorsement is not in blank, but is filled up; that it expresses fully the contract, and can raise no implication of another. The majority of decisions hold that the guaranty operates as an indorsement with enlarged liability. But such a guaranty is wholly inoperative until the note is transferred by the payee to a third party. *(Hutson v. Rankin*, 213 *Pac. 345.)*

Place of indorsement.

The indorsement may be written:

(1) *On the instrument itself.* — Indorsement is derived from the Latin word *indorsa.* Literally, it means "writing on the back/' While indorsement is usually written on the back, it may be written on the face of the instrument. The place is not essential. The law looks to the intention of the parties rather than to the form as to indorsement, (see Sees. 17[f], 63.) When it is not clear in what capacity a person intended to sign, he shall be deemed an indorser; or

(2) *Upon a paper attached thereto.* — Where the indorsement is on a slip of paper physically attached to the instrument so as to become part of it, die paper is known as *allonge.*

Use of allonge for indorsement.

The question as to whether an allonge can be used whether or not there is still room in the instrument has given rise to much conflict.

Although the law makes no distinction, the better view seems to be that it is immaterial whether there is still room or not. As one author has said: "why should such a space be material when some indorsements are on an attached piece of paper?" In neither case does the leaving of a blank space facilitate fraud, since nobody would gain any advantage by inserting his name in the space and rendering himself liable to those who indorsed below him upon the note or the allonge. (Beutel's Brannan, *op. cit.,* p. 601.)

Sec. 32. *Indorsement must be of entire Instrument.* — The indorsement must be an indorsement of the entire instrument An indorsement which purports to transfer to the indorsee a part only of the amount payable, or which purports to transfer the instrument to two or more indorsees severally, does not operate as a negotiation of the instrument. But where the instrument has been paid in part, it may be indorsed as to the residue.

Indorsement must be of entire r instrument.

The general rule is that the "indorsement must be an indorsement of the entire instrument." The reason is that the instrument must be delivered to the indorsee and there cannot be partial delivery of one instrument.

The object of the provision is to avoid multiplicity of suits. A bill or note divided into different parts divides the cause of action.

EXAMPLE:

An indorsement of a note for P5,000.00 which is "Pay to A" or "Pay to A P5,000.00" is a good indorsement; but "Pay to A P4,000.00." leaving the balance without indorsement is not a valid negotiation of the instrument. Such indorsement renders the instrument non-negotiable. A would not be considered a holder but merely an assignee in which case he would be subject to all defenses available between the original parties.

A is not a holder because the law (Sec. 191, par. 7.) defines a holder as "the payee or indorsee of a bill or note who is in possession of it, or the beaTer thereof." A is not a payee or bearer of the note.

Neither is he an indorsee. For being only a part indorsee, he is considered merely as an assignee, (see Montinola vs. The Phil. National Bank, 88 Phil. 178 [1915].)

Indorsement to multiple payees or indorsees.

(1) *Joint payees.* — Similarly, an indorsement purporting to transfer the instrument to two or more persons severally does not operate as a negotiation of the instrument for again the cause of action is split. However, the. negotiation is valid where the indorsees are joint. This is impliedly recognized by Section 41. The indorsements of all the indorsees are required for further negotiation of the Instruments.

(2) *Alternative payees.* — Instruments are sometimes payable to two or more alternative payees. In such case, the negotiation

of the instrument may be made by the indorsement of either of the payees.

EXAMPLES:

(1) An indorsement of a note for P5,000.00 as follows: "Pay to A P4,000.00, and pay to B, PI,000.00," does not operate as a negotiation of the note; neither A nor B can sue or further indorse. But "Pay to A and B" is valid negotiation. The indorsements of both A and B are required to negotiate the instrument.

(2) If the note provides: "Pay to A or B," either A or B may indorse the instrument.

(3) M issues an order note to P who indorses it to A. Subsequently, A makes the following indorsement: "Pay to B or C. (Sgd.) A." Under Section 32, die indorsement does not operate as a negotiation of the note.

When partial indorsement allowed.

If part of the amount has already been paid, the unpaid balance may be indorsed as this is expressly authorized by law.

EXAMPLE:

In the first example above, if the maker has paid P4,000.00 to A, the payee, the latter can indorse it to someone else as to the balance, thus: "Pay to B PI,000.00." In this case, A must acknowledge receipt or payment of P4,000.00.

Sec. 33. *Kinds of indorsement.* — An indorsement may be either special or in blank; and it may also be either restrictive or qualified, or conditional.

Classification of indorsement.

(1) *As to the methods of negotiation:*

(a) special (Sec. 34.); or

(b) blank, *(ibid.)*

(2) *As to the kind of title transferred:*

(a) restrictive; or

(b) non-restrictive. (Sec. 36.)

(3) *As to scope of liability of indorser:*

(a) qualified; or

(b) unqualified or general. (Sees. 38,66.)

(4) *As to presence or absence of limitations:*

(a) conditional; or

(b) unconditional. (Sec. 39.)

(5) *The other kinds of indorsements are:*

(a) joint (Sec. 41.);

(b) successive (see Sees. 50,68.);

(c) irregular or anomalous (Sec. 64.); and

(d) facultative, (see Sec. 111.)

Note that once an instrument as issued satisfies all the requirements of negotiability (Sec. 1.), no indorsement, even restrictive one (Sees. 36-37.), can negate its negotiable status.

Sec. 34. ***Special indorsement; indorsement in blank.*** **— A special indorsement specifies the person to whom, or to whose order, the instrument is to be payable; and the indorsement of such indorsee is necessary to the further negotiation of the instrument. An indorsement in blank specifies no indorsee, and an instrument so indorsed is payable to bearer, and may be negotiated by delivery.**

Special indorsement explained.

A *special indorsement* is one where the name of the payee is specified. It is also known as specific indorsement or indorsement in full. Special and blank indorsements are "unqualified indorsements."

(1) *Forms.* — There are two forms of special indorsements:

(a) One that specifies the person to whom the instrument is payable, *i.e.,* "Pay to A"; and

(b) One that specifies the person to whose order the instrument is to be payable, i.e., "Pay to the order of A" or "Pay to A or order."

In either case, the indorsement must be followed by the signature of the indorser. Unlike in the case of the instrument itself, it is not necessary to use the words of negotiability, *i.e.,* "or order" or "to the order of," and their omission does not affect the negotiability of an instrument which is negotiable on its face. (Sec. 36, par. 2.) In the first example above, the indorsement, in legal effect, is "Pay to A or order."

(2) *Negotiation of order and bearer instruments.* —

(a) If the instrument is *originally payable to order,* and it is negotiated by the payee by special indorsement, the indorsement of the indorsee is necessary to the further negotiation of the instrument. (Sec. 34.)

(b) If the instrument is *originally payable to bearer*, it may nevertheless be further negotiated by mere delivery even if the original bearer indorsed it specially but the special indorser is liable only to such holders as make title through his indorsement. A special indorsement will turn a bearer paper into an order paper and the party specified will have to indorse the instrument before it can be negotiated further. (Sec. 40.)

Blank indorsement explained.

A *blank indorsement* is one which specifies no particular indorsee. Such as indorsement generally consists only of the signature of the payee or indorser. (Sec. 31.) An instrument so indorsed is payable to bearer (see Sec. 191.) or whoever possesses it and may be negotiated by the indorser by delivery alone regardless of whether the instrument is originally payable to bearer or not. The use of bearer Instruments involves greater risk through theft or loss than the use of order paper. A thief or finder could likewise negotiate the instrument by mere delivery and if payment were made in good faith, the real owner would not have the right to recover from the maker or drawer.

This type of indorsement is the most commonly used form of indorsement.

EXAMPLE:

If M makes a note payable to the order of P and the latter wants to negotiate it to A, he simply writes his signature on the back of the note and delivers the same to A.

In this case, although P is an indorser, A is not an indorsee but the bearer thereof because he is in possession of a note (or bill) which is payable to bearer. (Sec. 191, par. 4.)

One of the most common methods of creating a bearer paper is to make a check that already has imprinted "Pay to the order of " read: "Pay to the order of cash" or "Pay to the order of bearer."

Sec. 35. ***Blank Indorsement; how changed to special indorsement.*** **— The holder may convert a blank indorsement into a special indorsement by writing over the signature of the indorser in blank any contract consistent with the character of the indorsement.**

Conversion of blank indorsement to special indorsement.

Under Section 9(e), an instrument made payable to order on its face becomes payable to bearer if the only or last indorsement is in blank. The holder, however, may protect himself from liability by changing the blank indorsement to a special indorsement.

Under Section 35, an instrument made payable to bearer by an indorsement in blank may be converted into an order instrument by writing over the signature of the indorser in blank any contract not inconsistent with the character of the indorsement. But a bearer instrument always remains a bearer instrument negotiable by mere delivery whether the last indorsement is a blank or a special one. (see Sec. 40.)

EXAMPLES:

(1) Suppose M makes a note payable to P or order. The instrument is, therefore, originally payable to order. If it is indorsed especially by P to A, then A to B in blank, the instrument is converted into a bearer instrument because the last indorsement is a blank indorsement.

But if the blank indorsement of A is followed by a special indorsement by B to C, its further negotiation can be effected only by the indorsement of C, the special indorsee. (Sec. 32.)

(2) In the above example, the indorsement by P to A, and A to B may appear thus:

Pay to A (Sgd.) P (Sgd.) A

B, as the holder of the instrument with the blank indorsement, may protect himself against the possibility of loss of title through subsequent negotiation, for example, by a thief, by converting it into a special indorsement, as for example, by writing over the signature of A the words "Pay to B," thereby indorsing it to himself. Thus, the following will appear:

Pay to A (Sgd.)P Pay to B (Sgd.) A

But B cannot, however, write over it any contract inconsistent with the character of the indorsement, that is, it must not change the contract of the blank indorser.

Thus, adding "protest waived," or "demand and notice waived" or "without recourse" would constitute a material alteration as it would vary the liability of A, the indorser, and if made without the consent of A, the same would avoid the indorsement (Sawyer State Bank v. Sutherland, 162 N.W. 696.); or the words "I guaranty payment" for the effect of this would be to deprive A of the right of notice in case of dishonor. (Belden v. Hann, 61 Iowa 42.)

Sec. 36. ***When indorsement restrictive.*** **— An indorsement is restrictive which either —**

(a) Prohibits the further negotiation of the instrument; or

(b) Constitutes the indorsee the agent of the indorser; or

(c) Vests the title in the indorsee in trust for or to the use of some other person.

But the mere absence of words implying power to negotiate does not make an indorsement restrictive.

Restrictive indorsement explained.

As previously seen, the signature of the indorser without additional words is a sufficient indorsement. (Sec. 31.) However, appropriate words may be added which prohibit or limit the further negotiation of an instrument. A *restrictive indorsement* is one so worded that it either prohibits entirely the further negotiation of an instrument or restricts its further negotiation to a particular person or for a particular purpose; or modifies the rights of the holders or the liabilities of die indorser.

(1) *Limits rights of indorsee.* — By means of a restrictive indorsement, an indorser notifies all prospective holders that the indorsee has only the authority to deal with the instrument as thereby directed and that the indorsee has only a restrictive title thereto. Thus, by such indorsement an indorser can safeguard his interests by limiting the rights of the indorsee whenever he should find it necessary to entrust negotiable paper to another.

(2) *Destroys negotiability of instrument.* — Such indorsement destroys the negotiability of the instrument and bars further negotiation to a holder in due course. A restrictive indorsee is not a holder in due course in the strict sense of that term or in his own right, and defenses available against the indorser are not cut off by the transfer of the instrument under such an indorsement, in the absence of waiver or estoppel. (11 Am. Jur. 2d 435.) All subsequent indorsees acquire only the title of the first indorsee under the restrictive indorsement. (Sec. 37,2nd par.)

(3) *Three classes.* — The law defines three classes of restrictive indorsement.

EXAMPLES:

The restrictive indorsement is signed by the payee (P) as follows:

(a) *Prohibits further negotiation.*

"Pay to A only"

"Pay to A and to no other person"

Here, A is the only one authorized to receive payment.

Note: Banking rules prohibit the drawee bank from having checks with *more than one indorsement* The banking rule banning acceptance of checks for deposit or cash payment with more than one indorsement unless cleared by some bank officials does not invalidate the instrument; neither does it invalidate the negotiation or transfer of the said check In effect, this rule destroys the negotiability of bills or checks by limiting their negotiation by indorsement of only the payee.

Under Section 36(9), the only kind of indorsement which stops the further negotiation of an instrument is a restrictive indorsement which prohibits the further negotiation thereof.

In this kind of restrictive indorsement, the prohibition to transfer or negotiate must be written in express words at the back of the instrument, so that any subsequent party may be forewarned that it ceases to be negotiable. Although the holder of a check cannot compel a drawee bank to honor it because there is no privity between them unless it accepts the check, such bank may not legally refuse to honor a negotiable bill or check drawn against it with more than one indorsement if there is nothing irregular with the bill or check and the drawer has sufficient funds. It will make itself liable to suit for damages at the instance of the drawer for wongful dishonor of the bill or check. (Gempesaw vs. Court of Appeals, 218 SCRA 682 [1993].)

(b) *Constitutes indorsee agent of indorser.*

"Pay to A for collection"

"Pay to A for collection and remittance"

"Pay to A for collection only"

"Pay to A for deposit."

A does not acquire title over the instrument. The indorsements also prohibit the further negotiation of the instrument.

Where the holder of a check deposits it with a bank other than the drawee bank, negotiating the check with the indorsement "for deposit," views differ as to whether this type of indorsement is restrictive or non-restrictive, (see "Relation between depositor and bank" under Sec. 189.)

(c) *Vests title in indorsee for the benefit of the indorser or a third party.*

"Pay to A in trust for B"

"Pay to A as trustee for P"

"Pay to A as agent of P"

"Pay to A for my use" "Pay

to A for the use of B"

The indorsements transfer the legal title to the instrument to A as trustee for B or P, the beneficial owner. They give notice that the paper cannot be negotiated by A for his own debt or for his own benefit. But indorsement itself by the use of the word of negotiability "or order" indicates that A may still negotiate the instrument, (see Sec. 47.)

Effect of absence of words of negotiability.

Under the second paragraph of Section 36, the mere absence of words implying power to negotiate does not make an indorsement restrictive. Thus, "Pay to A," is the same as "Pay to order of A" or "Pay to A or order."

In other words, the instrument, originally negotiable continues to be negotiable in spite of the absence of such words in an indorsement. But if in their place a restrictive word such as "only" is employed so as to prevent further negotiation, the instrument is not only restrictively indorsed but it also ceases to be negotiable.

Sec. 37. *Effect of restrictive indorsement; rights of indorsee.* — A restrictive indorsement confers upon the indorsee the right —

(a) To receive payment of the instrument;

(b) To bring any action thereon that the indorser could bring;

(c) To transfer his rights as such indorsee, where the form of the indorsement authorizes him to do so.

But all subsequent indorsees acquire only the title of the first indorsee under the restrictive indorsement.

Rights of indorsee in restrictive indorsement.

Under any form of restrictive indorsement, the indorsee may receive payment on the instrument; sue there on in his name; and also negotiate the instrument except when it is prohibited in the indorsement. (Sec. 36[a].) However, the rights of the indorsees subsequent to the first indorsee are subject to the terms of the restrictive indorsement, (see par. 2.)

EXAMPLE:

In the indorsement, "Pay to A for collection, (Sgd.) P," A is merely an agent of P and any action he may file on the instrument is, therefore, subject to defenses available against P, his indorser. Similarly, if A negotiates the instrument to B, a subsequent indorsee, the latter "acquires only the title" of . A, the first indorsee, whose right is merely to collect.

If P has already been paid, A and B cannot enforce the instrument anymore.

Sec. 38. ***Qualified indorsement.*** **—A qualified indorsement constitutes the indorser a mere assignor of the title to the instrument. It may be made by adding to the indorsees signature the words "without recourse" or any words of similar import. Such an indorsement does not impair the negotiable character of the instrument.**

Qualified indorsement explained.

Qualified indorsement is one which constitutes the indorser a mere assignor of the title to the instrument.

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(1) *Words used clearly express intention.* — An indorsement may be qualified by adding to the indorser's signature the words "without recourse" or words of similar meaning like "sans recourse," "at indorsee's own risk," or "indorser not holder" to either a blank or a special indorsement. Thus:

"Pay to the order of A without recourse on me. (Sgd.) P."

"Pay to A, indorser not holder. (Sgd.) P."

The word "recourse" in ordinary legal and commercial usage means a resort to a person who is secondarily liable after the default of the person who is primarily liable. (Industrial Bank & Trust Co. v. Hesselberg, 195 SW 2d 470.) An indorsement "without recourse" does not affect the negotiable quality of an instrument. It shows only an unwillingness to be answerable for the solvency of prior parties — a prudent precaution, particularly where the note has a long time to run before it matures. (Epler v. Funk, 8 Pa. 468.)

(2) *Words used do not clearly express intention.* — There is a conflict of opinion as to whether the words "I hereby transfer and assign all my right, title, and interest[7]' and other similar words of assignment or transfer appearing above the signature of the indorser constitute an indorsement without recourse.

By the weight of authority, they have been held to constitute a negotiation and render the writer liable to an innocent holder as an indorser, and not as an assignor. "It is not enough that words are used which simply express an assignment... when an indorser intends to qualify his indorsement and instead of using the words "without recourse" he attempts to avail of others of similar import, those other words must be such as to clearly express that intention." (Devilbliss v. Burns, 16 Miss. 724,138 So. 346.)

However, other courts hold that an assignment of "right, title, and interest" is a qualified indorsement only on the ground that the words are of similar import as "without recourse." (see 11 Am. Jur. 2d 378-379,386-387.) Construing the terms, they limit the right acquired by the transferee to those which the transferor had therein and thus constitute him as a mere assignor, (see Spencer v. Halpern, 34 S.W. 711.)

Effect of qualified indorsement.

(1) *Indorser; a mere assignor.* —A special or blank indorsement indicates that the indorser, in addition to transferring little to the

instrument, is guaranteeing its payment if the holder is unable to obtain payment from the maker, acceptor, or drawer at maturity. The purpose of a qualified indorsement "without recourse" is to transfer title without guaranteeing payment by the primary party. In other words, it makes the indorser a mere assignor to the instrument.

(2) *Indorser's liability limited.* — It does not mean, however, that the qualified indorser incurs no liability at all. The effect of the qualified indorsement is merely to limit his liability. He is secondarily liable for breach of his warranties as an indorser under Section 65. Warranty liability is still present even if the indorsement is qualified unless such indorsement specifically excludes warranties. Thus, he is liable if the instrument is dishonored by non-acceptance or non-payment due to: (a) forgery; (b) lack of good title to the instrument indorsed; (c) lack of capacity to contract on the part of prior parties; or (d) the fact that the instrument was valueless or not valid at the time of the indorsement which fact was known to him. But the qualified indorser is not liable to the indorsee if the instrument is dishonored for some other reason like the insolvency of the person primarily liable.

(3) *Negotiability of instrument not effected.* — It is a good precaution to indorse without recourse where the instrument has a long period of maturity so that there is danger that the principal debtor might become insolvent. Note that a qualified indorsement "does not impair the negotiable character of the instrument."

EXAMPLE:

M makes a promissory note payable to the order of P who indorses the same "without recourse" to A.

If M refuses to pay because his signature has been forged, P would be liable to A because, as qualified indorser, P warrants among other things that the instrument is genuine. (Sec. 65[a].)

But if M cannot pay because of insolvency, and such insolvency was not known to P at the time of negotiation, A cannot make P pay. The effect of A's qualified indorsement is to exempt P from paying the instrument in case of default of M. So A cannot recover the amount of the note from P.

Sec. 39. ***Conditional indorsement*****—Where an indorsement is conditional, a party required to pay the instrument may disregard the condition and make payment to the indorsee or his transferee whether the condition has been fulfilled or not. But any person to whom an instrument so indorsed is negotiated, will hold the same, or the proceeds thereof, subject to the rights of the person indorsing conditionally.**

Absolute and conditional indorsements explained.

(1) An *absolute indorsement* is one by which the indorser binds himself to pay, upon no other condition than the failure of prior parties to do so, and of due notice to him of such failure.

(2) A *conditional indorsement*, on the other hand, is one by which the indorser imposes some other conditions to his liability or on the indorsee's right to collect the proceeds of the instrument.

(a) A conditional indorsement has no effect on the further negotiation of the instrument. The party required to pay, if he chooses, may make payment, disregarding the condition without incurring any liability because he is expressly authorized to do so under Section 39. But the person who received payment will hold the proceeds subject to the right of the conditional indorser.

(b) A conditional indorsement does not prohibit the further negotiation of the instrument regardless of whether the condition has been fulfilled or not. It should be remembered that while a condition in the indorsement does not destroy negotiability, a condition appearing on the face of the instrument renders the instrument non-negotiable. (Sec. l[b].)

EXAMPLE:

M makes a note for P50,000.00 payable to P or order who indorses as follows: "Pay to A on completion of the construction by him of my house. (Sgd.) P."

The condition imposed is binding in favor of P as regards A and subsequent holders through A. If A has not finished the construction of P's house on the date of maturity of the instrument, M may refuse to pay A on the ground that the condition has not been or has not yet been fulfilled.

Without the condition having been fulfilled M may, if he wants to, disregard the condition and pay A. This M may do because as the principal debtor, M has die right to terminate his obligation upon its maturity and cannot be burdened with conditions which were not part of his contract. In such a case, however, A holds the proceeds in trust for P and does not become the owner thereof until the condition is fulfilled. If the condition is not complied with, he must turn over the P50,000.00 to P, the person indorsing conditionally.

Different combinations of indorsements.

All indorsements are either special or in blank; restrictive non-restrictive, etc. Thus, different combinations are possible.

EXAMPLE:

(1) *special and restrictive*
"Pay to A only. (Sgd.) P"

(2) *special and qualified*
"Pay to A without recourse. (Sgd.) P"

(3) *special and conditional*
"Pay to A if he marries before he reaches the age of 25.
(Sgd.) P"

(4) *blank and restrictive*
"For collection only. (Sgd.) A"

(5) *blank and qualified*
"Without recourse. (Sgd.) A"

(6) *blank and conditional*
"Payable upon completion of my house in Pateros, Metro Manila. (Sgd.)A"

(7) *special, unrestrictive, unqualified*
"Pay to B. (Sgd.) A"

(8) *and so on*

Sec. 40. *Indorsement of instrument payable to bearer.* — Where an instrument, payable to bearer, is indorsed specially, it may nevertheless be further negotiated by

delivery; but the person indorsing specially is liable as indorser to only such holders as make title through his indorsement.

Effect of special indorsement where instrument originally payable to bearer.

By virtue of the present section, an instrument payable to bearer is not converted into an instrument payable to order by being indorsed specially and, therefore, notwithstanding the provisions of Section 34, the indorsee may further negotiate the instrument by mere delivery. In such a case, the person indorsing specially is liable only to those holders who can trace their title to the instrument by a series of unbroken indorsements from such special indorser. His liability shall be that of a general indorser as provided in Section 66.

The liability of a person who negotiates by delivery alone (which is exactly the same as one who indorses qualifiedly) is governed by Section 65.

EXAMPLE:

M issues a promissory note payable to P or bearer and delivers it to P. To negotiate the note to A, P has only to deliver the same to A. With or without the indorsement of P, A becomes the holder of the instrument by its delivery because indorsement is not necessary. (Sec. 30.)

If P indorses the instrument to A, the latter may nevertheless negotiate it by mere delivery to B. However, B will have no right against P since he (B) did not obtain his title through the indorsement of P. But A, as indorser and M, as maker, will be liable to B.

Suppose A also indorses the note to B who negotiates the same to C by mere delivery. The following indorsements thus appear on the back:

Pay to A. (Sgd.) P	
	Pay to B. (Sgd.) A

(1) In this case, P is liable to A and also to B as a general indorser under Section 66. A is likewise liable to B.

(2) C obtains his title through negotiation by delivery of the instrument by B and not through the indorsements of P and A. Hence, P and A are liable to C. But B would be liable to C under Section 65.

Application of Section 40.

(1) *Only to instruments originally payable to bearer.* — This section applies only to instruments originally payable to bearer. Therefore, it cannot apply where the paper is originally made payable to order and indorsed in blank because by Section 9, a note or bill which upon its face, is payable to order, becomes payable to bearer only when the last indorsement is in blank; hence, when a blank indorsement is followed by a special indorsement, the instrument is not within the terms of Section 9.

Thus, if a check drawn to the order of P is indorsed in blank by the payee, and delivered to A, and A indorses it to the order of B, it is no longer payable to bearer for the reason that the last indorsement which by Section 9 is made the test, is a special indorsement.

(2) *Reason.* — The reason for making a distinction in this respect between instruments originally drawn payable to bearer and instruments which have become so payable because indorsed in blank is obvious. In one case, the maker or drawer has expressly provided that the instrument shall be payable to bearer, and it cannot be made payable to order without modifying these terms. But where, upon its face, it is payable to order, a transferee, taking a blank indorsement does not, by indorsing it specially, change its tenor as originally drawn. (Ogden, *op. cit.,* p. 213, citing Crawford's Annotated Neg. Inst. Law, Sec. 40, pp. 83, 84.)

Sec. 41. *Indorsement where payable to two or more persons.* — Where an instrument is payable to the order of two or more payees or indorsees who are not partners, all must indorse unless the one indorsing has authority to indorse for the others.

Indorsement where instrument payable to two or more joint payees or indorsees.

This section refers to a joint indorsement.

(1) *Two or more payees or indorsees jointly.* — Under Section 8(d); an instrument may be payable to the order of "two or more payees jointly." Under Section 8(e), an instrument may be payable to the order of "one or some of several payees." Section 41 does not apply to instruments payable to two or more payees severally, such as "Pay to the order of P or A" for they are governed by Section 8(e) and may be negotiated by any of such alternative payees irrespective of the share corresponding to each in the instrument. Anyone of such parties in possession of the instrument is the holder.

(2) *Indorsement by all payees or indorsees.* — If the instrument isling payable to the order of two or more payees or indorsees, all must indorse in order for the transaction to operate as a negotiation. If only one indorses, his indorsee would have no right of action for said indorsement would be contrary to the provisions of Section 32.

(3) *Indorsement to a co-payee.* — A check payable to the order of two persons, when indorsed by only one of such payees, who had no authority to indorse for the other, was held no longer transferable as a negotiable instrument but only as a non- negotiable chose in action. (American Nat. Bank v. First Nat. Bank, 277 Pd. 951.) But it has been held that the indorsement and delivery of the instrument by one of two joint payees to his co- payee may transfer full title to the latter. (State Bank of Cornell v. Pacific Grain Co., 125 Wash. 149,215 P. 350.)

When joint indorsement by all payees or indorsees not required.

There are two exceptions to the rule requiring joint indorsement.

(1) Where the payees or indorsees are partners; and

(2) Where the payee or indorsee indorsing has authority to indorse for the others.

EXAMPLE: »

M makes a note payable to the order of P and A. The indorsement of either P or A alone, or the indorsement of both of them, by one without authority from the other, does not constitute a negotiation of the instrument because it would not be an indorsement of the entire instrument. If P and A are'» partners, or the one indorsing has authority to indorse for the other, the indorsement will bind the other.

Similarly, if M makes a note payable to the order of P who indorses "Pay to A and B," both must indorse unless A and B are partners or the one indorsing has authority to indorse for the other.

Section 41 should be interpreted in the light of our law on partnership. Under our civil law concept, unlike that under the common law, a partnership has a personality separate and distinct from the partners composing it. (Art. 1767, Qvil Code.) Hence, an indorsement of an instrument payable to P and A as partners doing business under a firm name must be in the name, of such firm and not in the name of P and A as joint payees or indorsees. Of course, the partner indorsing must have authority, express or implied, to sign for the partnership.

Sec. 42. *Effect of Instrument drawn or indorsed to a person as cashier.* — Where an instrument is drawn or indorsed to a person as "cashier" or other fiscal officer of a bank or corporation, it is deemed *prima facie* to be payable to the bank of corporation, of which he is such officer; and may be negotiated by either the indorsement of the bank or corporation, or the indorsement of the officer.

Indorsement where instrument drawn or indorsed to a person as cashier.

(1) The cashier of a bank, the president of a corporation or any other administrative officer, as secretary or treasurer, may be expressly authorized to issue negotiable paper for the corporation, or he may have such power from implication by reason of having previously exercised the power. (Old Fellows v. Eturges First Nat. Bank, 42 Mich. 461; Old Cott v. Trogar Co., 27 N.W. 546,84 Am. Dec. 298.)

(a) So that in a case where S was cashier of C bank, a certificate of deposit issued by C bank to order of "S cashier" was indorsed "S cashier," and came to the plaintiff, a holder in due course, it was held that the indorsement was that of the bank, and it was not competent for the bank to show that

' S acted in his own interest and in violation of his duty to the bank. (Johnson v. Buffalo Bank, 134 Iowa 931,112 N.W. 165.)

(b) Where a note was indorsed to A, parol evidence was held not admissible to show that the bank was intended as indorsee even though A was, in fact, cashier of said bank. In case A delivers the note to the bank without indorsement, the bank may sue upon it, but subject to defenses. (First National Bank v. McCullough, 50 Ore. 508,93 Pac. 366.)

An instrument drawn or indorsed to the order of the "cashier of the University of the Philippines" is deemed *prima facie* payable to said university and may be negotiated by the university through the indorsement of any of its duly authorized officers. Thus, if the president is authorized by the by-laws of the university, he may indorse the instrument.

The word "corporation" in this section is held not to include cities and towns, so that no authority is conferred upon a town treasurer to imposed upon his town the liability of an indorser (Franklin Savings Bank v. Framingham, 95 N.E. 925; Capital Savings Bank Co., etc. v. Framingham, 246 Fed. 553,158 C.C.A. 523.), so that an instrument payable to the "Treasurer of the town in F" in legal effect stands on the same footing as it is payable to the town, which is the real payee and the treasurer may not indorse it for circulation. (Quincy Mut. Fire Ins. Co. v. Int. Trust Co., 217 Mass. 370,104 N.E. 845.)

The presumption established in this section may be disproved by sufficient evidence to the contrary. It may be shown that the instrument really belongs to the cashier personally as the real creditor of the maker or drawer, (see Sec. 20.)

Sec. 43. ***Indorsement where name is misspelled, and so forth.*** **— Where the name of a payee or Indorsee is wrongly designated or misspelled, he may indorse the instrument as therein described, adding, if he thinks fit, his proper signature.**

Indorsement where name misspelled, etc.

Where the name of the payee or indorsee is "Luz M. Villamayor" when the surname should spell "Villamor/' the instrument may be indorsed as therein described, thus:

(1) (Sgd.) Luz M. Villamayor; or by the same name but adding his proper signature as follows:

(2) (Sgd.) Luz M. Villamayor
(Sgd.) Luz M. Villamor

The payee or indorsee may sign his name in the same way as it appears in the instrument but signature in both names may be required by a person paying or giving value for the instrument, (see [US] U.C.C., Sees. 3-203.) A person may correct a spelling error only if the intention of the maker or drawer was that the instrument should be payable to the person making the correction. Any variance between the name of the payee on the face of an instrument and the signature on the back thereof should be ignored if the payee and the indorser are the same person.

Sec. 44. ***Indorsement in representative capacity.*** **— Where any person is under obligation to indorse in a representative capacity, he may indorse in such terms as to negative personal liability.**

Indorsement in representative capacity.

An instrument may be indorsed by a person either personally or through an agent. The authority of the agent need not be in writing. See comments under Section 20 as to how such indorsement should be made.

Sec. 45. ***Time of indorsement; presumption.*** **— Except where an indorsement bears date after the maturity of the instrument, every negotiation is deemed *prima facie* to have been effected before the instrument was overdue.**

Presumption as to time of indorsement.

This section is important because in order to constitute one a holder in due course he must have taken the instrument before it was overdue. (Sec. 52[b].)

If the indorsement bears a date, the presumption is that it is the true date. (Sec. 11.) If the indorsement is without a date, the presumption is that it was negotiated before maturity. The one who alleges that the indorsement was effected after maturity has the burden of proof.

It has been held that the fact that an indorsement appears to be in much fresher ink than the face of a demand note is not sufficient to overcome the presumption that it was indorsed before it was overdue. (Gibbons v. Longino & Reid, 153 Miss. 749,121 So. 490.)

EXAMPLE:

A note payable on December 10, 2010 bears the undated indorsement of the payee. The presumption is that he indorsed the note on or before December 10, 2010, that is, before the. note was overdue. The presumption, however, is rebuttable. It can be shown that the negotiation was actually made after December 10,2010.

Sec. 46. ***Place of Indorsement; presumption.*** **— Except where the contrary appears, every indorsement is presumed *prima facie* to have been made at the place where the instrument is dated.**

Presumption as to place of indorsement.

In the absence of evidence to the contrary, an indorsement is presumed to have been made at the place where the instrument is dated. Again, the presumption is rebuttable.

The place of indorsement becomes important where the law in different countries varies. In such a case, an indorsement is governed by the law of the state where.it is made although the instrument is executed in a different state. (Heidelberger v. Heidelberger, 155 N.Y.S, 993.)

EXAMPLE:

Suppose a note is dated as follows:

"Manila, December 10,2010."

If it is subsequently indorsed by the payee without indicating the place of indorsement, the presumption is that the indorsement was made in Manila. He who alleges otherwise has the burden of proof.

Sec. 47. *Continuation of negotiable character.* — An instrument negotiable in its origin continues to be negotiable until it has been restrictively indorsed or discharged by payment or otherwise.

Continuation of negotiable character of originally negotiable instrument.

(1) *General rule.*—Asa general rule, an instrument negotiable in origin is always negotiable until paid. This is true although the negotiable instrument has been dishonored, or is already overdue, but any holder who acquires the instrument can no longer be a holder in due course in accordance with Section 52(b). An instrument indorsed after it become overdue is considered payable on demand. (Sec. 7.)

(2) *Exceptions.* — They are:

(a) When the instrument has been restrictively indorsed; or

(b) When ithas been discharged by payment or otherwise.

It should be remembered that not every restrictive indorsement prohibits further negotiation of the instrument (see Sec. 36.) and, therefore, the words "restrictively indorsed" in this section should be construed to refer only to such restrictive indorsement as prohibits further negotiation of the instrument, *(ibid.,* [a].)

Payment is not the only way of discharging an instrument. This is the reason why the law includes the word "otherwise." A negotiable instrument ceases to be negotiable when it is discharged by any of the different ways enumerated in Section 119.

Conversion from non-negotiable to negotiable instrument.

The general rule is that a paper which is non-negotiable (see Sec. l[d].) in its inception continues to be non-negotiable.

An indorsement of such paper cannot change its character, and a blank indorsement does not have the effect of making the paper a bearer instrument, not only because of the change of contract which this would involve but also because the Negotiable Instruments Law provision as to the effect of a blank indorsement has no application to a non-negotiable instrument, (see Sec. 9[e].)

However, the view has been taken that although an instrument as originally made is not negotiable for lack of words of negotiability, yet if it is indorsed to "order" or "bearer," it becomes as *between the indorser and subsequent holders,* a negotiable instrument and subject to the principles and usages of instruments of that character. (De Hass v. Debert, [CA3] 70 F. 227; Neutzel v. Mackie, 253 P. 166; Carruth v. Walker, 8 Wis. 252; 11 Am. Jur. 2d 389.)

Sec. 48. ***Striking out indorsement*—The holder may at any time strike out any indorsement which is not necessary to his title. The indorser whose indorsement is struck out, and all indorsers subsequent to him, are thereby relieved from liability on the instrument.**

When holder may strike out indorsement.

(1) *An instrument payable to bearer on its face* (Sec. 9.) may be negotiated by mere delivery without indorsement. (Sec. 30.) In case it is indorsed, it remains a bearer instrument and may be further negotiated by mere delivery. (Sec. 40.) By virtue of Section 48, the holder may strike out all intervening indorsements or any of them for none of them is necessary of his title.

EXAMPLE:

Suppose M makes a note payable to P or bearer. The note is indorsed specially and in succession as follows:

Pay to A	(Sgd.)P
Pay to B	(Sgd.) A
Pay to C	(Sgd.) B

C, the present holder, may strike out all indorsements because they are not necessary to his title. The instrument, being originally payable to bearer on its face, it remains a bearer instrument in spite of the special indorsements and, therefore, may be negotiated by mere delivery.

If C cancels P's indorsement, then P, whose indorsement is struck out, and A and B "indorsers subsequent to him" (P), are released from liability on the instrument. C could claim only against M, the maker. A and B are also discharged from liability because they are deprived of their right of recourse against P. (see Sec. 120[c].)

If C strikes out B's indorsement then only B will be freed from liability, (see Sec. 40.)

(2) *An instrument originally payable to order* (Sec. 8.) may be negotiated only by the indorsement of the payee completed by delivery. (Sec. 30.) When the indorsement is special, the indorsement of the special indorsee is necessary to the further negotiation of the instrument. When the indorsement is in blank, the instrument becomes payable to bearer and may be negotiated by mere delivery. (Sec. 34.)

Under Section 9(e), an instrument which upon its face is payable to order, becomes payable to bearer when the only or last indorsement is in blank. Hence, when a blank indorsement is followed by special indorsements and the holder strikes out all indorsements subsequent to the blank indorsement, the instrument would become payable to bearer as the last indorsement would be in blank. The special indorsements are not necessary to the holder's title as even without any subsequent indorsement he could have acquired title to the instrument by mere delivery. The indorser whose indorsement is cancelled and all indorsers subsequent to him are thereby discharged from their liability on the instrument, (see Sec. 120[c]; Sec. 48.)

But the indorser may not strike out the payee's indorsement. Since the instrument is payable to order, it cannot be validly negotiated without his indorsement.

EXAMPLE:

Suppose M issues a promissory note payable to the order of P. It is indorsed as follows:

(Blank indorsement)	
	(Sgd.)P
Pay to B	
	(Sgd.) A
Pay to C	
	(Sgd.) B

In this case, the indorsement of A and B are not necessary to C's title by virtue of the blank indorsement of P. If their indorsements are cancelled, the note would become payable to bearer as the remaining indorsement would be an indorsement in blank. C may "aver that the first blank indorser (P) refers immediately to him." (Preston **V.** Mann, 25 Conn. 127.)

If A's indorsement is stricken out, B is also relieved from liability being an indorser subsequent to A. But P's indorsement is necessary to the title of C since P cannot validly negotiate the note which is payable to order, to C by mere delivery.

Sec. 49. ***Transfer without indorsement; effect of.*** **— Where the holder of an instrument payable to his order transfers it for value without indorsing it, the transfer vests in the transferee such title as the transferor had therein, and the transferee acquires, in addition, the right to have the indorsement of the transferor. But for the purpose of determining whether the transferee is a holder in due course, the negotiation takes effect as to the time when the indorsement is actually made.**

Effect of transfer without indorsement.

This section is applicable only to an instrument payable to order. The indorsement of the payee is necessary to its negotiation. (Sec. 30.) The special indorsee of an order instrument should likewise indorse it if he wants to negotiate it further. (Sec. 34.)

Where the holder of a bill payable to order transfers it for value without indorsing it, the transferee cannot negotiate the bill by indorsing it to another.

Section 49 contemplates a situation where the payee or indorsee delivers said instrument for value without, however, indorsing it. The transaction operates as an equitable assignment and the transferee acquires the instrument subject to defenses and equities available among prior parties. He cannot negotiate it. If the transferor had legal title, the transferee acquires such title and, in addition, the right to have the indorsement of the transferor and also the right, as holder of the legal title, to maintain legal action against the maker or acceptor or other party liable to the transferor. (Furbee v. Furbee, 17 W. Va. 722,188 SE. 123.)

Before the indorsement is made, the transferee is not a holder of the instrument notwithstanding Section 59. Under Section 191, he is neither a "holder" because he is not a payee or indorsee, nor a "bearer" because die instrument is not payable to bearer. The negotiation takes effect as of the time the indorsement is actually made for the purpose of determining whether or not the transferee is a holder in due course.

EXAMPLE:

M issues an instrument payable to P or order. P delivers it to A for value without indorsing it.

The transfer does not constitute negotiation but it vests in A such title as P had and in addition, it gives A the right to have Fs indorsement and to recover from M who has, however, the right to require proof from A that the transfer to him was legitimate. Thus, such an instrument may still be effectually transferred by mere delivery. However, before the instrument is actually indorsed by P, A cannot be considered a "holder" since he does not come within the definition in Section 191, nor is he a "bearer" as the instrument is not payable to bearer.

A is a mere assignee who holds the instrument subject to equities. For instance, if there was an absence of consideration, M could set up that fact as a defense against A although the latter had no knowledge of it at the time of the transfer.

Before indorsement, transferees do not enjoy the presumption of ownership in favor of holders since they are neither payees nor indorsees of such instruments. Something more than mere possession is necessary to authorize payment to them in the absence of other facts from which the authority to receive payment may be inferred. (Bank of the Philippines Island vs. Court of Appeals, 512 SCRA 620 [2007].)

Note that Section 49 speaks of transfer without indorsement of an instrument "for value." If the transfer is gratuitous, the donee-transferee has no right to compel the donor-transferor to make the indorsement although, as a legal owner of the instrument, he has a right to sue thereon.

Effect of indorsement after transfer.

As already stated in the above example, A may require P to indorse the instrument and unless there is proof of an agreement to the contrary, he has a right to an unqualified indorsement. (Simpson v. First Nat. Bank, 185 P. 262.)

The indorsement of P converts the transfer into a "negotiation" and makes A a "holder," *i.e.,* the indorsee of the instrument in possession of it. (Sec. 191, par. 7.) But the time for determining whether A is a holder in due course is as of the time of actual indorsement. Hence, if by that time A had already notice of thie absence of consideration, he cannot be a holder in due course although he had no such notice at the time of delivery. The reason is that negotiation is completed at the time of indorsement, not at the time of delivery.

> **Sec. 50.** ***When prior party may negotiate Instrument* — Where an instrument is negotiated back to a prior party, such party may, subject to the provisions of this Act, reissue and further negotiate the same. But he is not entitled to enforce payment thereof against any intervening party to whom he was personally liable.**

Right of prior party to negotiate.

Section 50 refers to a *reacquirer* or a holder who negotiates an instrument and then subsequently reacquires it. (see Sees. 59, **121.)**

If a prior party reacquires an instrument before maturity, he may negotiate the same further. But after paying the holder, he may not claim payment from any of the intervening parties. The law, to avoid multiplicity of suits, denies an action to a party thus situated. However, it was ruled in a case, if the instrument had passed through his hands without indorsement, or it had been indorsed by him without recourse, the reason would not exist, and there could be no objection, founded on his prior holding or indorsement, to the maintenance of an action by him against the parties liable on the instrument. (Moore v. Cross, 19 N.V. 229,75 Am. Dec. 326.)

EXAMPLE:

M makes a note payable to the order of P. It is indorsed successively as follows:

Pay to A

(Sgd.) P

Pay to B

(Sgd.) A

Pay to C

(Sgd.) B

Pay to D

(Sgd.) C

Pay to B

(Sgd.) D

Pay to E

(Sgd.) B

In the above example B, a prior party, reacquires the note. He may further negotiate the same to any subsequent holder.

For instance, he may indorse it to E. If several persons indorse in succession (successive indorsements) they are liable to each other in the order they indorse. (Sec. 68.) But in this case, B may not sue C and D to whom he was personally liable before his reacquisition of the instrument. If B can hold C and D liable in his capacity as a subsequent holder to them, then C and D should also be able to hold B, a prior indorser, liable to them. This would result in multiplicity of actions. B's rights would, therefore, be limited to M, P, and A. But C and D are not discharged from liability on the instrument

E, the present holder, could have a right of recourse not only against M, P, A, and B, but also against C and D. But if B strikes out his indorsement to C under Section 48, and this B can do because his indorsement to C is not necessary to his title, C and D will be released from liability.

Limitations on renegotiation.

In the following cases, a prior party cannot further negotiate the instrument:

(1) Where it is payable to the order of a third person, and has been paid by the drawer (Sec. 121[a].);

(2) Where it was made or accepted for accommodation and has been paid by the party accommodated *(ibid.,* [b].); and

(3) In other cases, where the instrument is discharged when acquired by a prior party. (Sec. 119.)

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CHAPTER IV

RIGHTS OF THE HOLDER

Sec. 51. ***Right of holder to sue; payment.*** **— The holder of a negotiable instrument may sue thereon in his own name; and payment to him in due course discharges the instrument.**

Classes of holders.

"Holder" means the payee or indorsee of a bill or note who is in possession of it, or the bearer thereof (Sec. 191, par. 7.) entitled to receive the sum for which it calls. Thus, the term includes not only persons possessing *bearer* Instruments but also payees and indorsees possessing *order* instruments.

It is the policy of the law to seek to protect the holder of a negotiable instrument, but holders of negotiable instruments may be of three classes and the rights of each class of holder and defenses assertable against that class may be different under particular circumstances. In an ascending order of rights, the classes are:

(1) Holders simply (Sec. 51.);

(2) Holders for value (see Sec. 26.); and

(3) Holders in due course. (Sees. 52,57.)

A person who qualifies as a holder but does not meet all the conditions to qualify as a holder in due course is called *ordinary holder* or *mere holder* (or assignee or transferee).

In the hands of any holder other than a holder in due course, a negotiable instrument is subject to the same defenses whether real or personal (see Sec. 58.) as if it where non-negotiable. However, it does not mean that an instrument in the hands of such holder is non-negotiable. Under Sections 58 and 59, a holder who is not himself a holder in due course but derives his title from a holder in due course is given the rights of such prior holder.

The taking for value (see Sec. 25.) is essential to the status of a holder in due course, that is, to the right to enforce an instrument free from certain defenses; and a holder for value, as such, may enforce the liability of an accommodation party notwithstanding that at the time of taking the instrument he knew him to be only an accommodation party, (see Sec. 29.) Also, the time when and the extent to which value (Sees. 52,54.) is given is material on the question of status as a holder in due course. (11 Am. Jur. 2d 356.)

The holder of a negotiable Instrument is not necessarily the owner thereof. For example, a thief who steals a bearer paper is a holder but obviously is not the owner although he can legally transfer (negotiate) the same to another who then becomes the new holder.

Rights of holder in general.

In general, the following are the rights of a holder:

(1) *To sue.* — A holder may sue on the instrument in his name. Under Section 51, a holder even though he be a holder only for collection may sue in his own name. (Alabama City, G. & A. Ry Co. v. Kyle, 202 Ala. 552.) Also, the indorsee (pledgee) of a note, as a collateral security, may sue as he is a "holder" within this section. (Walmer v. First Acceptance Co., 212 N.W. 638.) A person who is neither the payee nor a holder of a bad check has neither the personality to sue nor a cause of action against the drawer. (Tam Weng Tek vs. Makasiar, 350 SCRA 475 [2001].)

Where a negotiable instrument has been in circulation, and there is no defense between the antecedent parties, a purchaser of such instrument as collateral security is entitled to recover thereon against the maker, the whole amount regardless of what he may have paid therefor (Cheen vs. Lopez, 36 Phil. 1 [1917].); and

(2) *To receive payment.* — He may receive payment and if the payment is in due course (Sec. 88.), the instrument is discharged. (Sec. 119.) *Payment in due course* is payment "made (a) at or after

the maturity of the instrument (b) to the holder thereof (c) in good faith and without notice that his title is defective/[7] (Sec. 88.) Payment must be made at or after maturity in order to discharge the instrument for if the instrument is paid before maturity, the prior party who reacquires the same, may reissue and further negotiate it under Section 50.

Right of transferee of unindorsed instrument to sue.

The authorities are not uniform as to the question of whether the transferee of an unindorsed instrument may sue in his own name.

A transferee of unindorsed instrument is certainly not a "holder" as defined by Section 191, and, therefore, cannot be a holder in due course under Section 52. It is believed, nevertheless, that he may do so. If the "transfer vests in the transferee such title as the transferor had" (Sec. 49.) and if the transferor had legal title, this must pass by the transfer although subject to defenses. (Beutel's Brannan, *op. cit.,* p. 467.)

Sec. 52. ***What constitutes a holder in due course.*** **— A holder in due course is a holder who has taken the instrument under the following conditions:**

(a) That it is complete and regular upon its face;

(b) That he became the holder of it before it was overdue, and without notice that it had 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 to him he had no notice of any infirmity in the instrument or defect in the title of the person negotiating it.

What constitutes a holder in due course.

A *holder in due course* is a holder who took the instrument under the conditions enumerated in Section 52. He takes the Instrument free of most defenses, or adverse claims to it by other parties. The law, in using the term "holder in due course," uses it as the equivalent for the old expression *"bona fide holder"* or "*bona fide* holder for value without notice/' (Drumm Construction Co. v. Forbes, 137 N.E. 225.) Only a negotiation (Sec. 30.) can operate as a valid transfer to make the transferee a holder in due course.

(1) *Presence of all conditions.* — All the four conditions must concur in order to qualify a person as a holder in due course. If any one of them is absent, the holder cannot be considered a holder in due course. Every holder is generally deemed *prima fade* a holder in due course. (Sec. 59.)

It is obvious that one cannot be a holder in due course unless he is a holder. By the term "holder" the law refers to the payee or indorsee of a bill or note, who is in possession of it, or the bearer thereof. (Sec. 191, par. 7.)

(2) *Status as mere assignee.* — The holder of a non-negotiable instrument (such as a simple contract) cannot attain the status of a holder in due course. He is a mere assignee subject to defenses. The fact that the instrument is non-negotiable is a sign of warning to a prospective purchaser and places him on his guard and on inquiry. (First Nat. Bank v. Greenlee, 166 N.W. 559.) A part indorsee of an instrument (see Sec. 32.), is considered merely as an assignee. (Montinola vs. Phil. National Bank, 88 Phil. 178 [1951].) A transferee who receives an Instrument other than by issue or negotiation (see Sees. 30, 191, pars., 7, 8, 10.) cannot acquire the status of a holder in due course regardless of the other circumstances under which the acquisition of the instrument took place.

(3) *Presumption.* — A *prima facie* presumption exists that the holder of a negotiable instrument is a holder in due course. Consequently, the burden of proving otherwise lies in the person who disputes the presumption. (State Investment House, Inc. vs. Court of Appeals, 217 SCRA 32 [1993].)

(4) *Rights of the holder irt due course/not a holder in due course.* — The only disadvantage of a holder who is not a holder in due course is that the instrument is subject to defenses as if it were non-negotiable. (Baitaan Cigar & Cigarette Factory, Inc. vs. Court of Appeals, 230 SCRA 643 [1994].) On the other hand, a holder

in due course is afforded most-favored status under the law. He takes the instrument free of many defenses that exist between the original parties. Thus, it is possible for a holder in due course to acquire greater rights under a negotiable instrument than those possessed by the payee /holder.

EXAMPLE:

M buys a machine from P for P500,000 under an installment contract. After delivery, P assigns his rights under the contract (to collect the price) to A. The machine turns out to be defective. M can successfully assert this fact as a defense against P had there been no assignment. The same would be true if M had simply given a non-negotiable note. The rights acquired by A are those possessed by P, no more and no less.

On the other hand, if M had given P a negotiable note (or check) in payment of the machine, and A acquired the note under circumstances that qualified him as a holder in due course, then A would be entitled to recover the full amount of the note given by M despite the fact that P had violated his contract with M.

Similarly, a mere assignee like an ordinary holder can enforce the instrument against the primary party if the latter has no defense available to him.

Payee as holder in due course.

Is the payee entitled to the same protection under Section 52 as any other *bona fide* holder for value?

There is a marked conflict of opinion on this point.

(1) *Contrary view.* — Those who hold the negative view contend that under subsection 4 of Section 52, the holder in due course must have acquired the instrument through negotiation and an instrument is issued and not negotiated to a payee. (Bretton Mill Co. v. Williams, 184 N.W. 265.)

(2) *Affirmative view.* — But "there can be no doubt that a proper interpretation of the Act as a whole leads to the conclusion that a payee may be a holder in due course under any of the circumstances in which he meets the requirements of Section 52."

"x x x Since 'holder/ as defined in Section 191, includes a payee who is in possession, the word 'holder' in the first clause of Section 52 and in the second subsection may be replaced by the definition in Section 191 so as to read a 'holder in due course is a payee or indorsee who is in possession', etc." (see De Ocampo vs. Gatchalian, 3 SCRA 596 [1961], citing Brannan's on NIL, 6th ed., p. 553; see comments under Sec. 30.) Under the U.S. Uniform Commercial Code, a payee may be a holder in due course. (Sec. 3-302[2] thereof.)

The weight of authority sustains the view that a payee may be a holder in due course. (Yang vs. Court of Appeals, 409 SCRA 159 [2003].)

EXAMPLE:

W delivered to H, husband, a check made payable to P, a creditor of W, with instruction to pay her debt with it. H handed the check to P as a payment upon debt of his own to P who accepted it as such in good faith. It was held that P was a holder in due course. (Brannan, *op. tit, ibid.,* p. 680; Boston Steel & Iron Co. v. Steuer, 183 Mass. 140, 66 N.E. 646.) In this situation, P qualified as a holder in due course if he gave value for the check, took it before it was overdue, and without notice of the lack of authority of H.

Here, P, the payee, has not directly dealt with W, the drawer of the check He is not an immediate party to the check (see Prudencio vs. Court of Appeals, 143 SCRA 7 [1986].)

Drawee as holder in due course.

While a payee may be a holder in due course, a drawee does not, by paying a bill, become a holder in due course under this section. (American Homing Co. v. Milliken Nat. Bank, 273 Fed. 550.)

A *holder* refers to dne who has taken the instrument as it passes along in the course of negotiation towards the drawee and not the drawee who, on the acceptance and payment of the instrument, thereby strips it of all negotiability and reduces it to a mere voucher or proof of payment. (Nat. Bank of Commerce v. Seattle Nat. Bank, 187 Pac. 342.)

Instrument complete and regular upon its face.

(1) *Wanting in any material particular.* — An instrument is *incomplete* when it is wanting in any material particular or particular proper to be inserted in a negotiable instrument without which die same will not be complete, (see Sec. 14 for examples of incomplete instruments.)

The taking of an incomplete instrument puts the purchaser on inquiry as to why it is incomplete. If he fails to do so, he takes the instrument subject to all defenses and equities. But if the omission is not an important particular, sudi omission will not deprive the holder of the right of a holder in due course. If the omission or "incompleteness" has no effect on the clear meaning of the instrument, the same would not necessarily make the instrument incomplete.

(2) *Alteration apparent on face of instrument.* — The instrument must also be regular upon its face. The most common type of irregularity is an alteration in the instrument. To render the instrument *irregular* under Section 52(a), alteration, tampering or erasure must be visible or apparent on the face of the instrument, for if it is not apparent, the matter is governed solely by Section 124 which renders the instrument void.

Therefore, the rule is that when a mere inspection of an instrument shows that it has been altered, a purchaser is not a holder in due course because such instrument is not regular on its face. (Idaho State Bank v. Hooper Sugar Co., 276 PAC. 659,68 A.L.R. 969.)

EXAMPLES:

The following are complete and regular or are not complete and regular upon its face:

(1) An instrument payable "on or before . . . after date" (Remedial Plan v. Ott, 250 S.W. 825.) is not complete and regular.

(2) Likewise, is a bill dated "August 1,1919" and payable "December 1" but not naming the year of maturity. (United Ry & Logging Surety Co. v. Seberian Comm. Co., 291 P. 21.)

(3) So is an instrument blank as to payee or acceptor (Bronson v. Stetson, 232 N.W. 741; Clay v. Dobyas, 255 S.W. 946.) or drawee.

(4) Hie mere absence of the required revenue stamps from a negotiable instrument does not make it incomplete. (Farmers' Savings Bank v. Noel, 187 N.W. 555.)

(5) Although a printed name of a payee was stricken out and another payee's name inserted in writing but the same is a common practice by the holder bank, it was likewise held that the note was complete and regular on its face. (Clapper v. Gouble, 28 P. 2d 755.)

(6) An instrument having the figures on the upper rigjht hand corner and a blank space for the amount in words is

complete and regular on its face, since the court can ascertain, within the four comers of the instrument and excluding nothing there appearing, the terms and conditions of the obligation. (Babb & Martin, *op. ext.,* p. 215.)

(7) The omission of the pronoun "we" or "I" in the space left therefor on a printed note " — promise to pay" does not make the instrument incomplete since the meaning of the note can be gathered upon its face.

Holder before instrument is overdue.

(1) *When instrument overdue.* — An instrument is overdue after the date of maturity.

(a) The date of maturity is the time fixed therein, (see Sees. 4,85.)

(b) If the instrument is payable on demand (Sec. 7.), the date of maturity is determined by the date of presentment. Under the law, presentment must be made within a reasonable time after its issue, if it is a promissory note, or after the last negotiation thereof, if it is a bill of exchange, (see Sees. 71,143[a].) After the lapse of such reasonable time, the instrument is deemed overdue.

(c) If the instrument is with a fixed maturity designated by a calendar date *(e.g.,* June 10), it is overdue at the beginning of the day after the fixed date *(i.e.,* June 11). If it is payable on the occurrence of a specified event which is certain to happen, the date of maturity is fixed by the happening of the event (Sec. 4[c].) and becomes overdue the next day after said date.

Overdue instrument puts all persons on notice. —Anegotiable instrument in circulation past its maturity date carries strong indication that it has been dishonored. The question instantly arises: why is it in circulation when it should have been presented for payment to the person primarily liable? An overdue paper puts all persons on notice that it may not have been paid because of a valid defense to such payment.

But one taking an instrument on the date of maturity takes before maturity because the principal debtor has the whole day to pay. Hence, it cannot be considered as notice that the instrument has been dishonored.

Overdue instrument still negotiable. — An overdue instrument is still negotiable, and although (in the hands of one who neither is, nor makes title through, a holder in due course) it is subject to defenses existing at the time of transfer, it is certainly not "subject to the same defenses as if it were non-negotiable/[7]

Thus, payment by M (maker) to P (payee) of a past due note after its negotiation by P to A after maturity, is no defense to an action by A, since M made the instrument negotiable and cannot rightly assume that it has not been transferred. The result would, of course, be different where the note is a non-negotiable chose in action or had the payment been made after maturity but prior to the transfer by P. (Babb & Martin, *op. cit.,* pp. 221-222.)

Where instrument in part overdue and in part not.

Suppose the transferee of an installment note acquires it after one or more but less than all the installments are due on its face, can he be a holder in due course where the past due installment have not in fact been paid?

(1) *Where installments due before transfer.* — An installment note is overdue as to installments due before the transfer, and a transferee thereof cannot be a holder in due course as to such installments, whether or not he had notice of the non-payment.

(2) *Where transferee without notice of non-payment.* — If the transferee had no notice of the non-payment, he is a holder in due course as to installments to mature in the future. In the absence of an acceleration clause, the fact that the maturity date of one or more installments have passed cannot make the instrument overdue as to installments payable in the future.

(a) Circulation of a negotiable instrument after the due date of an installment except the last cannot serve as notice that the installment had not been paid for the instrument was designed to circulate until the maturity date of the last installment. A transferee may assume that the ordinary course of business has been followed and the installments due have been paid.

(b) It is different where the principal obligation is overdue. An installment note, however, has several maturities, and if the maturity of each installment is regarded as the maturity of the instrument, then the instrument would be overdue after the maturity of the first installment.

(c) The possession by the payee or the holder of an installment note with one or more installments overdue, does not signify dishonor. The holder would necessarily retain it for collection of the balance of the installments.

(d) Even if it is assumed that non-payment of an installment is tantamount to dishonor of the whole instrument, the holder has no notice of dishonor unless he has notice of nonpayment.

(3) *Where transferee with notice of non-payment.* — May a purchaser be considered a holder in due course as to future installments where he took the note with notice or knowledge that one or more installments were not paid when due? It has been held in a case that such a purchaser cannot be a holder in due course. The majority opinion, however, did not explain upon what provision of the Negotiable Instruments Law its conclusion was based.

The dissenting opinion believed otherwise on the following grounds:

(a) Non-payment of an installment note does not constitute dishonor of the entire note. If the rule were otherwise, even if future installments were subsequently paid, the whole note would be regarded as "previously dishonored" and consequently, knowledge of a transferee that one installment was paid late would preclude his being a holder in due course as to future installments, for he would have notice that the instrument was "previously dishonored;"

(b) It is established that even though the holder has failed to give proper notice of dishonor as to an installment, he is not prevented from giving such notice as to future installments that are not paid at maturity dates in the same way that knowledge of dishonor of one of a series of notes does not constitute notice that all the notes of the series are dishonored (see Sec. 89.);

(c) Notice of non-payment of an installment (or by analogy of interest) does not, as a matter of law, constitute notice of any infirmity in the instrument or defect in the title of the person negotiating it within the meaning of Section 52(d). Such notice is at most evidence of bad faith to be weighed by the court with other facts to determine whether the transferee took the note in question in good faith; and

(d) It is contrary to common experience to hold that in each case in which a past due installment is unpaid, notice of such fact alone is notice that the maker has a defense against future installments payable under the note. Failure to pay a past due installment may have arisen from unexpected circumstances affecting the ability of the maker to pay rather than from an equitable defense. (Bliss v. California Co-op Producers, 181 P. [2d] 369.)

Holder without notice of dishonor.

(1) Ways *and time of dishonor.* — An instrument may be dishonored either by non-acceptance (see Sec. 149.) or by nonpayment. (see Sec. 83.) Dishonor by non-acceptance refers only to a bill of exchange. While dishonor by non-payment can only take place at the time of maturity, dishonor by non-acceptance of a bill may occur even before the date of its maturity.

EXAMPLE:

Suppose R draws a bill of P1,000.00 payable to the order of P addressed to W as the drawee. The bill is payable on November 30, 2010. P presents the bill for acceptance on November 10, 2010, but W refuses to accept.

In this connection, it should be noted that when a bill is dishonored by non-acceptance all that the drawer has to do is to inform the holder that he does not accept the bill. Hence, the fact of dishonor may not appear on the face of the bill. But if P negotiates the bill to A who knows that the bill has been previously dishonored by non-acceptance, A cannot be a holder in due course.

(2) *Negotiation after maturity or dishonor.* — An overdue or dishonored instrument may still be negotiated either by indorsement or by delivery to the same extent as before maturity (see Sec. 47.), but in the case of the former, the holder cannot be a holder in due course (Sec. 52[b].) while in the case of the latter, the holder without notice can be a holder in due course, *(ibid.)*

A party who acquired unpaid checks deposited with a bank for collection, after they were returned to the bank as the drawer had no funds, some of them stamped "account closed," is not a holder in due course under the circumstances, since, he knew, upon taking them up, that the checks had already been dishonored. (Chan Wan vs. Tan Kim, 109 Phil. 706 [I960].)

(3) The great weight of authority holds that the mere fact that interest due is unpaid, the principal not being due, does not render the note dishonored. (Barbour v. Finke, 201 N.W. 711.)

Holder in good faith.

(1) *Meaning of good faith.* — The words "in good faith" under Section 52(c) refer only to the good faith of the indorsee of transferee and not to the seller of the paper. (Helmer v. Krolick, 36 Mich. 321.) *Good faith* means "honesty in fact in the transaction concerned." Each situation must be examined separately to determine good faith. A holder must take in good faith, but if he does not take in bad faith, his good faith is sufficiently shown.

(2) *Proof of good faith. — Good faith* is a broad term that cannot be precisely defined. Its existence or absence is to be determined

by a consideration of the facts and cicumstances of the particular case. It is generally agreed, however, that the term implies not only honesty of intention but the absence of suspicious circumstances, or if such circumstances exist, then such inquiry as will satisfy a prudent man of the validity of the transaction, (see Pennington Country Bank v. Moorehead Bank, 125 N.W. 119.)

(3) *Meaning of bad faith.* — Under Section 56, it means that the person to whom an instrument is negotiable must have actual knowledge of facts which render it dishonest for him to take a particular piece of negotiable paper.

(4) *Proof of bad faith.* - To show knowledge of such facts that the taking would amount to bad faith, it is not necessary to show knowledge of the exact truth. It is sufficient that if the facts within the knowledge tend to show that there was something wrong with the transaction. (Gramatan Nat. Bank & Trust Co. v. Pierce, 159 A 2d 781.)

The principle is closely analogous to the equitable doctrine of clean hands. Thus, where a holder took an instrument payable to a corporation from an officer thereof for a private debt of the officer, it was held that the holder cannot be a holder in due course as he knows from the face of the instrument itself that the officer is not the owner of the instrument. (Fear v. Campbell, 288 Pa. 549.)

In any case, the test of good faith or bad faith is subjective.

Effects of crossing a check.

Crossing a check relates to the mode of making payment, the drawer intending the check to be deposited only by the rightful person, *i.e.,* the payee named therein. In order to preserve the credit worthiness of checks, jurisprudence has pronounced that crossing of a check should have the following effects:

(1) The check may not be encashed but only deposited in the bank;

(2) The check may be negotiated only once—to one who has an account with a bank; and

(3) The act of crossing the check serves as warning to the holder that the check has been issued for a definite purpose so

that he must inquire if he has received the check pursuant to that purpose; otherwise, he is not a holder in due course.[1] (Bataan Cigar and Cigarette Factory, Inc. vs. Court of Appeals, 230 SCRA 643 [1994]; Bank of America, NT & SA vs. Associated Citizens Bank, 588 SCRA 51 [2009].)

A holder, therefore, cannot claim it acted in good faith when it accepted and discounted post-dated crossed checks from tha payee, when it was all too aware that the subject checks were crossed and bore restrictions that they were for deposit to payee's account only; hence, could not be further negotiated to it. (Hi- Cement Corp. vs. Insular Bank of Asia and America, 534 SCRA 269 [2007].)

Note that the law does not absolutely bar a holder who is not a holder in due course from recovering on the checks. The holder may recover from the party who indorsed/encashed the checks "if the latter has no valid excuse for refusing payment." *(Ibid.)*

ILLUSTRATIVE CASE:

Payee of a crossed check accepted the same from his debtor in payment of the latter's account but the check was drawn by a third person who had no obligation with the payee.

Facts: X represented himself as the agent of P in the sale of a car allegedly owned by P. R, a prospective buyer, issued a crossed check (see Sec. 185.) upon request of X for P6,000.00 payable to P on the understanding that the check was to be shown only to P as evidence of R's good faith to purchase the car.

X instead paid the check to P for the hospital bill of X's wife in P's clinic and was given P156.25 as change.

Issue: May P be considered a holder in due course and hence, entitled to recover from R?

Held: No. Although P was riot aware of the circumstances under which the check was delivered to X by R, P was guilty of gross neglect (see Sec. 56.) amounting to legal absence of good faith since the surrounding circumstances, *i.e.,* that R

[1]See "Special types of check," No. (6), under Section 185.

had no obligation with P, that the amount of the check did not correspond exactly with the obligation of X to P and that the check is a crossed check, which means that the check could only be deposited but may not be converted into cash, should have put P on inquiry as to the why and wherefore of the possession of the check by X and why he used it to pay his account to P. *(De Ocampo vs. Gatchalian, 3 SCRA 596 [1961].)*

Holder for value.

Any consideration sufficient to support a simple contract is *value.* (Sec. 25.) It is not necessary that die consideration should be adequate, (see Art. 1355, Civil Code.) Thus, the purchase of an instrument at a discount does not necessarily prevent one from being a *bona fide* holder especially if the financial condition of the issuer of the instrument is not well-known. Hpwever, where the discount is unusually large or grossly unreasonable this fact, together with other facts, may be material on the question of good faith.

Love and affection do not constitute value within the meaning of the law. (Cockrell v. Mckenna, 48 A.L.R. 234.)

Under the U.S. Uniform Commercial Code, a holder takes the instrument for value —

(1) To the extent that the agreed consideration has been performed or that he acquires a security interest in or a lien on the instrument otherwise than by legal process; or

(2) When he takes the instrument in payment of or as security for an antecedent claim against any person whether or not the claim is due; or

(3) When he gives a negotiable instrument for it or makes an irrevocable instrument to a third person. (Sec. 3-303.)

Holder without notice of infirmity in instrument or defect of title.

(1) The status of a holder in due course can be predicated only on a negotiation, since one of the requirements or conditions of holder-in-due course status is that at the time the instrument "was negotiated to him he had no notice of any infirmity in the instrument or defect in the title of the person negotiating it."

(Sec. 52[d].) However, under Section 59, every holder is deemed *prima facie* to be a holder in due course.

(2) Under Section 56, in order to constitute *notice,* the holder must have had actual or chargeable knowledge of the infirmity or defect (see Sec. 55.) or must have had acted in bad faith. This absence of knowledge and lack of bad faith is the essential basis that renders a holder a holder in due course. Notice that if the instrument has been dishonored, any defense against the instrument after the instrument has been acquired does not prevent a holder from qualifying as a holder in due course.

EXAMPLE:

If P steals from M, maker, a note payable to bearer and negotiates it to A who has notice of the theft, A cannot be a holder in due course. However, if A acquires the note before he has notice of the theft, A will still be considered a holder in due course assuming the other conditions are present. (Sec. 16.)

(3) Knowledge of an agent acting within the scope of his authority is a constructive knowledge of the principal and will render the principal not a holder in due course.

Sec. 53. *Where person not deemed holder In due course.* — Where an instrument payable on demand is negotiated an unreasonable length of time after its issue, the holder Is not deemed a holder in due course.

Holder in due course in instrument payable on demand.

One of the requisites of due course holding is that the holder of the instrument became such '^before it is overdue." (Sec. 52[b].) It obviously applies to an instrument payable at a fixed or determinable future time.

With respect to instruments payable on demand, Section 53 governs in determining whether the purchase is one of an overdue instrument. Under Section 53, if the negotiation of a demand instrument is made outside of the reasonable time after its issue, the holder cannot be deemed a holder in due course, for the fact that the instrument has been in circulation for such a length of time gives rise to a strong indication that it has already been dishonored.

As to what constitutes a reasonable time, depends upon the facts of the particular case. The law provides that "regard is to be had to the nature of the instrument, the usage of trade or business (if any) with respect to such instruments, and the facts of the particular case." (Sec. 193.)

Sec. 54. *Notice before full amount paid.* — Where the transferee receives notice of any infirmity in the instrument or defect in the title of the person negotiating the same before he has paid the full amount agreed to be paid therefor, he will be deemed a holder in due course only to the extent of the amount theretofore paid by him.

Effect of notice before full payment.

(1) *No amount has yet been paid.* — Where an instrument has been taken but the purchaser has not yet paid anything, and he receives notice of infirmity in the instrument or defect in the title of the holder, he is relieved from the obligation to make payment. If he does so, it is quite clear that he is not entitled to the same protection as a holder in due course. The term "paid," as used in Section 54, is not limited to the payment of money, but includes; the performance in any other manner of an obligation, (see Art. 1232, Civil Code.)

(2) *An amount has been paid.* — Where the instrument has been transferred to him in consideration of his promise to make future payments to his transferor, he is under no legal obligation to pay the balance of the amount he has agreed to pay on discovering the infirmity or defect. If he does, he can be considered a holder in due course only to the extent of the amount theretofor paid to him.

EXAMPLES:

(1) A promissory note for P20,000.00 signed by M, as maker, and payable to bearer, is delivered to P in payment of goods sold. The goods were not delivered to M by P and, therefore, there was failure of consideration. P indorsed the note to A upon the terms of payment of P12,000.00 and the

balance in a month. Before A could pay the balance of P8,000.00, he received notice of the defect in die title of P.

. Under these circumstances, A is a holder in due course to the extent of P12,000.00, the amount paid by him before he learned of P's defective title but not as to the P8,000.00 balance, although he pays it later on.

(2) A note for P10,000.00 obtained by P, payee, by means of fraud was negotiated by P for P9,000.00 to A, a *bona fide* purchaser without notice, upon terms of payment of P5,000.00 cash and P4,000.00 in a month. Within the month, A was notified by M, maker, of the equity of fraud as against P. How much should A recover from M?

Under Section 54, only P5,000.00, thereby depriving A of the benefit of the bargain. Suppose A had paid the whole consideration of P9,000.00 before receiving notice. In the case, A, under Section 57, can recover P10,000.00, the full amount of the note, from M, thus receiving the benefit of the bargain, (see Dresser v. Railway Construction Co., 93 U.S. 92.)

When Section 54 not applicable.

Section 54 is intended to define the situation in which the holder must protect himself by refusing to make further payments.

(1) It is applicable only where the obligation incurred by the holder of a bill or note is such that upon discovering the infirmity in the instrument, he is relieved from all further legal obligations to make further payments, as, for example, where the note has been transferred to him in consideration of his promise to make future payments to his transferor. In that case, if it should turn out that, by reason of fraud on the part of the transferor, the maker of the note had a defense thereto, the transferee would be under no obligation to pay the balance of the amount that he had agreed to pay the transferor.

(2) It does not apply where the holder has given for the paper his promise which he must perform, as, for instance, when he has incurred liability to a third person. In such a case, he is in the same position and entitled to the same protection as one who has paid for the instrument in money or property at the time of the transfer. (Pennoyer v. Dubois State Bank, 249 Pac. 795.)

ILLUSTRATIVE CASE:

Indorsee (bank) of a promissory note had no notice of the fraud at the time it issued its certificate of deposit but did have notice at the time it paid the certificate.

Facts: P Company, through its agent, by fraud sold to M shares of its capital stock, paid for by M in two promissory notes dated July 21,1920 and payable to the order of P six (6) months from date. The following day, P negotiated the notes to A frank) which, without knowledge of the fraud, paid for the notes by the issuance of its own certificate of deposit payable to the order of P, nine (9) months from date. On December 31, 1920, P as payee of the certificate of deposit, negotiated it to B (another bank) as collateral security for a loan. M refused to pay the notes when presented by A, on their maturity on January 21,1921, informing A of the facts which constituted the fraud.

A had no notice of the defense at the time it issued its certificate of deposit but did have notice at the time it discharged the certificate of deposit by payment. A sued M on the notes.

Issue: Was A a holder in due course?

Held: Yes. A gave the certificate of deposit for the notes "for value" within the meaning of Sections 52(c) and 25 — the other conditions necessary to make it a holder in due course being present — and if it was under legal obligation to pay the certificate of deposit when it became due, its right to protection as a holder in due course was the same as if it had paid money for the notes when it acquired them.

When A received notice of the fraud, it could have protected itself from liability on the certificate by enjoining its transfer or having it impounded by the court pending decision on the question of fraud. However, the duty of bringing proceedings for such a purpose was on M unless A had purposely concealed from M the fact that the notes had been taken in exchange for the certificate of deposit and this deprived M of the opportunity to take steps to protect itself. When a check had been given for a note, it has been held that the drawer of the check had no duty of stopping payment on the check after notice of the fraud on the note.

The record did not disclose the date of the negotiation to B. This negotiation is deemed *prima facie* to have been effected before the certificate was due. B was entitled to the presumption declared in the first clause of Section 59. If A had been sued by; B on the certificate, A could not have set up as defense the fraud practised in obtaining the notes. *(Pennoyer v. Dubois State Bank, supra.)*

Sec. 55. *When title is defective.* — The title of a person who negotiates an instrument is defective within the meaning of this Act when he obtained the instrument, or any signature thereto, by fraud, duress, or force and fear, or other unlawful means, or for an illegal consideration, or when he negotiates it in breach of faith, or under such circumstances as amount to a fraud.

Defective title in general

Defects of title are defined in Section 55 to cover all those situations which are known as personal or equitable defenses *(infra.)* and also to cover those equities of ownership where there is a breach of faith in negotiation.

Infirmities then must include things that are wrong with the instrument itself as distinguished from those things that are lacking in the contracts on the instruments. Such infirmities are to be found in situations arising under Sections 13, 14, 15, 16 (usually defects of title), 21, 23,124, and 125. (Beutel's Brannan, *op. cit.,* p. 706.)

When title of a person defective.

The title of a person who negotiates an instrument is defective under Section 55 in two ways, namely:

(1) *In the acquisition.* — when he obtained the instrument or any signature thereto by fraud, duress, or force and fear or other unlawful means, or for an illegal consideration; or

(2) *In the negotiation.* — when he negotiates the instrument in breach of faith, or under such circumstance as amount to a fraud. Duress or force and fear include all acts which overcome the signer's will. (28 Harvard L-Rev. 358.)

Good faith of taker and negotiator.

The object of Section 55, when taken in connection with Section 56, is to prevent one from becoming a holder in due course who takes an instrument with notice that his transferor is not acting honestly. It is the. same object as it is found in the good faith in Section 52(c) but viewed from a somewhat different angle. Said clause has regard to the attitude of the taker of the instrument, while Section 55 emphasizes rather the honesty of the negotiator as brought to the notice of the taker.

The object of the whole is, however, a single one — to require a thoroughly honest and fair transaction to constitute one a holder in due course. (Fehr v. Campbell, 52 ALR 506.)

EXAMPLES:

Fraud. — Brokers employed to buy stock represented that they bought the stock and received a check therefor, but had not in fact bought. It was held that their title to the check was defective because they obtained it by means of fraud. (People State Bank v. Miller, 185 Mich. 565.)

Duress, or force and fear. — Where A, by the use of violence and intimidation, forced P to indorse a promissory note in favor of A.

Other unlawful means. — Where the instrument has been stolen. It has been held that a person who acquires an instrument by indorsement of a part thereof gets title by unlawful means since the transfer is in contravention of the law. (Edgar v. Haines, 141 N.E. 837.)

Illegal consideration. — A note given to stifle a criminal prosecution is invalid (Hart v. Brown, 216 S.W. 552.) or in consideration of the payee killing a person.

Negotiation in breach of faith. — Where the payee of a note negotiated it after receiving payment from the maker (Delancy v. Brownwood, 213, Pac. 578.); where the payee transfer the instrument in breach of agreement (Silverman v. Cates, 211 N.Y. Supp. £91.); where a note is given in payment of goods to be delivered and the note is negotiated without delivery of the goods (Glends State Bank v. Abbot, 216 Pac. 100.); where a note held merely as collateral or security is negotiated. (Bell v. McDonald, 139 N.E. 613.)

Circumstances amounting to fraud. — Where the payee of a note negotiated it after being told that the maker intends to resist payment or that the transferor had no legal right to transfer.

ILLUSTRATIVE CASE:

1. Collecting bank, instead of remitting the proceeds of the check of another bank deposited with it, to the payee, replaced the check with two of its manager's checks, without consulting the payee or the drawer-payor, which MCs were later encashed by alleged members of a syndicate.

Facts: F (Ford Phils., Inc.) drew and issued its Citibank check in the amount of P4,746,114.41 in favor of the CIR (Commissioner of Internal Revenue) as payment for its percentage or manufacturer's sales taxes for the third quarter of 1977. The check was deposited with PCIBank and was subsequently sent to Central Clearing with the indorsement at the back "all prior indorsements and/or lack of indorsements guaranteed/' Upon presentation with Citibank, the proceeds of the check was paid to PCIBank as collecting or depository bank.

The proceeds of the check were never paid to or received by the CIR, the payee thereof. Investigation revealed that the check was recalled by GR, the General Ledger Accountant of F. He purportedly needed to hold back the check because there was error in the computation of the tax due to the BIR. With GR's instruction, PCIBank (instead of remitting the proceeds to the CIR) replaced the check with two of its own manager's checks (MCs). Alleged members of a syndicate later deposited the two MCs with another bank and encashed the same.

F had to make payment for the second time to the BIR.

Issue: Has F the right to recover from die collecting bank (PCIBank) and the drawee bank (Citibank) the value of the check intended as payment to the CIR?

Held: PCIBank is solely responsible for the loss of the proceeds of the check which shall be paid together with 6% interest thereon to F from the date when the original complaint was filed until the amount is fully paid.

(1) Issuance of the MCs not in the ordinary course of business. —"The Board of Directors of Ford, we note, did not confirm the request of Godofredo Rivera [GR] to recall Citibank Check No. SN-04867. Rivera's instruction to replace the said check with PCIBank's Manager's Check was not in the ordinary course of business which could have prompted PCIBank to validate the

(2) *PCIBartk employees negligent.* — "On record, PCIBank failed to verify the authority of Mr. Rivera to negotiate the checks. The neglect of PCIBank employees to verify whether his letter requesting for the replacement of the Citibank Check No. SN-04867 was duly authorized, showed lack of care and prudence required in the circumstances."

(3) *Duty of PCIBank, as agent, to consult its principal, the CIR.* — "Furthermore, it was admitted that PCIBank is authorized to collect the payment of taxpayers in behalf of the BIR. As an agent of BIR, PCIBank is duty bound to consult its principal regarding the unwarranted instructions given by the payor or its agent."

(4) *Relationship between payee and collecting or depository bank.* — "It is a well-settled rule that the relationship between the payee or holder of commercial paper and the bank to which it is sent for collection is, in the absence of an agreement to the contrary, that of principal and agent. A bank which receives such paper for collection is the agent of the payee or holder."

(5) *Absence of authority from drawer-payor.* — "Even considering *arguendo,* that the diversion of the amount of a check payable to the collecting bank in behalf of the designated payee may be allowed, still such diversion must be properly authorized by the payor. Otherwise stated, the diversion can be justified only by proof of authority from the drawer, or that the drawer has clothed his agent with apparent authority to receive the proceeds of such check."

x x x x x x

(6) *Proximate cause of loss.* — "Having established that the collecting bank's negligence is the proximate cause of the loss, we conclude that PCIBank is liable in the amount corresponding to the proceeds of the check." *(Philippine Commercial International Bank vs. Court of Appeals, 350 SCRA 446 [2001].)*

2. A syndicate headed by an officer of the collecting bank, tampered with the cross-checks issued by the drawer-payor (taxpayer), payable to the Commissioner of Internal Revenue and succeeded in encashing the check, the drawee bank failing to discover the irregularity.

Facts: F (Ford Phils., Inc.) drew two Citibank checks representing payment of percentage taxes, payable to the CIR

(Commission of Internal Revenue). Both checks were "crossed checks" and contain two diagonal lines on their upper left corners between which were written the words "payable to the payee's account only."

The checks never reached the BIR. The two BIR Revenue Tax Receipts were considered "fake and spurious." F was forced to pay the BIR anew. It filed an action against PCIBank and Citibank for the recovery of the amount of the two checks.

Investigation revealed that GR, employed by F as its General Ledger Accountant, prepared F's checks for payment to the BIR. Instead, however, of delivering the same to the payee, he passed on the first F check to a co-conspirator named RC who was a pro manager of the San Andres Branch (Manila) of PCIBank. In connivance with one WD, RC himself subsequently opened a checking account in the name of a fictitious person denominated as "Reynaldo Reyes" in the Meralco Branch of PCIBank where WD worked as Assistant Manager.

After an initial deposit of P100.00 to validate the account, RC deposited a worthless Bank of America check in exactly the same amount as the first F check. While this worthless check was coursed through the POBank's main office enroute to the Central Bank for clearing, RC replaced it with the first F check and accordingly tampered the accompanying documents to cover the replacement. As a result, the F check was cleared by Citibank and the fictitious account of "Reynaldo Reyes" was credited with the amount of the F check. The same method was again utilized by the syndicate in profiting from the second F check which was subsequently pilfered by AM, GR's assistant atF.

Issue: Has F the right to recover from the collecting bank (PCIBank) and the drawee bank (Citibank) the value of the checks intended as payment to QR?

Held: PCIBank and Citibank must share the loss on a fifty- fifty ratio, with 6% interest thereon, from the date the complaint was filed until full payment of said amount.

(1) *Checks unlawfully negotiated.* — "It was established that instead of paying the checks to the C3R, for the settlement of the appropriate quarterly percentage taxes of Ford, the checks were diverted and encashed for the eventual distribution among the members of the syndicate. As to the unlawful negotiation of the

check the applicable law is Section 55 of the Negotiable Instruments Law (NIL) x x x . Pursuant to this provision, it is vital to show that the negotiation is made by the perpetrator in breach of faith amounting to fraud. The person negotiating the checks must have gone beyond the authority given by his principal. If the principal could prove that there was no negligence in the performance of his duties, he may set up the personal defense to escape liability and recover from other parties who, through their own negligence, allowed the commission of the crime/'

(2) *F not guilty of contributory negligence, t-* "Foremost, we must resolve whether the injured party, Ford, is guilty of the 'imputed contributory negligence' that would defeat its claim for reimbursement, bearing in mind that its employees, Godofredo Rivera and Alexis Marindo, were among the members of the syndicate.

x x x x x x

Since a master may be held for his servant's wrongful act, the law imputes to the master the act of the servant, and if that act is negligent or wrongful and proximately results in injury to a third person, the negligence or wrongful conduct is the negligence or wrongful conduct of the master, for which he is liable. The general rule is that if the master is injured by the negligence of a third person and by the concurring contributory negligence of his own servant or agent, the latter's negligence is imputed to his superior and will defeat the superior's action against the third person, assuming, of course that the contributory negligence was the *proximate cause* of the injury of which complaint is made."

(3) *Actions of F's employees not the proximate cause of encashing the checks.* — "Accordingly, we need to determine whether or not the action of Godofredo Rivera, Ford's General Ledger Accountant, and/or Alexis Marindo, his assistant, was the *proximate came* of the loss or damage. As defined, proximate cause is that which, in the natural and continuous sequence, unbroken by any efficient, intervening cause produces the injury, and without which the result would not have occurred.

It appears that although the employees of Ford initiated the transactions attributable to an organized syndicate, in our view, their actions were not the proximate cause of encashing the checks payable to the CIR. The degree of Ford's negligence, if any, could not be characterized as the proximate cause of the injury to the parties, x x x

As to the preparation of Citibank Checks Nos. SN-10597 and 16508, it was established that these checks were made payable to the CIR. Both were crossed checks. These checks were apparently turned around by Ford's employees, who were acting on their own personal capacity.

Given these circumstances, the mere fact that the forgery was committed by a drawer-payor's confidential employee or agent, who by virtue of his position had unusual facilities for perpetrating the fraud and imposing the forged paper upon the bank, does not entitle the bank to shift the loss to the drawer-payor, in the absence of some circumstance raising estoppel against the drawer. This rule likewise applies to the checks fraudulently negotiated or diverted by the confidential employees who hold them in their possession."

(4) *Duty of PCIBank to ascertain that checks deposited in payee's account only.* — "Indeed, the crossing of the check with the phrase 'Payee's Account Only,' is a warning that the check should be deposited only in the account of the CIR. Thus, it is the duty of the collecting bank PCIBank to ascertain that the check be deposited in payee's account only. Therefore, it is the collecting bank (PCIBank) which is bound to scrutinize the check and to know its depositors before it could make the clearing indorsement 'all prior indorsements and/or lack of indorsement guaranteed'.

(5) *Liability of PCIBankfor wrongful acts of its officers or agents.* — "In this case, there was no evidence presented confirming the conscious participation of PCIBank in the embezzlement. As a general rule, however, a banking corporation is liable for the wrongful or tortuous acts and declarations of its officers or agents within the course and scope of their employment. A bank will be held liable for the negligence of its officers or agents when acting within the course and scope of their employment. It may be liable for the tortuous acts of its officers even as regards that species of tort of which malice is an essential element.

In this case, we find a situation where the PCIBank appears also to be the victim of the scheme hatched by a syndicate in which its own management employees had participated, x x x The PCIBank pro-manager, Castro, received Citibank

Check Numbers SN 10597 and 16508. He passed the checks to a co-conspirator, an Assistant Manager of PCIBank's Meralco Branch, who helped Castro open a Checking account of a fictitious person named 'Reynaldo Reyes.' Castro deposited a worthless Bank of America Check in exactly the same amount of Ford checks. The syndicate tampered with the checks and succeeded in replacing the worthless checks and the eventual encashment of Citibank Check Nos. SN 10597 and 16508. The PCIBank Pro-manager, Castro, and his co-conspirator Assistant Manager apparently performed their activities using facilities in their official capacity or authority but for their personal and private gain or benefit.

A bank holding out its officers and agents as worthy of confidence will not be permitted to profit by the frauds these officers or agents were enabled to perpetrate in the apparent course of their employment; nor will it be permitted to shirk its responsibility for such frauds, even though no benefit may accrue to the bank therefrom. For the general rule is that a bank is liable for the fraudulent acts or representations of an officer or agent acting within the course and apparent scope of his employment or authority. And if an officer or employee of a bank, in his official capacity, receives money to satisfy an evidence of indebtedness lodged with his bank for collection, the bank is liable for his misappropriation of such sum.

Moreover, as correctly pointed out by Ford, Section 5 of Central Bank Circular No. 580, Series of 1977 provides any theft affecting items in transit for clearing shall be for the account of the sending bank, which in this case is PCIBank."

(6) *Citibank likewise negligent.* — "But in this case, responsibility for negligence does not lie on PCIBank's shoulders alone."

The evidence on record shows that Citibank, as drawee bank, was likewise negligent in the performance of its duties. Citibank failed to establish that its payment of Ford's checks were made in due course and legally in order, x x x As ruled by the Court of Appeals, Citibank must likewise answer for the damages incurred by Ford on Citibank Checks Numbers SN 10597 and 16508, because of the contractual relationship existing between the two. Citibank, as the drawee bank, breached its contractual obligation with Ford and such degree of culpability contributed to the damage caused to the latter.

On this score, we agree with the respondent court's ruling. Citibank should have scrutinized Citibank Check Numbers SN10597 and 16508 before paying the amount of the proceeds thereof to the collecting bank of the BIR. One thing is clear from the record: the clearing stamps at the back of Citibank Check Nos. SN 10597 and 16508 do not bear any initials. Citibank failed to notice and verify the absence of the clearing stamps. Had this been duly examined, the switching of the worthless checks to Citibank Check Nos. 10597 and 16508 would have been discovered in time. For this reason, Citibank had indeed failed to perform what was incumbent upon it, which is to ensure that the amount of the checks should be paid only to its designated-payee. The fact , that the drawee bank did not discover the irregularity seasonably, in our view, constitutes negligence in carrying out the bank's duty to its depositors.

The point is that as a business affected with public interest and because of the nature of its functions, the bank is under obligation to treat the accounts of its depositors with meticulous care, always having in mind the fiduciary nature of their relationship/'

(7) *PCIBank and Citibank failed their respective obligations.* — "Thus, invoking the *doctrine of comparative negligence*, we are of the view that both PCIBank and Citibank failed in their respective obligations and both were negligent in the selection and supervision of their employees resulting in the encashment of Citibank Check Nos. SN 10597 and 16508. Thus, we are constrained to hold them equally liable for the loss of die proceeds of said checks issued by Ford in favor of the OR."

(8) *Banking business impressed with public interest.* — "Time and again, we have stressed that banking business is so impressed with public interest where the trust and confidence of the public in general is of paramount importance such that the appropriate standard of diligence must be very high, if not the highest, degree of diligence. A bank's liability as obligor is not merely vicarious but primary, wherein the defense of exercise of due diligence in the selection and supervision of its employees is of no moment.

Banks handle daily transactions involving millions of pesos. By the very nature of their work the degree of responsibility, care and trustworthiness expected of their employees and officials is far greater than those of ordinary clerks and employees.

Banks are expected to exercise the highest degree of diligence in the selection and supervision of their employees/'

(9) *F not completely blameless.* — "Finally we also find that Ford is not completely blameless in its failure to detect the fraud. Failure on the part of the depositor to examine its passbook, statements of account, and cancelled checks and to give notice within a reasonable time (or as required by statute) of any discrepancy which it may in the exercise of due care and diligence find therein, serves to mitigate the banks' liability by reducing the award of interest from twelve percent (12%) to six percent (6%) per annum.

As provided in Article 1172 of the Civil Code of the Philippines, responsibility arising from negligence in the performance of every kind of obligation is also demandable, but such liability may be regulated by the courts, according to the circumstances. In *quasi-delicts,* the contributory negligence of the plaintiff shall reduce the damages that he may recover." *(Ibid.)*

Sec. 56. ***What constitutes notice of defect.*** **— To constitute notice of an infirmity in the instrument or defect in the title of the person negotiating the same, the person to whom it is negotiated must have had actual knowledge of the infirmity or defect, or knowledge of such facts that his action in taking the instrument amounted to bad faith.**

What constitutes notice of infirmity or defect.

In order to constitute *notice,* the transferee must have actual knowledge of the infirmity or defect; or knowledge of such facts (which do not appear on the face of the instrument) that his action in taking the instrument amounts to bad faith. Actual knowledge is usually shown by the instrument itself.

(1) *Mere negligence to make inquiries not sufficient.* — Under Sections 54 and 56, negligence in itself is not sufficient to constitute notice since it is not the equivalent of either actual knowledge or bad faith. The question of bad faith or good faith is mostly a question of fact. Notice is to be determined by the simple test of honesty and good faith and not by speculative issue as to the indorsee's negligence. (City Nat. Bank vs. Mason,

186 N.W. 30.) Mere suspicious circumstances may not be enough. Thus, consulting an attorney before taking a note does not show bad faith. (Kelomitz v. Jansen, 226 Pac. 1023.) Nor does the fact that the payee indorse "without recourse" constitute a badge of guilty knowledge. (Continental Nat. Bank v. Cole, 51 Idaho 140.)

(2) *Knowledge amounting to bad faith.* — There is difference, however, between the existence of suspicious circumstances, on the one hand, and actual suspicion of the holder, on the other. "If the holder had actual knowledge of suspicious circumstances, coupled with the means of readily informing himself of the facts and he willfully abstained from making inquiries, his intentional ignorance may amount to bad faith." (Hess v. Iowa Banker's Mort. Co., 201 N.W. 91; see De Ocampo vs. Gatchalian, 3 SCRA 596 [1961], *supra*; Sec. 52[c].)

It is not necessary that the buyer of the instrument had notice or knowledge of the exact fraud or the particulars thereof, committed by the assignor, since all that is required is "knowledge of such facts that his action in taking the instrument amounted to bad faith."

(a) Thus, the purchaser whq takes the instrument after being told that the maker intends to resist payment or that the transferor had no legal right to transfer (though honestly believing that the law would sustain the transfer cannot be held a holder in due course. (Babb & Martin, *op. cit.,* p. 216.)

(b) Also, while inadequacy of price is not of itself sufficient to show bad faith, the inadequacy may be so gross as to justify a finding of bad faith as where one paid P50.00 for a note of P500.00, the solvency and credit of the maker being well-known.

(c) Where a negotiable instrument signed by a person known to be insolvent is sold at a very large discount, such circumstance alone is sufficient to require the purchaser to make inquiry as to the genuineness thereof and if he fails to make such inquiry, he cannot be deemed a *bona fide* purchaser. In any case, die fact that the instrument was purchased at a discount may, taken together with other circumstances, rebut the presumption that the holder is one in due course. (Vosburg v. Diedendorf, 119 N.Y. 357.)

(d) But the indorsee of a note payable to the order of P or A (see Sec. 8[e].) and indorsed by A only, who takes it in good faith for value and without notice of any infirmity in the instrument or defect in the title, is a holder in due course. (Voris v. Schoonover, 91 Kans. 530.)

(3) *Effect of notice of defect.* — Knowledge or chargeable notice of any defect, at the time of taking of an instrument, which destroys the status of a holder as a holder in due course, opens all defenses otherwise cut off against him and not merely that relating to the defect of which he had notice, (see Sec. 58.) Thus, a holder with knowledge of failure of consideration is subject to the defense that a note was obtained by fraud. This does not, however, modify the rule that one holding from a holder in due course may have all the rights of the latter, *(ibid.;* 11 Am. Jur. 2d 454-455.)

Notice to the agent is ordinarily deemed notice to the principal and notice to a partner is notice to the partnership.

ILLUSTRATIVE CASE:

Holder refused to say how and why the stolen check was passed to hitn by the culprit.

Facts: P purchased from D (bank) a cashier's check for P800,000.00. The check' was stolen from D's manager to whom P entrusted the check for safekeeping. The facts pointed to A as the culprit. P immediately accomplished "stop-payment" order.

B, the holder of the check, when asked how he came to possess the check said it was paid to him by A in a "certain transaction" but refused to elucidate further. An information for theft was instituted against A.

Issue: Is B a holder in due course?

Held: No. B refused to say how and why the check was passed to him by A who stole the check. He had, therefore, notice of the defect of his title over the check from the start.

P bought the check from D for purposes of transferring his funds from D to another bank near his establishment, realizing that carrying money in this form was safer than if it were in cash. The check was P's property. At the outset, D knew it was

Fs check and no one else, since P has not paid or indorsed it to anyone. D was, therefore, liable to nobody oh the check but P. When the payment on it was stopped, D was not the one who did it but P.

From the moment the check was lost and /or stolen no one outside of P can be termed a holder in due course because P had not indorsed it in due course. *(Mesina vs. Intermediate Appellate Court, 145 SCRA 497 [1986].)*

(4) *Doctrine of constructive notice not applicable.*—The doctrine has never been applied to commercial paper. The true test as to negotiable paper is that of good or bad faith. Thus, a notice of *lis pendens* affecting land is applicable only to a person who is dealing with the land itself, and a purchaser of a negotiable instrument secured by a mortgage on the land is not dealing in land, and constructive record notice of an infirmity in the instrument does not amount to bad faith. (Foster v. Augustanna College and Theological Seminary, 218 Pac. 335.)

ILLUSTRATIVE CASE:

Assignee redelivered note to assignor, as a custodian, but the latter subsequently assigned the note to another who acted in good faith.

Facts: M executed and delivered to P a note, secured by a duly registered mortgage on a land. P assigned the note and mortgage to A. The note itself was not indorsed but the assignment was accomplished by virtue of a separate document. A redelivered the note and mortgage to P, as a custodian, to facilitate the collection of interest payments.

Subsequently, P assigned the note and mortgage to B who had no actual knowledge of the previous assignment to A. Both assignments were registered.

P became bankrupt. A sued B to establish his ownership of the documents and for the possession thereof.

Issue: Who has a better right to the note and mortgage, A or B?

Held: The title of B, the second assignee, must prevail notwithstanding that the assignment to B by P was made in fraud of the right of A without P having any title, thereto. *(Foster v. Augustanna College and Theological Seminary, supra.)*

Sec. 57. ***Rights of holder in due course.*** **— A holder in due course 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.**

Rights of a holder in due course.

The following are the rights of a holder in due course:

(1) He may sue on the instrument in his own name (Sec. 51.);

(2) He may receive payment and if the payment is in due course, the instrument is discharged *(ibid.)}*

(3) He holds the instrument free from any defect of title of prior parties;

(4) He holds the instrument free from defenses available to prior parties among themselves; and

(5) He may enforce payment of the instrument for the full amount thereof against all parties liable thereon, (see Sec. 54.)

Importance and foundation of due course holding.

(1) Section 57 shows the commercial importance of due course holding. A holder in due course acquires a right better than any of his predecessors because he takes the instrument free of most defenses available to prior parties among themselves. Thus, the fact that the instrument has been stolen, or negotiated in breach of faith, or has not been delivered is no defense against a holder in due course. A holder in due course may enforce the full amount of the instrument without regard to the amount he paid for it. (see Sees. 27,54,124 for exceptions to this rule.)

(2) The doctrine which protects a holder in due course is founded on the broadest principles of public policy, with regard to the utility, free circulation, and credit of negotiable paper in the commercial world. Indeed, the convenience and necessities of commerce require negotiable instruments which can pass almost as freely in the commercial world as legal tender, and demand,

consequently, the protection of those holding them in due course. This protection is sometimes explained as an estoppel.

In other words, one putting negotiable paper on the market is estopped from contesting the consequences and incidents of his act; It is also said that the basic principle on which paper having defects is sustained in the hands of a holder in due course is comprehended in the legal maxim that where loss has happened which must fall on one of two innocent persons, it shall be borne by him who is the occasion of the loss. The one who made the wrong possible is estopped by his neglect. (11 Am. Jur. 2d 428429.)

Real defenses available against a holder in due course.

The defenses referred to in Section 57 that cannot be set up against a holder in due course are the so-called "personal defenses" or equities, as distinguished from absolute or real defenses. They are cut-off by negotiation of the instrument to a holder in due course. This rule which permits a holder in due course to take an instrument free of all personal defenses is a necessity if commercial papers are to circulate freely and prospective purchasers are to accept them routinely and willingly. Real defenses, which attach to the instrument itself, would be available against all persons even as against a holder in due course, (see Sec. 58.)

In the case of immediate parties, all defenses are available.

A holder not a holder in due course acquires the instrument subject to all defenses, whether personal or real, because he is treated as a mere assignee of a non-negotiable paper.

Sec. 58. ***When subject to original defenses.*** **— In the hands of any holder other than a holder in due course, a negotiable instrument is subject to the same defenses as if it were non-negotiable. But a holder who derives his title through a holder in due course, and who is not himself a party to any fraud or illegally affecting the instrument, has all the rights of such former holder in respect of all parties prior to the latter.**

Defenses in general.

Defenses are grounds or reasons pleaded or offered by the defendant in a case, showing why the plaintiff, as a matter of law or fact, should not be given the relief he seeks. There are two kinds of defenses which may be interposed to an action upon a negotiable instrument: real, absolute, or universal defenses and personal, limited, or equitable defenses. Some defenses are either real or personal depending on the factual situations out of which arise the particular defense, (see Exs. a, b.)

(1) *Real defenses* are those that are available against all parties, both immediate and remote, including holders in due course or holders through the latter. In other words, there are cases when a holder in due course is not legally entitled to payment from the primary party. They are called "real" because they attach to the *res,* that is, the instrument itself regardless of the merits or demerits of the holder or the conduct or agreement of the parties to it. (Ogden, *op. ext.,* p. 309.) They challenge the validity of the Instrument itself. It cannot be enforced by the holder because there is no contract to enforce.

This does not imply, however, that the instrument is valueless and can never be enforced. It is only unenforceable against the party entitled to set up the defense *(e.g.,* maker's defense that he was infant when he executed and delivered the instrument sued on or that his signature thereon is a forgery) but not against those to whom such a defense is not available such as, in the case of forgery, persons precluded from setting it up. (Sec. 23.)

Generally, the case of the real or absolute defense is presented where the contract is void (not merely voidable) because of the absence of one or more of the essential elements of a contract (see Art. 1318, Civil Code.) or where the contract itself is declared void by law. (see Art. 1409, *ibid.)* Usually, a real defense applies only to the person who has made or drawn the instrument.

Examples of real defenses:

(a) Incapacity as far as the incapacitated person is concerned (see Art-1327, *ibid.);*

(b) Illegality of contract when declared by law (see Art. 1409, *ibid.)-,* except where the maker or drawer is himself a party to the illegality; thus, a note for a gambling debt (an illegal consideration) is a mere personal defense (see Sec. 55.);

(c) Want of delivery of incomplete instrument (Sec. 15.);

(d) Forgery (Sec. 23.);

(e) Want of authority, apparent and real *(ibid.)}*

(f) Duress amounting to forgery as where one takes the hands of another and forces him at gunpoint to sign his name. There are varying degrees of duress under the law. If, for example, a person signs his name under a vague threat or through fear of economic retaliation, the defense is only personal in nature. The duress must be so overwhelming that the victim is entirely deprived of his will;

(g) Fraud *in factum* or fraud in *esse contractus* (Sec. 14.);

(h) Fraudulent alteration by holder (Sees. 124, 1st sentence; 125.);

(i) Prescription (see Arts. 1140-1142, 1144-1147, Civil Code.);

(j) Other infirmities appearing on the face of the instrument (Sec. 52.); and

(k) Discharge at or after maturity. (Sees. 88,118,121,122.)

(2) *Personal defenses* are those which grow out of the agreement or conduct of a particular person in regard to the instrument which renders it inequitable for him, though holding the legal title, to enforce it against the party sought to be made liable but which are not available against a holder in due course (see Sec. 57.) or holders with all the rights of a holder in due course, (see Sec. 59.) They include every defense assertable in action under ordinary contract law. They are called "personal defenses" because they are available only against that person or subsequent holder who stands in privity with him. (Ogden, *op. cit.,* p. 309.) In other words, they can be used only between original parties or immediate parties or against one who is not a holder in due course.

Note that while a real defense questions the legal validity of the instrument itself, a personal defense affects only the validity of the agreement for which the instrument was issued.

The validity of the instrument is recognized. It is the underlying agreement that is in question.

Examples of personal defenses:

(a) Filling of wrong date (Sec. 13.);

(b) Filling up of blanks not in accordance with the authority given and within reasonable time (Sec. 28.);

(c) Want of delivery of complete instrument (Sec. 16.);

(d) Absence or failure of consideration (Sec. 28.);

(e) Simple fraud or fraud in inducement (Sec. 55.);

(f) Acquisition of instrument (not signature) by duress, or force and fear *(ibid.);*

(g) Acquisition of instrument by unlawful means *(ibid.);*

(h) Acquisition of instrument for an illegal consideration *(ibid.);*

(i) Negotiation of breach of faith (*ibid.);*

(j) Negotiation under circumstances that amounts to fraud *(ibid.);*

(k) Innocent alteration or spoliation, (see Sees. 124 [last sentence], 125.) *Spoliation* is an alteration made by a stranger to an instrument. If the original meaning can be ascertained, the holder in due course may recover according to its original tenor;

(1) Set-off between *immediate* parties (see Sec. 58.);

(m) Discharge by payment or renunciation or release before maturity (Sees. 50,121,122.);

(n) Discharge of party secondarily liable by discharge of prior party (Sec. 20[c].);

(o) Usury—because the contract of loan itself is not void but only the agreed interest[2] (see Sec. 7, Usury Law; Art. 1413, Civil Code.); and

(p) Want of authority of the agent who has apparent authority, (see Art. 1869, *ibid.),* but if the principal can show

^sury is now legally non-existent.

that the agent had no express, implied, or apparent authority to sign, the defense is real.

Immediate, remote, and prior parties explained.

(1) *Immediate parties.* — Assume that M makes and delivers his promissory note to P (payee) and that P indorses to A, and A to B. M and P are said to be immediate parties because they are in direct contractual relation to each other. Where, however, M makes and delivers to X, an intermediary, his (M's) promissory note payable to the order of P, and X delivers the note to P (payee) for value, M and P are not immediate parties. *Immediacy* signifies privity not mere proximity, (see Sec. 16.)

(2) *Remote parties.* — A remote party is one who takes title to an instrument by negotiation from either the original payee or any subsequent holder. In the preceding illustration, M and B are remote parties — that is, parties who are not in direct contractual relation to each other. Other pairs of remote parties are: M and A, P and B.

(3) *Prior parties.* — In the example given in (1) above, M, P, and A are prior parties with respect to B. (see Babb & Martin, *op. cit.,* p. 223; see comments under Sec. 16.)

A holder in due course is free from personal "defenses available to prior parties among themselves." (Sec. 57.) As between the immediate parties, no distinction need be made between real and personal defenses. So as between M and P, or P and A, or A and B above, we might say that all defenses are real. But when the instrument has passed to a remote party like A in relation to M, the latter, a prior party, can only set up real defenses. However, if A is not a hoider in due course, the instrument is subject to all defenses. (Sec. 58.) In such a case, A is a mere assignee and the general rules on contract would apply.

Defenses available against a holder not a holder in due course.

A mere assignee or one who is not a holder in due course takes the instrument subject to all valid claims of any party which would be available in an action on an ordinary contract.

"Same defenses/' as used in Section 58, does not limit the defenses, since the section is not exclusive and does not prevent pleading other defenses of an entirely different character not dealt with or covered in such section but specifically permitted by any other statute. (Turkenkoph v. Te Beest, 232 P. 2d 684.) Unless he has the rights of a holder in due course, any person takes the instrument subject to all valid claims or defenses of any party which would be available in an action on a simple contract, (see Uniform Commercial Code, 3-306.)

Defenses subject to estoppel.

Through estoppel, an admission or representation is rendered conclusive upon the person making it, and it cannot be denied or disproved as against the person relying thereof. (Art. 1431, Civil Code.)

Real and personal defenses are subject to estoppel since the rules and principles governing estoppel generally are applied to commercial instruments. In fact, practically all the defenses such as forgery or illegality may be precluded by estoppel, (see Ogden, *op. cit.,* p. 357; see Sec. 23.)

Fraud in factum and fraud in inducement distinguished.

There are two kinds of fraud relating to negotiable instrument, namely:

(1) *Fraud in the execution or fraud in factum.* — It exists in those cases in which a person, without negligence, has signed an instrument which was in fact a negotiable instrument, but was deceived as to the character of the instrument and without knowledge of it, as where a note was signed by one under the belief that he was signing as a witness to a deed, or where the signature was procured by fraudulent use of carbon paper.

This kind of fraud is a real defense (see Sec. 14.) because there is no contract. It implies that the person did not know what he was signing. But where the signer by the exercise of reasonable diligence could have discovered the nature of the instrument, the fraud cannot be considered a real defense, as where a person, who can read, signed a note but failed to read it; and

(2) *Fraud in the inducement or simple fraud.* — It is that which relates to the quality, quantity, value or character of the consideration of the instrument. In this case, the signer is led by deception to execute what he knows is a negotiable instrument and, therefore, necessarily signed with knowledge that the instrument would probably pass into the hands of an innocent purchaser. Here, the deceit is not in the character of the instrument but in its amount or its terms. (Ogden, *op. cit.f* p. 326.) It implies that the signer knew what he was signing but that he was induced by fraud to sign. (Babb & Martin, *op. cit.,* p. 231.)

A clear illustration of this fraud exists where a person is induced to sign a note for the price of a worthless stock which was fraudulently represented by the payee as to its value. Such type of fraud is only a personal defense because it does not prevent a contract.

Mere carelessness or negligence, in the absence of any fraud, is neither a real nor personal defense.

Rights of holder not in due course.

A holder not in due course has the following rights:

(1) He may sue on the instrument in his own name (Sec. 51.);

(2) He may receive payment and if the payment is in due course, the instrument is discharged *(ibid.);*

(3) He is entitled to the instrument but holds it subject to the same defenses as if it were non-negotiable (Sec. 58.); and

(4) He has all the rights of the holder in due course from whom he derives his title in respect of all parties prior to such holder, provided he is not himself a party to any fraud or illegality affecting the instrument, *(ibid.)*

Right of holder not in due course to receive payment.

It does not follow as a legal proposition that simply because one is not a holder in due course he cannot recover on the instrument. The law does not provide that a holder not in due course may not, in any case, recover on the instrument.

If B, for instance, purchases from A an overdue negotiable promissory note signed by M, B is not a holder in due course but he may recover from M (Sec. 51.) or A, if M or A has no valid excuse for refusing payment. The only disadvantage of a holder who is not a holder in due course is that the negotiable instrument is subject to defenses as if it were non-negotiable. (Sec. 58; Chan Wan vs. Tan Kim, 109 Phil. 76 [I960].)

Where (crossed) checks were issued by the drawer without consideration (see Sec. 28.) in breach of faith (Sec. 55.), no right of recourse is available to a holder in bad faith against the drawer. (State Investment House vs. Intermediate Appellate Court, 175 SCRA 310 [1989]; Atrium Management Corporation vs. Court of Appeals, 353 SCRA 23 [2001].)

Rights of purchaser from a holder in due course.

Whether a holder takes a negotiable instrument free of equities and defenses that might obtain between the original parties depends upon the further fact of his status as a holder in due course or as a taker through such holder.

(1) *Rights of a mere transferee.* — If a person is not a holder in due course, his rights are those of a transferee of a non-negotiable instrument so that he is not free from personal defenses.

(2) *Rights of transferee from a holder in due course.* — Section 58 provides this exception: a holder who derives his title from a holder in due course has all the rights of the latter even though he himself is a mere transferee or does not satisfy the requirements of a holder in due course, (see Sec. 59.)

(a) The rule has a logical basis. "If a third party cannot take commercial paper from an innocent holder free from equitable defenses because such third party knows of its original infirmities, then the rights of the innocent holder are greatly reduced. His market for such paper would be limited to those who like himself had no notice of its original infirmities. Since the innocent holder could collect from the maker, it can make no difference to the maker into whose hands the note may pass/' (Underwood v. Posha, 150 Pac. 571.)

If one could stop the negotiability of paper against which there is no defense, by giving notice that a defense once existed while it was held by another (purchaser from an innocent holder), it is obvious that an important element in its value as a safe and reliable medium for the exchange of commerce would be at once taken away. (Shade v. Barnes Bros., 151NW 42.)

(b) Note that there are two requisites: 1) that he derives his title through a holder in due course; and 2) that he was not himself a party to any fraud or illegality affecting the instrument But a payee or indorsee whose title is defective cannot better it by selling the instrument to a holder in due course and buying it again. (Andrews v. Robertson, 87 N.W. 190; Peltier v. McFerson, 186 Pac. 524.)

A payee may be a holder in due course provided he meets the requirements of Section 52. (see De Ocampo vs. Gatchalian, 3 SCRA 596 [1961], *supra.)* "It is a well-known rule of law that if the original payee of a note unenforceable for lack of consideration repurchases the instrument after transferring it to a holder in due course, the paper again becomes subject into the payee's hands to the same defenses to which it would have been subject as if the paper had never passed through the hands of a holder in due course." The same is true where the instrument is transferred to an agent of the payee. (Fossum vs. Fernandez Hermanos, 44 Phil. 675 [1923].)

The principle above, as stated by our Supreme Court, seems to apply whether or not the reacquirer was a party to the "illegality or fraud affecting the instrument." (Sec. 58.) A holder not in due course should not be permitted to wash an instrument clean by passing it into the hands of a holder in due course and then repurchase it. He is remitted to his former position. Similarly, a holder in due course who negotiates the instrument to a holder other than the one in due course and then reacquires it, will hold the instrument as a holder in due course.

EXAMPLES:

M is induced through (simple) fraud committed by P to issue a promissory note in favor of P. Here, P *is a party to the fraud.* P indorsed the note to A. A *has notice* of the fraud but did not take part in it. By A, the note is indorsed to B, *a holder in due course.* B, in turn, indorses the note to *C who knows* how the note was obtained but wihout being a party to the fraud.

(1) In this case, even if C is not a holder in due course, he has all the rights of such holder in respect of M, P, and A, having derived his title from B, a holder in due course, and the defenses of fraud cannot be set up against him. In effect, C is a holder in due course relative to M, P, and A.

(2) If instead of indorsing the note to C, B indorses it to P, payee, the latter cannot recover on the instrument because he is party to the fraud. P is remitted to his original position when he first acquired the note from M.

(3) If the note is indorsed by C to D, *who has also notice* of die defect but was not a party to the fraud, D cannot recover from M because D did not acquire his title from a holder in due course.

(4) Assuming that C is a holder in due course and A reacquires from him the note, the latter is not given the former's rights although he was not a party to the fraud. A is remitted to his original position which he occupied when he first acquired the note from P. The act of A in negotiating the note to a holder in due course in order to cut off M's defense upon his (A's) reacquisition of the instrument may be considered fraud under Section 55.

(5) If B who takes the note from A as a holder in due course and negotiates it to C who is not a holder in due course, reacquires it from C, B will hold the note as a holder in due course. He is remitted to his former position.

Sec. 59. *Who is deemed holder in due course.* — Every holder is deemed *prima facie* to be a holder in due course; but when it is shown that the title of any person who has negotiated the instrument was defective, the burden is on the holder to prove that he or some person under whom he claims acquired the title as holder in due course. But the last mentioned rules does not apply in favor of a party who

became bound on the instrument prior to the acquisition of such defective title.

When holder presumed a holder in due course.

The presumption expressed in this section to the effect that every holder is deemed *prima facie* to be a holder in due course arises only in favor of a person who is a holder in the sense defined in Section 191, that is, a payee or indorsee who is in possession of the instrument, or the bearer thereof. There is no presumption that a person through whose hands an instrument has passed was a holder in due course. (Fossum vs. Fernandez Hermanos, 44 Phil. 675 [1923].)

(1) *Proof of being a holder.* — Once the person through whose hands an instrument has passed shows that he is a holder, the presumption accrues in his favor. He does not have to prove that he acquired the instrument under all the circumstances required under Section 52.

(2) *Where indorser's title defective.* — When it is shown that the title of any person who has negotiated the instrument was defective (see Sec. 55.) as when the instrument is not payable to him or to bearer (De Ocampo vs. Gatchalian, 3 SCRA 596 [1961].), then the burden of proof shifts to the holder who must show he is a holder in due course although he is not himself a holder in due course. A person who acquires title from a prior holder in due course is referred to as *holder through a holder in due course.*

(a) Where proof has been offered of the genuineness of the maker's and payee's signatures, the holder is deemed to be a holder in due course and the duty of proceeding to offer some proof of fraud or defect specified, is cast upon the party alleging it, and, until such proof is offered, there is no duty upon the holder to prove that he or some other person under whom he claims acquired the title as holder in due course. (Van Syckel v. Egg Harbor Coal & Lumber Co., 162 Alt. 627.)

(b) The law establishes an exception to the second rule, *i.e.,* the holder has no burden of proving that he is a holder in due course in favor of a party who became bound on the instrument prior to the acquisition of such defective title. In other words, in this case, we revert to the presumption that the holder is a holder in due course.

EXAMPLES:

(1) P obtained the note of M through (simple) fraud, and negotiates it to A, A to B, B to C, and C to D, the present holder.

The presumption is that D is a holder in due course. But once M proves the fraud committed by P, the burden is shifted to D to prove that he is actually a holder in due course or that C, from whom he acquired title, is a holder in due course.

(2) Suppose the fraud was committed by A against P, the presumption that D is a holder in due course is not destroyed because M became bound on the instrument before the acquisition of the defective title by A.

Note that P is similarly situated as M in the first example. As P became bound on the instrument contemporaneous (not prior to) with the acquisition of A's defective title, the presumption of due course holding does not accrue in favor of D as far as P is concerned once P shows that the title of A was defective.

(3) Let us suppose now that the fraud was committed by B against A. In this case, the situation of A is the same as that of M in the first example, and P, the same as that of M in the second example.

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CHAPTERV

LIABILITIES OF PARTIES

Sec. 60. *Liability of maker.*—The maker of a negotiable instrument by making it engages that he will pay it according to its tenor, and admits the existence of the payee and his then capacity to indorse.

Classification of parties according to liability.

Liability refers to the obligation of a party to a negotiable instrument to pay the same according to its terms. The parties to a negotiable instrument may be classified according to their liability as follows:

Primarily liable:

(a) the maker of a promissory note;

(b) the acceptor of a bill of exchange; and

(c) the certifier of a check.

(2) *Secondarily (conditionally) liable:*

(a) the drawer of a bill; and

(b) the indorser of a note or a bill.

(3) *Not liable:*

(a) The drawee until he accepts the instrument in which case he becomes an acceptor.

A person becomes a party to an instrument by signing his name thereon. The general rule is that no person is liable on an instrument unless his signature appears thereon, (see Sees. 18-

Primary party and secondary party distinguished.

Under the law (Sec. 192.), the "person primarily liable on the instrument is the person who by the terms of the instrument is absolutely required to pay the same. All other parties are secondarily liable/'

The principal distinction between a primarily liable party and a secondarily liable party is that, while the former is unconditionally bound, the latter is conditionally bound. Being unconditionally liable, the primary party is absolutely required to pay the instrument upon its maturity. On the other hand, the secondary party undertakes to pay the instrument only after certain conditions have been fulfilled, to wit: due presentment for payment or acceptance to primary party (see Sec. 70.), dishonor by such party (see Sees. 184 and 151.), and the taking of proceedings required by law after dishonor, (see Sees. 89,118.) Secondary parties are liable in the reverse order in which they signed the instrument, (see Sec. 68.)

Generally, the liability of all secondary parties to an instrument ends when the primary party pays the full amount of the instrument to the proper party, (see Sees. 119-120.) In short, secondary parties face only potential secondary liability on the instrument.

Liability of maker.

The term "maker" here applies only to the promissory note. It includes an accommodation maker and a surety who signs as maker.

(1) *Liability unconditional.* — The maker is undoubtedly a party primarily liable as he is the one to whom the holder will look first for payment and the one who is expected to pay. He engages to pay the note according to its terms, subject to no condition whatsoever. Due presentment for payment (Sec. 70.), and due notice of dishonor (Sec. 89.) are not necessary for the purpose of charging the maker with liability, which is necessary, however, to fix the liability of any drawer or indorser. He promises to pay not only to the payee but to any subsequent holder who is legally

entitled to the instrument at its maturity date even if the holder does not demand payment at that time. He remains fully liable despite the fact that the instrument is presented for payment late until prescription has run. (see Sec. 75.) Moreover, he "admits the existence of the payee and his *then* capacity (at the time of signing the note) to indorse."

The rule operates to prevent the maker from escaping liability by showing the non-existence and incapacity of the payee. The payee must exist because there is no negotiable instrument until it is delivered to him. The payee must have the capacity to contract because the note is intended to be negotiated and not to be retained with die payee.

(2) *Presumption arising from signature.*—A person placing his name on the face of a note is *prima facie* a maker and liable as such (Howell v. Robertson, 150 S.E. 32.); and he is presumed to have acted with care and to have signed the instrument in question with full knowledge of its contents. (Tan Sia vs. Yu Biao Sontua, 56 Phil. 707 [1932].)

EXAMPLE:

M issues a promissory note to P for P500.00 payable on demand. P indorses the note to A.

Upon being sued by A, M cannot say that the agreement between him and P was to pay only P300.00. Neither can he allege that P is a non-existent nor fictitious person. He is also precluded from setting up such defenses as minority, insanity, or *ultra vires* act of a corporation.

Sec. 61. *Liability of drawer.* — The drawer by drawing the instrument admits the existence of the payee and his then capacity to indorse; and engages that on due presentment the instrument will be accepted or paid, or both, according to its tenor, and that if it be dishonored, and the necessary proceedings on dishonor be duly taken, he will pay the amount thereof to the holder, or to any subsequent indorser who may be compelled to pay it. But the drawer may insert in the instrument an express stipulation negativing or limiting his own liability to the holder.

Liability of drawer.

Just as the maker of a note, the drawer, by merely signing his name on the bill as drawer, admits the existence of the payee and his *then* capacity to indorse the instrument at the time it was executed.

(1) *Liability conditional.* — However, the drawer does not promise to pay the bill absolutely. He makes no warranties but he engages to pay after certain conditions are complied with, to wit:

(a) The bill is presented for acceptance (see Sec. 143.) or for payment (see Sec. 70.), as the case may be, to the drawee;

(b) The bill is dishonored by non-acceptance or nonpayment, as the case may be; and

(c) The necessary proceedings of dishonor are duly taken. Such proceedings are:

1) notice of dishonor is given to the drawer (Sec. 89.) subject to certain exceptions (see Sec. 114.); and

2) in case of foreign bills, protest is made followed by a notice of protest, (see Sec. 152.)

(2) *Liability of a general indorser.* — The drawer, therefore, is only secondarily liable to the holder, or to any subsequent indorser, who may be compelled to pay it. (Sec. 61.) His liabilities are conditional in the same manner as the liabilities of a general indorser. (see Sec. 66.) The phrase "to any subsequent indorser" refers to any of the indorsers between the drawer and the holder. They may also be called as *intervening indorsers.* Note that the drawer may, by express stipulation, inserted in the instrument, negative or limit his own liability to the holder, *(ibid.)*

(3) *Liability of a drawer of a check.* — The drawer may not unilaterally discharge himself from liability on checks issued by him merely as security and not for value to a payee who negotiated the same without his knowledge and consent to a holder in due course, by the mere expediency of withdrawing his funds from the drawee bank. By issuing a check, the drawer impliedly represents that funds or credit are available for its payment in the drawee bank. (State Investment House, Inc. vs. Court of Appeals,

217 SCRA 32 [1993]) The drawer can still be made liable under a separate contract distinct from the instrument. Thus, in a case, where the drawer also executed a separate letter of undertaking in consideration for the bank's negotiation of its sight drafts, the drawer can still be made liable under the letter of undertaking even if he is discharged due to the bank's failure to protest the non-acceptance of the drafts, (see Sees. 89, 152.) where he promised to pay on demand the full amount of the drafts. The liability under the letter of undertaking is direct and primary, and independent from that under the sight drafts, which subsists even if they are dishonored for non-acceptance or non-payment. (Producers Bank of the Phils, vs. Excelsa Industries, Inc., 587 SCRA 370 [2009]; Velasquez vs. Solid Bank Corporation, 550 SCRA 119 [2008].)

There is a slight difference between the liability of a drawer of a check and that of a drawer of other bills of exchange, (see Sec. 186.)

EXAMPLE:

Suppose R, as drawer, draws a bill on W, as drawee, payable to the order of P. The bill is indorsed successively by P to A, by A to B, and by B to C, the present holder.

In this case, R is liable only to C if W dishonors the bill by non-acceptance or non-payment and the necessary proceedings of dishonor are taken. After such proceedings are taken, the indorsers P, A, and B would also be liable to C and if, say, B pays C, B may, in turn, recover from R, P, or A. P, A, and B are the intervening indorsers.

R, as drawer, is permitted by law to negative or limit his own liability to the holder. Thus, R may insert in the bill the words "I shall not be bound in case this instrument is dishonored" or "without recourse."

Drawer distinguished from maker.

The following are the differences:

(1) The drawer issues a bill of exchange, while the maker, a promissory note;

(2) The drawer is only secondarily liable, while the maker is primarily liable; and

(3) The drawer can negative, or limit his liability, while the maker may not do so.

Sec. 62. ***Liability of acceptor.*** **— The acceptor by accepting the instrument engages that he will pay it according to the tenor of his acceptance; and admits —**

(a) The existence of the drawer, the genuineness of his signature, and his capacity and authority to draw the instrument; and

(b) The existence of the payee and his then capacity to indorse.

Liability of acceptor.

(1) *Liability of drawee before acceptance.* — As already pointed out, the drawee of a bill is not liable thereon before acceptance, (see Sec. 189.) He is not obligated to the payee or any holder to accept a bill although he may be liable to the drawer for breach of contract if he refuses without valid reason to accept the bill. As a general rule, a refusal by the drawee to accept a bill constitutes a dishonor of the instrument which triggers the liability of secondary parties — drawer and indorser — except those indorsing qualifiedly (Sec. 38.), that is, without guaranteeing payment. Unless the drawee accepts, he owes no duty to either the payee or any other holder. His only obligation is to the drawer to pay in accordance with the latter's orders.

(2) *Liability of drawee after acceptance.* — Once the drawee accepts, he becomes an acceptor. He is in virtually the same position as the maker of a note. The same result takes place when a drawee bank certifies a check drawn on the bank. (Sec. 187.) The acceptor is primarily bound on the instrument for by his acceptance, he engages to pay it according to the terms of his acceptance, subject to no condition whatsoever. His acceptance, in other words, is a promise to pay.

The bank (drawee) on which a check is drawn, is under strict liability based on the contract between the bank and its customer (drawer), to pay the check only to the payee's order. The drawer's instructions are reflected on the face and by the terms of the check, otherwise, the bank violates its duty to charge the drawer's account only for properly payable items and shall be liable for the amount charged to the drawer's account. (Phil. National Bank vs. Rodriguez, 566 SCRA 513 [2008].); Bank of America, NT & SA vs. Associated Citizens Bank, 588 SCRA 51 [2009]; Bank of America, NT & SA vs. Philippine Racing Club, 594'SCRA 301 [2009].)

(3) *Retraction of acceptance.* — The bill of exchange itself implies a representation by the drawer that the drawee is already in receipt of funds to pay, and the acceptance (admission of the truth of that representation) makes the drawee primarily liable. The drawee who has accepted cannot retract this admission as against a holder for value, since he has thereby obtained a suspension of the holder's remedies against the drawer and an extension of credit. (Babb & Martin, *op. cit.ƒ* p. 191.)

(4) *Payment of check despite stop-payment order.* — If a drawee-bank accepts or pays a check despite a stop payment order from the drawer, through oversight or otherwise, it cannot refuse to pay the holder or recover what has been paid; neither may it debit the drawer's account unless the acceptance nor payment was made prior to the receipt of the order.

(5) *Similarity to liability of maker and drawer.* — The acceptor has the same liability as the maker of a promisory note and the drawer of a bill with respect to the existence of the payee and his capacity to indorse, (see comments under Sees. 60 and 61.) Like the maker, neither presentment for payment nor notice of dishonor is necessary to charge him with liability, except where he is an acceptor for honor, (see Sec. 165.)

Liability depends on tenor of acceptance.

In general, no one but the drawee may accept; a stranger or volunteer is not bound by acceptance, *(ibid.,* p. 192.) The exception is when a bill is accepted for honor *supra protest,* (see Sees. 158, **161.)**

It is to be noted that while the maker of a note or the drawer of a bill engages to pay according to the tenor of the instrument, the acceptor engages to pay according to the tenor of his *acceptance,* which is not the same as the tenor of the bill itself because the acceptance may be qualified. (Sees. 139, 141.) Of course, if his acceptance is general or absolute (see Sec. 139.), then he is liable to pay according to the tenor of his acceptance which incidentally is also the tenor of the bill itself.

The nature of acceptance is important only in the determination of the kind of liabilities of the parties involved, but not in the determination of whether a commercial paper is a bilPof exchange or not. As long as a commercial paper conforms with the definition of a bill of exchange (Sec. 126.), that paper is considered a bill of exchange. (The Philippine Bank of Commerce vs. Aruego, 102 SCRA 530 [1981].)

EXAMPLE:

If R draws on W a bill for P500.00 payable 30 days after sight, W, not being a party to the bill may refuse to accept the same.

If he accepts, he becomes primarily liable. But his liability depends on the kind of acceptance that he makes. Thus, if W accepts the bill for P200.00, he is liable only for P200.00; the tenor of his acceptance, and not P500.00, the tenor of the bill.

Similarly, if he accepts the bill but payable "90 days after sight," he is bound to pay the bill as accepted. If he merely signs the bill as acceptor, then he is bound to pay unconditionally the bill according to its tenor which is the same as the tenor of his acceptance.

Effect of acceptance of an altered bill.

Suppose a bill is altered without authority by the payee before acceptance, and is subsequently accepted by the acceptor as altered, is the latter liable to an innocent holder according to the original tenor of the bill or according to its altered tenor. In other words, is the altered tenor of the bill, the tenor of acceptance? For instance, if a bill originally for P3,000.00 is altered by P, the payee, to P8,000.00 and is accepted by W, the acceptor, for P8,000.00, how much is W liable to A, a holder in due course — for P3,000.00 or P8,000.00?

Before the adoption of the Uniform Negotiable Instruments Law, the common law rule was that an acceptor was liable according to the tenor of the bill. Since the adoption of the Negotiable Instruments Law, writers and authorities on the law on negotiable instruments have differed in their views as to the effect of Section 62 on an altered instrument.

(1) *Tenor of acceptance.* — According to one view, W is liable for P8,000.00 as it is the tenor of his acceptance. "Since an acceptor by Section 62, engages to pay the bill according to the tenor of his acceptance, he must pay to the innocent payee or subsequent holder die amount called for by the bill at the time he accepted, even though larger than the original amount ordered by the drawer." (Ames and Woodword as cited in Beutel's Brannan, *op. cit.,* p. 904.) In a case, the drawee bank was held liable on its erroneous payment of a check to a due course holder (see Sec. 52.) according to the tenor of the check at the time of payment, which was the raised amount. In said case, the payee relied on the drawee bank's clearance and payment of a foreign draft (the amount in which was altered from P300,000 to P380,000) and was not negligent (it delivered the purchased jewelry only when the draft was cleared and paid). Commercial policy favors the protection of any one who, in due course, changes his position on the faith of the drawee bank's clearance and payment of a check or draft. Since the payee is protected by Section 62, its collecting agent bank where it deposited the draft, has no right to debit the amount it refunded to the drawee bank from the payee's account. The remedy of the collecting bank is against the drawee-bank or the person responsible for die alteration. (Far East Bank & Trust Co. vs. Gold Palace Jewellry Co., 502 SCRA 604 [2008].)

(2) *Original tenor of bill.* — The opposite view holds that W is liable only for P3,000.00, the original tenor of the bill. This view seems to be more logical. Section 62 should be read in relation to the definition of acceptance in Section 132." Assent to the order of the drawer" in Section 132 means "assent to pay according to the order of the drawer" and not according to what appears to be the order of the drawer.

It is argued that the acceptor has "assented to the alteration" by accepting an altered bill (see *ibid.,* p. 917.) under Section 124. But it is difficult to see how an acceptor could have "assented" if he had no knowledge of the alteration. Furthermore, it should be noted that under Section 124 (par. 2.), a holder in due course may enforce payment of a materially altered instrument not according to its altered tenor but "according to its original tenor."

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/arrantlefe of the acceptor.

The acceptor, by signing the bill as such, warrants the existence *of the payee* and his *then* capacity to indorse. In addition, he also *admits* the existence of the drawer, the genuineness of his signature, and his capacity and authority to draw the bill.

(1) *Defenses precluded.* — The acceptor is consequently precluded from asserting as a defense that the drawer is fictitious or non-existent, or that the drawer's signature is a forgery, or that he has no funds in his hands belonging to the drawer with which to pay the bill, or that the drawer has overdrawn his account, or that the drawer has no capacity to contract or has no authority to draw a bill. By accepting unconditionally a bill, the drawee becomes liable to a holder, and he cannot allege want or failure of consideration between him and the drawer. The holder is a stranger as regards the transaction between the drawer and the drawee. (National Bank vs. Picornell, 46 Phil. 716 [1924].)

(2) *Matters not admitted.* — The acceptor does not admit the genuineness of the indorser's signature (First Nat. Bank v. Northwestern Nat. Bank, 152 111. 296, 38 N.E. 739.) because it is only the signature of the drawer that he warrants, although the purported indorsement was on the bill at the time it was accepted.

An acceptor is only held to a knowledge of the signature of the drawer. By accepting a bill, he only admits the genuineness of such signature and cannot be charged with knowledge of the want of genuineness of any other part of the instrument or of the title of the holder.

Payment without acceptance.

For purposes of the rule, payment by the drawee may not be considered as equivalent of acceptance, (see Sec. 23.) There is a distinction between payment and acceptance, (see Sec. 189.) The latter is a "promise to perform an act" whereas the former is the actual performance thereof." In the words of the law, "the acceptance of a bill is the signification by the drawee of his assent to the order of the drawer." But acceptance is not required for checks, for the same are payable on demand.

The truth is that payment of the amount of a bill check t the drawee implies not only acceptance but also compliance witi the drawee's obligation. (Philippine National Bank vs. Court of Appeals, 25 SCRA 693 [1968].) Indeed, payment amounts to more than an acceptance, for the second is an obligation to pay, the first, a discharge of the indebtedness. The first implies not only the drawee's assent to the order of the drawer but also an admission of his corresponding obligation to pay the instrument and his clear compliance with that obligation.

The rule, holding that such payment has all the efficacy of an acceptance, is founded upon the principle that the greater includes the less. (Bank of Rolla v. Salem Bank, KH Mo App. 719,125 S.W. 513; Neal v. Coburn, 92 Me. 139.) The payment of the check includes its acceptance. (Far East Bank & Trust Co. vs. Gold Palace Jewellry Co., 562 SCRA 604 [2008].)

It has been held that acceptance by the drawee may be implied. (Sumacad vs. The Province of Samar, 100 Phil. 71 [1956].)

ILLUSTRATIVE CASE:

Drawee bank requested indorsee who was asking payment of a check to furnish it with photostatic copies thereof and present the check for certification.

Facts: R (province of Samar) issued a check to P (postmaster of Borongan, Samar) for the sum of P25,000 drawn against the Cebu branch of W (Phil. National Bank). P negotiated the check to A who presented the check to the municipal treasurer of Borongan for payment, but the latter did not choose to pay the same.

The letters of A to the Bureau of Posts seeking payment were referred by its Director to W, the drawee, which requested the Bureau of Posts to furnish it with photostatic copies of the check which copies it duly received, and A to present the check to the provincial treasurer and provincial auditor of R for certification in accordance with a circular issued by the Secretary of Finance.

Before the check could be certified as being in order, R withdrew its deposit with W, thereby leaving a small balance insufficient to cover the amount of the check A transferred his rights to B who was unable to cash it.

Issue: Was there an implied acceptance by W?

Held: (1) Yes. In requesting photostatic copies of the check in question and requiring A to present the check for certification, W voluntarily assumed the obligation of holding so much of the deposit as would be sufficient to cover the amount of the check, or before allowing the withdrawal that exhausted said deposit, of making the necessary inquiry on the matter. An implied acceptance of the check by W was thereby created.

The request on the Bureau of Posts and the requirement imposed on A by W would be an empty gesture if W did not thereby mean to assume the obligation of paying the check and holding sufficient deposit of R for the purpose. However, such obligation is merely subsidiary, R being primarily liable to pay fiie same. *(Sumacad vs. The Province of Samar, supra.)*

(2) No. Under the facts of the case, no obligation was created on the part of W to pay the amount of the check. To hold W liable, the original check must have been presented to W for payment and W should have refused to honor or cash it. The subsequent withdrawal of R of its deposit could not be prevented by W and if it had refused, it might be held responsible for damages for refusing to allow the withdrawal.

The only party liable for the payment of the check is R. W should be held free from any liability, primarily or subsidiarily. *(Justice S. Padilla, dissenting, see Sec. 132.)*

Sec. 63. ***When person deemed indorser.*** **— A person placing his signature upon an instrument otherwise than as maker, drawer or acceptor is deemed to be an indorser, unless he clearly indicates by appropriate words his intention to be bound in some other capacity.**

When a person deemed an indorser.

A person signing his name on the back of an instrument is, nothing else appearing, a general indorser (Sec. 66; Ang Tiong vs. Ting, 22 SCRA 713 [1968].) and liable as such, (see Sec. 17[f].) Being an indorser, he is chargeable only after presentment and notice of dishonor.

(1) *Parol evidence inadmissible.* — The law absolutely fixes the status of the indorser (Baumeisher v. Kuntz, 42 So. 886.); it does not merely raise a presumption that he is such. So, one who

signs as an indorser cannot show by parol evidence his intention to be bound in some other capacity, as for example, that he signed merely as an agent or for the purpose only of identifying a person on the instrument The law requires that he indicates by appropriate words his intention to be bound in some other capacity on the instrument itself.

(2) *Reason for the rule.* — The mle is founded upon commercial necessity. The full and free circulation of negotiable papers which take the place of money is a matter of great importance. To require each assignee, before accepting them, to inquire into and investigate every circumstance bearing upon the original issuance and to take cognizance of all the equities between the original parties, would utterly destroy their commercial value and seriously impede business transactions. (Majors v. Mckin- non, 53 SE. 447.)

When a person liable as guarantor or surety.

(1) *Liability as guarantor.* — Accordingly, a person who writes, in addition to his signature on the back of an instrument, "I hereby guarantee payment of this instrument" or "payment guaranteed," or their equivalent, indicates his intention to be bound as a guarantor in which case he is not discharged from liability merely because of the lack of due presentment or due notice of dishonor. He waives the need for presentment, protest, or notice of dishonor. Unlike, however, an indorser, a guarantor is liable only subsidiarily after the assets of the principal debtor have been exhausted. (Art. 2058, Civil Code.)

(2) *Liability as surety.* — Also, a person who writes his name on the back of an instrument followed by the words "as surety," shows by such added words his intention to be bound as a surety rather than as an indorser. As surety, he is primarily and absolutely liable with the principal debtor without benefit of exhaustion of the properties of the latter (Art. 2047, par. 2, *ibid.)* and without also the necessity of presentment or notice of dishonor.

(3) *Signature made for identification only.* — A party is liable only as a guarantor and not as indorser if his indorsement is

made for identification only, (see American Bank vs. Macondray & Co., Inc., 4 Phil. 695 [1905].)

(4) *Engagement of guarantor.* — Under the Uniform Commercial Code (see Introduction), a guarantor may sign an instrument either *payment guaranteed* or *collection guaranteed.*

(a) When a guarantor signs an instrument *payment guaranteed* or equivalent words, the signer engages that if the instrument is not paid when due he will pay it according to its tenor even if the party entitled to payment has riot attempted to collect from the party liable for it.

(b) On the other hand, when he signs *collection guaranteed,* or equivalent words, the signer engages that if the instrument is not paid when due he will pay it according to its tenor but only after the party entitled to payment has tried to collect from the party liable for it and has been unable to do so and it is apparent that it is useless to proceed against him. (see Sec. 3-416, U.C.C.)

Liability of agent bank for collection.

As a mere *agent* for collection, a bank is not bound to know the genuineness of prior indorsements, (see Jai-Alai Corp. vs. Bank of P.I., 66 SCRA 429 [1975]; see Sec. 23.)

(1) An intermediate or collecting bank which accepts a check for deposit and forwards it to the drawee-bank for payment stamped "all prior indorsements guaranteed," does not indorse the check as a general indorser but merely as an agent bank, guaranteeing only "prior indorsements," not the genuineness of the check itself, so that it is not liable to the drawee bank which paid the check in case the signature of the drawer was forged, (see Phil. National Bank vs. Court of Appeals, 25 SCRA 693 [1968].)

(2) A bank is estopped, however, from raising the non- negotiability of checks (it accepts for deposit) on the back of which it stamped its guarantee of "all prior indorsements and/ or lack of indorsement" and subsequently presented those checks for clearing with another bank which on the strength of the guarantee cleared the checks and credited the account of the

first bank. (Banco de Oro Savings & Mortgage Bank vs. Equitable Banking Corp., 157 SCRA 188 [1988].)

Sec. 64. ***Liability of Irregular Indorser.*** **— Where a person, not otherwise a party *to* an instrument, places thereon his signature in blank before delivery, he is liable as indorser, in accordance with the following rules:**

(a) If the instrument is payable to the order of a third person, he is liable to the payee and to all subsequent parties.

(b) If the instrument is payable to the order of the maker or drawer, or is payable to bearer, he is liable to all parties subsequent to the maker or drawer.

(c) If he signs for the accommodation of the payee, he is liable to all parties subsequent to the payee.

Irregular or anomalous indorsement explained.

The term usually denotes an indorsement for some purpose other than to transfer the instrument, or an indorsement by a stranger to the instrument or by one not in the actual or apparent chain of title, especially an indorsement made prior to the delivery of the instrument to the payee. The purpose of the indorsement not for transfer is usually to add the signer's credit to the instrument, (see 11 Am. Jur. 2d 387-389.)

When a person an irregular or anomalous indorser.

Section 64 deals only with the liability of an irregular indorser to the payee and subsequent parties. The rights and liabilities of several irregular indorsers as among themselves are governed by Section 68. Section 64 has no application to a case where the signature was placed on the instrument after delivery to the payee.

Based on this section, an *irregular* or *anomalous* indorser is a person who, (1) not otherwise a party to an instrument, (2) places thereon his signature in blank, (3) before delivery. The phrase "not otherwise a party to an instrument" means that the irregular indorser is not a maker, drawer, acceptor, or regular indorser thereon.

The irregular or anomalous indorser indorses the instrument in an unusual, singular or peculiar manner. His name appears where we would naturally expect another name. Thus, if an instrument is made payable to the order of P as the payee, P's name should appear on the back of the instrument as the first indorser but instead we find the name of X. In such case, X is an irregular or anomalous indorser. (see Ogden, *op. cit.,* p. 241.)

Usually, an irregular or anomalous indorser is an accommodation indorser. He is not necessarily so where he participates in the consideration for the instrument, (see Sec. 29.)

Rules as to liability of irregular or anomalous indorser.

Section 64 sets out rules for three classes of cases regarding the liability of an irregular or anomalous indorser.

EXAMPLES:

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(1) *Instrument payable to the order of a third person.*

M makes a note payable to P or order. P, however, does not have faith in the financial ability of M and is willing to take the note only if X's financial ability "is back of it." M then secures X's indorsement in blank before the note is delivered to P. P negotiates the note to A for some obligation. When A takes the instrument, X's name appears as the first indorser followed by P's name.

X is liable to P, payee, and A, a subsequent party, but not to M (Subsec. [a].)

(2) *Instrument payable to the order of maker or drawer or to bearer.*

Suppose the note is payable to the order of M (which means that the maker and the payee are the same person), M cannot circulate the instrument without X's indorsement thereon. X then signs his name and M indorses and delivers the instrument to A.

X is liable to A, a party subsequent to M, the maker, and to subsequent parties but not to M. But M is liable to X. The liability of M is that of a first indorser while X, of a second indorser. If the note were payable to bearer, X would also be liable to all parties subsequent to M. (Subsec. [b].)

(3) *Irregular indorser signing for accommodation of payee.*

Suppose in the first illustration, P wants to discount the note with A, a bank, but the bank is not willing to rely on the financial ability of M and P alone. P then secures X to accommodate him. X without receiving any valuable consideration therefor, but only for the purpose of lending his name and credit to P, indorses the note in blank.

X is liable to all parties subsequent to P, the payee. P is, in effect, the first indorser, and X, the second indorser. (Subsec. [c].)

Warranties of irregular indorser.

It must be noted that Section 64 provides only for the parties to whom an irregular indorser is liable. His warranties are the same as those of a general indorser under Section 66 inasmuch as his indorsement is in blank which, in itself, is an indorsement without qualification.

Sec. 65. ***Warranty where negotiation by delivery, and so forth.* — Every person negotiating an instrument by delivery or by a qualified indorsement warrants —**

(a) That the instrument is genuine and in all respects what it purports to be;

(b) That he has a good title to it;

(c) That all prior parties had capacity to contract;

(d) That he has no knowledge of any fact which would impair the validity of the instrument or render it valueless.

But when the negotiation is by delivery only, the warranty extends in favor of no holder other than the immediate transferee.

The provisions of subdivision (c) of this section do not apply to persons negotiating public or corporation securities, other than bills and notes.

Negotiation by delivery/qualified indorsement.

Every indorser makes certain warranties or guarantees about the instrument the is negotiating. (Sec. 65, 66.) This *warranty liability* is unconditional, *i.e.,* it is not conditioned upon proper presentment and dishonor of the Instrument and the giving of notice of the dishonor.

(1) Negotiation "by delivery" tinder Section 65 means that indorsement is not necessary because the instrument is payable to bearer. The words "by delivery," therefore, refer to a holder who negotiates the instrument in the same condition in which he received it, making no indorsement at all. So a blank indorser of an instrument does not negotiate it "by delivery" within this section (Consolidated Motors Co. v. Urschel, 115 Kan. 147, 222 Pac. 745.) as his liability would be governed by Section 66.

(2) A qualified indorsement is made by adding to the indorser's signature the words "without recourse" or any words of similar import, (see Sec. 38.)

Warranty liability of one negotiating by delivery and of qualified indorser.

(1) The liability of a person negotiating a bearer instrument by mere delivery is the same as the person who negotiates by qualified indorsement. (Sec. 38.) Both do not assume to pay the instrument in the event of its dishonor unless the dishonor is based on any of the four implied warranties enumerated in Section 65. They are, in fact, merely assigning a credit.

(2) Their liabilities differ, however, with respect to the person in whose favor the warranty extends. While the liability of the one who negotiates by mere delivery extends in favor only of his immediate transferee (par. 2.), the qualified indorser is liable to all subsequent holders who make title through his indorsement for a breach of any of his warranties.

EXAMPLES:

(1) M makes a promissory note payable to bearer and delivers the same to P, who negotiates it to A either by delivery or by a qualified indorsement.

If the note is dishonored in the hands of A due to the insolvency of M, A cannot recover from P because P does not warrant M's solvency.

However, P is liable if the instrument is forged for he warrants that the "instrument is genuine" (a); or if P had stolen the note from M for he warrants that "he has a good title to it" (b); if M is a minor for he warrants that all prior parties had capacity to contract (c);" or if P knew that the instrument was invalid for want or failure of consideration or that M was insolvent but concealed that fact from A for he warrants that "he has no knowledge of any fact which would impair the validity of the instrument or render it useless." (d)

Suppose the note is negotiated by P to A, and A to 6, all by delivery, is P liable to B for violation of any of the four warranties? No. because the warranties of P extend only to A, his immediate transferee. A, of course, is liable to B, his immediate transferee.

(2) R issued 10 checks (two of three crossed checks [see Sec. 185.] are bearer checks and one, uncrossed bearer check) payable to P, Inc. X, a sales agent of P, Inc., indorsed all the checks to A Corp. which deposited the same in its current account with Bank of P. I. After temporarily crediting the amount thereof to A Corp.'s account, Bank of P. I. debited the amount against the account of A Corp. upon being informed by P, Inc. that the indorsement by X were forgeries.

Under Section 65, the warranty of R with respect to the bearer checks, extends only to Bank of P. I. (see Jai-Alai Corp. vs. Bank of P.I., 66 SCRA 29 [1975]; see Sec. 23.)

Liability of collecting/issuing bank.

The warranty "that the instrument is genuine and it all respects what it purports to be" covens all the defects in the instrument affecting the validity thereof, including a forged indorsement. Thus, the last indorser will be liable for the amount indicated in the negotiable instrument even if a previous indorsement was forged. It has been held in a line of cases that "a collecting bank which indorses a check bearing a forged indorsement and presents it to the drawee bank guarantees all prior indorsements, including the forged indorsement itself, and ultimately should be held liable therefor."

The above rule is subject to exceptions. One such exception is when the issuance of the check itself was attended with negligence. Thus, while the collecting bank is generally held liable, the issuing bank is just as liable or more than the collecting bank where the subject check was negligently issued *(e.g.,* to a stranger on instruction by telephone of supposed depositor, without written authorization).

Where both banks were negligent, the Supreme Court allocated the loss between them considering their comparative or relative negligence and the demands of substantial justice. In one case, the proportionate sharing was 50%-50%, in another, the drawee bank was held liable for 60% of the amount of the check and the collecting bank, 40%. (Allied Banking Corporation vs. Lim Sio Wan, 549 SCRA 504 [2008].)

Sale of public or corporate securities.

Brokers and other persons "negotiating public or corporation securities, other than bills and notes" do not warrant the capacity of prior parties. (Sec. 65,2nd par.)

EXAMPLE:

Under a legislative authority, the City of Manila issued bonds. X bank buys some of these bonds and sells some to P, an investor. The Supreme Court subsequently decided that the law authorizing the issue of the bonds and the bonds (on some ground or another) are void.

In this case, X bank is not liable to P for breach of implied warranty. X did not impliedly warrant that the City of Manila had the capacity to issue the bonds in question, (see Babb & Martin, *op. tit.,* pp. 212-213.)

Sec. 66. ***Liability of general indorser.*** **— Every indorser who indorses without qualification, warrants to all subsequent holders in due course —**

(a) The matters and things mentioned in subdivisions (a), (b) and (c) of the next preceding section; and

(b) Thattheinstrumentisatthetimeofhisindorsement, valid and subsisting.

And, in addition, he engages that on due presentment, it shall be accepted or paid, or both, as the case may be, according to its tenor, and that if it be dishonored, and the necessary proceedings on dishonor be duly taken, he will pay the amount thereof to the holder, or to any subsequent indorser who may be compelled to pay it.

Warranty liability of general or unqualified indorser.

The drawer and general indorser guarantee payment of the instrument, provided certain steps are taken to charge them with liability.

Similarity to that of qualified indorser and person negotiating by delivery. — Section 66 incorporates subsections (a), (b), and (c) of Section 65. (see Jai-Alai Corp. of the Phil. vs. Bank of P.I., 86 SCRA [1975], under Sec. 23.) Insofar as the first three warranties in Section 65 are concerned, the liability of the general indorser is similar to the liability of the qualified indorser and a person negotiating by delivery. It must be emphasized that the law is not applicable to non-negotiable intruments like treasury warranties. (Metropolitan Bank & Trust Co. vs. Court of Appeals, 194 SCRA 169 [1991].) He cannot interpose the defense that signatures prior to him are forged. (Associated Bank vs. Court of Appeals, 252 SCRA 620 [1996].)

Warranty that instrument valid and subsisting. — As regards the fourth warranty, however, the similarity ends. While the unqualified indorser guarantees that the instrument is valid and subsisting, whether or not he has no knowledge of that fact, the qualified indorser warrants merely that he has no knowledge of any fact which would invalidate the instrument or render it useless. If the instrument indorsed turns out to be invalid, the unqualified indorser is liable because of the fourth warranty but the qualified indorser is not liable unless he was aware of the cause of the invalidity.

A subsequent party which caused a defect in the instrument cannot have any recourse against any of the prior indorsers in good faith. Thus, a bank which caused the dishonor of a check upon presentment to the drawee bank, through the qualified indorsement of its employee, where full payment by the drawee-bank would have taken place where it not for the "irregular indorsement," cannot hold prior indorsers liable on the instrument for its dishonor. (Gonzales vs. Rizal Commercial Banking Corp., 508 SCRA 459 [2006].)

Warranty that instrument will be honored. — The unqualified indorser also warrants that the instrument will be honored, (par. 2.) So he is liable in case the instrument will not be paid because of the insolvency of any prior party but a qualified indorser is not liable unless he had knowledge of such insolvency, (see Ang Tiong vs. Ting, 22 SCRA 713 [1968].) When a person makes an unqualified indorsement of an instrument, the law specifies and defines his liability and parol testimony is not admissible to explain or defeat such liability. (Velasco vs. Tan Livan & Co., 43 Phil. 196 [1924].)

After an instrument is dishonored by non-payment, indorsers cease to be merely secondarily liable. They become principal debtors whose liability becomes identical to that of the original obligor. The holder need not even proceed against the maker or drawer before suing the indorsers. The maker or drawer is not an indispensable party in an action against the indorsers. (Tuazon vs. Heirs of B. Ramos, 463 SCRA 408 [2005].)

Warranty that prior indorsements genuine. — By stamping on a (crossed) check accepted by it for deposit its guarantee that all "prior endorsements and/or lack of endorsements guaranteed/' a collecting bank makes the assurance that it had ascertained the genuineness of all prior indorsements. By such deliberate and positive act, it has for all legal intents and purposes treated the said check as negotiable instrument and, accordingly, assumed the warranty of the indorser. In case the indorsement is forged or unauthorized, the bank, in paying the check, becomes liable to the payee for the value thereof. (Associated Bank vs. Court of Appeals, 208 SCRA 465 [1992].)

Warranty available only to a holder in due course. — The warranties of a general indorser as provided in Section 66 are based upon a transfer of title and are available only to a holder in due course. They do not attach to the indorsement for deposit and collection made by the payee/holder of a bill or check. In case of erroneous payment by the drawee bank, the collecting bank has no legal right to debit the amount of the payee for any amount it refunded to the drawee-bank. Under Section 36, a restrictive indorsement *{e.g.,* one only for purposes of collection) does not in any way transfer the title of the instrument to the collecting bank The collecting bank cannot invoke the warranty of the payee/ depositor who indorsed the instrument for collection. (Far East Bank & Trust Co. vs. Gold Palace Jewelry Co., 562 SCRA 604 [2008].)

(6) *Warranty of collecting bank as indorser.* —A collecting bank where a check is deposited, and which indorses the check upon presentment with the drawee bank is an indorser and assumes the warranty of an indorser under Section 61. In check transactions, the collecting bank or as last indorser generally suffers the loss because it has the duty to ascertain the genuineness of all prior indorsements considering that the act of presenting the check for payment to the drawee is an assertion that the party making the presentment has done its duty to ascertain the genuineness of the indorsements when a bank stamps a check with the phrase "all prior indorsements and/or lack of indorsement guaranteed" it treats the checks, for all intents and purposes, as a negotiable instrument and accordingly, assumes the warranty of an indorser. Without such warranty, the drawee would not make payment on the check. As indorser, he cannot deny liability for damages in case the warranty has proven to be false and inaccurate. (Banco de Oro Savings & Mortgage Bank vs. Equitable Banking Corp., 157 SCRA 188 [1988]; Bank of America, NT & SA vs. Associated Citizens Bank, 588 SCRA 51 [2009].)

Right of holder not in due course to enforce warranties of general indorser.

Although Section 66 states that the warranties of unqualified indorsers run "to all subsequent holders in due course," it should not be construed literally in the sense that holders not in due course cannot enforce the warranties.

The warranties of Section 65 run to any person to whom the instrument has been negotiated and there is no reason why the same result should not be obtained under Section 66. To hold otherwise, the transferee of a qualified indorser would have greater rights than the transferee of a general indorser. (Beutel's Brannan, *op. cit.,* p. 958.)

Conditions precedent to make indorser liable.

The unqualified indorser, in addition to his warranties, engages to pay the instrument if it is dishonored. In order to enforce his liability in this respect, the following conditions must be complied with:

(1) Due presentment for payment or acceptance, as the case may be, must be made; and

(2) If the instrument is dishonored (by non-presentment or non-acceptance), the necessary proceedings on dishonor be duly taken. (Sec. 66, par. 2.)

These conditions, unless waived, must be met in order that a secondary party may be held liable on his *promissory* liability as distinguished from his *warranty* liability. The liability of the unqualified indorser is similar to that of the drawer, (see Sec. 61.) An indorsement is presumed unqualified. To be qualified, it must contain specific words qualifying liability, (see Sec. 38.)

Indorser's liability as warrantor distinct from his liability to pay.

Even the qualified indorser who does not guarantee payment of the instrument may nevertheless incur liability for breach of one or more of the implied warranties. These warranties are imposed in view of the fact that the indorser is actually a seller of property. And although the general indorser's obligation to pay the instrument may never become absolute because of non- presentment or omission to give due notice of dishonor, he may, nevertheless, be held liable if there has been breach of any implied warranty. His liability as warrantor is distinct from his liability to pay the instrument. As warrantor, his liability is unconditional.

No steps (due presentment, due notice of dishonor, protest, *infra.)* are necessary to fix an indorser's liability for breach of warranty. (Babb & Martin, *op. cit,* p. 211.)

EXAMPLE:

R delivers to P a check for P3,000.00. P increases the amount to P8,000.00 and indorses the check to A, and by A to B. The forgery was not known to A and B. B took the check for value and satisfied the requirements of a holder in due course.

In this case, B can recover a judgment against R, the drawer in the amount of P3,000.00, and a judgment against A in the amount of P5,000.00 for breach of the warranty of genuineness. Note that A is liable notwithstanding the fact that he had no knowledge of the forgery, (see *ibid.)*

Indorser and drawer distinguished.

An indorser and a drawer are similar in that they are both secondarily liable on the instrument. But they are different in the following manner:

(1) An indorser is a party to either a note or a bill, while a drawer, only to a bill;

(2) An indorser does not make any admission regarding die existence of the payee and his capacity then to indorse, while the drawer makes such admission; and

(3) An indorser has warranties, while a drawer makes no warranties, but he engages to pay after certain conditions are complied with, (see Sees. 61 and 66.)

The liabilities of the drawer are conditional in the same manner as those of the general indorser. *(ibid.)*

General indorser and irregular indorser distinguished.

The following are the differences:

(1) A general indorser makes either a blank or special indorsement, while an irregular indorser always makes a blank indorsement;

(2) A general indorser indorses the instrument after its delivery to the payee, while an irregular indorser indorses before its delivery to die payee; and

(3) A general indorser is liable only to parties subsequent to him, while an irregular indorser is liable to tine payee and

subsequent parties unless he signs for the accommodation of the payee in which case he is liable only to all parties subsequent to the payee, (see Sec. 64[c].)

Sec. 67. ***Liability of indorser where paper negotiable by delivery.*** **— Where a person places his indorsement on an instrument negotiable by delivery he incurs all the liabilities of an indorser.**

Liability of indorser of bearer instrument.

(1) *Negotiation by delivery.* — An instrument payable to bearer (Sec. 9.) is negotiable by delivery (Sec. 30.) and the transferor is liable to the immediate transferee under Section 65. It is, therefore, not necessary for the holder to indorse the instrument if his purpose is just to negotiate the same.

(2) *Negotiation by indorsement.* — There is nothing, however, to prevent the holder from indorsing the instrument if he wants to. In such a case, his liability will be governed by Section 65 or by Section 66 depending upon whether the indorsement is qualified or unqualified.

(a) If he indorses specially, he is liable only to holders who make title through his indorsement, (see Sec. 40.)

(b) If he indorses without qualification, he incurs the liability of a general indorser. (see Jai-Alai Corp. of the Phil, vs. Bank of P.I., 66 SCRA 29 [1975].)

Sec. 68. ***Order in which indorsers are liable.*** **— As respects one another, indorsers are liable *prima facie* in the order in which they indorse; but evidence is admissible to show that as between or among themselves, they have agreed otherwise. Joint payees or joint indorsees who indorse are deemed to indorse jointly and severally.**

Order of liability among indorsers.

(1) *Among themselves.* — This section governs the liability of indorsers only as among themselves. It establishes a disputable presumption that every indorser is liable to all indorsers subsequent to him. This *prima facie* order of liability may be rebutted because it may be shown by parol evidence either written or oral,

that "as between or among themselves they have agreed otherwise." Thus, an irregular indorser (Sec. 64.) will not be liable to the accommodated party although from the order in which he indorsed, the latter appears subsequent to the former.

(2) *To the holder.* — The holder of an instrument which has been dishonored is not bound by the above section. As to him, indorsers are liable in any order and none of them can interpose as a defense against him an agreement among themselves that they are not liable in the order of their indorsements. The rule must be qualified in the case of a qualified indorser and an indorser of a bearer instrument, title to which the immediate holder took by delivery alone.

EXAMPLE:

An instrument payable to the order of P bears the following indorsements on the back thereof: P, A, B and C. The present holder is D.

D may recover payment from any of said indorsers since Section 68 (1st sentence) governs only the liability of the indorsers among themselves but not their liability to the holder. So if D sues A, the latter cannot allege that he and B have agreed that B should be liable first.

If A is made to pay by D, A can go against P, a prior indorser, but not against B and C, subsequent indorsers, to whom he is, in turn, liable. However, if after paying D, A can prove that their agreement is that B should be liable first, A can enforce reimbursement from B.

Liability of joint payees or joint indorsees who indorse.

(1) *Solidary liability.* — Under Section 68, "joint payees or joint indorsees who indorse are deemed to indorse jointly and severally." Their liability, therefore, is solidary so that none of them can escape liability just because proper notice of dishonor (Sec. 89.) was not given to the other. Parol evidence is inadmissible that they signed as guarantors only. But the one who pays may demand reimbursement from the others.

(2) *Joint liability.* — Under Section 184, a note made payable to the order of the maker is not complete until indorsed by him.

The same is true of a bill payable to the drawer's order. In the light of Section 184, the last sentence of Section 68 does not apply to an instrument containing the words "we promise to pay" and made payable to the order of the makers themselves because in such a case their liability is joint and not solidary, (see Sec. 17[g].)

Successive negotiations contemplated.

Section 68 does not determine the order of liability of joint indorsers among themselves. Thus, in a note with an indorsement beginning "I/or we, hereby guarantee," signed in succession by P, A, B, C, and D, C has no right to indemnification by P, A and B, the preceding indorsers, under Section 68.

In fixing the order of liability, Section 68 contemplates successive negotiations and successive indorsements.

> **Sec. 69.** ***Liability of an agent or broker.*** **— Where a broker or other agent negotiates an instrument without indorsement, he incurs all the liabilities prescribed by section sixty-five of this Act, unless he discloses the name of his principal and the fact that he is acting only as agent.**

Liability of an agent or broker.

(1) *Personal liability.* — This section refers to instruments which are payable to bearer and are, therefore, negotiable by delivery.

(a) The agent or broker who negotiates by mere delivery incurs the liabilities prescribed in Section 65.

(b) If he negotiates the instrument by qualified indorsement, his warranties are also those stated in Section 65 and if by general indorsement, those stated in Section 66.

(2) *Exemption from liability.* — To escape personal liability, he must disclose his principal and the fact that he is acting only as agent. (Sec. 20.) Parol evidence is not admissible to relieve a broker or other agent whose indorsement brings him within Section 69. (Peoples Bank v. Baker, 193 S.W. 632.)

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CHAPTER VI

PRESENTMENT FOR PAYMENT

Sec. 70. ***Effect of want of demand on the principal debtor.* — Presentment for payment is not necessary in order to charge the person primarily liable on the instrument; but if the instrument is, by its terms, payable at a special place, and he is able and willing to pay it there at maturity, such ability and willingness are equivalent to a tender of payment upon his part. But, except as herein otherwise provided, presentment for payment is necessary in order to charge the drawer and indorsers.**

Meaning of presentment for payment.

By *presentment for payment* is meant the presentment of an instrument *(i.e.,* promissory note or accepted bill) to the person primarily liable for the purpose of demanding and receiving payment.

Presentment for payment to person primarily liable not necessary.

(1) *Liability absolute on date for payment.* — Presentment and demand for payment are not necessary in order to charge the person primarily liable, that is, the maker or the acceptor since his liability is absolute. In other words, the holder can sue the maker or the acceptor, although no demand has been made on him, as soon as the date for payment has passed without the instrument being paid.

(2) *Where instrument payable at a special place.* — This is true whether the instrument is payable on time or on demand, and even if the instrument is payable at a special place *(e.g.,* at a bank

or at an office or at a residence but not at an unspecified place, like City of Manila). However, in this case, the ability *and* willingness on the part of the primary party to pay there at maturity are equivalent to a tender or offer of payment on his part so that if the instrument is not paid and is overdue, he cannot be considered in delay and, therefore, not being at fault, he is not liable for costs and interests subsequently accruing although he is not relieved from making payment of the amount due.

(3) *Wherepresentment requiredby terms ofinstrument.* — Neither is presentment for payment necessary to charge the maker or the acceptor even if it is required according to the terms of the instrument. Worse, the failure to make the presentment would not put him in default notwithstanding that the instrument is overdue and unpaid.

EXAMPLE:

M issued to P an interest-bearing promissory note in the amount of PI,000.00 payable at X bank. M has deposit at maturity and at all times thereafter a sum sufficient to pay the note if presented.

P's failure to present the note at maturity does not release M from liability for the principal sum of PI,000.00 and interest up to maturity (even though X bank fails) but M is not liable for interest after maturity. If P sues M on the note, M—not P— will be entitled to court costs. (Babb & Martin, *op. cit.,* p. 190.)

There must be evidence not only of ability but also of willingness on the part of M to pay the note at the bank named at maturity. (Corley v. French, 294 S.W. 513.)

(4) *Rule applicable to notes payable on demand.* — It has been held that the rule that presentment for payment is not necessary to charge the person primarily liable is applicable to notes payable on demand and suit thereon may be maintained though no demand has been made. (Schuman v. Citizens State Bank, 144 N.W. 388.)

(5) *Risk assumed by holder in case presentment not made.* — But neglect to present a check does not affect the debt for which it was given. (Greenwich v. Oregon Imp. Co., 148 N.Y. 758.)

Practically, the only risk assumed by the holder of a check in case presentment was not made within a reasonable time, so far as the rights against the drawer are concerned, is the insolvency of the drawee. (Springfield and Mauie Ins. Go. v. lincher, 30 111. 399; see Sec. 186.)

Presentment for payment to persons secondarily liable necessary.

(1) *Presentment first to primary party required.* — The persons secondarily liable, that is, the drawer and the indorsers, stand on a different footing. Since they undertake to pay only if the instrument is dishonored (Sees. 61, 66.), it is obvious that a demand for payment must first be made upon the person primarily liable (although the only purpose of such demand is to charge the indorsers with liability). The demand is effected by presenting the instrument to him for payment.

(2) *Effect where presentment not made.* — If the instrument is not presented to the person primarily liable, the drawer and the indorsers are discharged from their secondary liability unless such presentment is excused (Sees. 79, 80.) or dispensed with. (Sees. 82,151.) In the event of non-acceptance or non-payment, notice of dishonor must be given to the drawer and each indorser, otherwise the party to whom notice is not given will be released from liability. (Sec. 89.)

Sec. 71. ***Presentment where instruments is not payable on demand and where payable on demand.*** **— Where the instrument is not payable on demand, presentment must be made on the day it falls due. Where it is payable on demand, presentment must be made within a reasonable time after its issue, except that in the case of a bill of exchange, presentment for payment will be sufficient if made within a reasonable time after the last negotiation thereof.**

Date of presentment of instrument.

The date of presentment depends on whether the instrument is payable at a fixed or determinable future time or on demand.

(1) If the instrument is *payable at a fixed or determinable future time*, presentment must be made on the date it falls due without period of grace (Sec. 85.), otherwise, the drawer and indorsers will be discharged from liability. (Sec. 70.) Presentment made before maturity is not effective (Long v. Alder, 88 S.W. 802.) and a notice to the makers before maturity reminding them of the date when the note would fall due is not a proper presentment. (Williard State Bank v. Clark, 208 Pac. 549.)

(2) If the instrument is *payable on demand,* the law makes a distinction as to presentment for payment between promissory notes and ordinary bills of exchange, (see Sec. 186.)

(a) In case of the former, presentment must be made to the maker *within a reasonable time after its issue or delivery.* Just what constitutes a reasonable time is a question of fact, (see Sec. 193.) Actually, it is a question of law upon the facts proved in each case. In one case, a demand made after 60 days was held to be unreasonable (Plymouth Country Trust Co. v. Scarlan, 118 N.W. 468.), while in another case, a delay of 7 months was held to be not unreasonable. (Buckner v. Horowitz, 144 N.Y.S. 161.)

The burden is on the holder of a note, when seeking to hold an indorser, to prove due and timely presentment. (Commercial National Bank v. Zimmerman, 185 N.Y. 218.)

(b) If the instrument is a bill of exchange, presentment for payment to the drawee or acceptor must be made *within a reasonable time after the last negotiation thereof.* The time from the issuance up to the last negotiation is not considered. Under Section 71, therefore, the liability of the drawer and indorser of a bill could continue for an indefinite time limited only by the statute of limitations so long as each negotiation takes place promptly after each indorser acquires title. The "last negotiation" under Section 71 means the last transfer for value.

In a case where a check dated September 13,1960 drawn by one of the respondents and signed at the back by the others, was presented by the petitioner only on March 5, 1964 to the drawee-bank which dishonored it on the same date and made a formal notice of dishonor to the petitioner through a letter dated April 27,1964, it was held that "under these circumstances the petitioner undoubtedly failed to exercise prudence and diligence on what he ought to do as required by law." (Far East Realty Investment, Inc. vs. Court of Appeals, 166 SCRA 256 [1988].)

Sec. 72. ***What constitutes a sufficient presentment* — Presentment for payment, to be sufficient, must be made —**

(a) By the holder, or by some person authorized to receive payment on his behalf;

(b) At a reasonable hour on a business day;

(c) At a proper place as herein defined;

(d) To the person primarily liable on the instrument, or if he is absent or inaccessible, to any person found at the place where the presentment is made.

Requisites for a sufficient presentment for payment.

If the presentment for payment does not comply with any of the requisites provided in this section, the effect is the same as if no presentment is made and consequently, the persons secondarily liable are discharged.

(1) *By whom.* — The holder, as owner of the instrument, has obviously the right to make the presentment. However, any person authorized by him is a proper party to present the instrument and the authorization need not be in writing. A presentment for payment of a promissory note by a bank having it for collection is sufficient. (Fowler Paper Co. v. Vest Jones etc., Co., 183 111. App. 310.)

By crossing a check (see Sec. 185.), the drawer intends the same for deposit only by the rightful person, *i.e.,* the payee named therein. There is no proper presentment where the check is presented for payment not by die payee but by his transferee. In the absence of proper presentment, no right of recourse is available against the drawer. (State Investment House vs. Intermediate Appellate Court, 175 SCRA 310 [1989].)

It is believed that a transferee of an unindorsed instrument (Sec. 49.) is included in the term "holder" as used in Section 72(a).

(2) *When.* — The term "reasonable hour on a business day" means during business hour. What constitutes business hours depends upon the general custom of the place of the particular transaction. (Columbia Banking Co. v. Bowen, 114 N.W. 541.)

(a) If payable at a bank, the presentment of the instrument must be made during banking hours. (Sec. 75.)

(b) If presented at a place of business, it must be made during the usual business hours in that place. (Junt v. Adams, 17 Me. 230.)

(c) If presented at the residence of the person liable to pay, it must be made between the usual hours of rising and retiring. (Salt Springs Nat. Bank of Syracuse v. Burton, 58 N.Y.430.)

(3) *Where.* — The proper place of presentment is discussed in the next section.

(4) *To whom.* — Presentment for payment must be made to the primary party — to the maker in case of a promissory note, or to the acceptor in case of an accepted bill. If the bill of exchange or check is payable on demand, the presentment must be made to the drawee although he is not liable on the bill, (see Sees. 61, 66, and 70.)

If the person primarily liable is absent or inaccessible, then presentment must be made to any person of sufficient discretion at the proper place of presentment. Thus, where a note is payable at a certain store, presentment for payment at such store to a person connected therewith is sufficient and no personal demand on the maker is necessary. (Nelson v. Grondhal, 100 N.W. 1093.) If the holder after the exercise of reasonable diligence cannot find the person to make payment on the day and at the place of payment, he has done all that is required of him.

Sec. 73. ***Place of presentment*** **— Presentment for payment is made at the proper place:**

(a) Where a place for payment is specified in the instrument and it is there presented;

(b) Where no place of payment is specified, but the address of the person to make the payment is given in the instrument and it is there presented;

(c) Where no place of payment is specified and no address Is given and the instrument is presented at the usual place of business or residence of the person to make payment;

(d) In any other case if presented to the person to make payment wherever he can be found, or if presented at his last known place of business or residence.

Place of presentment.

(1) *Order of enumeration.* — The proper, place of presentment is the place specified in the order of enumeration from subsection (a) to subsection (d). This means that if subsection (a) can be applied, presentment made in any other place under subsections (b) to (d) will be improper and, therefore, will not come under Section 72(c). Likewise, subsection (c) should be made applicable only if subsections (a) and (b) cannot be applied. Subsection (d) is applicable only if presentment cannot be made at any other place.

(2) *Where place specified.* — Presentment of a note payable at a specified place where the payee resides, at a different place which was the domicile and place of business of the maker, is not sufficient to charge indorsers. (Eagle Lumber Co. v. Oil States Lumber Co., 98 So. 270.) Where a note is payable at a designated branch of a trust company, presentment at title principal office or at any other branch of the company is not sufficient. (Ironclad Mfg. Co. v. Sacken, 114 N.Y. Supp. 43.) A specified place of payment must indicate a definite address. If only the name of the town or city is stated then subsection (b) applies and in default of the same, subsection (c). The usual residence referred to is the usual ordinary and habitual residence. (Cuddy v. Sasandela, 161 Atl. 297.)

Sec. 74. *Instrument must be exhibited*. — The instrument must be exhibited to the person from whom payment is demanded, and when it is paid must be delivered up to the party paying it.

Mode of presentment for payment.

Presentment refers to the act of the holder of a negotiable instrument of exhibiting a note to the maker and demanding payment, or showing a bill to the drawee and requesting its acceptance or payment.

A valid presentment for payment consists of something more than a mere demand. It requires personal or face to face demand at the proper place, exhibiting the instrument to the maker or acceptor (Grese v. Le Monte, 162 N.Y.S. 982.) from whom payment is demanded.

Exhibition of the instrument.

(1) *Purpose of exhibition.* — The purpose is to enable the debtor: (a) to determine the genuineness of the instrument and the indorsements and the right of the holder to receive payment; and (b) to enable him, upon payment, to take possession of it to guard against a lawsuit by a subsequent holder. In the case of the acceptor who pays a bill, he has the right to have it delivered to him for use as a voucher in settlement of accounts with the drawer.

(2) *Presentment without exhibition.* — If the instrument is not exhibited, the presentment would be ineffectual as the debtor is entitled to see the instrument and demand its surrender upon payment. Demand by telephone is not sufficient because exhibition of the instrument is not possible. (Robinson v. Loncaster Co., 138 Atl. 58.)

(3) *Informal demand without presentment.* — An informal demand for the payment of a demand note, not accompanied by a presentment of it and not intended as a formal presentment and demand, is not sufficient to put the note in dishonor as to charge an indorser. Such informal demand, however, may have an important bearing on the question of whether the note was actually presented for payment within a reasonable time. (State of N.Y. National Bank v. Kennedy, 145 App. Div. [N.Y.] 669.)

(4) *Waiver of maker's right to exhibition.* — But the instrument need not actually be exhibited unless such exhibition is demanded. Thus, the maker's right to an exhibition of a note is waived

when he does not demand to see the note and he refuses payment on some other grounds. (Greensteen v. Kucharski, 140 Atl. 482.)

Sec. 75. *Presentment where instrument payable at bank.* — Where the instrument is payable at a bank, presentment for payment must be made during banking hours, unless the person to make payment has no funds there to meet it at any time during the day, in which case presentment at any hour before the bank is closed on that day is sufficient.

Presentment where instrument payable at a bank.

Where an instrument is payable at a bank, it is equivalent tq an order to the bank to make payment, for the account of the principal debtor. (Sec. 87.)

The banking hours in Metro Manila are from 9:00 o'clock A.M. to 3:00 o'clock P.M., at least six (6) hours, on all working days, from Monday to Friday. Normally, there are no banking hours on Saturdays, Sundays and holidays. Banks or any of their branches or offices may open for business on non-working days (Saturdays, Sundays, or holidays) for at least three (3) hours a day, but they shall report to the *Bangko Sentral ng Pilipinas* (BSP) the additional days during which they or their branches or offices shall transact business. (Sec. 21, R.A. No. 8791.) The BSP must be notified of banking operations on additional days so that it can manage banks cash balances as well as make provisions for additional cash requirements that may arise during weekends.

(1) *During banking hours.* — If the instrument is payable at a bank and the person to make payment has funds in die bank to meet it on the date of maturity, presentment must be made during banking hours. Presentment made outside banking hours is not sufficient inasmuch as banks do not make payment outside of banking hours. Persons secondarily liable will be discharged. But in the absence of evidence to the contrary, the instrument will be presumed to have been presented during banking hours.

(2) *Any time during the day.* — If the person to make payment has no funds in the bank to meet the payment any time during

the day, presentment at any hour before the bank is closed is sufficient to hold persons secondarily liable. The reason is that even if presentment was made during banking hours, the instrument could not have been paid just the same.

(3) *Before close of banking hours.* — The person to make payment has until the close of banking hours of the bank where the instrument is made payable in which to pay it. If before the close of such hours he deposits funds to the banks there enough to pay the instrument, a demand earlier in the day is premature. Hence, the instrument is not considered dishonored though payment has been refused earlier in the day. (German-American Bank v. Millimen, 31 Miss. 87,65 N.Y. Supp. 242.)

(4) *After date of maturity.* — Unlike the indorser, the maker of a note is not discharged in any way by the fact that the note is presented for payment after maturity date unless prescription has run. He has the duty to pay even if the holder does not demand at that time. Where, however, the note is payable at a specified bank and the bank became insolvent after the maturity date but before presentment for payment — with the result that the maker is "deprived of funds" during the delay — the maker "may discharge his liability by written assignment to the holder of his rights... the payor bank in respect [to] such funds" (see Sec. 3-502[l][b], UCC.), and the maker is thereby discharged of further laibility to the holder. If the bank does not pay, the loss falls on the holder because of the late presentment.

Sec. 76. *Presentment where principal debtor is dead.* — Where the person primarily liable on the instrument is dead, and no place of payment is specified, presentment for payment must be made to his personal representative, if such there be, and if, with the exercise of reasonable diligence, he can be found.

Presentment where principal debtor is dead.

This section and Sections 77 and 78 are applicable only if no place of payment is specified. If there is a place specified in the instrument, presentment should be made at such place.

If the principal debtor is dead, presentment for payment may be made to his executor or administrator if there be one and can be found. But presentment may be dispensed with if with the exercise of reasonable diligence no personal representative can be found, (see Sec. 82[a].) However, the holder is not excused from giving notice of dishonor to the indorser, if he wishes to hold the latter liable on the instrument.

Sec. 77. ***Presentment to persons liable as partners.*** **— Where the persons primarily liable on the instrument are liable as partners, and no place of payment is specified, presentment for payment may be made to any one of them, even though there has been a dissolution of the firm.**

Presentment to persons liable as partners.

Each partner is an agent of the partnership or his co-partners and is presumed to have authority to act for the others. Hence, presentment may be made to any one of them or to the agent of one of them. A dishonor by one is a dishonor by all.

The same rule applies even though there has been a dissolution of the partnership. Thus, if a partner dies before the maturity of a partnership note, a demand on the surviving partner will be sufficient.

Sec. 78. ***Presentment to joint debtors.*** **— Where there are several persons, not partners, primarily liable on the instrument, and no place of payment is specified, presentment must be made to them all.**

Presentment to joint debtors.

If the parties primarily liable are not partners, their liability is only joint. In a joint obligation, there are as many debts as there are debtors, each debt being considered distinct and separate from each other. (Art. 1208, Gvil Code.) Hence, presentment must be made to all of them to hold the drawer and indorsers on their secondary liability, (see Sec. 17[g].)

The reason for the rule is well-stated in a case as follows:

"It seems to me that the undertaking of the defendant in the present case, an indorser of the note, was that he would pay if the makers of the note did not, when payment should have been properly demanded of them. If either of them should pay it, the indorser would be discharged. He did not undertake that if either of the makers should refuse to pay it, he would; but that if all of them refused to pay it, then he would be responsible.

Otherwise, the greater the number of makers, the greater the risk he would run of being obliged to pay it in the first instance; for the holder might choose to demand it of the only insolvent among them. Upon general principles, then, I think that payment should have been demanded of each of the makers/' (Taylor v. Davidson, 2 Cranch, C.C. Fed. Case No. 13769.)

Sec. 79. ***When presentment not required to charge the drawer.*** **— Presentment for payment is not required in order to charge the drawer where he has no right to expect or require that the drawee or acceptor will pay the instrument.**

When presentment not required to charge drawer.

This section refers only to the drawer. All other parties secondarily liable will be discharged unless presentment for payment is made to fasten their liability.

Section 79 is an instance where a party secondarily liable is not discharged in spite of lack of presentment. Thus, presentment is not required to charge the drawer where he has no funds with the drawee unless arrangement has been made for payment of the bill (Simonoff v. Granite City Nat. Bank, 116 N.E. 636.); or where the drawer of a check has stopped payment thereof (Sibree v. Thomas, 116 111. App. 422.); or where the drawer of a check has withdrawn funds from the drawee-bank leaving nothing with which to pay the check. (Gilman v. Bailey Coruage Co., 141 Atl. 321.)

Neither is presentment required where the drawer and the drawee is considered a maker and under Section 70, he is liable without presentment.

Sec. 80. ***When presentment not required to charge the indorser.*** **— Presentment for payment is not required in order to charge an indorser where the instrument was made or accepted for his accommodation and he has no reason to expect that the instrument will be paid if presented.**

When presentment not required to charge indorser.

This section refers only to an indorser for whose accommodation an instrument is *mode* or *accepted.* As far as all other parties secondarily liable are concerned, presentment is still necessary to charge them.

The reason for the rule is that the accommodated payee-in- dorser is the real debtor and not the maker or acceptor. Hence, he is not discharged even if no presentment for payment is made to the maker or acceptor who, in substance, is a surety for the debt.

It is not necessary under this section (see also Sec. 115.) that a loan for which notes are given should have been made for the sole accommodation of an indorser. It is enough if it is only partly for his benefit. (Bergen v. Trimble, 101 Atl. 137.)

Sec. 81. ***When delay in making presentment is excused.*** **— Delay in making presentment for payment is excused when the delay is caused by circumstances beyond the control of the holder, and not imputable to his default, misconduct, or negligence. When the cause of delay ceases to operate, presentment must be made with reasonable diligence.**

When delay in making presentment excused.

Is should be noted that under this section only the delay in making of presentment is excused and not the making of the presentment itself. Under Sections 79 and 80, like in Section 82, presentment for payment itself is excused.

"Circumstances beyond the control" of the holder are "events which could not be foreseen, or which, though foreseen are inevitable" (Art. 1174, Civil Code; see Sec. 147.), such as extreme weather conditions. As soon as the cause which operated to prevent the making of presentment is removed, presentment must be made with reasonable diligence.

Sec. 82. *When presentment may be dispensed with.* — Presentment for payment is dispensed with —

(a) Where after the exercise of reasonable diligence, presentment, as required by this Act can not be made;

(b) Where drawee is a fictitious person;

(c) By waiver of presentment, express or implied.

When presentment may be dispensed with.

The facts excusing presentment or failure to give notice of dishonor, or a waiver thereof must be especially pleaded. Proof thereof is not otherwise admissible. (Calbraith v. Shepard, 86 Pac. 1113.)

(1) *Where reasonable diligence has been exercised*. — Reasonable diligence implies active search. If practicable, the holder should make inquiries of the payee when neither the maker nor his residence could be found. (Cuddy v. Sarrandea, 161 Atl. 297.) But the fact that the bank was closed by the government dispenses with presentment (Spencer v. Rurakiewicz, 192 N.E. 161.) Likewise, presentment is dispensed with when the proper place of presentment cannot be determined because Section 73 is not applicable. But insolvency of the maker even if known to the indorser, will not excuse presentment for payment. (Nolan v. N.E. Wilcox Motor Co., 195 S.W. 58.)

(2) *Where drawee is fictitious.*—If the drawee is fictitious, there is no one to whom presentment is to be made and, therefore, it is dispensed with.

(3) *Where there is waiver.* — The waiver may be before or after maturity (Thompson v. Curry, 91 S.E. 801.), and it may be express or implied.

(a) "Presentment waived" or "waiving demand and protest," written before the signature of the drawer or indorser, is an express waiver.

(b) Implied waiver of presentment may be manifested by an act or conduct of a party calculated to lead the holder to believe that presentment is waived or to mislead or prevent him from treating the instrument as he otherwise would like, for instance, where the drawer promised from time to time to pay a bill, making no objection on the ground that the bill had not been presented to the drawee. (Simonoff v. Granite City Nat. Bank, 116 N.E. 636.)

Waiver of presentment of a note by the maker does not operate as a waiver by the indorser. (Horton v. Reid, 87 P. 2d 936.)

Summary of rules as to presentment for payment.

(1) Presentment for payment is not necessary to charge persons primarily liable but is necessary to change persons secondarily liable. (Sec. 70.)

(2) In the following cases, presentment for payment is not necessary to charge persons secondarily liable:

(a) as to drawer, under Section 79;

(b) as to indorser, under Section 80;

(c) when presentment is dispensed with under Section 82; and

(d) when the bill has been dishonored by non-acceptance as provided in Section 151.

Sec. 83. ***When instrument dishonored by non-payment* — The instrument is dishonored by non-payment when —**

(a) **It is duly presented for payment and payment is refused or can not be obtained; or**

(b) **Presentment is excused and the instrument is overdue and unpaid.**

When instrument dishonored by non-payment.

(1) *Non-payment upon due presentation.* — Under sub-section (a) , there are two requisites, to wit: (a) that the instrument is duly presented for payment to the party primarily liable thereon; and
(b) that payment is either refused or cannot be obtained. In other words, an instrument is dishonored by non-payment as long as it is not paid although the primary party may be willing to pay. Thus, there is already dishonor where on presentment, the maker promises to pay five days later. (Bredow v. Wall, 143 Atl. 849.)

(2) *Non-payment without presentation.*—Under subsection (b), it is necessary that: (a) presentment is excused (Sees. 79, 80, and 82.); (b) the instrument is overdue (see Sees. 85,86, and 194.); and
(c) it is unpaid. Thus, if presentment is waived/the instrument is deemed dishonored if it is overdue and unpaid even if the holder did not make presentment.

The provision makes it clear that although presentment may be excused, the indorser is still entitled to notice of dishonor of the instrument by its being overdue and unpaid. But where there has been no presentment for payment and presentment is not excused, the instrument is not dishonored although it is already overdue and unpaid. (Carter v. Jennings, 98 So. 687.)

Sec. 84. *Liability of person secondarily liable, when instrument dishonored.* — Subject to the provisions of this Act, when the instrument is dishonored by nonpayment, an immediate right of recourse to all parties secondarily liable thereon accrues to the holder.

Effect of dishonor by non-payment.

As to the holder, after an instrument is dishonored by nonpayment, the persons secondarily liable become the principal debtors and he need not proceed against the person primarily liable before suing them.

(1) The law says: "Subject to the provisions of this Act." This means that the immediate right of recourse against secondary parties will accrue only after the giving of due notice of dishonor to them. (Sec. 89.) The application of Section 84 to an indorser of

a check dishonored by non-payment is subject to the condition imposed by Section 186 to the effect that the check must be presented for payment within a reasonable time after its issue. (Phil. National Bank vs. Seato, 91 Phil. 756 [1952].)

(2) The "right of recourse to all parties secondarily liable" means the right of the holder to enforce the liabilities of said parties as defined in Sections 61, 65 and 66. This right is "immediate" because the holder may immediately bring suit against the secondary parties and the latter cannot interpose the defense that the suit should have been brought first against the maker or acceptor.

Sec. 85. *Time of maturity.* — Every negotiable instrument is payable at the time fixed therein without grace. When the day of maturity fells upon Sunday, or a holiday, the instruments is payable on the next succeeding business day. Instruments falling due or becoming payable on Saturday are to be presented for payment on the next succeeding business day, except that instruments payable on demand may, at the option of the holder, be presented for payment before twelve o'clock noon on Saturday when that entire day is not a holiday.

Time of maturity of instrument.

As the law expressly says that the instrument is payable at the time fixed therein without grace, it is not permitted to show a custom or usage fixing a date, of maturity different from that clearly indicated on the face of the instrument. If grace is provided in the instrument, the instrument is payable on the last date of grace.

(1) *On a Sunday or holiday.* — Presentment for payment cannot be made on Sunday or a holiday. If the date of maturity falls on Sunday or a holiday, it will have to be presented on the next succeeding business day.

(2) *On a Saturday.*—If the instrument falls due on a Saturday, and it is a time instrument, it should be presented for payment on the next succeeding business day, *i.e.,* Monday, or the next succeeding business day if Monday is a holiday. The rule is

intended for the benefit of the debtor. Since the business hours on Saturdays are only up to noontime, the law intends not to deprive the debtor of half a day within which to look for money.

(3) *On demand.* — If the instrument which falls due on a Saturday is payable on demand, it may be presented for payment before 12:00 o'clock noon on Saturday, or on Monday, at the option of the holder, The reason for the rule in this case is that the instrument being payable on demand, the presumption is that the party primarily liable has the money ready at any time for payment, (see Sec. 71.)

EXAMPLE:

An instrument payable on October 4, 2010 must be presented for payment on October 4,2010 and it is considered dishonored if it is not paid on that date. If a grace of five days is provided in the instrument, then presentment must be made on October 9, the last day of grace.

If October 4,2010 or October 9,2010, as the case may be, is Sunday or a holiday, the holder must present the instrument on the next succeeding business day.

If the instrument falls due on Saturday, being a time instrument, it should be presented on Monday, or the next succeeding business day, if Monday is a holiday. The holder has no option of presenting it for payment on either Saturday or the next succeeding business day.

If the instrument is payable on demand, and October 4, 2010 or October 9, 2010 is a Saturday, presentment may be made before 12:00 o'clock on Saturday, or on Monday, October 6,2010 or October 11,2010, as the case may be, at the option of the holder.

Instruments falling due or becoming payable on Saturday.

An instrument "falls due" on Saturday, if it is payable on Saturday; it "becomes payable on Saturday" when it falls due on another day like Friday which happens to be a holiday and, therefore, the instrument shall instead be payable on Saturday which is the next day.

In either case, presentment should also be made, not on Saturday but on the next succeeding business day.

EXAMPLE:

In the example given, if October 5, 2010 is Saturday, the instrument falls due on Saturday.

If October 5,2010 is Friday which is a holiday, the instrument becomes payable on Saturday. In either case, it should be presented for payment on the next succeeding business day in the same manner as if October 5,2010 is a Sunday or a holiday

Sec. 86. ***Time; How computed.*****—Where the instrument is payable at a fixed period after date, after sight, or after the happening of a specified event, the time of payment is determined by excluding the day from which time is to begin to run, and by including the date of payment.**

Computation of time of maturity.

In determining the proper date for presentment, we count from the day following the date from which the time is to run (even if the said date is a holiday), and include the last day of the period.

(1) Hence, in an instrument dated April 5,2010 and payable three months after the date/the due date is July 5,2010.

(2) Also in an instrument dated November 8, 2009 and payable after twelve months, the due date is November 8,2010, and not November 9,2010.

(3) But one dated January 31, and payable one month after date will mature on February 28, or February 29, if it is a leap year. (Rochner v. Knickerbocker, 63 N.Y. 163.)

(4) If an instrument is payable ten days after October 11, 2010, the date of maturity is October 21, 2010. By counting or adding ten days from October 12,2010, the last of die ten days is October 21,2010.

It must be remembered that the party primarily liable has all the last day to make payment. Hence, an action brought on the date of maturity is premature.

Sec. 87. *Rule where instrument payable at bank.* — Where the instrument is made payable at a bank it is equivalent to an order to the bank to pay the same for the account of the principal debtor thereon.

Rule where instrument payable at a bank.

An instrument made payable at a bank is equivalent to an order to pay addressed to the bank. The bank may charge the amount of the instrument out of the deposit of the maker or drawer without the necessity of getting additional authority from the latter. The instrument itself is sufficient authority. But a bill of itself does not operate as assignment of the funds in the hands of the drawee-bank available for the payment thereof and the bank is not liable unless and until it accepts the same, (see Sees. 127 and 189.)

This section applies only where the instrument is payable at a particular named bank, *e.g.,* Philippine National Bank. So that the fact that a note made payable at "any bank in Manila" is sent by the maker for collection to a bank in Manila in which he has a deposit when the note matured, does not authorized that bank to pay the note from such deposit. (Carpenter v. National Showmut Bank, 187 Fed. Rep. 1.)

Sec. 88. *What constitutes payment in due course.* — Payment is made in due course when it is made at or after the maturity of the instrument to the holder thereof in good faith and without notice that his title is defective.

Requisites of payment in due course.

Payment in due course is payment in the usual course of business. To effect a discharge of an instrument (Sec. 119[a].) payment should be in money since in a negotiable instrument, the promise or order is to pay a sum certain in money. (Sec. l[b].) The party bound to make payment has no right to do so in any other medium (Art. 1249, Civil Code.) in the absence of agreement to that effect, (see Sec. 119[d].)

To constitute payment in due course, the following requirements must be present:

(1) *Payment must be made at or after date of maturity.* — Payment before maturity does not discharge the instrument anymore than if it were merely discounted. It would constitute a negotiation back to the primary party. (Sec. 50.) If the instrument is renegotiated to a holder in due course, the latter may recover on the instrument;

(2) *Payment must be made to the holder.* — So the maker of a note is not discharged when he pays the payee who is no longer the holder because he has already transferred the note to a holder in due course (Arrington v. King, 17 S.W. 302.) unless it is shown that he was authorized by the holder to receive payment. (Henry Knight & Sons v. Shall, 118 So. 80.) In such a case, the remedy of the maker is against the one who received the payment (Werthmen v. Blatt, 126 Misc. Rep. 583.); and

(3) *Payment must be made in good faith and without notice that the holder's title is defective.* — The maker of a note or the acceptor of a bill must satisfy himself, when the instrument is presented to him for payment, that the holder traces his title through genuine indorsements for if there is a forged indorsement (see Sec. 23.), it is a nullity and no right passes by it and payment by him does not operate as a discharge of the instrument. (Horter v. Mechanics Nat. Bank, 44 Atl. 715; Tolmen v. Am. Nat. Bank, 8 Atl. 480.)

The phrase "in good faith" refers to the maker or acceptor and not to the holder.

EXAMPLE:

M issues a note payable to P or order. The note is indorsed in blank and delivered by P to A from whom it was obtained through fraud by B who presented it to M on maturity for payment.

If M had no notice of the fraud, payment by him discharges the note. This would not be so if the payment was made before maturity or M had notice of the fraud when he made the payment.

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CHAPTER VII

NOTICE OF DISHONOR

Sec. 89. ***To whom notice of dishonor must be given. —*** **Except as herein otherwise provided, when a negotiable instrument has been dishonored by non-acceptance or non-payment, notice of dishonor must be given to the drawer and each indorser, and any drawer or indorser to whom such notice is not given is discharged.**

When instrument considered to be dishonored.

A negotiable instrument is considered to be dishonored:

(1) If it is not accepted when presented for acceptance; or

(2) If it is not paid when presented for payment at maturity; or

(3) If presentment is excused or waived and the instrument is past due and unpaid, (see Sees. 83,149.)

Meaning of notice of dishonor.

Notice of dishonor is bringing, either verbally or in writing, to the knowledge of the drawer or indorser of an instrument, the fact that a specified negotiable instrument, upon proper proceedings taken, has not been accepted or has not been paid and that the party notified is expected to pay it. (Martin v. Brown, 75 Ala. 442.)

If such notice is given by a notary public, it is called a *protest.* (see Sec. 153.)

Object of notice of dishonor.

The object of giving notice of dishonor is two-fold:

(1) To inform the parties secondarily liable that the maker or acceptor, as the case may be, has failed to meet his engagement; and

(2) To advise such parties that they will be required to make payment. (Wyatt & Wyatt, *op. cit.,* pp. 471-472.)

The purpose of giving prompt notice of dishonor is to enable the party, whom the holder wishes to charge, to preserve and enforce his rights against prior parties. (Jones v. Board of Education of Town of Pelham, 272 N.Y. Supp. 5.) The notice preserves the right of the holder to recover on the instrument and enforce the liability of the drawer or indorsers thereon.

Effect of failure to give notice of dishonor.

When an instrument is dishonored by non-acceptance on presentment for acceptance (bill) or by non-payment at its maturity (both bill and note), notice of such dishonor must be given to the persons secondarily liable, namely: the drawer, if it be a bill, and each indorser, whether it be a bill or note. Any such person to whom such notice is not given is discharged. However, although the indorser to whom notice is not given is discharged, he is still liable for breach of warranties pertaining to the instrument. (Sees. 65 and 66.)

The holder is not required to notify all the indorsers, although the law says "each indorser/' He may select to hold only one or some of the indorsers and any party "to whom such notice is not given is discharged."

Burden on holder to prove notice given.

The burden of proving due notice or that notice was waived or excused is on the holder. (Washington Horse Exchange Co. v. Bonner, 103 S.E. 907.) It is incumbent upon the plaintiff who seeks to enforce the defendant's liability upon a negotiable instrument to establish such liability by proving that notice was given to the defendant within the time and in the manner required by law, that the instrument in question had been dishonored. (Asia Banking Corporation vs. Javier, 44 Phil. 779 [1923].)

The loss of a note does not excuse compliance with Section 89. (Klotz v. Silver, 127 N.Y. Supp. 1090.)

ILLUSTRATIVE CASE:

Drawer was not given notice by payee of prior dishonor by non-acceptance by drawee but given notice by holder-indorsee of second dishonor by drawee.

Facts: R, drawer, drew, a bill of exchange on W, drawee, payable to the order of P, payee, and issued the same to P for value. P presented the bill to W for acceptance but the bill was dishonored by non-acceptance. No notice of dishonor by non-acceptance was given to R.

Subsequently, P negotiated the bill to A, indorsee, who had no knowledge of the prior dishonor. W again dishonored the bill. A immediately gave notice of dishonor to R. A sued R.

Issue: Is R discharged from liability for failure of P, a prior holder, to give notice of dishonor?

Held: No, if a party holding a bill of exchange receives notice of its dishonor, he is bound to communicate this to the drawer. In the absence of notice, the drawer is discharged as against the party failing to give the necessary notice but not as against an innocent indorsee who has no knowledge that the bill has been dishonored, because a former holder has omitted to give notice to the drawer that the drawee has refused acceptance.

A contrary doctrine would be destructive of the very policy and effect of this specie of instrument by rendering its credit of so precarious a nature that no person would be found willing to trust to it, especially if a number of names were indorsed upon it. *(Dunn v. O'Keefe, 5 M. & S. 282 [1816].)*

Indorser entitled to notice of dishonor.

Notice is essential; mere knowledge by the indorser of non-payment is not sufficient. (Marshall v. Sonneman, 64 Atl. 874.)

(1) *Any kind of indorser.*—"Each indorser" and "any indorser" include any kind of indorser. (Dealer Sav. Bank v. Barberton

Pottery Co., 17 Ohio 539.) Hence, an accommodation indorser is entitled to notice (Douvely v. Garvan, 151 Atl. 168; Bradley v. Buchanan, 21 Kansas 274.); and also an irregular indorser, being likewise an indorser. (see Sec. 64.) The holder of a check is entitled to an unqualified notice of dishonor by the drawee before he is required, in order to hold an indorser liable, to notify him that payment has been refused. (Citizens Bank v. Bank of Pleasantville, 135 la. 605.)

(2) *Liability of qualified indorser and indorser negotiating by delivery.* — It would seem that lack of notice of dishonor has no effect on a qualified indorser and a person negotiating an instrument by delivery inasmuch as such indorsers do not undertake to pay the instrument in the event of its dishonor. But, as already pointed out, they are still liable on their warranties, (see Sec. 65.)

When notice of dishonor not necessary.

The general rule enunciated in Section 89 is not applicable in the cases mentioned under Sections 109, 111, 112, 114,115,116, and 117.

Only the drawer and indorsers or their agents are entitled to notice of dishonor. The maker and acceptor do not have to be notified because they are the very ones who dishonored the instrument. Thus, a joint maker, though a surety, is not an indorser and is primarily liable and, therefore, is not entitled to notice of dishonor. (Rouse v. Wooten, 53 S.E. 430.) Even an accommodation maker is not entitled to notice. (Felker v. Boatmen's Bank, 225 S.W. 3Q6.)

An assignor of a check under Article 1628[1] of the Civil Code is liable to the assignee in case of dishonor of the check notwithstanding the absence of notice of dishonor to the assignor.

'Art 1628. The vendor in good faith shall be responsible for the existence and legality of the credit at the time of the sale, unless it should have been sold as doubtful; but not for the solvency of the debtor, unless it has been so expressly stipulated or unless the insolvency was prior to the sale and of common knowledge.

Even in these cases he shall only be liable for the price received and for the expenses specified in No. 1 of Article 1616.

The vendor in bad faith shall always be answerable for the payment of all expenses, and for damages. (1529)

ILLUSTRATIVE CASE:

Assignor of a check was not given notice by the assignee of the dishonor by the drawee-bank.

Facts: At the request of F, R corporation (assignor) granted X discounting privileges which R had with E corporation (assignee). X issued a post-dated check payable to R which, following the discounting process, indorsed the check in favor of E. Thereafter, E issued a check payable to R which indorsed it in favor of X. X then made use of and negotiated the check.

Accompanying the exchange of checks was a deed of assignment executed by R in favor of E with die conformity of X. Under the said deed, the subject of the discounting was the aforecited check. At the back thereof, was a suretyship agreement whereby F unconditionally guaranteed to E the full, faithful and prompt payment and discharge of any and all indebtedness of R. The check, however, was dishonored by the drawee-bank upon presentment for payment. E immediately reported the matter to F who thereupon issued a substitute check in favor of E which was again dishonored.

Despite repeated demands, R and F failed to settle the obligations with E, thus, prompting the latter to institute an action in court.

For its defense, R argues, among others, that it was actually discharged of its liability over the substitute check when E failed to give its notice of dishonor.

Issue: Is die assignor liable to its assignee for its dishonored checks?

Held: Yes. An assignment of credit done onerously has an effect similar to that of a sale. If there be any breach of the warranties provided in Article 1628, the assignor-vendor should be held answerable therefor. E is actually enforcing the deed of assignment and the check covered thereby is merely as incidental or collateral matter. This particular check merely evidenced the credit which was actually assigned to E. R is being held liable for both checks. It is only what is represented by the said checks that R is being asked to pay. As long as credit remains outstanding, it shall continue to be liable to E as its assignor.

The dishonor of an assigned check simply stresses its liability and the failure to give notice of dishonor will not discharge R from such liability. This is because the cause of action stems from the breach of warranties embodied in the deed of assignment and not from the dishonoring of the check alone. *(Nyco Sales Corporation vs. BA Finance Corporation, 200 SCRA 637 [1991].)*

Sec. 90. *By whom given.*—The notice may be given by or on behalf of the holder, or by or on behalf of any party to the instrument who might be compelled to pay it to the holder, and who, upon taking it up, would have a right to reimbursement from the party to whom the notice is given.

By whom notice of dishonor given.

Under this section, the notice may be given: (1) by the holder; or (2) another in behalf of the holder; or (3) by a party to the instrument who may be compelled to pay it to the holder and who, upon taking it up, would have a right to reimbursement from the party to whom the notice is given; or (4) another person in behalf of such party.

So, notice by a mere stranger, *(e.g.,* one who is no longer liable on, and has no interest in, the instrument) is ineffectual unless he is acting as agent of a party who is entitled to give notice of dishonor. (Sec. 91.) It has been held that the drawee who refuses to accept is not a party or chargeable on the bill, and notice from him of non-acceptance is no degree better than from any other stranger. (Stanton v. Blossom, 14 Mass. 116.) One wrongfully in possession of the instrument cannot give notice without authority from the holder. (Hofrichter v. Enyeart, 99 N.W. 658.)

The object of requiring the notice to come from the holder is to enable him as the person chiefly interested, to fix or waive the liabilities of the persons secondarily liable. (Harris v. Robin-son, 45 U.S. [4 How.] 336.)

EXAMPLES:

M makes a note payable to the order of P. The note is indorsed successively by P to A, by A to B, by B to C, and by C to D, the present holder. Suppose the note is dishonored in the hands of D.

(1) D or his agent may give notice of dishonor to P, A, B, and C, the parties secondarily liable.

(2) If D notifies only C, the latter, who thereby can be compelled by D to pay, may, in turn, notify P, A, and B.

(3) B may give notice to A and P whom he can hold liable. Likewise, A may give notice to P. But A cannot give notice to B because A is the one liable to B who is a subsequent party and, therefore, A has no right to reimbursement from B. For the same reason, P would have no right to notify A.

(4) If D gives notice only to B, the effect is to discharge C due to lack of notice (Sec. 89.) since B would have no right to notify C.

(5) If B, after having been given notice by D, does not choose to notify P and A, then the latter would also be discharged from the instrument, *(ibid.)*

(6) Upon his discharge, C becomes a total stranger and as such he is not entitled to give notice unless he is acting as an agent of a party who can give proper notice of dishonor.

Sec. 91. ***Notice given by agent.*** **— Notice of dishonor may be given by an agent either in his own name or in the name of any party entitled to give notice, whether that party be his principal or not.**

Authority to give notice not necessary.

The agent need not be authorized by the principal to give the notice. Under this section, any person can be an agent of any party entitled to give notice. The notice may be given in the name of the agent or the party entitled to give notice, (see Sec. 97.)

Sec. 92. ***Effect of notice on behalf of holder.*** **— Where notice is given by or on behalf of the holder, it inures to the benefit of all subsequent holders and all prior parties who have a right of recourse against the party to whom it is given.**

Effect of notice given by holder.

Notice of dishonor given by or on behalf of the holder inures to the benefit of: (1) all holders subsequent to the holder who has given notice; and (2) all parties prior to the holder but subsequent to the party to whom notice has been given and against whom they have a right of recourse.

In other words, a party can charge a prior party who has received notice of dishonor although he himself has not given said prior party any notice. The reason for this is that a party entitled to a notice of dishonor need to be notified only once.

EXAMPLE:

M makes a note payable to P or order. The following are the indorsers of the note in the order of their indorsements:

P
A
B
C
D — holder
E — subsequent holder

The above note is dishonored in the hands of D, who notifies P, A, B, and C.

The notice given by D to P operates to the benefit of *A,* B, and C, parties subsequent to P, and E, a subsequent holder, although they themselves have not notified P.

The notice to A inures to the benefit of B, C, and E; the notice to B, to the benefit of C and E; and the notice to C, to the benefit of E. Therefore, should B, for example, pay C, B may go against P or A on the basis of the notice given to P or A although B has not himself given notice of dishonor.

But the notice to A does not operate in favor of P because P has no right of recourse against A. It is A who can hold P liable.

Sec. 93. ***Effect where notice Is given by party entitled thereto.*** **— Where notice is given by or on behalf of a party entitled to give notice, it {nures to the benefit of the holder and all parties subsequent to the party to whom notice is given.**

Effect of notice given by party entitled thereto.

Notice of dishonor given by or on behalf of the party entitled to give notice (Sec. 90.) inures to the benefit of: (1) the holder, and (2) all parties subsequent to the party to whom notice is given including parties subsequent to the holder who gave notice. (Sec. 92.)

EXAMPLE:

In the preceding example, if D notifies only C, then P, A, and B are discharged from their liability for lack of notice. (Sec.
89.) The notice to C (Sec. 93.) makes him "a party entitled to give notice" as he "might be compelled to pay it (the instrument) to the holder, and who, upon taking it up, would have a right to reimbursement from the party to whom notice is given." (Sec.
90.)

If C, however, within the time fixed by law (see Sees. 94, 107.), gives due notice to P, A, and B, such notice inures to the benefit of D, the holder and also of E as he is also a party "subsequent to the party to whom notice was given." (Sec. 93.) C's notice to P inures to the benefit of A, B, D, and E, parties subsequent to P, although they themselves did not give notice to P.

For the same reason, Cs notice to A inures to the benefit of B, D and E, etc. Thus, A is not discharged by failure of D to give him notice if A is notified properly by a person entitled to give notice like C.

Sec. 94. ***When agent may give notice.*** **— Where the instrument has been dishonored in the hands of an agent, he may either himself give notice to the parties liable thereon, or he may give notice to the principal. If he gives notice to his principal, he must do so within the same time as if he were the holder, and the principal upon the receipt of such notice has himself the same time for giving notice as if the agent had been an independent holder.**

When and to whom agent may give notice.

Under this section, the agent, in case the instrument is dishonored in his hands, may give notice either to his principal or directly to the parties secondarily liable thereon without notifying his principal.

(1) *Notice to parties secondarily liable.*—If the agent gives notice directly to the parties secondarily liable, he must do so within

the time fixed by Sections 102,103,104, and 107; otherwise, they are discharged for lack of notice unless, of course, the principal himself notifies them within the same time.

(2) *Notice to principal* — If he chooses to give notice to his principal, he must notify the latter within the same time referred to as if he were a holder. The principal, upon receiving such notice, has also the same time for giving notice to the parties secondarily liable as if the instrument was dishonored on tike day that he received the notice.

EXAMPLE:

A note indorsed by P, A, and B is dishonored in the hands of X, agent of C, the present holder. X, may give notice either to P, A, and B directly or to C, his principal, and let the latter notify P, A, and B.

Under Section 103, if X, P, A, and B reside in the same place, the notice must be given by X within the next following day. So, if the instrument is dishonored on October 10, X must give notice to P, A, and B not later than October 11.

If X gives notice to C instead, such notice must be given also not later than October 11. C has, in turn, until the next day October 11 to give notice to P, A and B, or until October 12.

Sec. 95. *When notice sufficient.* — A written notice need not be signed, and an insufficient written notice may be supplemented and validated by verbal communication. A misdescription of the instrument does not vitiate the notice unless the party to whom the notice is given is in fact misled thereby.

Sec. 96. *Form of notice.* — The notice may be in writing or merely oral and may be given in any terms which sufficiently identify the instrument and indicate that it has been dishonored by nonacceptance or nonpayment. It may in all cases be given by delivering it personally or through the mails.

Form of notice.

(1) Notice of dishonor may be in writing or merely oral. Notice may thus be given by telephone, provided it be clearly

shown that the party notified was really communicated with, that is fully identified as the party at the receiving end of the line. (American National Bank v. Nat. Fertilizer Co., 143 S.W. 597.) Notice may also be sent by telegraph. (Jurgens v. Wichman, 108 N.Y. 881.)

(2) A notice which contains a copy of the instrument and declares that payment has been demanded and refused, is sufficient. (Marshall v. Sonneman, 64 Atl. 874.) But a mere statement that the instrument is due and payable is insufficient notice. (Kelleman v. Havas, 290 S.W. 700.)

Contents of notice.

Whether written or oral, the notice must set forth:

(1) the identity of the instrument;

(2) the fact that it has been dishonored by non-acceptance or non-payment; and

(3) a statement that the party giving notice intends to look to the party addressed for payment.

How notice given.

Notice of dishonor may be given: (1) by personal delivery; or (2) by mail. The word "may" in the last sentence of Section 96 has been construed to mean "must." (Price v. Warner, 60 Oreg. 7,118 Pac. 173.)

Defect in notice.

(1) *Lack of signature or insufficiency.* — The fact that a written notice is not signed or insufficient would not invalidate it. (Sec. 95.) Thus, failure to state in the notice of dishonor the date of the making and maturity of a note, and the name of the payee does not invalidate the notice. (Herman Lumber Co. v. Bjurstrom, 131 N.Y.S. 689.) Any such insufficiency may be supplemented and validated by oral communication.

(2) *Misdescription of instrument.* — Neither does misdescription of the instrument, such as, as to the amount, or the date, or the names of the parties, or the date of maturity, or other defect,

vitiates the notice unless it misleads the party to whom it is sent. (Sec. 95; Keng v. Husley, 85 No. 525.) The purpose of the notice is to appraise the party entitled thereto of the dishonor of die instrument. So that when he is, in fact, not misled by the misdescription, the notice is sufficient.

(3) *Lack of statement of recourse to indorser.* — A notice of dishonor need not state that the sender looks to the indorser for payment, where it may be inferred that the indorsee looks to die indorser, and no other inference could reasonably be drawn from the notice. (Nelson v. First National Bank, 69 Fed. 798.)

Sec. 97. *To whom notice may be given*. — Notice of dishonor may be given either to the party himself or to his agent in that behalf.

Person to be given notice.

The notice of dishonor may be given to the party himself or to his agent in *that behalf.*

(1) *Agent authorized to receive notice.*— The agent to whom notice is given must be authorized to receive notice for the drawer or indorser concerned and not merely an agent for a specified purpose. Thus, notice to an agent having authority merely to sell, collect and remit is not sufficient. (Swift v. Miller, 113 N.E. 447.) Also, an oral notice by telephone to a clerk of an indorsing corporation especially when it does not appear that the clerk had communicated it to die management is ineffective. (Robinson v. Lancaster Foundry C., 136 Ati. 58,50 A.L.R. 1196.)

(2) *Reason for requiring authority from principal.* — Under Section 91, the agent giving the notice of dishonor need not be authorized by the principal. Under Section 97, an agent to be competent to receive notice of dishonor must be authorized. The reason for the difference is that, while in Section 91, the giving of notice benefits the principal, in Section 97, the receipt of notice creates liability.

Sec. 98. *Notice where party is dead.* — When any party is dead, and his death is known to the party giving notice, the notice must be given to a personal representative, if

there be one, and if with reasonable diligence he can be found. If there be no personal representative, notice may be sent to the last residence or last place of business of the deceased.

Notice where party is dead.

When the party sought to be charged is dead, the notice must be given to his personal representative provided that:

(1) His death is known to the party, giving notice;

(2) There is a personal representative; and

(3) If with reasonable diligence the said personal representative could be found.

Accordingly, where the holder knows that the party concerned is dead, he must use reasonable diligence to find out whether there is a personal representative of such decedent or not.

It has been held that an executor named in the will, but not yet approved by the court is a "personal representative" within the rule. (Drexler v. McGlynn, 33 Pac. 773.) A notice sent to the "estate of" a deceased indorser at his last residence was also held sufficient. (Bank of Port Jervies v. Darleng, 36 N.Y. Supp. 153.) Where there are several personal representatives, notice to one of them is good. (Beals v. Peck, 12 Barb. [N.Y.] 245.)

When notice to personal representative not required.

In the following cases, there is no duty to give notice to the personal representative:

(1) If the death is not known to the party giving the notice; or

(2) Although the fact of death is known, the decedent has no personal representative; or

(3) If there be one but with reasonable diligence, he cannot be found.

In any of the above situations, "notice may be sent to the last residence or last place of business of the deceased."

Sec. 99. ***Notice to partners.*** **— Where the parties to be notified are partners, notice to any one partner is notice to the firm even though there has been a dissolution.**

Notice to partners.

Each partner is an agent of the partnership. Hence, notice to the partners is notice to the partnership. This could still be true although the notice was fraudulently suppressed by the partners receiving it. (Kensington Nat. Bank v. Ware, 32 Pa. Super. Ct. 247.) But the fraudulent partner is liable to his co-partners, (see Sec. 77; Arts. 1794 and 1818, Civil Code.)

Section 99 has no application to the individual undertakings of a partner. (Deffler v. Loundenback, 233 111. Appl. 240.)

Sec. 100. ***Notice to persons jointly liable.*** **— Notice to joint parties who are not partners must be given to each of them unless one of them has authority to receive such notice for the others.**

Notice to joint parties.

Where persons not partners indorse, each is entitled to notice and upon failure to give such notice, neither could be charged, because as to them, each must have separate notice. (Willis v. Green, 5 Hue. 232.)

Under Section 68, joint payees or joint indorsees who indorse an instrument are deemed to indorse jointly and severally. Their liability is solidary, not joint; so that if one of them is notified, that one is not discharged by reason of failure to give notice to the other joint indorsees. (Doherty v. First Nat. Bank, 186 S.W. 937.)

Section 100, therefore, does not refer to the "joint payees or joint indorsees" mentioned in Section 68. Since joint accommodation indorsers are neither payees nor indorsees, they are not solidarity liable under Section 68 and they may be governed by Section 100. Hence, notice must be given to each one of the joint accommodation indorsers unless: (1) they are partners; or (2) one of them has authority to receive such notice from the others. (First Nat. Bank of Lundington v. Mich-Ark. Oil Corp., 204 N.W. 719.)

Sec. 101. ***Notice to bankrupt.*** **— Where a party has been adjudged a bankrupt or an insolvent, or has made an assignment for the benefit of creditors, notice may be given either to the party himself or to his trustee or assignee.**

Notice to bankrupt.

This section contemplates two situations: (1) the party secondarily liable has been declared a bankrupt or an insolvent; and (2) the party secondarily liable has made an assignment of his properties for the benefit of creditors.

In either case, notice may be given to the party himself or to his trustee or assignee. From the moment that notice of dishonor is duly served, the liability of the secondary party is fixed. However, it is necessary for the holder to file his claims in the insolvency proceedings and to prove the giving of due notice of dishonor before he can enforce his rights against said party, (see Act No. 1956, The Insolvency Law.)

Sec. 102. ***Time within which notice must be given.*** **— Notice may be given as soon as the instrument is dishonored and unless delay is excused as hereinafter provided, must be given within the times fixed by this Act.**

Time within which notice must be given.

The times fixed for giving notice are provided for in Sections 103,104, and 107. The times for giving notice are those specified in Section 103 if the party giving notice and the party to be notified reside in the same place, that is, they reside within the corporate limits of the same town or city, and those in Section 104, if they reside in different places. Delay in giving notice of dishonor within the period specified will discharge the persons secondarily liable unless such delay is excused in accordance with Section 119.

(1) Each party into whose hands a dishonored bill may pass, is allowed one entire day for the purpose of giving notice. A different rule would subject every party to the inconvenience of giving an account of all his other engagements in order to prove that he could not reasonably be expected to send the notice on the same day of dishonor. Thus, the rule excludes all discussion as to the particular occupations of the party on the day. (Bray v. Hadwen, 5 Maule & S. 68.)

(2) Notice of dishonor can be given only after the instrument has been actually dishonored by non-acceptance or non-payment. Thus, notice of dishonor before maturity of the instrument even on the ground that the maker has indicated his intention not to pay the same is premature and ineffective. (Case v. McKinnis, 313 Pac. 222.)

(3) An instrument cannot be dishonored by non-payment until after the maturity. After dishonor, notice maybe given earlier than is required by law. (see Sees. 103 and 104.) The purpose of early notice is, in addition to holding the parties secondarily liable on the instrument, to afford the latter an opportunity to discharge it, thereby avoiding court action.

Sec. 103. ***Where parties reside in same place.*** **— Where the person giving and the person to receive notice reside in the same place, notice must be given within the following times:**

(a) If given at the place of business of the person to receive notice, it must be given before the close of business hours on the day following.

(b) If given at his residence, it must be given before the usual hours of rest on the day following.

(c) If sent by mail, it must be deposited in the post office in time to reach him in usual course on the day following.

Notice where parties reside in same place.

Section 103 provides for two *means* of giving notice of dishonor: personally and by mail. The *place* where the notice may be given is either the place of business or the residence of the party to receive the notice, at the option of the party giving the notice.

The specific words of Section 103 cannot be modified by the definition of a reasonable time in Section 193 which has no application to this section but applies to cases like that described in Section 144 and perhaps, others. (Jones v. Carolina Nat. Bank, 103 S.E. 27.)

(1) *At the place of business.* — Notice given after the close of business hours on the day following dishonor would be late. Thus, where the holder of a demand note presented it to the maker on the 17th of the month and was told to return on the 22nd for payment but on the 22nd the maker had absconded, the notice given on the 22nd to the indorser was held not within the time limit, the dishonor having occurred on the 17th. (Bredow v. Well, 143 Atl. 849.) So also, if the holder's agent called at the indorser's place of business to give notice of dishonor of the note, but he was absent from the city and after calling again in four or five days, he saw the indorser and gave him the notice, it was held that the notice was not given on time as it could have been given by mail. (Price v. Warner, 118 Pac. 173.)

Where the time for giving notice falls on a Sunday or a holiday, the act may be done on the next succeeding business day. (Sec. 194.)

(2) *At the residence.* — It has been held that notice is sufficient if given during any of the hours when the members of the household are attending to their ordinary affairs. (Adams v. Wright, 14 Wis. 442.) In case the party to be notified has a place of business in one place and a residence in another place, the holder has the option to send the notice to either place.

(3) *By mail.* — If the notice of dishonor is mailed on time, that is, deposited at the mailbox "in time to reach him in usual course on the day following" the dishonor, it is immaterial that through miscarriage in the mails or for any cause not imputable to the sender, the notice does not reach the addressee the day following the dishonor, (see Sec. 105.) Thus, it has been held that a notice placed in a mail on the day of protest but not postmarked until the next day at noon, is mailed in time and it will be presumed,

in the absence of any contrary evidence, that the notice reached its destination on the day following before the close of business hours. (Wilson v. Peck, 121 N.Y. Suppl. 344.)

Sec. 104. ***Where parties reside in different piaces.*** **— Where the person giving and the person to receive notice reside in different places, the notice must be given within the following times:**

(a) If sent by mail, it must be deposited in the post office in time to go by mail the day following the day of dishonor, or if there be no mail at a convenient hour on that day, by the next mail thereafter.

(b) If given otherwise than through the post office, then within the time that notice would have been received in due course of mail, if it has been deposited in the post office within the time specified in the last subdivision.

Notice where parties reside in different places.

Under the foregoing section, the notice may be given by mail or otherwise than by mail.

The words "go by mail" means an actual departure in the course of mail from the post office in which the notice was deposited, in case there is a mail from that post office to the destination of the notice at a convenient hour on the required day. (Harris v. Baker, 115 N.E. 292.) The term "convenient^ in subsection (a) has reference to the sender. It has been held that when the departure time for the mail the day after dishonor is between 9:00 and 11:00 o'clock in the morning it is convenient. (First Nat. Bank v. Miller, 102 N.W. 820.) If the notice was given otherwise than by mail, it must be received within the time that it would have been received in due course of mail.

The burden is upon the holder to prove that the notice was mailed within the time prescribed; it is not enough merely to show that the notice was deposited in the post office on the day following the dishonor. It is also necessary to show that the notice was deposited in time to go by mail the day following the day of dishonor. (Nickel! v. Bradshaw, 183 Pac. 12.)

EXAMPLES:

(1) *by mail.* — H, *holder,* resides in Manila and R, drawer (or indorser), resides in Olongapo City. The instrument is dishonored on October 10,2010.

If the notice is given by mail, it need not reach R on October 11, 2010, but it must be deposited in the mails not later that October 11, 2010, so as to go by mail on October 11, 2010, the day following the day of dishonor.

If there is no mail on October 11, 2010 or if there is, but leaves at an inconvenient hour, say, 4:00 o'clock in the morning and the next mail is 5:00 o'clock in the afternoon on October 12,2010, the notice must be deposited in time for it to go by the 5:00 o'clock mail on October 12,2010.

(2) *otherwise than by mail.*—If H fails to deposit the written notice in the mails on time, the same may still be given in some other way as by personal messenger. What is important is that R should receive the notice not later than the time he would have received it had it been mailed.

Suppose that the notice would have been received by R on October 14, 2010 had it been mailed to him under paragraph (a) of Section 104. If notice is given by personal messenger after October 14,2010, the notice is inoperative and R is discharged.

Sec. 105. ***When sender deemed to have given due notice.* — Where notice of dishonor is duly addressed and deposited in the post office, the sender is deemed to have given due notice, notwithstanding any miscarriage in the mails.**

When sender deemed to have given due notice.

Notice by mail is deemed to have been properly made where: (1) the notice of dishonor is duly addressed; and (2) deposited in the post office.

As long as the sender has done everything which the law requires him to do, the notice would still be considered on time although it does not reach the addressee due to miscarriage in the mails. The notice must be properly addressed, stamped, and mailed. The notice is not "duly addressed" when it is addressed at an address different from that given on the instrument and was not received by him (Century Bank v. Breibant, 151 N.Y.S. 582.) or where it is addressed to the indorser without any address. (Peoples Bank & Trust Co. v. Allen, 353 Atl. 704.)

The burden of proof rests upon the plaintiff to show a compliance with the statutory provisions in order to hold the indorser (or drawer) as the liability of the indorser depends entirely upon compliance as to notice. (Bank v. Zimmerman, 185 N.Y. 210.)

Sec. 106. ***Deposit in post office; what constitutes.*** **— Notice is deemed to have been deposited in the post office when deposited in any branch post office or in any letter box under the control of the post office department.**

When notice deemed to have been deposited.

Section 106 defines the act of depositing in the post office.

The notice may be deposited in: (1) the post office, (2) any branch post office, or (3) any letter box under the control of the post office.

So deposit in a mail box is equivalent to deposit in the post office. But a notice properly addressed and left in a place in the notary's office where mail was usually collected by the postman, was held not a mailing of the notice as required by the law. (Friedman v. Maltensky, 103 Atl. 731.) Neither is deposit of a notice of dishonor of a negotiable paper in a private letter box of a private office a deposit as required by Section 106. (Townsend v. Auld, 10 Misc. 343.) However, delivery to a mail carrier while making his rounds has been held a deposit within the meaning of this section. (Pearce v. Langfit, 101 Pa. 507.)

Sec. 107. ***Notice to subsequent party; time of.*****—Where a party receives notice of dishonor, he has, after the receipt of such notice, the same time for giving notice to antecedent parties that the holder has after the dishonor.**

Time of notice to subsequent party.

A party who receives notice of dishonor is entitled to give notice of dishonor to prior parties within the same period of time that the holder has after the dishonor as if he were the holder.

In other words, under Section 107, the instrument is considered dishonored in the hands of a party who receives a notice of dishonor from the holder on the date he receives such notice and not on the date the instrument is dishonored in the hands of the holder.

EXAMPLE:

P, A, B, and C are indorsers and D is the holder. All of them reside in the same place.

If the instrument is dishonored on October 10, D may notify any of or all the indorsers prior to him. D must give notice not later than the next day, October 11.

Assuming D notifies only C on October 11, C upon receipt of the notice of dishonor from D may, in turn, notify any or all of the antecedent parties not later than October 12. However, if D immediately notifies C on October 10, C must give notice to antecedent parties not later than October 11. C cannot take an extra day to notify P, A, and/or B.

If they reside in different places, the notice mUst be given within the time provided for in Section 104.

Sec. 108. ***Where notice must be sent.*** **— Where a party has added an address to his signature, notice of dishonor must be sent to that address; but if he has not given such address, then the notice must be sent as follows:**

(a) Either to the post office nearest to his place of residence or to the post office where he is accustomed to receive his letters; or

(b) If he lives in one place, and have his place of business in another, notice may be sent to either place; or

(c) If he is sojourning in another place, notice may be sent to the place where he is so sojourning.

But where the notice is actually received by the party within the time specified in this Act, it will be sufficient, though not sent in accordance with the requirements of this section.

Place where notice must be given.

Where a party has added an address to his name, the notice must be sent to that address and it will be sufficient even though the address is an incorrect one. (Lenkosky v. Raymond, 104 N.E. 489.) But if no address is indicated, then the notice must be sent to the places stated in subsections (a), (b), and (c).

(1) The term "residence" in subsection (a) is not used in a strict sense as necessarily implying a permanent, exclusive or actual abode in the place, but it may be satisfied by a temporary, partial or even constructive residence. (Wachusett National Bank v. Fairbrother, 148 Mass. 181.) The statute is mandatory. Thus, where the indorser has not added his address to his signature, the notice *must* be sent to the post office nearest to his place of residence or where he is accustomed to receive his letters. In such case, the burden is on the holder to discover the "place of residence" and to send the notice to the nearest post office. This appears to be the measure of "diligence" required by law. (Cummings v. Roderick, 28 App. Div. 253,50 N.Y. Supp. 1053.)

(2) The phrase "place of business" in subsection (b) does not comprehend every place where a person may transact any business. It refers to die place, where he carries on business as merchant, tradesman, professional man, or other similar trade or calling. (Harr v. Edsell, 183 Atl. 67.) Where the residence and the place of business are in the same place, notice must be sent to the residence. *(In re* Mandelbaun, 80 Misc. 475,141 N.Y.S. Supp. 319.) Notice to an indorser who has added no address, addressed to a house where he does not reside or do business or receive his letters is not good, even though he owns the house and his sons do business there. (Ebling Brewing Co. v. Reinheimer, 66 N.Y. Supp. 458.)

(3) "Sojourning" in subsection (c) is something more than mere "traveling." It applies to a temporary as differentiated from a permanent residence; (Henry v. Ball, 1 Wheat 5,4 L. ed. 21.) So

that when an indorser vacationing in Baguio has not given his address, notice to him may be sent to Baguio.

Receipt, not manner, of notice essential.

What is important is that the party to be notified actually receives the notice on time (Sees. 103 and 104.) wherever the notice is given. (Sec. 108, last par.) The law is not so much concerned with the address of the party to be misdirected, if it is in fact received, it is sufficient compliance with die law. (South Side Trust Co. v. Lamb, 57 Pa. Super. Ct. 645.)

The mere manner in which the notice is sent is wholly immaterial. But the burden of proof of actual receipt of the notice is on the party who gives the notice.

Sec. 109. ***Waiver of notice.*** **— Notice of dishonor may be waived either before the time of giving notice has arrived or after the omission to give due notice, and the waiver may be express or implied.**

Waiver of notice of dishonor.

Waiver is the intentional abandonment of a known right. With reference to notice of dishonor, waiver is the willingness on the part of the drawer or the indorser concerned to be bound as such even without due notice of dishonor. It may be made before die time of giving notice (see Sec. 110.) or after omission to give due notice.

Form of waiver.

The burden of proof is on the holder to show waiver of notice and, being in derogation of a statutory right, it must be proved by clear and convincing evidence.

Waiver is *express* when it is made orally or in writing as when "notice of dishonor waived" appears above the signature of an indorser. It is *implied* where it is inferred from act or language.

Implied waiver usually takes place after there has been omission to give notice. The following cases were held to constitute implied waiver after maturity: payment of interest by an indorser after he learns: of the default of the maker (Hurst v. Bent, 14 N.E. 852.); admission of liability after dishonor (First Nat. Bank v. Tanaqua Mfg. Co., 71 Pa. Super. Ct. 39.); promise to pay the note if the maker does not pay (Richardson v. Kulp, 78 Ati. 1062.); and suggesting a plan of settlement. (Louisa First Nat. Bank v. Anderson, 999 S.E. 461.)

Sec. 110. ***Whom affected by waiver.*** **— Where the waiver is embodied in the instrument itself, it is binding upon all parties; but where it is written above the signature of an indorser, it binds him only.**

Persons affected by waiver.

As to who are affected by an express waiver depends on where the waiver is written.

(1) If the waiver is embodied in the instrument itself, that is, it appears in the body or on the face of the instrument, it binds all parties.

(2) If it is written above the signature of an indorser, it binds him only.

EXAMPLE:

Suppose the instrument reads as follows:

I promise to pay or order P10,000.00 on or before November 31,2010 waiving presentment for payment and notice of dishonor.

(Sgd.) M

The following indorsements appear on the back.

ToA

(Sgd.) P

ToB

(Sgd.) A

ToC

(Sgd.) B

The waiver in the above example binds not only the maker M, but the indorsers P, A, and B since it appears in the body of the instrument itself. It is, therefore, not necessary for C to give notice to P, A and B to charge them because the waiver is a part of the contract not only of the maker M, but also of the indorsers P, A, and B, as well.

It would be different if the waiver had been written, say, above the signature of A pnly. In that case, only A would be bound by the waiver. C must give notice to P and B; otherwise, they would be discharged.

There is a conflict of opinion as to whether the waiver may be deemed embodied in the instrument and binding upon all indorsers when it is printed or written on the back of the instrument above the indorsements. It is believed that the question is one of construction.

Sec. 111. ***Waiver of protest*** **— A waiver of protest, whether in the case of a foreign bill of exchange or other negotiable instrument, is deemed to be a waiver not only of a formal protest, but also of presentment and notice of dishonor.**

Effect of waiver of protest.

Protest is the formal instrument executed usually by a notary public certifying that the legal steps necessary to fix the liability of the drawee and the indorsers have been taken, (see Sec. 152.) Strictly speaking, the term "protest" applies only to foreign bills (see Sec. 152.) but the custom to treat inland bills and notes in the same manner has become so nearly universal, tfyat in common usage, the term means the taking of such steps as are required to charge the indorser. (Annville Bank v. Kettering, 106 Pa. St. 531.)

(1) Where protest is waived the following are also deemed waived: (a) presentment and (b) notice of dishonor. This is so because "protest" means 3II the steps accompanying dishonor necessary f:o charge a party secpndarily liable. (M^ury v. Wijilock, 269 Pac. 811.) But a waiver of notice of protest waives notice only and is not a waiver of presentment. (Atkinson v. Skidmqre, 153 S.W.457.)

(2) Where presentment for payment is waived, notice of dishonor is also waived (Boumerster v. Knutz, 42 So. 886.); but waiver of the latter does not include waiver of the former. (Hayward v. Empire State, 93 N.Y. Supp. 449.) When an indorser waives presentment and notice Of dis-honor, he thereby enlarges his liability and his indorsement is known as a *facultative indorsement.*

Sec. 112. ***When notice Is dispensed with.*** **— Notice of dishonor is dispensed with when, after the exercise of reasonable diligence, it can not be given or does not reach the parties sought to be charged.**

When notice dispensed with.

Reasonable diligence is a relative term. It depends upon the circumstances of each case. It implies active search. Where the facts are undisputed, it is a question of law whether sufficient diligence has been shown.

(1) The holder should endeavor to find out the whereabouts of the party to be notified. Thus, merely examining the telephone directory for the address is not sufficient. (Best v. Bexin Co., 55 A.L.R., 670.) Also, notice of dishonor to the indorser at a certain address in the city where the indorser had never lived and which was not received is ineffective. (Passaic Nat. Bank & Trust Co. v. Knapp, 158 Atl. 393.)

(2) There is due diligence when the holder inquired for the payee and mailed the notice to the address given, then later he learned of the indorser's address and mailed a second set of notices. (First Nat. Bank of Belmar v. Gray, 127 Atl. 201.) Where personal service is relied upon, the evidence must show diligent efforts to make personal service upon the indorser either at his place of business or if he has no place of business, at his residence; and if he be absent, it is not necessary to call a second time and the notice may be left with any of one found in charge or no one there, then the giving of notice is deemed to be waived. (American Exch. Nat. Bank v. American Hotel Victoria Co., 92 N.Y. Supp. 1006.)

The last clause of this section is but a restatement of the rule in Section 105.

Sec. 113. ***Delay in giving notice of dishonor; how excused.* — Delay in giving notice is excused when the delay is caused by circumstances beyond the control of the holder, and not imputable to his default, misconduct or negligence. When the cause of delay ceases to operate, notice must be given with reasonable diligence.**

When delay in giving notice excused.

The rule in this section is similar to that in Section 81 excusing delay in making presentment. Section 112 dispenses with the duty to give notice but this section excuses merely the delay in giving it.

It has been held that delay in giving notice of dishonor caused by the necessity of making inquiries as to the address of the party to be notified is excusable where the holder was ignorant of the address. (The Elmville [1904], p. 319.) But the delay will not be excused in the case where the holder's agent called at the defendant's place to give him notice of dishonor, but he was absent from the city, since notice by mail was practicable. (Price v. Warner, 118 Pac. 173.)

Sec. 114. ***When notice need not be given to drawer.* — Notice of dishonor is not required to be given to the drawer in either of the following cases:**

Where the drawer and drawee are the same person.

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

When the drawer is the person to whom the instrument is presented for payment.

Where the drawer has no right to expect or require that the drawee or acceptor will honor the instrument.

Where the drawer has countermanded payment.

When notice to drawer not required.

(1) *Holder has option to treat bill as promissory note.* — There is no necessity of giving the notice of dishonor under subsections (a) and (b) since in these two cases the holder is given the

option under Section 130 to treat the bill as a promissory note. The drawer will be regarded as a maker and a primary party. Furthermore, since the drawer is the same person who dishonored the instrument, he already knows of the dishonor and obviously notice to him is superflous. (see Sec. 82[b].)

It has been held that a bill drawn by an agent on his principal (drawee) with the authority of the latter is equivalent to bill drawn by the principal on himself. (First Nat. Bank of Artesia v. Home, Ins. Co., 113 Pac. 815.)

(2) *Drawer has knowledge of dishonor.* — Under subsection (c) , the reason for not requiring notice is that the drawer has knowledge of the dishonor since he is the one who dishonored the instrument. The presentment itself constitutes notice of dishonor of the instrument. Thus, where the bill is payable at the office of the drawer and it is there presented for payment (Sec. 73[a].) at maturity but the drawee is not there and the presentment is made to the drawer (Sec. 72[d].) who refuses payment, the holder need not give notice to the drawer as the latter already knows of the dishonor.

(3) *Drawer knew bill would be dishonored.* — Under subsection (d) , it has been held that the drawer of the check is not entitled to notice of dishonor when he has no account with the drawee- bank (Demateis v. Vezu, 193 Pac. 793.) or has no funds with the drawee-bank to meet it (Ellenbogen v. State Bank, 197 N.Y. Supp. 278.) and this is especially true when there is no existing contractual relation between the drawer and the drawee binding the drawee to accept or pay. But the simple fact that the drawer has no funds with the drawee does not always operate to excuse the holder to give notice to the drawer. The drawee may have agreed to advance the amount for the drawer who has a reason, therefore, to "expect" the drawee to accept or pay. (see Sec. 79.) But the fact of drawing without funds, in the absence of other proof to explain it, is fraud. (Miser v. Trovinger's Ex'rs., 7 Ohio St. 281.)

The drawer of a check issued to another merely as a security (for jewelry to be sold on commission) is liable to a holder in due course. He cannot simply withdraw his funds from the drawee-bank to excuse himself from liability after the check has beeen negotiated without his knowledge to a holder in due course and there is no need to serve him notice of dishonor. (State Investment House, Inc. vs. Court of Appeals, 217 SCRA 32 [1993].)

(4) *Drawer countermanded payment.* — The reason for not giving notice under subsection (e) is that the drawer knows that the instrument will be dishonored. When the drawer countermands payment, he orders the drawee not to pay. The order is referred to as *stop payment order.* It is useful when a check is lost or when the drawee does not receive the value he expected when he issued the check. Only the drawer has the right to stop payment. A drawer may not stop payment on a certified check, (see Sec. 86.)

Sec. 115. *When notice need not be given to indorser.* — Notice of dishonor is not required to be given to an indorser in either of the following cases:

(a) When the drawee is a fictitious person or a person not having capacity to contract, and the indorser was aware of the fact at the time he indorsed the instrument;

(b) Where the indorser is the person to whom the instrument is presented for payment;

(c) Where the instrument was made or accepted for his accommodation.

When notice to indorser not required.

This section applies only to the indorser concerned. Failure to give due notice of dishonor to all other secondary parties will relieve them of their liability.

(1) Subsection (a) is similar to subsection (b) of Section 114. The only difference is the exception that the indorser must be aware of the fact therein stated. If he is aware of such fact, he has no reason to expect or require the instrument to be accepted or paid. But the knowledge by the indorser that the maker is insolvent *(In re* Mandelbaum, 141 N.Y. Supp. 319.) or that the instrument had been dishonored (Nat. Life & Accident Co. v. Varner, 100 S.W. 662.) does not dispute dispense with notice.

(2) Under subsection (c), the indorser (accommodated party) is in fact die principal debtor (see Sec. 80.) and, therefore, he is not entitled to notice, (see Sees. 29 and 119[b].)

Sec. 116. ***Notice of non-payment where accepted refused.*— Where due notice of dishonor by non-acceptance has been given, notice of a subsequent dishonor by nonpayment is not necessary, unless in the meantime the instrument has been accepted.**

Effect where notice of non-acceptance already given.

When a bill is dishonored by non-acceptance, an immediate right of recourse against all secondary parties accrues to the holder and no presentment for payment is necessary (see Sec. 151.), since dishonor of the 'instrument by non-payment is to be expected. If nevertheless the holder presents the bill for payment on maturity and it is dishonored, he need not notify again the secondary parties.

However, if the instrument is accepted after it has been dishonored by non-acceptance, it is necessary for the holder to present the instrument for payment upon maturity. In case of non-payment, the holder must give the corresponding notice of dishonor. Failure to do so will discharge the secondary parties.

EXAMPLE:

A bill drawn by R on W and payable on July 30, 2010 is indorsed successively by P, A, and B. C, the holder, presents the bill for acceptance on July 10, 2010 to W who refuses to accept the bill.

Under Section 151, after C gives notice of dishonor to R, the drawer, and P, A, and B, the indorsers, he may enforce his right against them without the necessity of presentment for payment. If C presents the bill to W on maturity and it is dishonored, notice of the subsequent dishonor by non-payment is not necessary.

But suppose W later changes his mind and accepts the bill on July 20, 2010. C must present the bill for payment to W on

July 30, 2010 and if W refuses to pay, C must give notice of dishonor by non-payment to R, the drawer, and P, A, and B, the indorsers. The act of notice will discharge them from liability.

Sec. 117. ***Effect of omission to give notice of non-acceptance.*** **— An omission to give notice of dishonor by non-acceptance does not prejudice the rights of a holder in due course subsequent to the omission.**

Effect of omission to give notice of non-acceptance.

In case of dishonor by non-payment, no holder subsequent thereto can be a holder in due course because the maturity of the instrument appears on the face thereof and, therefore, the holder knows of such dishonor from the fact that the instrument is overdue, (see Sec. 52[b].) But any holder may present an instrument for acceptance before maturity and in order to dishonor it, all that the drawee has to do is to refuse to accept it without having to write anything on the instrument.

Under Section 117, the failure of the previous holder to give a notice of dishonor by non-acceptance cannot prejudice a holder, in due course who may still present the instrument to the drawee for acceptance and notify the drawer and indorsers if acceptance is refused.

EXAMPLE:

R drew a bill against W in favor of P. The bill is payable on October 30, 2010. P presents the bill for acceptance to W who refuses to accept the same. P fails to give notice of dishonor by non-acceptance to R within the time prescribed in Section 103 or 104. The effect of the lack of notice is to discharge R from liability.

Before maturity, P indorses the instrument to A, a holder in due course. As to A, R is not discharged because A cannot be prejudiced by the omission of P to give R notice of dishonor by non-acceptance and in case W refuses to accept it, A may notify R and P and hold them on their secondary liability.

Sec. 118. ***When protest need not be made; when must be made.*** **— Where any negotiable instrument has been dishonored it may be protested for non-acceptance or nonpayment, as the case may be; but protest is not required except in the case of foreign bills of exchange.**

When protest required and not required.

(1) *Foreign bills of exchange.* — Protest is necessary only in the case of foreign bills of exchange (Sec. 129.) which have been dishonored by non-acceptance or non-payment, as the case may be. If it is not so protested, the drawer and indorsers are discharged. (Sec. 152.)

(2) *Other negotiable instrument.*—Protest for other negotiable instruments, *i.e.,* inland bills of exhange, checks, and promissory notes, is optional except in the cases provided in Sections 158, 161, and 171. Formal protest of a promissory note by a notary public is thus not essential to hold an indorser. What is essential is presentment and demand at the time and place provided for in the instrument, followed by notice to the indorser of such presentment, demand, and non-payment. (McBride v. Illinois National Bank, 138 App. Div. [N.Y.] 346.)

It is, however, advantageous to protest these instruments also when dishonored since the holder obtains a most convenient record evidencing the fact of dishonor, (see Sec. 153.)

Summary of rules as to notice of dishonor.

(1) Like presentment for payment, notice of dishonor is not necessary to charge persons primarily liable but is necessary to charge persons secondarily liable; and

(2) In the following cases, notice of dishonor is not necessary to charge persons secondarily liable:

(a) when notice is waived under Section 109;

(b) when protest is waived under Section 111;

(c) when notice is dispensed with under Section 112;

(d) as to the drawer under Section 114;

(e) as to an indorser under Section 115;

(f) where due notice of dishonor by non-acceptance has been given under Section 116; and

(g) as to a holder in course, without notice of dishonor by non-acceptance, subsequent to the omission to give notice under Section 117.

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CHAPTER VIII

DISCHARGE OF NEGOTIABLE INSTRUMENT

Sec. 119. ***Instrument; how discharged.*** **— A negotiable instrument is discharged —**

(a) By payment in due course by or on behalf of the principal debtor;

(b) By payment in due course by the party accommodated, where the instrument is made or accepted for accommodation;

(c) By the intentional cancellation thereof by the holder;

(d) By any other act which will discharge simple contract for the payment of money;

(e) When the principal debtor becomes the holder of the instrument at or after maturity in his own right.

Meaning and effect of discharge of instrument.

Discharge of an instrument means a release of all parties, whether primary or secondary, from the obligations arising thereunder. It renders the instrument without force and effect and, consequently, it can no longer be negotiated. (Young v. Carr, 26 [2d] 555.)

Concept of discharge.

The word "discharge" is used in the Negotiable Instruments Law in reference both to the instrument itself and to the parties to it. (Gannon v. Bronston, 55 S.W. 2d 358.) The law provides for discharge of the instrument by specified methods (Sec. 119.), and for discharge of persons secondarily liable also by specified methods. (Sec. 120.)

Discharge of the instrument obviously includes discharge of the person or persons primarily liable on it and a person secondarily liable on an instrument is also discharged by an act which discharges the instrument. (11 Am. Jur. 2d 946-947.)

Methods for discharge of instrument.

The Negotiable Instruments Law contains no express provision for release of a party primarily liable. The obvious reason is that none is necessary. Such a party is absolutely bound to pay in the first instance, and can be relieved only by a discharge of the instrument itself. (Merchant's Nat. Bank v. Smith, 190, p. 523.)

The methods for the discharge of a negotiable instrument provided in Section 119 are exclusive *(ibid.),* upon the familiar rule that the express mention of one thing implies the exclusion of another. (Vanderford v. Farmer's Bank, 105 Md. 168.) Thus, the fact that a post-dated check was merely issued as security is not a ground for the discharge of the instrument as against a holder in due course to whom the instrument was negotiated without the knowledge and consent of the maker or drawer. (State Investment House, Inc. vs. Court of Appeals, 217 SCRA 32 [1993].)

(1) *Payment by principal debtor.*—The general rule is that when an instrument upon which several are liable, some primarily and some secondarily, if it is satisfied by him who is primarily liable, a complete discharge results. It no longer has legal existence. (Comstock v. Buckley, 141 Wis. 231.)

In order that payment may produce the effect of discharging the instrument under subsection: (a), it must be made (a) by or on behalf of the principal debtor (b) at or after its maturity, (c) to the holder thereof, (d) in good faith and without notice that the holder's title is defective. (Sec. 88.) Hence, payment by a stranger will not discharge the instrument unless the payment is for the debtor, (see Art. 1236, Civil Code.)

The term "principal debtor," as used in Sections 119(a), (e), 120(e), and 122, should be interpreted to mean exactly what it says — it refers to the person *ultimately* bound to pay the debt

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and not necessarily to the "person primarily liable" on the instrument, (see Sec. 192.) So, payment by an accommodation party like a guarantor or surety will not discharge the instrument since he is not the "principal debtor."

It must be remembered that the holder is not bound to accept payment by check or other negotiable instrument because it does not meet the requirements of a legal tender. (Art. 1249, Civil Code; Belisario vs. Natividad, 60 Phil. 156 [1934].)

(2) *Payment by accommodated party.* — As between the accommodation party and the accommodated party, the latter is the real debtor. Hence, payment by the accommodated party is actually payment by the principal debtor and this is true whether he appears as a party to the instrument or not.

(3) *Intentional cancellation of instrument by holder.* — To effect a discharge of the instrument, the cancellation must: (a) be intentionally done; (b) by the holder thereof. Cancellation may be done by writing the word "cancelled" or "paid" on the face of the instrument. There is also cancellation when the instrument is torn up, burned, mutilated or destroyed. The presumption is that the cancellation is intentional.

(4) *Any act which discharges a contract.* — As to other acts of discharging contracts in general for the payment of money, the law on obligations and contracts and other existing legislations will apply, (see Art. 18, Civil Code; Sec. 196.)

Article 1231 of the Civil Code provides:

"Obligations are extinguished:

(1) By payment or performance;

(2) By the loss of the thing due;

(3) By the condonation or remission of the debts;

(4) By the confusion or merger of the rights of creditor

and debtor;

(5) By compensation;

(6) By novation.

Other causes of extinguishing of obligations such as annulment, rescission, fulfillment of a resolutory condition and prescription are governed elsewhere in this Code."

Note that while the various causes of discharging a simple contract such as payment, condonation, etc. will operate to discharge the instrument as between the immediate parties, they will not in the hands of a holder in due course.

(5) *Reacquisition by principal debtor in his own right.* — In order that there will be discharge under subsection (e), the reacquisition must be: (a) by the principal debtor, (b) in his own right, and (c) at or after the date of maturity. When the principal debtor becomes the holder of the instrument in his own right, the instrument is discharged because of the merger in his person of the characters of creditor and debtor. (Art. 1275, Civil Code.)

"In his own right" means not in a representative capacity. (Schawartzman v. Post, 84 N.Y. Supp. 922.) So, if the debtor reacquires the instrument as the. agent of another or as pledge from the holder, or as administrator of the intestate estate of the holder, he does not do so in his own right. The reacquisition must be "at or after maturity" otherwise no discharge will be effected because the debtor, on reacquiring the instrument, can re-negotiate the same under Section 50.

Sec. 120. *When person secondarily liable on the instrument are discharged.* —A person secondarily liable on the instrument is discharged:

(a) By any act which discharges the instrument;

(b) By the intentional cancellation of his signature by the holder;

(c) By the discharge of a prior party;

(d) By a valid tender of payment made by a prior party;

(e) By a release of the principal debtor, unless the holder's right of recourse against the party secondarily liable is expressly reserved;

(f) By any agreement binding upon the holder to extend the time of payment, or to postpone the holder's right to enforce the instrument, unless made with the assent of the party secondarily liable, or unless the right of recourse against such party is expressly reserved.

Methods of discharge of secondary parties.

Section 120 applies only to parties secondarily liable on the instrument. A maker even though he be a surety for a co-maker (Niotaze State Bank v. Cooper, 162 Pac. 1169.), an accommodation co-maker (Ford v. Schall, 221 Pac 1052.), and an accommodation acceptor (Davis v. Simpson, 21 Ala. 616.) are not persons secondarily liable within this section.

(1) *Any act which discharges instrument.* — If the instrument is discharged under Section 119, it ceases to have force and effect. Hence, all parties, whether primarily or secondarily liable, will also be discharged. But a discharge of a secondary party does not effect a discharge of the instrument itself.

(2) *Intentional cancellation of signature.* — If the holder intentionally strikes out the signature of a person secondarily liable, the effect is to discharge him from liability on the instrument as if he has never been a party to the same. And no consideration is necessary to support such discharge. (McCormick v. Shea, 99 N.Y. Supp. 467.) However, the right of a holder to cancel the signature of an indorser is subject to the limitation that the indorsement is not necessary to the holder's title. (Sec. 48.)

(3) *Discharge of prior party by act of holder.* — The discharge of a party as by intentional cancellation of his signature (subsection [b].) also operates as a discharge of parties subsequent to the party discharged. The reason for the rule is that the discharge deprives a subsequent party of a right of recourse against the party discharged by the holder. "Prior party" is not limited to prior indorsers but includes as well principal debtors within its meaning. (Davis v. Cutheil, 152 Pac. 14.)

Subsection (c) applies only to discharge by the act of the holder and not to discharges by operation of law. Therefore, it does not include a discharge by bankruptcy (Silverman v. Rubenstein, 162 N.Y. Supp. 733.) or a discharge by the statute of limitations (Romero v. Hopweel, 210 Pac. 231.), or a discharge of a party for failure of the holder to give him notice of dishonor. (West River Bank v. Taylor, 34 N.Y. 128; see Sec. 68,2nd sentence.)

(4) *Valid tender of payment.* — "Tender of payment" means the act by which one produces and offers to a person holding

a claim or demand against him the amount of money which he considers and admits to be due, in satisfaction of such claim or demand without any stipulation or condition. (Salinas v. Ellis, 2 S.E. 121.)

A valid tender of payment made by a prior party, if accepted, would result in the discharge of said party and necessarily of all parties subsequent to him. (subsection [c].) It is but just, therefore, that the holder's refusal without any justifiable reason to accept a valid tender of payment made by a prior party should discharge the subsequent parties. (Sec. 70.) The refusal to accept the tender does not operate to discharge the debt but the tender stops the running of interest and relieves the party making the tender from subsequent liability for costs and attorney's fees in case of litigation.

(5) *Release of the principal debtor by act of holder.* — The release of the principal debtor discharges the instrument and, therefore, all the secondary parties are also discharged. Moreover, with the release of the principal debtor, subsequent parties lose their right of recourse against him. Such, however, would not be the case if the holder reserved his right of recourse against the said subsequent parties, for then the effect of the reservation by the holder of his right is the implied reservation by the subsequent parties of their right of recourse against the principal debtor. This reservation of the right of recourse must be express. Hence, it cannot be implied from acts and conduct. (Phoenix v. Nat. Bank, 166S.W.830.)

As under subsection (c), the release of the principal debtor must be by the act of the holder and not by operation of law like a judgment for the maker in an unsuccessful suit by the indorsee against him. (Highleyman v. McDowell Motor Car Co., 216 S.W. 52.)

EXAMPLE:

Suppose M is the maker of an instrument payable to the order of P who indorsed it to A, by A to B, and by B to C, the present holder.

If C releases M, the maker P, A, and B, the persons secondarily liable, are likewise discharged. But if C, iii releasing M, expressly reserved his right against the parties secondarily liable, then they are not discharged. By such reservation, it is understood that the right of recourse of P, A, and B against M are also reserved.

(6) *Extension of time of payment.* — The phrase "agreement binding on the holder" means agreement binding on the holder made with the principal debtor. Hence, an agreement by die holder with a third party to extend the time of payment does not discharge the indorsers. (Brosemer v. Brosemer,, 162 N.Y. Supp. 1067.) To be binding, the agreement must be supported by a valuable consideration and for a definite period. (Cape Charles Bank v. Farmer's Mut. Exch,, 92 S.E. 918.)

Subsection (f) is consistent with the rule that an extention granted to the debtor by the creditor without the consent of the guarantor extinguishes the guaranty. (Art. 2079, Civil Code.) But the mere failure on the part of the holder to demand payment does not of itself constitute an extension of time referred to herein. *(Ibid.;* see Clark vs. Sellner, 42 Phil. 388 [1921].)

The agreement to extend the time of payment does not discharge a party secondarily liable: (a) where the extension of time is consented to by such party; and (b) where the holder expressly reserves his right of recourse against such party.

Sec. 121. *Right of party who discharges instrument.* — Where the instrument is paid by a party secondarily liable thereon, it is not discharged; but the party so paying it is remitted to his former rights as regards all prior parties, and he may strike out his own and all subsequent indorsements, and again negotiate the instrument, except —

(a) Where it is payable to the order of a third person, and has been paid by the drawer; and

(b) Where it was made or accepted for accommodation, and has been paid by the party accommodated.

Effect of reacquisition by prior party.

Payment at or after maturity by a party secondarily liable does not discharge the instrument. It only cancels his own liability and that of parties subsequent to him. (see Sec. 50.)

With respect to prior parties, primary or secondary, the reacquirer, for the most part, is remitted to his former position, and consequently, he may strike out his own and all subsequent indorsements as they are not necessary to his title, (see Sec. 48.) If the party so paying was formerly a holder in due course, he may recover from prior parties as such a holder even though at that time he already had notice of defenses.

Negotiation by prior party.

The first clause contains the provisions: (1) that the instrument is not discharged; and (2) that it may again be negotiated. Do the exceptions in subsections (a) and (b) apply to the rule that the instrument is not discharged, or to the right to further negotiate the instrument? (see Sec. 50.)

While there is slight ambiguity in this section, the punctuation would seem to indicate, however, that the exception is intended only to apply to the right to negotiate. (Beutel's Brannan, *op. cit.,* p. 1172.) Moreover, the exception may operate harshly, if it is made to apply to the rule that the instrument is not discharged because it would deny the drawer who pays a bill of the right to recover from the acceptor. Thus, where the drawer of certified check which he had drawn payable to the U.S. Government for taxes was required to take up the check because of failure of the drawee-bank, the check is not discharged and the drawer is subrogated to the right of the payee and can recover in full. (Cuesta Rey & Co. v. Newsom, 102 Pla. 853.)

EXAMPLE:

R is the drawer of a bill addressed to W, the drawee, and payable to the order of P. The bill is accepted by W and indorsed by P, A, B, and C in succession.

If A pays the bill, it is not discharged, but it discharges him and B, and C to whom he is personally liable. But he "is remitted to his former rights as regards all prior parties" R and P, and he may strike out his indorsement to B as well as the indorsement of C and renegotiate the instrument.

Of course, A's right to sue R and P and to renegotiate may be exercised even without cancelling intervening indorsements.

If the bill is paid by R, the case would come under subsection (a) and so R cannot further negotiate the bill. If P is an accommodated party and P pays, neither can he renegotiate the bill as his case would fall under subsection (b).

Sec. 122. ***Renunciation by holder,*****; — The holder may expressly renounce his rights against any party to the instrument, before, at, or after its maturity. An absolute and unconditional renunciation of his rights against the principal debtor made at or after the maturity of the instrument discharges the instrument. But a renunciation does not affect the rights of a holder in due course without notice. A renunciation must be in writing, unless the instrument is delivered up to the person primarily liable thereon.**

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Meaning of renunciation.

The term *renunciation* describes the act of surrendering a right or claim with or without recompense. While there are decisions to the contrary, it has been held that Section 122, when read together with Sections 119 and 120, applies only to renunciation by a unilateral act of the holder (Hazelhurst Oil Hill, etc. Co. v. Booze, 130 So. 120.), *i.e.,* a release without consideration.

On the other hand, Section 119(e) would cover the case of an oral renunciation supported by a consideration; so an oral release without consideration is ineffective.

How renunciation by holder made.

Arenunciation of a debt evidenced by a negotiable instrument must be made by a written declaration to that effect. If oral, it should be accompanied by a surrender of the instrument to the person primarily liable thereon. (Sec. 122.)

The mere expression of an intention or desire to renounce is not enough. Thus, where the holder of a demand note being in *articulo mortis* instructed his nurse to write a memorandum to the effect that the note should be destroyed as soon as it could be found, it was held that there was no renunciation under the law. *(In re* George, 44 Ch. 627.)

Section 122 deals with express renunciation and does not apply to or prevent a discharge by oral novation under which the obligation of the other persons is accepted in lieu of the maker of the instrument. (Nelson v. Hudson, 299 S.W. 1111.)

Effect of renunciation.

(1) A renunciation in favor of a secondary party may be made by the holder before, at, or after maturity of the instrument. The effect of the renunciation is to discharge only such secondary party and all parties subsequent to him but the instrument itself remains in force, (see Sec. 120[c].)

(2) A renunciation in favor of the principal debtor may be effected at or after maturity. The effect of the renunciation is to discharge the instrument and all parties thereto, provided the renunciation is made absolutely and unconditionally.

In either case, said renunciation does not affect the rights of a holder in due course without notice. If the renunciation is made before maturity of the instrument, it runs the risk of being negotiated later so as to gain new life in the hands of a holder in due course since renunciation is only a personal defense. (Shaffer v. Akron Products Co., 109 N.E. 2d 24.)

EXAMPLE:

D is the holder of an instrument made by M and indorsed in succession by P, A, B, and C.

If D renounces his rights against B, then B and C are discharged. If D makes the renunciation in favor of M, the instrument is discharged as well as all the parties.

Now, if D, after he has made the renunciation, negotiates the instrument to E, a holder in due course without notice, E can still enforce the instrument because under the law "a renunciation does not affect the rights of a holder in due course without notice."

Sec. 123. ***Cancellation; unintentional; burden of proof.*** **— A cancellation made unintentionally, or under a mistake or without the authority of the holder, is inoperative; but where an instrument or any signature thereon appears to have been cancelled the burden of proof lies on the party who alleges that the cancellation was made unintentionally, or under a mistake or without authority.**

When cancellation inoperative.

Cancellation of an instrument is not limited to the writing of the word "cancelled" or "paid" or the drawing of crisscross lines across the instrument. It includes tearing, erasure, obliteration, or burning. It may be made by any other means by which the intention to cancel the instrument may be evidenced. (Booth v. Smith, 3 Woods [U.S.] 19.)

If the cancellation is made: (1) unintentionally, or (2) by mistake or through fraud, or (3) without authority, it is inoperative. Cancellation, however, is presumed to be intentional. Hence, the burden is on the holder claiming its ineffectiveness to overcome the presumption by contrary proof.

Sec. 124. ***Alteration of instrument; effect of.*** **— Where a negotiable instrument is materially altered without the assent of all parties liable thereon, it is avoided, except as against a party who has himself made, authorized, or assented to the alteration and subsequent indorsers.**

But when an 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.

Meaning of material alteration.

Material alteration is defined to be any change in the instrument which affects or changes the liability of the parties in any way (Foxworthy v. Colby, 89 N.W. 800.), as specified in Section 125 or changes the contract of the parties in any respect.

Any other alteration is immaterial and, therefore, inoperative to affect the liability of any party to the instrument prior to the alteration. Thus, adding words implied by law or making marginal figures to make them correspond to the sum written in words is not a material alteration. (Smith v. Smith, 1 R.1.398.)

Effect of alteration of instrument.

This section has reference to physical alterations of the instrument. So, an extension of time given by the holder of a note to the principal maker without the consent of a surety co-maker is not an alteration.

(1) *Alteration by a party.* — The effect of a material alteration by the holder is to discharge the instrument and all prior parties thereto who did not give their consent to such alteration.

(a) Since no distinction is made, it does not matter whether it is favorable or unfavorable to the party making the alteration (Franklin Ins. Co. v. Courtney, 60 Ind. 134.) or to the interests of prior parties (Keller v. State Bank, 24 N.E. 94.) or whether it is innocently or fraudulently made (First Nat. Bank of Sparta v. Yowell, 294 S.W. 1101.), since material alteration includes innocent changes (Hoofman v. Planters' Nat. Bank, 39 S.E. 134.) without regard to the motive or the purpose of the party making it. So that, where the instrument has been altered, although innocently, it is discharged but the innocent party can sue upon the original debt for which it has been given. (First Nat. Bank of Sparta v. Yowell, 294 S.W. **1101.)**

(b) The law makes certain exceptions as to the effect of material alteration. It does not discharge the instrument as against: 1) a party who has made the alteration, 2) a party who authorized or assented to the alteration, and 3) indorsers who indorsed subsequent to the alteration.

(c) When an alteration is apparent, the party claiming under the instrument has the burden to explain the alteration or that he had no part therein or that he was a holder in due course but where the alteration is not apparent on the face by the use of ordinary care in inspecting the instrument, the burden is on the party alleging it. (Arnold v. Wood, 191 S.W. 960.) When the drawee-bank pays a materially altered check, it has no right to claim reimbursement from the drawer, much less, the right to deduct the erroneous payment if made from the drawer's account since it did not pay according to the original tenor of the instrument. (Metropolitan Bank & Trust Co. vs. Cabilzo, 510 SCRA 259 [2006].)

EXAMPLE:

M makes a promissory note for P3,000.00 payable to P or order. P negotiates the note to A who, with the consent of P, raises the amount to P8,000.00 and thereafter indorses it to B, B to C, and C to D, under circumstances which make D not a holder in due course.

The note is discharged as against M; hence, D cannot enforce it as against M even for the original tenor. A, however, would be liable to D for P8,000.00 as he is the party who himself made the alteration although D is not a holder in due course. Moreover, as indorser, A warrants that the instrument is genuine and in all respects what it purports to be. (Sees. 65 and 66.)

P would also t»e liable to D for P8,000.00 as he authorized or assented to the alteration.

Likewise, B and C would be liable to D for P8,000.00 as they are subsequent indorsers.

(2) *Alteration by a stranger.* — When the material alteration of the instrument is made by a stranger, it is called *spoliation.* In England, spoliation has the same effect as alteration. Although Section 124 does not make any distinction, American courts hold that spoliation has no effect upon the instrument if the original meaning can be ascertained. (Brooks v. Allen, 62 Ind. 401; Singer Sewing Machine Co. v. Bayer, B9 N.W. 741; and others.)

(3) *Right of holder in due course.* — A material alteration avoids the instrument in the hands of one who is not a holder in due course as against any prior party who has not assented to the alteration. But if an altered instrument is negotiated to a holder in due course, he may enforce payment thereof according to its original tenor regardless of whether the alteration was innocent or fraudulent, (see Sec. 62.)

EXAMPLE:

In the example given, if D were a holder in due course, he could enforce the instrument against M for P3,000.00, its original tenor, (see Sec. 14.) Of course, D can recover from P, A, B, or C P8,000.00 should M dishonor the instrument.

Reason for rule in relation to material alteration.

The law in relation to material alteration of instruments, rests upon public policy, in that, to maintain the integrity surrounding commercial relations, no party to bebenefited should be permitted under any guise to alter the written obligation of another without his authority or assent. To do otherwise would open the door to the perpetration of all kinds of fraud to the prejudice of the party or parties to be bound who have no control whatever over the possession of such instruments which are passed from hand to hand and, therefore, cannot prevent any person in possession thereof from making changes therewith in disregard of honesty and good conscience. (Born v. Lafayette Nute Co., 139 N.E. 364.)

The reason of the law imposing the discharge of the debt itself upon one who tampers with the instrument is upon the principle that "no man should be permitted to take the chance of gain by the commission of a fraud, without running the risk of loss in case of detection." (Daniels, *op. cit.,* [5th ed.], Sec. 1410a.)

Sec. 125. *What constitutes a material alteration.* — Any alteration which changes —

(a) The date;

(b) The sum payable, either for principal or interest;

(c) The time or place of payment;

(d) The number or the relations of the parties;

(e) The medium or currency in which payment is to be made;

(f) Or which adds a place of payment where no place of payment is specified, or any other change or addition which alters the effect of the instrument in any respect, is a material alteration.

When alteration is material.

Under Section 125, a change in any of the matters mentioned or any other change which alters the effect of the instrument in any respect constitutes a material alteration. Any other alteration is immaterial and will not discharge the instrument. Thus, the alteration on the serial number of a check is not a material alteration, an item which is not an essential requisite for negotiability and, therefore, the drawee-bank is not justified to refuse the check in question, the referral to the serial number being redundant and inconsequential. (International Corporate Bank vs. Court of Appeals, 501 SCRA 20 [2006].)

(1) *Date.*—A change in the date of the instrument whether it hastens or postpones the time of payment is material (Wright v. O'brien, 119 N.E. 469.); so also a change in the date from which interest is to run. (Bailey v. Citizen's Bank of Meeker, 247 Pac. 42.)

But the change in the date of indorsement is not material where the date is not necessary to fix the maturity of the instrument unless the issue is whether the indorsement was made before or after maturity, (see Sec. 52[b].) The filing of date blanks is not material nor is it an alteration, (see Sec. 14.)

(2) *Sum payable.* —- Any change in the amount of the principal or interest whether increasing or reducing it is always a material alteration. (Cushing First Nat. Bank v. Ketchum, 172 Pac. 81.) The addition of the words "with interest" with or without a fixed rate, is also material. (Broadway Nat. Bank v. Hefferman, 107 N.E. 921.)

But an alteration of the marginal figures of an instrument is not material when the sum stated in words in the body remains unchanged. (Prudential Trust Co. v. Coghlin, 144 N.E. 283.) Neither is the insertion by the payee of die words "with interest" after execution with authority of the maker material (Levy v. Cerons, 146 N.Y. Supp. 312.); nor the insertion of die legal rate of interest where die instrument has a provision for "interest at — percent," since the legal import is not thereby changed. (Haas v. Commerce Trust Co., 194 Ala. 672.)

(3) *Time of payment.* — A change in the maturity of die instrument whether the time of payment is thereby curtailed or extended is material. (Palomeki v. Laurell, 168 Pac. 835.)

But a change in the marginal notation of the date of maturity of an instrument in order of correct an obvious mistake is not a material alteration (Clem v. Chapman, 262 S.W. 168.); nor is the change of a marginal note "Due 2-29-19" to March 1 material when the year "1919" was not a leap year. (Whether v. First Nat. Bank, 214 Pac. 536.)

(4) *Place of payment.*—Any alteration which changes the place of payment or inserts a place of payment where none is specified is material. Thus, the change of the place of payment from a town to a particular bank is material since the maker is deprived of the advantages under Section 70 of an instrument payable at a special place and possibly subject him to the disadvantages of an instrument payable at a bank. (Mechanics Am. Nat. Bank v. Helmbacker, 201 S.W. 3830 So also the addition of the name of the city after that of the bank designated as the place of payment. (Marion Savings Bank v. Leahy, 204 N.W. 456.)

But the change of the name of a bank at which an instrument is payable after execution, from X bank to Y bank is jiot a material alteration where X bank is known to have gone out of existence and has become Y bank since even without the alteration the instrument would have been payable to Y bank. (First Nat. Bank Melton v. Pensacola Co., 190 Fed. Rep. 126.)

(5) *Number or relations of the parties.* — The addition of a comaker (Fairley v. Falcar, 214 N.W 538.); the addition of the word "surety" after the name of a co-maker (Eastman Nat. Bank v. Naylon, 268 Pac. 78.); or the word "trustee" after the name of the payee (Mechanics Am. Nat. Bank v. Helmbacker, 201 S.W. 383.); the erasure of the payee's name, and the insertion of the name of another person (Alford v. Delatte, 137 So. 500.) or just leaving a space blank (Stove v. Sargent, 107 N.E. 1014.); the erasure of words "agent for P" in a check payable to "X, agent P", leaving X's name (Union Tool Co. v. Farmers' and Merchants' Nat. Bank, 218 Pac. 424.); the erasure of the word "or" (St. John's Congregation v. Merchants' Nat. Bank, 165 N.W 491.); and the insertion of the words "Agent, Phil. National Bank" after the check was transferred by the payee, which converts the Bank from a mere drawee to a drawer, and therefore, changes its liability (Montinola v. Phil. National Bank, 88 Phil. 178 [1951].), are examples of the alterations which change the number or relations of the parties.

(6) *Medium or currency of payment* — Any change in the medium or currency in which payment is to be made is a material alteration like the insertion of die words "in current funds" (Angle v. M.W. Mutual Life Ins. Co., 92 U.S. 330.), or the words "in gold coins" (Wills v. Wilson, 3 Ore. 308.) or when a note payable in pesos, Philippine currency, is changed by making it appear as payable in American dollars.

(7) *Other alterations.* — Under the last paragraph, the substitution of the words "or bearer" for "or order" (Builders Lime & Cement Co. v. Weymer, 151 N.W. 100.); writing the words "protest waived" above a blank indorsement (Sawyer State Bank v. Sutherland, 162 N.W. 966.); and the erasure of the words "without recourse" above the signature of an indorser (Waltham State Bank v. Tuttle, 199 N.W. 970.) likewise constitute material alterations as they.alter the effect of the instrument.

A change in the pronoun "I" to "We" in a promissory note is a material alteration since it changes the obligation from solidary to a joint one.

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TITLE II

BILLS OF EXCHANGE

CHAPTER IX FORM AND INTERPRETATION

Sec. 126. ***Bill of exchange defined.*** **— A bill of exchange is an unconditional order in writing addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money to order or to bearer.**

Bill of exchange and promissory note distinguished.

The distinctions between a bill and a note are as follows:

(1) A bill contains an unconditional order addressed by one person to another requiring the latter to pay the instrument, while a note contains an unconditional promise made by one person to another to pay it (Sec. 184.);

(2) In a bill there are three parties; the drawer, the drawee and the payee or bearer, while in a note there are only two parties; the maker and the payee or bearer;

(3) In a bill, the drawer, the one who issues the instrument, is only secondarily liable, while in a note, the maker, the one who issues the instrument, is primarily liable;

(4) A bill drawn payable to the drawer's own order is complete without indorsement, provided, it has been accepted by the drawee, while a note drawn payable to the maker's own order is not complete until indorsed by him *(ibid.);*

(5) A bill must be presented for acceptance in certain cases (Sec. 143.) and the drawee is not liable unless and until he accepts the same, while in a note, there is no need of presentment for acceptance; and

(6) A bill payable on demand must be presented for payment within a reasonable time from its last negotiation, while a note payable on demand must be presented for payment within a reasonable time from its issue. (Sec. 71.)

When a promissory note like a bill of exchange.

When a note is indorsed by the payee it becomes just like a bill.

The maker corresponds to the acceptor, the indorser, to the drawer, and the indorsee, to the payee in a bill. Both the maker and the acceptor are primarily liable and both the indorsee in the note and the payee in the bill are the holders. The holder is the bearer of the instrument if the note is indorsed payable to bearer or if the bill is originally payable to bearer.

When a bill of exchange like a promissory note.

Likewise, after a bill of exchange has been accepted it becomes very similar to a promissory note. The acceptance is a promise to pay, and the position of the acceptor is that of promisor, principal debtor, or maker, while the drawer is in the position of first indorser or surety of the acceptor, (see 11 Am. Jur. 2d 51-52,665.)

A certified check (see Sec. 187.) is practically a promissory note with the bank as the maker. It discharges the drawer from liability thereon, (see Sec. 188.)

Other classes of bills of exchange.

The term "bill of exchange" includes drafts, orders, and checks. (Newman v. Slee, 139 Misc. 659, 249 N.Y. So. 622.) Thus, an order by R (drawer) on W (drawee) for payment of a specified sum of money to the order of P (payee) is a bill of exchange.

(1) A bill drawn in one state or country and payable in another state or country is known as a *foreign* bill of exchange. If it is drawn and payable within the same state, it is known as an *inland* bill of exchange.

(2) *Draft* is a bill of exchange payable on demand at sight *(demand* or *sight draft),* that is, when the holder presents it for payment, or a stated time after sight or at a definite future time or some future determinable time *(time draft).* A sight draft may be payable on acceptance. The term "draft" is often used and is the common term for all bills of exchange. And the words "draff[7] and "bill of exchange" are used indiscriminately. (Republic vs. First National City Bank of New York, 3 SCRA 851 [1961].)

(a) If drawn by a bank against its branch or another bank, it is called a *bank draft.* It has been defined as a bill of exchange drawn by a bank upon its correspondent bank, issued at the solicitation of a stranger who purchases and pays therefor. (Citytrust Banking Corporation vs. Court of Appeals, 196 SCRA 553 [1991].) With certain types of checks *(e.g.,* cashier's checks), the bank is both the drawer and the drawee. A draft drawn and payable in one country is a *domestic draft.* If drawn in one country and payable in another, it is an *international draft.*

(b) The drawee-bank acting as a "payor" bank is solely liable for acts done not in accordance with the instructions of the drawer-bank or of the purchaser of the draft. It has the burden of proving that it did not violate the instructions given to it. Meanwhile, the drawer if sued by the purchaser of the draft, is liable for the act of debiting the customer's account despite an instruction to stop payment. The drawer has the duty to prove that he complied with the order to inform the drawee, *(ibid.)*

(c) A draft differs from a check in that the former is always drawn on a bank while the latter is always drawn on a bank and payable on demand, (see Sec. 185.) Ordinarily, a bank draft is a more acceptable medium of payment than the check of a private individual, because of the bank's superior credit and resources. (Babb & Martin, *op. cit.,* p. 171.)

The following is a form of a bank draft:

Manila, Philippines
August 14,2010

PI,000.00

At sight pay to the order of *Ma. Fe* M. *de Leon* One Thousand Pesos and charge the same to the account of

Philippine National Bank
By:
Maria Corazon N. Santos
(Branch Manager)

To: *Philippine Commercial and Coconut Bank*

Manila

(2) *Trade acceptance* is a draft or bill of exchange drawn by the seller on the purchaser of goods and accepted by the latter by signing it as drawee.

(a) A trade acceptance, unlike an ordinary bill of exchange, has a definite date of maturity. It is oridinarily used in connection with the purchase and sale of goods. The seller is both the drawer and the payee on this draft. This situation is substantially the same as if the purchaser had given the seller his promissory note. The usual purpose of the transaction is to enable the seller to raise money on the paper even before the obligation of the purchaser is due or matures under the terms of the contract of sale through indorsement and discount.

(b) If the instrument is drawn against a bank instead of the purchaser, it is called *banker's acceptance.* The bank is not making a loan; it is merely lending its credit to the buyer. A banker's acceptance would, in general, be more desirable as a credit instrument than a trade acceptance for the reason that a bank draft has a stronger credit than the check of a private individual. When the bank accepts, it customarily requires the buyer either to create in the bank some security interest in the goods purchased or to keep on deposit an amount sufficient to meet the acceptance at its maturity date, *{ibid.,* p. 172.)

EXAMPLE:

S sold goods to B who wishes to utilize a negotiable Instrument rather than paying S immediately for the goods. So, S (drawer) draws a trade acceptance on B (drawee) for the purchase of the goods, ordering B to pay at a stated future time the stated amount to the order of S. Here, S is both the drawer and the payee of the instrument.

B accepts the paper by signing his name in the space provided for the purpose. The acceptance constitutes a promise by B (drawee-acceptor) to pay the instrument at its maturity. S can negotiate the instrument to a third party at a discount and receive cash immediately. The use by the seller of goods of the instrument in this manner explains what it is called "trade acceptance." In most cases, the parties are corporations which sign through authorized agents or officers.

The following is a form of trade acceptance.

Trade Acceptance
August 14,2010

No. 50 P10,000.00

Pay to the order of <u>Dante Q. Pantaleon</u> Ten Thousand Pesos __________________only. The transaction which gives rise to this instrument is the purchase of goods by the acceptor from the drawer. The drawee may accept this bill payable at any bank, banker or trust company in tiKe Philippines which such drawee may designate.

To: *Socrates de Leon* *Dante Q. Pantaleon*

1234 Escolta, Manila

Date of maturity: *October 15,2010*

Accepted

Date: *August 20,2010*

Payment at: *Philippine Commercial Bank, Manila*

Signature: *Socrates de Leon*

Sec. 127. *Bill not an assignment of funds in hands of drawee.* —A bill of itself does not operate as an assignment of the funds in the hands of the drawee available for the payment thereof, and the drawee is not liable on the bill unless and until he accepts the same.

Status of drawee prior to acceptance or payment/after payment.

Drawee, a mere stranger to the bill — A drawee is a stranger to the bill drawn on him unless and until he accepts the same. (Sec. 62.) The effect of acceptance is to constitute the drawee who becomes an acceptor, the principal debtor.

Drawee not bound to accept. — Before acceptance, the bill is merely an order to the drawee to pay. As far as the holder is concerned, the drawee is not bound to accept even if the drawer has sufficient funds in his hands. In other words, in order that a drawee may be liable on,a bill and then become obligated to the payee, it is necessary that he first accepts the same. In fact, Section 71 requires that with regards to bills of exchange, there is a need that they be presented either for acceptance or for payment within a reasonable time after their issuance or after the last negotiation thereof. Failure to make such presentment will discharge the drawer from liability or to the extent of the loss caused by the delay as provided in Section 180. (Republic vs. Phil. National Bank, 3 SCRA 851 [1961].)

Drawee not liable to holder in due course. — The mere issuance of a bill does not operate as an assignment of the funds in the hands of the drawee, (see Sec. 189.) Hence, a holder in due course of a dishonored bill has no cause of action against the drawee either at law or in equity (Macon Creamery Co. v. Mix, 7 S.W. 290.) but only against the drawer and indorsers, if any. But the drawee who refuses to accept may be made liable to the drawer.

Effect of payment. — There is no contractual relation created between a drawee-bank and the payee as a result of the payment by the former of the amount of the check. If the check is dishonored upon presentment for payment, the payee cannot sue the drawee-bank but only the drawer for lack of privity. (Security Bank and Trust Co. vs. Court of Appeals, 291 SCRA 33 [1998].)

Sec. 128. ***Bill addressed to more than one drawee.*** **— A bjll may be addressed to two or more drawees jointly, whether they are partners or not; but not to two or more drawees in the alternative or in succession.**

Bill addressed to several drawees.

A bill may be addressed to two or more drawees, thus: "To A and B" or "To A, B, and C" whether they are partners or not (see Sec. 145[a].); but it cannot be addressed to two or more drawees in the alternative, thus: "To A or B;" nor to two or more drawees in succession, thus: "To A, and in his absence, to B."

"The objection to the drawees being in the alternative or in succession is the difficulty in determining the exact date of the dishonor of the bill inasmuch as it cannot be said that the bill is dishonored until all of the drawees have dishonored it and if the presentment takes place for a period covering several days when the last dishonor is made, the first drawee who dishonored it may have already been released from his secondary liability due to die lapse of time before notice of dishonor was made by the holder. Notice of dishonor could not have been made earlier by the holder since there is still a remaining drawee, who has not yet dishonored it." (C. Alvendia, *op. cit.,* p. 179.)

Note that Section 128 refers to the drawee. Section 8(e) has reference to the payee.

Sec. 129. ***Inland and foreign bills of exchange.*** **— An inland bill of exchange is a bill which is, or on its face purports to be, both drawn and payable within the Philippines. Any other bill is a foreign bill. Unless the contrary appears on the face of the bill, the holder may treat it as an inland bill.**

Inland and foreign bills of exchange explained.

Section 129 classifies bills of exchange according to where the bills are drawn and paid. Under this section, a bill of exchange drawn in Manila and payable in Iloilo is an inland or domestic bill because it is both drawn and payable within die Philippines. But a bill drawn in the Philippines and payable in California, or both drawn and payable in California, or drawn in California and payable in New York is a foreign bill because it is not both drawn and payable within the Philippines.

For the purpose of the law on negotiable instruments, the several states of the U.S. are deemed foreign to each other. (Bank of U.S. v. Daniel, 12 Peters 32; Commercial Bank v. Barnum, 49 N.Y. 269.)

Importance of the distinction.

A foreign bill must be distinguished from an inland bill for the following reasons:

(1) While the former must be protested in case of dishonor to charge the drawer and the indorsers under Sections 118 and 152, the latter need not be protested; and

(2) It is necessary to determine whether a bill of exchange is an inland bill or a foreign bill for purposes of detenning the law that will govern the validity, interpretation, and effect of the bill. (Beutel's Brannan, *op. cit.,* p. 984; Art. 15, Code of Commerce; Art. 17, Civil Code.)

When foreign bill may be treated as inland bill.

A bill which is in fact foreign may be treated by the holder as an inland bill unless the contrary appears on its face. Thus, a bill drawn in New York and payable in the Philippines is a foreign bill but the holder may treat it as an inland bill if on the face of the bill it does not appear that it was drawn in New York.

Sec. 130. *When bill may be treated as promissory note.* — Where in a bill the drawer and drawee are the same person, or where the drawee is a fictitious person, or a person not having capacity to contract, the holder may treat the Instrument, at his option, either as a bill of exchange or a promissory note.

When bill may be treated as a note.

Under Section 130, a holder may treat an instrument at his option, either as a bill of exchange or a promissory note, when:

(1) The drawer and the drawee are the same person, like a draft drawn by a bank on its branch, or by a corporation on its treasurer, or by an agent on his principal by authority of the latter;

(2) The drawee is a fictitious person; and

(3) The drawee has no capacity to contract.

Where a person is the drawer and the drawee at the same time of a bill, he is practically ordering himself to pay. Treating the bill as a note would constitute the drawer the maker and, therefore, his liability is not secondary but primary. Where the drawee is a fictitious person, there is nobody who could accept the bill; and where he has no capacity to contract, his acceptance would not be valid. Acceptance is thus made impossible through the fault of the drawer. Hence, the holder may treat the bill at his option as a promissory note.

In all of these cases, the holder need not prove presentment for payment, have the acceptance of the drawee, or give notice of dishonor to charge the drawer, (see Sees. 17[e] and 185.) Even if the holder treats the bill as such, notice of dishonor is not required to be given to the drawer in order to make the latter liable. (Sec. H4[a],[b].)

Sec. 131. *Referee in case of need.* — The drawer of a bill and any indorser may insert thereon the name of the person to whom the holder may resort in case of need; that is to say, in case the bill is dishonored by non-acceptance or non-payment. Such person is called the referee in case of need. It is the option of the holder to resort to the referee in case of need or not, as he may see fit.

Referee in case of need.

Referee in case of need is the person named by the drawer or indorser as the one to whom the holder may resort in case of need, that is, in case the bill is dishonored by non-acceptance or non-payment. It is not obligatory upon the holder to apply to the referee in case of dishonor. The referee is not bound to pay the holder but he may be made liable to the party who named him.

The usual form is "In case of need, apply to X." If the referee pays the bill, the drawer or indorser will be liable to him for the amount. (Beutel's Brannan, *op. tit.,* p. 1228.)

EXAMPLE:

Pay to P or order P1,000.00 In case of need, apply to X. (Sgd.)R ToW

If the above bill is dishonored by W in the hands of P (or any holder thereof), P may apply to X for payment but before doing so, he must first have die bill protested, (see Sec. 167.) But P may, if he wants to, look immediately to R, die drawer (Sec. 84.), after due proceedings on dishonor have been taken by him. (Sees. 61,66.)

Referee X is not under obligation to pay the bill but he may subject himself to liability to P depending on their agreement. If X pays the bill, he may recover the amount from R (or indorser who has named him as referee in case of need).

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CHAPTER X

ACCEPTANCE

Sec. 132. *Acceptance; how made, etc.* — The acceptance of a bill is the signification by the drawee of his assent to the order of the drawer. The acceptance must be in writing and signed by the drawee. It must not express that the drawee will perform his promise by any other means than the payment of money.

Meaning of acceptance.

Acceptance of a bill, as stated in Section 132, is the signification by the drawee of his assent to the order of the drawer.

It has also been defined as "the act by which the drawee manifests his consent to comply with the request contained in the bill of exchange directed to him and it contemplates an engagement or promise to pay." (Hunt v. Security State Bank, 179 Pac. 248.)

Applicability.

Acceptance applies only to bills of exchange and not to promissory notes. It may be actual or constructive, (see Sees. 137, 191.)

In a certain sense it may be said that there can be no "acceptance" of a check which is a demand instrument. In the ordinary transaction there is no occasion for acceptance of a check. Accordingly, Chapter X has no application to that special kind of bill of exchange. (Murray v. American Sav. Bank, 197 NW 69.) However, Chapter XVI contains provisions (see Sees. 187-198.) relating to the certification of a check, and declares that such is an acceptance or equivalent thereto, (see 11 Am. Jur. 2d 566.)

Object and effect of acceptance.

(1) Unless and until he accepts, the drawee is not bound in any way as a party to a bill and the payee or other holder has no recourse against him even if it is shown that he had funds in his hands belonging to the drawer sufficient to cover the bill, and ought, in justice to the drawer, to have paid the bill.

The object of acceptance then, is to bind the drawee and make him an actual party liable to the instrument.

(2) By accepting a bill, the drawee admits everything essential to its validity. Accordingly, want or failure of consideration cannot be shown in a suit by the payee against the acceptor. The presumption is that every bill of exchange is drawn on account of some indebtedness from the drawee to the drawer, and that the acceptance is an appropriation of the funds of the latter in the hands of the former.

This rule is not unjust for it is the duty of the drawee to ascertain before accepting a bill whether he owes the drawer something which is exclusively within his knowledge but which the payee would have no means of knowing.

(3) Until the bill has been accepted, the drawer is the principal debtor. Upon acceptance, the bill, in effect, becomes a note. The drawee assumes the liability of the maker and the drawer, that of the first indorser. As long as a commercial paper conforms with the definition of a bill of exchange, the paper is considered a bill of exchange.

The nature of acceptance is important only in the determination of the kind of liabilities of the parties involved but not in the determination of whether a commercial paper is a bill of exchange or not. (The Phil. Bank of Commerce vs. Aruego, 102 SCRA 530 [1980].)

Formal requisites of acceptance.

Under Section 132, actual acceptance, to be valid, must be in writing signed by the drawee and must contain an express or implied promise to pay money. It is necessary that the acceptance be delivered or made known to the holder.

(1) *In writing.* — Acceptance made orally is not binding on the drawee. Thus, acceptance by telephone is not an acceptance. It was held, however, that acceptance by telegram is valid. (Commercial Bank v. First National Bank, 13 A.L.R. 986.) The reason for the rule requiring that the acceptance must be written "is that sound public policy requires some substantial and tangible evidence of the contract and more reliable in its nature than the statement or recollection of witnesses." (Selma Savings Bank v. Webster Country Bank, 206 S.W. 870.)

But the rule does not apply to constructive acceptance (Sec. 137.) and to a foreign bill payable in another state unless it is shown that the law of that state requires written acceptance. (Bank of Ladonia v. Bright-Coy Commission Co., 120 S.W. 648.)

Under Article 1320 of our Civil Code, "an acceptance may be express or implied." (see Sumacad vs. Province of Samar, 100 Phil. 72 [1956]; Sec. 62.)

(2) *Signed by the drawee.* — It is also required that the acceptance must be signed by the drawee. Indeed, the signature of the drawee without more is held to be sufficient acceptance. (Lawless v. Temple, 150 N.E. 176.) Without the signature of the drawee, he would not be liable.

(3) *Express a promise to pay money.* — The acceptance must always express a promise to pay money only. Thus, "accepted payable in goods" is not a good acceptance.

(4) *Delivered to the holder.* — The acceptance is still incomplete until the acceptor has delivered the bill back to the holder. Before delivery or notification, the acceptor may revoke or cancel his acceptance. (First Nat. Bank of Murfresbero v. First Nat. Bank of Nashville, 154 S.W. 965; Irving Bank v. Netherland, 36 N.Y. 335.)

How acceptance made.

Acceptance is usually made by writing across the face of the bill the word "accepted" under which the drawee signs his name, with the date also written.

The law does not require any particular form of word or words to constitute acceptance. Any equivalent word or expression such as "honored," "seen," "presented," "good," "I would pay" or the signature of the drawee without more is valid as acceptance. What is important is that an intention to accept may be inferred from the words used.

Sec. 133. ***Holder entitled to acceptance on face of bill.*** **— The holder of a bill presenting the same for acceptance may require that the acceptance be written on the bill, and, if such request is refused, may treat the bill as dihonored.**

Where acceptance may be made.

Acceptance may be on the bill itself or on a separate instrument such as in a letter or telegram. Acceptance on a separate paper may be either an acceptance of an existing bill (Sec. 134.) or an acceptance of a future or non-existing bill. (Sec. 135.)

In a constructive acceptance (Sec. 137.), there is no actual written acceptance by the drawee.

Right of holder to acceptance on face of bill.

Although it is not an essential requisite that an acceptance be written on the bill, under Section 133, the holder has the right to require that the acceptance be made on the bill itself. If the drawee refuses, the holder has the option to treat the bill as dishonored and go against the person secondarily liable after giving notice of dishonor. The reason for the rule is found in Section 134.

Section 133 is applicable to all bills of exchange and not only to sight bills. Although a bill payable at a fixed time need not be presented for acceptance to charge the drawer or indorser (see Sec. 143, par. 2.), yet it may be presented for acceptance at any time. (National Park Bank v. Saitta, m N.Y. Supp. 927.)

Sec. 134. Acceptance ***by separate instrument.*** **—Where an acceptance is written on paper other than the bill itself, it does not bind the acceptor except in favor of a person to whom it is shown and who, on the faith thereof, receives the bill for value.**

Acceptance by separate instrument.

Where the acceptance is written on a paper other than the bill itself, in order to bind the acceptor, Section 134 requires that: (1) the acceptance be shown to the person to whom the instrument is negotiated; and (2) such person must take the bill for value on the faith of such acceptance.

An example of the foregoing is acceptance by letter. Thus, a letter from the drawee to the drawer accepting a draft is not binding in favor of one who never saw the letter or advanced money on the faith thereof. (Jones v. Crumpler, 89 S.E. 292.) It will be noted that physical exhibition is absent in the case of the acceptance of a non-existing bill under Section 135. It is believed that as long as the holder knows of the acceptance and relies upon it, the acceptor must be held to his acceptance although it was not actually shown to the holder.

Acceptance by telegram.

The acceptance may be by telegram. But a telegram that a draft is "good/[7] or "good for the sum named" in answer to a telegram asking a bank if it would pay the draft is not an "acceptance" or an agreement to accept (see Colcord v. Banco des Tamaulipas, 168 N.Y. Supp. 710.) and the drawee is not liable as acceptor since it makes no promise to pay (Flathead Country State Bank v. First National Bank, 282 Fed. 398, C.C.A. [Mont.].) as such responses are merely informative. (Babb & Martin, *op. cit.,* p. 192.)

The court reasons that "good" constitutes an acceptance if written on the bill or check, but not if written in a collateral document, such as a telegram. The decision is adversely criticized. (Beutel's Brannan, *op. cit.,* p. 1237.)

Sec. 135. *Promise to accept; when equivalent to acceptance.* — An unconditional promise in writing to accept a bill before it is drawn is deemed an actual acceptance in favor of every person who, upon the faith thereof, receives the bill for value.

When promise to accept equivalent to acceptance.

Section 134 provides that an extrinsic acceptance must be in writing and is good only to persons to whom it is shown. On the other hand, Section 135 provides that a promise to accept is good to any person who "upon the faith thereof receives the bill for value." *{ibid.,* p. 1239.)

The promise to accept a future non-existing bill must be unconditional and in writing. There is a conflict of opinion as to whether a definite description of the bill to be accepted is essential, or whether a general agreement to accept is sufficient, it not being necessary that the agreement be to accept a particular bill. (Wauchula Dev. Co. v. People's Stock Yards State Bank, 86 Fla. 298; Segil Champion Livestock Commission Co. v. Davis, 194 Pac. 468; see Ogden, *op.ext.,* p. 170.) It is, of course, desirable that the promise to accept desdibe the bill so that there can be doubt of its application to it.

EXAMPLE:

Before the bill is drawn, P writes a letter to W asking him if he would honor R's draft for PI,000.00 to cover the purchase price of goods R wants to buy from P. P receives the reply: "YES." In view of this promise to accept on the part of W, P sells the goods to R.

Under Section 135, W is liable to P as acceptor because W's promise "is deemed an actual acceptance." But if P negotiates the bill to A and A neither saw nor knew of W's promise to accept, W will not be liable to A. (Sec. 134.)

Sec. 136. ***Time allowed drawee to accept*****—The drawee is allowed twenty-four hours after presentment in which to decide whether or not he will accept the bill; but the acceptance, if given, dates as of the day of presentation.**

Time allowed drawee to accept.

Since the drawee by accepting the instrument becomes liable on the bill as an acceptor, the law gives him time to make up his mind whether to accept or reject the bill.

Under this section, the drawee has 24 hours after presentment for acceptance within which to act upon the bill. However, should he decide to accept the bill, the acceptance shall be dated as of the day of presentation or the date when he first saw the bill.

EXAMPLE:

P is the holder of a bill payable 20 days after sight. If the bill is presented for acceptance by P to W at 10:00 o'clock a.m. on September 5, W has up to 10:00 o'clock a.m. of September 6 within which to accept the bill.

Until the expiration of that time, P has no right to demand an answer, nor, without categorial answer, to deem the bill either accepted or dishonored.

If it is accepted by W on September 6 the acceptance is deemed to have been given on September 5 and, therefore, the bill is due on September 25 and not on September 26.

Sec. 137. *Liability of drawee retaining or destroying bill.* — Where the drawee to whom the bill is delivered for acceptance destroys the same, or refuses within twenty- four hours after such delivery, or within such other period as the holder may allow, to return the bill accepted or non- accepted to the holder, he will be deemed to have accepted the same.

Constructive acceptance.

This section treats of constructive acceptance by operation of law. It should not be confused with implied acceptance which is acceptance inferred from any act or conduct of the drawee. (Sumcad vs. Province of Samar, 100 Phil. 72 [1956].) There is no implied acceptance, however, under the Negotiable Instruments Law in view of Sections 132 and 137, the decision in the above- cited case notwithstanding.

There is constructive acceptance: (1) where the drawee to whom a bill is delivered for acceptance destroys it; or (2) where the drawee refuses, within 24 hours after delivery or within such period as is given to him, to return the bill, accepted or non- accepted. The doctrine of constructive acceptance is based on the general principle of estoppel.

An accidental destruction would not be an acceptance. It must be willfully done. (Bailey & Co. v. Veneer Co., 190 S.W. 430.)

Effect of retention of bill.

There is a conflict of authority as to whether the word "refusal" includes mere retention of the bill by the drawee.

(1) The weight of authority inclines to the view that mere retention without refusal to return for more than 24 hours constitutes constructive acceptance under Section 137. (Beutel's Braririan, *op. cit.,* p. 1249.)

The reasons given for this view are stated in a case. They may be summarized as follows:

> "Under Section 136, 24 hours is sufficient time for the drawee to decide whether or not he will accept the bill, and Section 137, having allowed this time, requires him to return the bill accepted or non-accepted. If a demand and a refusal are conditions precedent to an acceptance, then the holder must not only present the bill for acceptance, but he must make a demand for its acceptance and await for a specific refusal before the drawee is deemed an acceptor. It is obvious that such a demand is wholly unnecessary. The presentation of a bill for acceptance is a demand for its acceptance, which, if the bill is retained by the drawee, implies a demand for its return if acceptance is declined. The manifest purpose in requiring the prompt return of the bill is for the protection of the holder. It is immaterial to the drawer when the bill is returned as he is protected by notice of dishonor." (Wisner v. First Nat. Bank of Gallitzin, 68 Atl. 955.)

(2) The above interpretation, however, seems to run counter to Section 150 which declares that if a bill is not accepted Within the prescribed time, the holder must treat it as dishonored to preserve his right of recourse against secondary parties. The rule deducible from Section 150, it is believed, refers to something of wrongful character amounting to an unauthorized conversion of the bill by the drawee. The word "refuses" implies that a demand for the return of the bill has been made but such a demand was refused.

It will be noted that Section 137 applies when "a bill is delivered for acceptance," not payment. It has been held that since presentment for payment *(supra.)* and presentment for accept ance *(infra.)* are two different acts, Section 137 has no application where a check was presented for payment and not for acceptance. (Urwiller v. Platte Valley State Bank, 83 N.W. 2d 88.)

Sec. 138. ***Acceptance of Incomplete bill.*** **— A bill may be accepted before it has been signed by the drawer, or while otherwise incomplete, or when it is overdue, or after it has been dishonored by a previous refusal to accept, or by non-payment. But when a bill payable after sight is dishonored by non-acceptance and the drawee subsequently accepts it, the holder, in the absence of any different agreement, is entitled to have the bill accepted as of the date of the first presentment.**

When acceptance may be made.

Under this section, acceptance may be made before the bill has been signed by the drawer or while otherwise incomplete; even after it is overdue; and even after it has been dishonored by non-acceptance or non-payment.

(1) *Where bill still incomplete.* — Although a bill is usually accepted within a reasonable time after execution, Section 138 allows acceptance to be made even while the bill is still incomplete. It does not mean, however, that the one to whom the bill is transferred while incomplete may become a holder in due course. (Clay v. Funkhouser Banking Co., 255 S.W. 946.)

(2) *Where bill already overdue or has been dishonored.* — An instrument does not lose its negotiable character by the mere fact that it is already overdue or it has been dishonored. A bill may still be accepted after 24 hours (Sec. 136.) or after there has been a refusal to accept or to pay.

The last sentence is similar to the provision contained in the last part of Section 136. While Section 138 applies only where the bill has been previously dishonored either by non-acceptance or non-payment, Section 136 refers to a bill which has not been previously dishonored.

Sec. 139. ***Kinds of acceptance.*** **— An acceptance is either general or qualified. A general acceptance assents**

without qualification to the order of the drawer. A qualified acceptance in express terms varies the effect of the bill as drawn.

Sec. 140. ***What constitutes a general acceptance.*** **— An acceptance to pay at a particular place is a general acceptance, unless it expressly states that the bill is to be paid there only and not elsewhere.**

Sec. 141. ***Qualified acceptance.*** **— An acceptance is qualified, which is —**

(a) Conditional; that Is to say, which makes payment by the acceptor dependent on the fulfillment of a condition therein stated;

(b) Partial; that is to say, an acceptance to pay part only of the amount for which the bill is drawn;

(c) Local; that is to say, an acceptance to pay only at a particular place;

(d) Qualified as to time;

(e) The acceptance of someone or more of the drawees, but not of all.

Kinds of acceptance.

As to liability, an acceptance may be: (1) general or (2) qualified. Both kinds of acceptance are defined in Section 139.

"Accepted" or "good" without anything more except the signature of the acceptor is a general acceptance as the acceptor binds himself to pay the bill according exactly to its tenor. The acceptance is still general although it is to pay at a particular place. Thus, "accepted, payable at the Philippine National Bank" is a general acceptance. (Sec. 140.) But if it reads "accepted, payable only at the Philippine National Bank," the same is a qualified acceptance, *{ibid.;* Sec. 141[c].)

EXAMPLES:

(1) *Conditional.* — "Received from A Co. an order from Y to pay his note as soon as proceeds of sale of hardware is available which I will do." (Milwaukee Corrugating Co. v. Taylor, 144 Pac. 653.)

(2) *Partial.* — Abill ofPl,000.00 is accepted thus: "Accepted for P700.00 only." (see Sec. 32.)

(3) *Local.* — see example under Section 140 above.

(4) *Qualified.* —Abill payable 30 days after date is accepted thus: "Accepted 60 days from date."

(5) *As to drawee.* — A bill addressed to X, Y and Z is accepted by X and Y only, (see Sec. 145[a].)

Sec. 142. *Rights of parties as to qualified acceptance.* — The holder may refuse to take a qualified acceptance, and if he does not obtain an unqualified acceptance, he may treat the bill as dishonored by non-acceptance. Where a qualified acceptance is taken, the drawer and indorsers are discharged from liability on the bill, unless they have expressly or impliedly authorized the holder to take a qualified acceptance, or subsequently assent thereto. When the drawer or an indorser receives notice of a qualified acceptance, he must, within a reasonable time, express his dissent to the holder, or he will be deemed to have assented thereto.

Right of holder to general acceptance.

A holder has a right to require a general or unqualified acceptance and if a qualified acceptance has been made, he may refuse it and treat the bill as dishonored by non-acceptance if he does not obtain an unqualified acceptance. Accordingly, he must notify the drawer and the indorsers of the dishonor.

The reason is that the drawer and the indorsers engage that the bill will be paid as drawn or indorsed by them and the effect of a qualified acceptance would be to make a contract for them without their consent. However, if the holder agrees to a qualified acceptance, he must give notice thereof to the drawer and the indorsers and, of course, they are not discharged from liability if they expressly or impliedly give their consent thereto.

There is implied assent, if the drawer or an indorser, after receiving notice of a qualified acceptance, does not express his dissent within a reasonable time to the holder.

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Chapter XI PRESENTMENT FOR ACCEPTANCE

Sec. 143. ***When presentment for acceptance must be made.*** **— Presentment for acceptance must be made —**

(a) Where the bill is payable after sight, or in any other case, where presentment for acceptance is necessary in order to fix the maturity of the instrument; or

(b) Where the biil expressly stipulates that it shall be presented for acceptance; or

(c) Where the bill is drawn payable elsewhere than at the residence or place of business of the drawee.

In no other case is presentment for acceptance necessary in order to render any party to the bill liable.

Meaning of presentment for acceptance.

Presentment for acceptance is the production or exhibition of a bill of exchange to die drawee for his acceptance or payment.

The words "presentment for acceptance" include presentment for payment also. While there is a conflict of authority, the cases maintaining this view represent die overwhelming weight of authority. (Beutel's Brarman, *op. dt.,* p. 1250.)

When presentment for acceptance necessary.

Section 143 enumerates the cases when presentment for acceptance is necessary.

Under subsection (a), it is essential to fix the maturity date of the instrument; under subsection (b), to comply with the express stipulation of the parties in the bill itself; and under subsection (c), to inform the drawee of the existence of the bill so that he can make arrangements for its payment on the date of maturity at the place designated therein.

EXAMPLES:

(1) *Bill payable after sight.* — A bill payable 30 days after sight. Its date of maturity shall be computed 30 days from the date of its presentment. The same is true with a bill payable so many days after demand.

(2) *Bill with express stipulation.* — This is self-explanatory.

(3) *Bill payable elsewhere.* — A bill payable to P at P.N.B, Manila, drawn against W, residing and having his place of business in Quezon City.

When presentment for acceptance not necessary.

Bills payable on demand *(e.g.,* checks) or on sight and time bills or bills payable at a day certain, or at a fixed time after its date, or upon other certain event which does not fall under Section 143(b) and (c), need not be presented for acceptance but only for payment in order to charge the drawer or indorsers. *(ibid.,* 2nd par.; see Phil. National Bank vs. Seato, 91 Phil. 756 [1952]; Prudential Bank vs. Intermediate Appellate Court, 216 SCRA 257 [1992].)

However, it is to the holder's interest that the bill should be accepted as only by accepting it does the drawee become bound to pay it and until such acceptance, the holder has for his debtor only the drawer, and the step is one which a prudent man of business ordinarily careful of his interest, would take for his protection; and if the drawee refuses to accept, the bill will be deemed dishonored by non-acceptance and the holder then must proceed in the same manner as if the bill required acceptance. (Nat. Park Bank v. Saitta, 111 N.Y. Supp. 927; see Sec. 150.)

Sec. 144. ***When failure to present releases drawer and indorser.*** **— Except as herein otherwise provided, the holder of a bill which is required by the next preceding section to be presented for acceptance must either present it for acceptance or negotiate it within a reasonable time. If he fails to do so, the drawer and all indorsers are discharged.**

Necessity for presentment for acceptance or negotiation within a reasonable time.

In the three cases provided in Section 143, it is necessary: (1) to present the bill for acceptance; or (2) to negotiate it (even without presentment for acceptance) within a reasonable time (see Sec. 193.) to charge the drawer and all indorsers.

The reason is that the drawer and indorsers have a right in having the bills accepted immediately in order to shorten the time of payment and thus put a limit to the period of their liability and likewise to enable them to protect themselves by other means before it is too late, if the bill is not accepted and paid within the time originally contemplated by them. (Mimrocks v. Woody, 2 S.E. 249.) And this is true even if it is shown that the drawee is perfectly solvent and no damage is caused to the drawer and indorsers by the delay. (Allan v. Eldred, 50 Ms. 132; Thornburg v. Emmens, 23 W. Vao 333; as to check see Sec. 186.)

Sec. 145. *Presentment; how made.* — Presentment for acceptance must be made by or on behalf of the holder at a reasonable hour, on a business day and before the bill is overdue, to the drawee or some person authorized to accept or refuse acceptance on his behalf; and

(a) Where a bill is addressed to two or more drawees who are not partners, presentment must be made to them all, unless one has authority to accept or refuse acceptance for all, in which case presentment may be made to him only;

(b) Where the drawee is dead, presentment may be made to his personal representative;

(c) Where the drawee has been adjudged a bankrupt or an insolvent or has made an assignment for the benefit of creditors, presentment may be made to him or to his trustee or assignee.

How presentment for acceptance made.

In order that presentment for acceptance may be.proper it is necessary that it: (1) must be made by or on behalf of the holder;

(2) at a reasonable hour; (3) on a business day; (4) before the bill is overdue and within a reasonable time (Sec. 144.); and (5) to the drawee or some person authorized to accept or refuse acceptance on his behalf, subject, of course, to the provisions of subsections (a), (b) and (c).

Unlike in presentment for payment (Sec. 73.), the place of presentment for acceptance is not material since the drawee need only write his acceptance on the bill if he wishes to accept.

(1) *Bill addressed to two or more drawees.* — It may be implied from subsection (a) that if the drawees are partners, presentment to one is sufficient subject to the limitations imposed in our partnership law (see Arts. 1801-1811,1815, and 1818, Civil Code.); otherwise, presentment to them all is mandatory unless one has authority to accept or refuse acceptance for all.

(2) *Drawee is dead.* — Presentment in this case is merely permissive since by Section 148(a) it is excused where the drawee is dead. (Beutel's Brannan, *op. cit.,* p. 1259.)

(3) *Drawee adjudged bankrupt.* — Since there is no provision which excuses presentment in case the drawee has been adjudged a bankrupt, etc., the word "may" in subsection (c) indicates merely a permission to adopt either one of the two alternative methods of presentment stated — not a permission to omit presentment altogether, *(ibid.)*

Sec. 146. *On what days presentment may be made.* —A bill may be presented for acceptance on any day on which negotiable instruments may be presented for payment under the provisions of Sections seventy-two and eighty-five of this Act. When Saturday is not otherwise a holiday, presentment for acceptance may be made before twelve o'clock noon, on that day.

Days when presentment for acceptance may be made.

See comments under Sections 72(b) and 85.

The last sentence of Section 146 regarding presentment on Saturday is different from Section 85.

Under Section 85, there is distinction between instruments payable on demand and instruments payable at a fixed or determinable future time. Where the instrument is not payable on demand and it falls due or it becomes payable on Saturday, it must be presented for payment on the next succeeding business day. Where presentment is for acceptance only, it may be made for all kinds of bills of exchange before 12:00 o'clock noon on Saturday provided that day is not a holiday.

Sec. 147. ***Presentment where time is insufficient*** **— Where the holder of a bill drawn payable elsewhere than at the place of business or the residence of the drawee has no time with the exercise of reasonable diligence to present the bill for acceptance before presenting it for payment on the day that it falls due, the delay caused by presenting the bill for acceptance before presenting it for payment is excused, and does not discharge the drawers and indorsers.**

Where time for presentment for acceptance insufficient.

Section 147 excuses delay in making presentment for payment when such delay is caused by presenting the bill for acceptance at a place other than the place where the bill is drawn payable, (see Sec. 81.) Such delay does not discharge the drawer and indorsers if the holder has no time even with the exercise of reasonable diligence to present the bill for acceptance before presenting it for payment on the date it falls due.

EXAMPLE:

Manila
September 5,2010

On or before September 10,2004 pay to P or order PI,000.00 at the Philippine National Bank, Manila.

(Sgd.) R

ToW
Zamboanga City

Under Section 143(c), P must present the bill for acceptance to W in Zamboanga City and under Section 71, he must also present the bill for payment at the Philippine National Bank on September 10,2010.

If the bill has been delivered to P on September 9, 2010, P will have no more time, despite the exercise of reasonable diligence to present it for payment on September 10, 2010 in Manila, after presenting it for acceptance to W in Zamboanga City. Under Section 147, the delay in making the presentment for payment is excused and does not discharge the drawer and indorsers from their liabilities.

Sec. 148. ***Where presentment is excused.*** **— Presentment for acceptance is excused and a bill may be treated as dishonored by non-acceptance in either of the following cases:**

(a) Where the drawee is dead, or has absconded, or is a fictitious person or a person not having capacity to contract by bill.

(b) Where, after the exercise of reasonable diligence, presentment cannot be made.

(c) Where, although presentment has been irregular, acceptance has been refused on some other ground.

When presentment for acceptance excused.

Section 147 excuses delay in making presentment for payment caused by presenting the bill for acceptance. Section 148 excuses *non-presentment* for acceptance.

Drawee is dead, etc. — In the cases mentioned in subsection (a), presentment for acceptance would be impossible or futile; hence, it is excused.

After exercise of reasonable diligence.—See comments under Sections 82 and 112.

Acceptance refused on some other ground. — Thus, where presentment is made on a Sunday or a holiday contrary to the provisions of Section 145 and, therefore, it is irregular but the acceptance is refused because of want of funds in the hands of the drawee belonging to the drawer.

Sec. 149. ***When dishonored by non-acceptance.*** **— A bill is dishonored by non-acceptance —**

(a) When it is duly presented for acceptance and such an acceptance as is prescribed by this Act is refused or can not be obtained; or

(b) When presentment for acceptance is excused, and the bill is not accepted.

When bill dishonored by non-acceptance.

The cases falling under subsection (a) are those provided for in Sections 132,133 and 142.

Subsection (b) refers to Section 148. It will be noticed that it is not sufficient that presentment for acceptance is excused. It is also necessary that the bill remains not accepted.

Sec. 150. ***Duty of hoider where bit! not accepted.*** **— Where a bill is duly presented for acceptance and is not accepted within the prescribed time, the person presenting it must treat the bill as dishonored by non-acceptance or he loses the right to recourse against the drawer and indorsers.**

Duty of holder in case of non-acceptance.

If, within twenty-four (24) hours after presentment as provided for in Section 136, the bill is riot accepted, "the person presenting it must treat the bill as dishonored." This means that the holder must take the necessary proceedings against the drawer and each indorser, that is, have the bill protested in those cases when required (Sec. 152.) and give notice of dishonor (Sec. 89.) in other cases.

Note that Section 150 does not declare that the bill dishonored by non-acceptance is a dishonored bill. The reason is that a holder in due course takes the bill not as a dishonored bill, (see Sees. 52[b], 117.)

Sec. 151. ***Rights of hoider where bill not accepted.*** **— When a bill is dishonored by non-acceptance, an immediate right of recourse against the drawer and indorsers accrues to the holder and no presentment for payment is necessary.**

Rights of holder where bill not accepted.

When a bill is dishonored by non-acceptance, the holder, after giving notice of dishonor and protesting when required (see Sees. 152,157.), may immediately proceed against the drawer and indorsers for the value of the bill without waiting for the date of maturity. Since payment cannot be expected after acceptance has been refused, there is no point waiting for the date of maturity to present the bill for payment. But if the bill is subsequently accepted, presentment for payment is necessary. (Sec. 116.)

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CHAPTER XII

PROTEST

Sec. 152. ***In what cases protest necessary.*** **— Where a foreign bill appearing on its face to be such is dishonored by non-acceptance, it must be duly protested for non-acceptance, and where such a bill which has not been previously been dishonored by non-acceptance is dishonored by non-payment, it must be duly protested for non-payment. If it is not so protested, the drawer and indorsers are discharged. Where a bill does not appear on its face to be a foreign bill, protest thereof in case of dishonor is unnecessary.**

Meaning of protest.

(1) By *protest* is meant the formal instrument executed by a notary public or other competent person certifying that the facts necessary to the dishonor of the instrument by non-acceptance or non-payment have taken place. (Norton, *op. cit.,* pp. 517-518.)

(2) Technically speaking, the word "protest" means only the formal declaration of the fact of non-payment executed by the proper person usually a notary public. (Maury v. Winlock, etc., Logging, Co., 269 Pac. 815.)

(3) In its popular sense, it includes all the steps or acts accompanying dishonor of a bill taken to fix the liability of the drawer and indorsers. (see Ogden, *op. cit.,* p. 432; 8 C.J. 662.)

Necessity of protest.

Protest is required only in case of dishonor either by non- acceptance or non-payment of foreign bills (see Sec. 129.) which appear on the face to be such. If not duly protested, the drawer and indorsers are discharged. (Sec. 152; see Behn, Meyer & Co. vs. Hongkong & Shanghai Banking Corp., 93 Phil. 963 [1953]; Velasquez vs. Solidbank Corporation, 550 SCRA 119 [2008]; see Sec. 185.) The discharge refers only to liability under the instrument but not with respect to liability under a separate contract or undertaking which gave rise to the instrument. Protest of inland bills, except in certain instances (Sees. 158,161, and 171.), and promissory notes is not required although they may be protested if desired. (Sec. 118.)

In the following cases, protest is absolutely required:

(1) Upon dishonor by non-acceptance of a foreign bill appearing on its face to be such (Sec. 152.);

(2) Upon dishonor by non-payment of a foreign bill appearing on its face to be such, it not having been previously dishonored by non-acceptance *(ibid.);*

(3) Before a bill can be accepted for honor, it must be protested for dishonor by non-acceptance or protested for better security (Sec. 161.);

(4) Before a bill can be presented for payment to the acceptor for honor or the referee in case of need, it must be protested by the holder for non-payment by any party liable thereon (Sec. 167.);

(5) Upon dishonor of the bill by the acceptor for honor, it must be protested by the holder for non-payment by the acceptor for honor (Sec. 170.); and

(6) Before a bill can be paid for honor, it must be protested by the holder for non-payment by any party liable thereon. (Sec. 171.)

Reasons for requiring protest in case of foreign bills.

Protest is required for two good reasons:

(1) It makes for uniformity in international transactions because most countries require it; and

(2) It furnishes authentic and satisfactory evidence of the dishonor to the drawer, who, from his residence abroad, would

experience difficulty in verifying the matter and thus be compelled to rely on the representations of the holder. (Ogden, *op. tit., pp.* 437-438.) Thus, the failure to pay and the reason therefor shall not rest on uncertainty or parol, but shall be authenticated under a solemn instrument by a public official which establish the rights and obligations of the parties. (Kardynal v. Grezezinki, 238 NW 213.)

Sec. 153. ***Protest; how made.*** **— The protest must be annexed to the bill, or must contain a copy thereof, and must be under the hand and seal of the notary making it, and must specify—**

(a) The time and place of presentment;

(b) The fact that presentment was made and the manner thereof;

(c) The cause or reason for protesting the bill;

(d) The demand made and the answer given, if any, or the fact that the drawee or acceptor could not be found.

Procedure for protest.

The following are the steps to be taken by the holder in making a protest:

(1) After the instrument is dishonored by non-acceptance or non-payment, as the case may be, the holder takes it to a notary public;

(2) The notary public himself presents the instrument *again* to the party who previously dishonored it, and demands its acceptance or payment;

(3) If the acceptance or payment is refused, the notary public on the day of dishonor then makes a minute of the dishonor on the instrument or on his notarial register, the minute consisting of his initials, the year, the month, and day of dishonor, and his charges. This act is called "noting";

(4) On the same day or afterwards, the notary public extends the protest thus noted by embodying in a certificate the fact of the protest and his acts in making presentment, demand and in

giving notice of dishonor. To the certificate, the notary public affixes his notarial seal; and

(5) After the notary public protests the instrument, he sends notice of dishonor to all the parties to the instrument. (Ogden, *op. ext.,* p. 438.)

Form and contents of certificate of protest.

Under Section 153, the protest: (1) must be annexed to the bill or must contain a copy thereof; (2) must be under the hand and seal of the notary making it; and (3) must specify the matters enumerated from subsections (a) to (b).

Without the authentication of the notary public, the certificate of protest of a foreign bill is no proof of the drawee's refusal to accept or pay the bill. (London & River Plate Bank v. Carr, 104 N.Y. Supp. 679.)

Purpose of certificate of protest.

The main purpose of the certificate of protest is to do away with the necessity of proving the fact of presentment, demand, non-payment, and notice of dishonor by witnesses in court. However, the certificate of protest is merely *prima facie* evidence of the facts therein stated. They may be disproved by competent evidence to the contrary.

Sec. 154. *Protest; by whom made.* — Protest may be made by —

(a) A notary public; or

(b) By any respectable resident of the place where the bill is dishonored, in the presence of two or more credible witnesses.

By whom protest made.

A foreign bill must be protested by a notary public because from the needs of the case, the intervention of a universally recognized authority is called for. (Commercial Bank v. Barksdale, 36 No. 563.) Where a notary public cannot be obtained, however, protest may be made by any respectable resident where the bill is dishonored in the presence of at least two credible witnesses.

Witnesses are not required if the protest is made by a notary public. The notarial protest is to be evidence of the facts stated in it of which the notary public is supposed to have personal knowledge, and credit is given to his official statements by the commercial world on the faith of his public and official character. (Commercial Bank of Kentucky v. William H. Barksdale & Co., 31 Mo. 563.)

Sec. 155. ***Protest; when to be made.*** **— When a bill is protested, such protest must be made on the day of its dishonor, unless delay is excused as herein provided. When a bill has been duly noted, the protest may be subsequently extended as of the date of the noting.**

When protest to be made.

The notary public need not make the formal certificate of protest on the same day the instrument is dishonored. But the noting of the matters required to be stated in Section 153 including the date of dishonor must be made on the date of dishonor while they are still fresh in the mind of the notary public.

The formal certificate of protest may be drawn up and completed at any time before bringing an action against the secondary parties and even during the trial (Daniel on Neg. Inst., par. 939.) but it should be dated as of the date of noting.

Thus, a bill dishonored on October 25, 2004 need not be protested on the same date but it must at least be "duly noted." If the formal protest is made subsequently, its effect will retroact to the day of the noting. But the notice of dishonor must be given within the prescribed time (Sees. 102,103,104, 107.), otherwise, the parties secondarily liable will be discharged. (Sec. 89.)

Sec. 156. ***Protest; where made.*** **— A bill must be protested at the place where it is dishonored, except that when a bill drawn payable at the place of business or residence of some person other than the drawee, has been dishonored by non-acceptance, it must be protested**

for non-payment at the place where it is expressed to be payable, and no further presentment for payment to, or demand on, the drawee is necessary.

Where protest to be made.

By the provisions of the foregoing section, a bill must be protested at the place where it has been dishonored.

The exception is that a bill dishonored by non-acceptance must be protested for non-payment at the place where it is expressed to be payable if that place is the place of business or residence of some person other than the drawee.

EXAMPLE:

Suppose the drawee resides in Tokyo but the bill is payable at the Philippine National Bank, Manila. The bill is presented for acceptance by the payee to the drawee in Tokyo but acceptance is refused. On its maturity, the bill is presented for payment to the Philippine National Bank in Manila. Payment is refused.

The holder must protest the bill for non-payment in Manila and no further presentment for payment to, or demand on, the drawee is necessary.

Sec. 157. *Protest both for non-acceptance and non-payment* —A bill which has been protested for non-acceptance may be subsequently protested for non-payment.

Protest both for non-acceptance and non-payment.

Where a bill has already been protested for non-acceptance, protest for non-payment is discretionary on the part of the holder. Under Section 151, presentment for payment is not necessary after the bill has been dishonored by non-acceptance.

Sec. 158. *Protest before maturity where acceptor insolvent* — Where the acceptor has been adjudged a bankrupt or an insolvent, or has made an assignment for the benefit of creditors, before the bill matures, the holder may cause the bill to be protested for better security against the drawer and indorsers.

Protest for better security before maturity.

Protest for better security is one made by the holder of a bill after it has been accepted but before it matures, against the drawer and indorsers, where the acceptor has been adjudged a bankrupt or an insolvent or has made an assignment for the benefit of creditors.

Such a protest is purely optional and its omission will not affect the holder's remedy against the drawer and indorsers. Its purpose must, therefore, be merely to apprise the persons secondarily liable of the situation of the acceptor by reason of which it has become improbable that the instrument will be paid upon its maturity and thus enable the former to arrange for the payment of the bill at maturity.

Sec. 159. ***When protest dispensed with.*** **— Protest is dispensed with by any circumstances which woulddispense with notice of dishonor. Delay in noting or protesting is excused when delay is caused by circumstances beyond the control of the holder and not imputable to his default, misconduct, or negligence. When the cause of delay ceases to operate, the bill must be noted or protested with reasonable diligence.**

When protest dispensed with.

The circumstances in which protest is dispensed with and the excuses for delay in making protest are the same as those in notice of dishonor, (see Sees. 109-118.)

Sec. 160. ***Protest where biii is lost, and so forth.*** **— When bill is lost or destroyed or is wrongly detained from the person entitled to hold it, protest may be made on a copy or written particulars thereof.**

Protest where bill is lost, etc.

It may be implied from this provision that the loss or destruction or wrong detention of a bill will not excuse protest. This is true whether the bill has already been accepted or not.

The reason is that any of the cases does not affect the contract of the parties.

The contents of die instrument may be proven as in the other cases of lost documents, (see Sees. 4,5, Rule 130, Rules of Court.)

Protest and notice of dishonor distinguished.

The differences are:

(1) Protest is required only, as a rule, in case of dishonor of a foreign bill appearing on its face to be such (Sec. .152.), while notice of dishonor, in any negotiable instrument, other tiian a foreign bill (Sees. 89,118.);

(2) Protest is always written (Sec. 153.), while notice of dishonor may be oral or written (Sec. 96.);

(3) Protest includes presentment, notice of dishonor, and all the steps accompanying dishonor (see Sees. 152 and 153.), while notice of dishonor is limited only to such notice (see Sec. 89.);

(4) Protest is made either by a notary public, or by any respectable resident in the presence of witnesses (Sec. 154.), while notice of dishonor, by a party or his agent (Sec. 91.);

(5) Protest is made, as a ride, at the place where the bill is dishonored (Sec. 156.), while in notice of dishonor, the place of dishonor is not essential (Sees. 103,104.); and

(6) Protest is made on the day of dishonor (Sec. 155.), while in notice of dishonor, the giving of notice is made within die times prescribed. (Sees. 102,103,104,107.)

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CHAPTER XIII

ACCEPTANCE FOR HONOR

Sec. 161. ***When bill may be accepted for honor.* — Where a bill of exchange has been protested for dishonor by non-acceptance or protested for better security, and is not overdue, any person not being a party already liable thereon may, with the consent of the holder, intervene and accept the bill *supra protest* for the honor of any party liable thereon, or for the honor of the person for whose account the bill is drawn. The acceptance for honor may be for part only of the sum for which the bill is drawn; and where there has been an acceptance for honor for one party, there may be.a further acceptance by a different person for the honor of another party.**

Meaning of acceptance for honor.

Acceptance for honor is an undertaking by a stranger to a bill after protest for the benefit of any party liable thereon or for the honor of the person for whose account the bill is drawn which acceptance inures also to the benefit of all parties subsequent to the person for whose honor it is accepted, and conditioned to pay the bill when it becomes due if the original drawee does not pay it.

Another name for acceptance for honor is *acceptance supra protest* since previous protest for non-acceptance or for better security is necessary.

Purpose of acceptance for honor.

The purpose of an acceptance for honor is to preserve the credit of the parties to the instrument or some party to it for whose honor the acceptance is made, as the drawer, drawee, or indorser, or somebody else. Someone desires to protect the credit of another on the bill, and he does so by writing "accepted" on the bill. In such case, consideration is presumed, and the presumption is that he has funds or money of the party for whose honor he accepts, (see Ogden, *op. cit.,* p. 368.)

The provisions on acceptance for honor and payment for honor (Chap. XIV.) embrace an ancient and obsolete practice for the protection of the credit of a drawer in a period of delay before he could be notified of dishonor by non-acceptance of a bill and take steps to protect his credit. They are rendered unnecessary by rapid communications and modern devices by which a substitute arrangement is promptly made. (11 Am. Jur. 2d 570-571.)

Requisites of acceptance for honor.

Before an acceptance for honor may be made, four requisites must concur:

(1) The bill must have been protested for dishonor by non-acceptance or for better security;

(2) The acceptor for honor must be a person not a party already liable thereon, that is, a stranger to the bill;

(3) The bill must not be overdue at the time of the acceptance for honor; and

(4) The acceptance for honor must be with the consent of the holder of the instrument.

The acceptor for honor must not be a party already liable on the bill like an indorser because if he is already liable thereon, his acceptance obviously would not give additional security to the holder. The consent of the holder is required because his right is suspended until the maturity of the bill.

Sec. 162. ***Acceptance for honor; how made.*** **— An acceptance for honor *supra* protest must be in writing, and indicate that it is an acceptance for honor, and must be signed by the acceptor for honor.**

Formal requisites of acceptance for honor.

The following requisites must be understood to be included in the requisites just enumerated:

(1) The acceptance for honor must be in writing;

(2) It must indicate that it is an acceptance for honor;

(3) It must be signed by the acceptor for honor;

(4) It must contain an express or implied promise to pay money (see Sec. 132.); and

(5) The accepted bill for honor must be delivered to the holder, *(ibid.)*

The practice is to write on the instrument, thus: "Accepted for the honor of P. (Sgd.) X."

It has been held that the acceptor for honor must appear before a notary public and declare his intention to accept the protested bill for the honor of some one or more of the parties thereon. (Gazzem v. Armstrong, 3 Dana [Ky.] 544; Ogden, *op. cit.,* p. 368.)

Sec. 163. ***When deemed to be an acceptance for honor of the drawer.*** **— Where an acceptance for honor does not expressly state for whose honor it is made, it is deemed to be an acceptance for the honor of the drawer.**

When an acceptance for honor deemed for honor of drawer.

An acceptance for honor which reads as follows: "Acceptance for honor" or "Accepted *supra protest"* or "Accepts S.P." without specifying the person for whose honor it is made is deemed to be an acceptance for the honor of the drawer.

The reason for the presumption is that only the drawer will become liable to the acceptor for honor, (see Sec. 164.) Acceptance for the honor of the drawer will thus discharge the most parties to the bill.

Sec. 164. ***Liability ofacceptor for honor.*****—Theacceptor for honor is liable to the holder and to all parties to the bill subsequent to the party for whose honor he has accepted.**

Rights and liability of acceptor for honor.

The acceptor for honor upon payment of the bill is subrogated to the rights which "the parties to the bill subsequent to the party for whose honor he has accepted" may have as regards the latter and all prior parties, (see Sec. 175.)

As the acceptor for honor takes the place of the person for whose honor he accepts, he is liable to the holder and all subsequent parties who have a right of recourse against the person for whose honor he accepts:

EXAMPLE:

Abill drawn by R against W with P, A, B, and C as successive indorsers is presented by the holder D for acceptance to W, who dishonors it and D has the bill protested for non-acceptance.

If the bill is accepted by X with the consent of D for the honor of B, X will be liable to the holder D, and indorser C who is a party subsequent to B but not to R, W, P, and A, who are parties prior to B.

If, after having been liable, X pays D, X will have a right of recourse against R, W, P, A, and B. But X's right to hold W liable will depend upon whether W is liable to R.

Sec. 165. *Agreement of acceptor for honor.* — The acceptor for honor, by such acceptance engages that he will, on due presentment pay the bill according to the terms of his acceptance, provided it shall not have been paid by the drawee, and provided also that it shall have been duly presented for payment and protested for non-payment and notice of dishonor given to him.

Agreement of acceptor for honor.

The undertaking of the acceptor for honor is not an absolute engagement to pay at all events, but only a collateral and conditional engagement to pay, if the drawee does not. (Schefield v. Bayard, 3 Wend. [N.Y.] 488.) In other words, the acceptor for honor is liable secondarily and not primarily. He binds himself to pay according to the terms of his acceptance, provided:

(1) The bill shall have been duly presented for payment;

(2) It shall not have been paid by the drawer;

(3) It shall have been protested for non-payment; and

(4) Notice of dishonor is given to him *supra protest.*

It is to be noted that the holder is required to make presentment for payment of the bill on maturity, notwithstanding prior dishonor thereof by non-acceptance. This rule is different from that in Section 151 which dispenses with presentment for payment when a bill is dishonored by non-acceptance. The reason is that the drawee, after his first refusal, may have reached an understanding with the drawer for the payment of the bill.

Sec. 166. ***Maturity of bill payable after sight; accepted for honor.*** **— Where a bill payable after sight is accepted for honor, its maturity is calculated from the date of the noting for non-acceptance and not from the date of the acceptance for honor.**

Maturity of bill payable after sight, accepted for honor.

This provision applies only to a bill payable after sight where it has been accepted for honor. The noting of the non-acceptance must be dated as of the date of the dishonor by non-acceptance, (see Sec. 155.)

The date of maturity is calculated from that date (see Sec. 136.) and not from the date of the acceptance for honor.

EXAMPLE:

Abill payable 20 days after sight is presented for acceptance to the drawer on October 1.

If acceptance is refused, the noting of its dishonor by non-acceptance should be made on the same date of dishonor.

If the bill is accepted *supra* protest on October 5, the date of maturity is on October 21, not October 25, as the 20-day period must be counted from October 1, the date of the noting.

Sec. 167. ***Protest of bill accepted for honor, and so forth.*** **— Where a dishonored bill has been accepted for honor *supra protest* or contains a reference in case of need, it must be protested for non-payment before it is presented for payment to the acceptor for honor or referee in case of need.**

Protest for non-payment of bill accepted for honor.

Except as to the referee in case of need (Sec. 131.), this section is superfluous since it is just a repetition of Section 165.

Sec. 168. ***Presentment for payment to acceptor for honor, how made.*** **— Presentment for payment to the acceptor for honor must be made as follows:**

(a) If it is to be presented in the place where the protest for non-payment was made, it must be presented not later than the day following its maturity.

(b) If it is to be presented in some other place than the place where it was protested, then it must be forwarded within the time specified in section one hundred and four.

When presentment for payment to acceptor for honor made.

Please refer to Sections 103 and 104 and comments thereunder.

Sec. 169. ***When delay in making presentment is excused.*** **— The provisions of section eighty-one apply where there is delay in making presentment to the acceptor for honor or referee in case of need.**

When delay in making presentment excused.

Please refer to Section 81 and comments thereunder.

Sec. 170. ***Dishonor of bill by acceptor for honor.*** **— When the bill is dishonored by the acceptor for honor, it must be protested for non-payment by him.**

Protest for non-payment by acceptor for honor.

The phrase "by him" at the end of the provision modifies "non-payment."

If the acceptor for honor does not pay the bill, the holder must protest the bill for non-payment by the acceptor for honor.

"With this protest there would have been three protests on said bill, namely:

(1) protest for dishonor by non-acceptance or for better security (Sec. 161.);

(2) protest for non-payment by the drawee in order to hold the acceptor for honor liable (Sec. i65); and

(3) protest for non-paymentby the acceptor for honor (Sec. 170.) in order to hold the drawer and indorsers whose liabilities have not yet become fixed because of the acceptance for honor." (C. Alvendia, *op. cit.,* p. 220.)

Acceptance for honor and ordinary acceptance distinguished.

Some distinctions between acceptance for honor and ordinary acceptance are as follows:

(1) In the former, there must be previous protest (Sec. 161.), while in the latter, protest is not required;

(2) In the former, the acceptor must be a stranger to the bill *(ibid.),* while in the latter, the acceptor is the drawee (Sec 132.);

(3) In the former, the consent of the holder is required, while in the latter (Sec. 161.), such consent is not required;

(4) In the former, the acceptor is secondarily liable (Sec. 165.), while in the latter, the acceptor is primarily liable (Sec. 62.);

(5) In the former, there may be several acceptors for honor for different parties in the bill (Sec. 161.), while in the latter, there can be no acceptors in the alternative or in succession (Sec. 128.); and

(6) In the former, the bill is not discharged upon payment by the acceptor for honor (Sec. 164.), while in the latter, it is discharged upon payment by the acceptor. (Sec. 119[a], [b].)

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CHAPTER XIV

PAYMENT FOR HONOR

Sec. 171. ***Who may make payment for honor.*** **— Where bill has been protested for non-payment, any person may intervene and pay it *supra protest* for the honor of any person liable thereon or for the honor of the person for whose account it was drawn.**

Meaning of payment for honor.

Payment for honor is payment made by a person, whether a party to the bill or not, after it has been protested for nonpayment, for the benefit of any party liable thereon or for die benefit of the person for whose account it was drawn.

Another term for payment for honor is *-payment supra protest* because prior protest for non-payment is required. It is not applicable to promissory notes. Thus, a person who, not being a regular party to a note, pays it for the honor or for the credit of the maker or indorsers, does not acquire any right of recourse against prior parties. (Smith v. Sawyer, 55 Me. 139, 92 Am. Dec. 576.)

Who may make payment for honor.

Under Section 171, payment for honor may be made by a party to the bill or by a stranger. Thus, it may be made by the drawee after he has refused to accept the bill. (Norton, *op. cit.,* p. 202.) It has been held that the drawer of check which has been dishonored and protested has a right to intervene and pay it to *protect his honor.* (Hooper v. Herring, 70 So. 308.)

Purpose and function of payment for honor.

Payment for honor may be availed of when the holder, knowing that the bill has already been dishonored for non-payment, does not want to indorse the bill and thereby incurs the liabilities of an indorser specified under Section 66 or of one negotiating by mere delivery under Section 65.

Sec. 172. ***Payment for honor; how made.*****—The payment for honor** ***supra*** **protest in order to operate as such and not as a mere voluntary payment must be attested by a notarial act of honor which may be appended to the protest or form an extension to it.**

Sec. 173. ***Declaration before payment for honor.*** **— The notarial act of honor must be on a declaration made by the payer for honor or by his agent in that behalf declaring his intention to pay the bill for honor and for whose honor he pays-**

Requisites of valid payment for honor.

In order that payment for hono? may operate as such, the following requisites must be present:

(1) The bill has been dishonored by non-payment (Sec. 83.);

(2) It has been protested for non-payment (Sec. 171.);

(3) Payment *supra protest* is made by any person, even a party thereto *(ibid.)}*

(4) The payment is attested by a notarial act of honor which must be appended to the protest or form an extension of it (Sec. 172.); and

(5) The notarial act must be based on the declaration made by the payer for honor or his agent of his intention to pay the bill for honor and for whose honor he pays. (Sec. 173.)

If the above formalities are not followed, the payment will operate as a mere voluntary payment and the payer acquires thereby no right to full reimbursement against the party for whose honor he pays, (see Arts. 1236-1237, Civil Code.)

Procedure for payment for honor.

The following are the steps involved in making a proper payment for honor:

(1) The payer for honor goes to a notary public after the bill has been noted or protested for non-payment and declares his intention to pay the bill for honor and for whose honor he pays;

(2) The declaration is recorded by the notary public either in the protest itself as an extension of it or in a separate paper attached thereto; and

(3) The payer for honor then notifies within a reasonable time the party for whose honor he pays that he will make the payment. (Daniel, *op. cit.,* par. 1258.)

Sec. 174. *Preference of parties offering to pay for honor.* — Where two or more persons offer to pay a bill for the honor of different parties, the person whose payment will discharge most parties to the bill is to be given the preference.

Preference of parties offering to pay for honor.

In payment for honor, the person whose payment will discharge the greatest number of parties to the bill is given the preference. The rule is different in acceptance for honor, (see Sec. 161, last clause.)

EXAMPLE:

R draws a bill payable to P or order with W, as the drawee, and A, B, C, and D, as successive indorsers, and E, as holder. W does not pay and E has duly protested non-payment.

If T offers to pay *supra* protest for the honor of C while S, for A, S is to be preferred as his payment will discharge B, C, and D, whereas payment by T will discharge only D.

Sec. 175. *Effect on subsequent parties where biii is paid for honor.* — Where a bill has been paid for honor, all parties subsequent to the party for whose honor it is paid are discharged, but the payer for honor is subrogated for, and succeeds to, both the rights and duties of the holder as

regards the party for whose honor he pays and all parties liable to the latter.

Effects where bill is paid for honor.

The effects of a payment for honor are as follows:

All parties subsequent to the party for whose honor it is paid are discharged; and

The payer for honor is subrogated for, and succeeds to, both the rights and duties of the holder as regards the party whose honor he pays and all parties liable to the latter. If the payment is made for the honor of all parties to the bill, the payer for honor may have recourse against all of them.

EXAMPLE:

In the example in the preceding section/ the payment *supra* protest by S for the honor of A will discharge B, C, and D, and S is subrogated to the rights of the holder E, with respect to W, R, P, and A. Of course, the right of S against W, R, and P will depend on whether or not they are liable to A.

If S pays for the honor of all parties to the bill, W, R, P, A, B, C, and D, then he may recover against all of diem.

Sec. 176. ***Where holder refuses to receive payment supra protest*****—Where the holder of a bill refuses to receive payment** ***supra protest,*** **he loses his right of recourse against any party who would have been discharged by such payment.**

Effect of holder's refusal to receive payment.

In payment for honor, the holder cannot refuse the payment. If he refuses, he cannot recover from the parties who would have been discharged had he accepted the same. In acceptance for honor, the holder's consent is necessary. (Sec. 161.)

EXAMPLE:

In the examples under Sections 174 and 175, if E refuses to receive payment *supra protest horn* S for the honor of A, he loses his right of recourse against B, C, and D who would have been discharged by such payment.

Sec. 177. ***Rights of payer for honor.*** **— The payer for honor, on paying to the holder the amount of the bill and the notarial expenses incidental to its dishonor, is entitled to receive both the bill itself and the protest.**

Rights of payer for honor.

The payer for honor is given the right to receive both the bill and the protest obviously to enable him to enforce his rights against the parties who are liable to him under Section 175.

Payment for honor and acceptance for honor distinguished.

Payment for honor is distinguished from acceptance from honor as follows:

(1) In the former, the protest must be for non-payment (Sec. 171.), while in the latter, for non-acceptance or for better security (Sec. 161.);

(2) In the former, the bill is overdue, while in the latter it must not be overdue (Sec. 161.);

(3) In the former, the consent of the holder is not required nor can the holder refuse (Sec. 176.), while in the latter, the consent of the holder is required (Sec. 161.);

(4) In the former, the acceptor is secondarily liable (Sec. 165.), while in the latter, the acceptor is primarily liable (Sec. 62.);

(5) In the former, a notarial act of honor is necessary (Sees. 162,173.), while in the latter, it is not necessary (see Sec. 162.);

(6) In the former, there can be only one payer for honor (see Sec. 174.), while in the latter, there may be several acceptors for honor (Sec. 161.); and

(7) The effects of payment for honor are those provided for in Sections 175 and 177, while the effects of acceptance for honor are those provided for in Sections 164 and 165.

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CHAPTER XV

BILLS IN SET

Sec. 178. ***Bills in set constitute one bill.*** **— Where a bill is drawn in a set, each part of the set being numbered and containing a reference to the other parts, the whole of the parts constitutes one bill.**

Bill in a set defined.

A *bill in a set* is one composed of several parts, each part being numbered and containing a reference to the other parts, the whole of the parts constituting but one bill.

EXAMPLE:

First Part

Manila, Philippines
December 10,2010

Exchange for P10,000.00
First

Three months after sight of this First of Exchange (Second and Third Unpaid) pay to the order of P10,000.00. Value received.

(Sgd.) R

ToW
1188 Park Avenue
New York City

Second Part

Manila, Philippines
December 10,2010

Exchange for P10,000.00
Second

Three months after sight of this Second of Exchange (First and Third Unpaid) pay to the order of P P10,000.00. Value received.

(Sgd.) R

ToW
1188 Park Avenue
New York City

Third Part

Manila, Philippines
December 10,2010

Exchange for P10,000.00
Third

Three months after sight of this Third of Exchange (First and Second Unpaid) pay to the order of P P10,000.00. Value received.

(Sgd.) R

ToW
1188 Park Avenue
New York City

This is a bill in a set consisting of three parts. It will be noticed that each part is completely worded as a bill but it gives warning as to the existence of the other parts. By seeing just one part of the bill, one may then easily know the number of parts the bill contains.

Purpose of bills in set.

Bills in set are usually availed of in cases where a bill had to be sent to a distant place through some conveyance. If each part is sent by different means of conveyances, the chance that at least one part of the set would reach its destination would be greater.

The purpose then of drawing a bill in set is to avoid the difficulties which would arise in case of loss or miscarriage on the way of the bill.

Sec. 179. ***Right of holders where different parts are negotiated.*** **— Where two or more parts of a set are negotiated to different holders in due course, the holder whose title first accrues is as between such holders the true owner of the bill. But nothing in this section affects the rights of a person, who in due course accepts or pays the part first presented to him.**

Rights of holders where different parts of a set are negotiated.

Each part of a bill in set may be negotiated. But the payee is not supposed to negotiate all of the parts since the only reason for drawing the bill in parts is to obtain greater assurance that at least one part will reach the payee or its destination safely. However, should the payee negotiate die different parts to different persons, then he is liable on each part. (Sec. 180.)

As between holders in due course, the owner of die bill is the holder whose tide first accrues, that is, the holder to whom a part is first negotiated. But if the drawee in good faith accepts or pays the part first presented to him, he is protected and he can rightfully refuse to accept or pay the bill presented by the holder in due course who first became the owner.

EXAMPLE:

In the example given under Section 178, if P negotiates the first part to A on September 20, the second part to B on September 25, and the third party to C on September 30, he is liable on every such part. (Sec. 180;)

Assuming A, B, and C are all holders in due course, as between them, A is the true owner of the bill as his title first accrues.

Supposing all three of them go simultaneously to W, the latter should accept or pay only A's part. But W is not liable to

A if W, in due course, pays the part held by C who is able to make presentment for acceptance (see Sec. 143.) or for payment of his part ahead of A.

Sec. 180. ***Liability of holder who indorses two or more parts of a set to different persons.*** **— Where the holder of a set indorses two or more parts to different persons, he is liable on every such part, and every indorser subsequent to him is liable on the part he has himself indorsed, as if such parts were separate bills.**

Liability of indorser of different parts of a set.

The holder of a bill drawn in a set is liable to each person to whom he has indorsed a part of the bill; and should the indorsees, in turn, indorse their respective parts of the bill, each would be liable on the part he has himself indorsed such part being considered a separate bill by itself.

The drawee is not liable for more than one part since his order is to accept or pay only one part, (see Sec. 183.)

EXAMPLE:

In the example under Section 179, P, as already stated, is liable to A, B, and C. In other words, P is liable for a total of P30,000.00.

If A, in turn, indorses the first part to D, B, the second part to E and C, the third part to F, then each would be liable to his respective indorsee. But R is liable only for one part or for P10,000.00.

Sec. 181. ***Acceptance of bill drawn In sets.*** **— The acceptance may be written on any part and it must be written on one part only. If the drawee accepts more than one part and such accepted parts are negotiated to different holders in due course, he is liable on every such part as if it were a separate bill.**

Liability of acceptor of different parts of a set.

The drawee is required to accept only one part of a bill drawn in a set; and the acceptance may be written on any part.

But should the drawee accept more than one part and they are negotiated to holders in due course, he is liable to every holder of the different parts as if such parts were separate bills.

Of course, if all the parts are in the hands of the same holder, the drawee is liable only for one part.

EXAMPLE:

In the example given in Section 179, suppose P, before negotiating the three parts of the bill, presented them for acceptance to W and W writes his acceptance on each part. Then P negotiates the three parts to A, B, and C, under circumstances which make them holders in due course.

W is liable to A, B, and C for P10,000.00 each, as if there were three separate bills. But if P does not negotiate the three parts, he is liable only for one part or for P10,000.00.

Sec. 182. *Payment by acceptor of bills drawn in sets.* — When the acceptor of a bill drawn in a set pays it without requiring the part bearing his acceptance to be delivered up to him, and that part at maturity is outstanding in the hands of a holder in due course, he is liable to the holder thereon.

Liability of acceptor who pays part of a set.

Any part of a bill in set may be negotiated. But the payee is not supposed to negotiate all of the parts since the only reason for drawing the bill in parts is to obtain greater assurance that at least one part will reach the payee or its destination safely. However, should the payee negotiate the different parts to different persons then he is liable on each part. (Sec. 180.)

The drawee does not warrant every part of the bill in a set that is indorsed but only the part accepted by him. Upon paying the bill, the acceptor should require surrender of the part bearing his acceptance. Should he fail to do so, he would still be liable to a holder in due course of such part.

EXAMPLE:

If W under the preceding example accepts only the first part and pays the second part without requiring the first part to be delivered up to him, he will also be liable to A, notwithstanding the payment to B.

Sec. 183. ***Effect of discharging one of a set* — Except as herein otherwise provided, where any one part of a bill drawn in a set is discharged by payment or otherwise, the whole bill is discharged.**

Effect of discharging a part of a set.

Any part of a bill drawn in a set may be negotiated. As far as the drawer, however, is concerned, the entire bill is discharged when any one part is discharged by payments or otherwise (see Sec. 119.) because a bill in a set constitutes only one bill.

The phrase "except as herein otherwise provided" refers to the exceptions mentioned in Sections 180,181, and 182.

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TITLE III

CHAPTER XVI PROMISSORY NOTES AND CHECKS

Sec. 184. ***Promissory note defined.*** **— A negotiable promissory note within the meaning of this Act is an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay on demand, or at a fixed or determinable future time, a sum certain in money to order or to bearer. Where a note is drawn to the maker's own order, it is not complete until indorsed by him.**

Note payable to maker's order.

A promissory note payable to the maker's own order (not to bearer) is not complete until indorsed by him. In the absence of delivery, the maker is not liable to any holder where his indorsement is forged, (see Sees. 14,15.)

The same reasoning applies to bills of exchange payable to the drawer's order; no obligation arises and the bill is incomplete until the drawer indorses and delivers it to some other person. But the principle should not apply after the drawee accepts, since an obligation has already arisen. (Beutel's Brannan, *op. cit.,* p. 1283.) The acceptance makes the bill complete.

The mere fact, however, that a note is not indorsed does not prevent recovery on the debt for which it was given (Armato v. Rose [La. App.], 170 So. 480.) by the maker.

There is a conflict in the cases as to whether a maker who indorses a note payable to himself is liable only as maker or both as maker and indorser.

Special types of promissory notes.

Promissory notes are used in a variety of credit transactions and usually carry the name of the transaction involved. When used alone, the term usually refers to the simplest kind of notes, that is, those merely containing a promise by one person to pay a sum of money to another.

Below are some other instruments which are in form and substance promissory notes.

(1) *Certificate of deposit.* — It is a written acknowledgment by a bank of the receipt of money received or on deposit which the bank promises to pay to the depositor, or to him or his order, or to some other person, or to him or his order, or to bearer, or to a specified person or bearer, on demand or on a fixed date, often with interest.

(a) A certificate of deposit creates the relation of debtor and creditor between the bank and the depositor. It should not be confused with the deposit slip issued by the bank when cash or checks are deposited in a checking account. A deposit slip is a mere receipt.

(b) A certificate of deposit (commonly called "CD") is negotiable only if drawn with all the essential elements of a negotiable paper, (see Sec. 1.) Its negotiability allows it to be indorsed or sold to pay debts or to serve as security (collateral) for a loan. It is not to be confused with savings deposit. It is most commonly a time deposit of money with a bank. In the absence of a promise to pay, it is a mere receipt.

(c) Certificates of deposit are frequently used by banks to get deposits for longer periods of time than regular savings deposits, for which they pay higher rate of interest. They resemble a check in that the one expected to pay is always a bank.

(d) The principles governing other types of bank deposits are applicable to certificates of deposits, as sure the rules governing promissory notes when they contain an unconditional promise to pay a sum certain of money absolutely. (Far East Bank and Trust Co. vs. Querimit, 373 SCRA 665 [2002].)

The following is a form of a negotiable certificate of deposit:

Philippine Commercial Bank
No. 1234 — Manila, Philippines December 14,2010
This certifies that Silverio S.L. Jose has deposited in this bank One Thousand Pesos payable on 30 days notice to the order of himself on the return of this certificate properly indorsed with interest at the rate of **12%** *per annum.*
(Sgd.) *Patricio N. Manguera* Cashier
This certificate is not subject to check.

(2) *Bond.* — It is an evidence of indebtedness issued by a public or private corporation, promising to pay a sum of money on a day certain in die future. Its negotiability is controlled by the same rules governing promissory notes, *(ibid.)* It runs for a longer period of time than a promissory note and is issued for debts of substantially larger amounts.[1]

Bonds are of two sorts:

(a) *registered bond* or one payable only to the person whose name appears on the face of the certificate and in the books of the company. Hence, it is not negotiable. It is transferable by the registration of the transferee's name in the books of the company; and

(b) *coupon bond* or one to which are attached coupons which entitle the holder to interest when due. These interest coupons may be detached and negotiated just like promissory notes independent of the main instrument.

'"A *certificate of indebtedness* pertains to a certificate for the creation and maintenance of a permanent improvement revolving fund, and is similar to a bond. Being equivalent to a bond, it is properly understood as an acknowledgment of an obligation to pay a fixed

(3) *Bank note.* — It is an instrument issued by a bank for circulation as money payable to bearer on demand, (see 8 C.J. 42.)

(4) *Due bill.* — It is a promissory note which shows on its face an acknowledgment by a person of his indebtedness to another. The word "due" is usually used.

The following is a form of a due bill.

Manila, Philippines
December 14,2010

P10,000.00
Due to Samuel M. Soriano One Thousand Pesos payable to his order.

Melquiades C. Gutierrez

(5) *Mortgage note.*—Two kinds are: the chattel mortgage note and the real estate mortgage note. As the name implies, the first is secured by personal property and the second, by real property. In sale of a house, for example, the note secured by mortgage on the property, is for the unpaid balance of the purchase price. The security contract, known as a mortgage, most frequently provides that the mortgage can be foreclosed if the note is not paid when it is due.

(6) *Title-retaining note.* — This type is secured by a conditional sales contract which ordinarily provides that the title to the goods shall remain in the payee's name until the note is paid in full. It is used to secure the purchase price of goods.

(7) *Collateral note.* — It is used when the maker pledges securities (shares of stocks, bonds, and other personal property) to the payee to secure the payment of the amount of the note. The securities are usually placed with the holder as collateral security. Banks also use a device called "signature note" for short-term unsecured loans or loans made without collaterals.

(8) *Judgment note.* — This is a note to which a power of attorney is added enabling the payee to take judgment against

the maker without the formality of a trial if the note is not paid on its due date. (Wyatt & Wyatt, *op. tit.,* p. 369; see Sec. 5.)

(9) *Installment note.* — It is a note payable in specified or periodic installments at predetermined time such as for payment of a refrigerator over a 12-month period.

> **Sec. 185.** ***Check defined.*** **—A check is a bill of exchange drawn on a bank payable on demand. Except as herein otherwise provided, the provisions of this Act applicable to a bill of exchange payable on demand apply to a check.**

Check defined.

The above provision gives the definition of a check. It has also been defined as a written order addressed to a bank or persons carrying on the business of banking by a party having money in their hands requesting them to pay on presentment to a person named therein or to his order or to bearer, a named sum of money, (see Hawley v. Jete, 10 Ore. 31,45, Am. Rep. 129.)

Distinctive characteristics of checks.

The two essential distinctive characteristics of checks are that they are drawn on a bank and payable instantly on demand.

(1) A check is customarily made out on the printed form supplied by the bank but the use of such form is not required by law. In actual practice, there is no acceptor to a check. The bank simply honors the check if it gives credit, and pays the money. In such case, the bank stands in the position of the acceptor.

(2) A check has been defined in terms requiring the drawer to be a person other than a bank, a check drawn by a bank being defined as a draft, (see Sec. 126.) But such instrument is generally subject to the rules applicable to checks. (11 Am. Jur. 2d 45-46.)

An instrument not drawn on a bank is not a check although it may be so styled on its face. (Amsinck vs. Rogers, 82 N.E. 134.)

(3) A check need not state that it is payable on demand. Presentment for acceptance is unnecessary. By issuing a check, the drawer, in effect, represents that there are funds in the bank

for its payment. (Firestone Tire & Rubber Co. of the Philippines vs. Ines Chavez & Co., Ltd., 18 SCRA 356 [1966].)

(4) Aside from serving as an instrument of credit in the settlement of an obligation, a check also serves as a receipt after it has been paid and cancelled by the bank. (Moran vs. Court of Appeals, 230 SCRA 799 [1994].)

Checks are generally governed by the same rules applicable to bills of exchange payable on demand.

Checks not mere contracts.

(1) *A representation of funds on deposit.* — Checks can not be categorized as mere contracts. A check is an order addressed to a bank and partakes of a representation that the drawer has funds on deposit against which the check is drawn, sufficient to ensure payment upon its presentation to the bank. It is not a mere undertaking to pay an amount of money. There is, therefore, an element of certainty or assurance that the instrument will be paid upon presentation.

For this reason, checks have become widely accepted as a medium of payment in trade and commerce, as a convenient substitute for money; they form part of the banking system and, therefore, not entirely free from the regulatory power of the state. (Lozano vs. Martinez, 146 SCRA 323 [1986]; Tan vs. Court of Appeals, 239 SCRA 310 [1994].)

ILLUSTRATIVE CASE:

Drawer of postdated checks issued merely for security withdrew her funds from drawee-bank after checks were negotiated to a holder in due course.

Facts: R issued to P, as security for pieces of jewelry to be sold on commission, two (2) postdated checks. Thereafter, P negotiated the checks without the knowledge and consent of R, to A, a holder in due course. R failed to sell the pieces of jewelry, so she returned them to A before maturity of the checks which, however, could no longer be retrieved as they had already been negotiated. Consequently, R withdrew her funds from the drawee-bank before the maturity date of the checks.

Issue: Is R liable to A?

Held: Yes. R may not unilaterally discharge herself from her liability by the mere expediency of withdrawing her funds from the drawee-bank. She is thus liable as she has no legal basis to excuse herself from liability on her checks to a holder in due course.

The drawing and negotiation of a check have a certain effect aside from the tranfer of tide or the incurring of liability in regard to the instrument by the transferor. The holder who takes the negotiated paper makes a contract with the parties on the face of the instrument. There is an implied representation that funds or credit are available for the payment of the instrument in the bank upon which it is drawn. Consequently, the withdrawal of the money from the drawee-bank to avoid liability on the checks cannot prejudice the rights of holders in due course. *(State Investment House, Inc. vs. Court of Appeals, 217 SCRA 32 [1993].)*

(2) *A representation of credit stated in monetary value.* — The delivery of a check, however, does not in itself constitute.payment of a debt (Art. 1249, Civil Code.) and may be refused by the creditor, (see Catholic Bishop of Malolos, Inc. vs. Intermediate Appellate Court, 191 SCRA 411 [1990].)

(3) *A substitute far cash.* —A check while not regarded as legal tender is normally, under commercial usage, a substitute for cash. The credit represented by it in stated monetary value is properly capable of appropriation. The conversion or misappropriation of the amount of the check by depositing the check payable to another in one's personal account when he has no right thereto constitutes estafa penalized under Article 315 (par. 3.) of the Revised Penal Code. (Sy vs. People, 172 SCRA 685 [1989].)

A check which has been cleared and credited to the account of the creditor shall be equivalent to a delivery to the creditor of cash in an amount equal to the amount credited to his account. (Equitable PCI Bank vs. Ong, 502 SCRA 119 [2007].) A check duly- stamped "paid" gives rise to the presumption that it was already paid to the intended payee. (Citibank, N.A. vs. Sembrano, 504 SCRA 378 [2006].)

(4) *As payment far an obligation*. —A check is not a legal tender, and an offer of a check in payment of a debt is not a valid tender

of payment. (Roman Catholic Bishop vs. Intermediate Appellate Court, 191 SCRA 411 [1990].) Since a check is only a substitute for money and not money, the delivery of such an instrument does not, by itself, operate as payment, and this is especially true in the case of a postdated check. (BPI Express Card Corp. vs. Court of Appeals, 296 SCRA 260 [1998].) The obligation is not extinguished and remains suspended until the payment by the commercial document is actually realized, (par. 3, Art. 1249, Civil Code.) A creditor may validly refuse payment by check, whether it be a manager's, cashier's, or personal check. (Tibaja, Jr. vs. Court of Appeals, 223 SCRA 163 [1993].) Acceptance of a check implies an undertaking of due diligence on the part of the holder presenting it for payment, (see Pio Barretto Realty Dev. Corp. vs. Court of Appeals, 360 SCRA 127 [2001].)

Under Article 1249 of the Civil Code, a check produces the effect of payment only when it has been cashed, or when through the fault of the creditor it has been impaired. Thus, if the check delivered by the drawer for the redemption of property was dishonored by the bank upon presentment by the sheriff for insufficient funds, the redemption is null and void. On the other hand, if the check had only become stale and was consequently dishonored by the bank, without fault of the drawer then it would be unfair to deprive him of the rights as he, had acquired as redemptioner, particularly, if, after all the value of the check has otherwise been received or realized by the party concerned. *(ibid.)*

Check and ordinary bill of exchange distinguished.

A check differs from an ordinary or regular bill of exchange in these particulars:

(1) A check is always drawn on a bank or banker, while an ordinary bill may or may not be drawn on a bank;

(2) A check is always payable on demand,[2] while an ordinary

[2]A post-dated check (see Sec. 12.) delivered before its date is technically not a check, rather it is a time draft. It becomes legally a check on or after the day of its date because it is alre ady payable on demand from foreword

bill is either payable on demand or at a fixed or determinable future time (Sec. 4.);

(3) A check is supposed to be drawn against a previous deposit of funds, while an ordinary bill need hot be drawn against a deposit;

(4) A check need not be presented for acceptance (see Sec. 185.), while an ordinary bill is required to be presented for acceptance in certain cases (Sec. 143.);

(5) A check is ordinarily intended for immediate payment, while an ordinary bill is for circulation as an instrument of credit;

(6) The death of the drawer of a check with the knowledge of the bank revokes the authority of the bank to pay (Glennan v. Rochester Trust Co., etc., 102 N.E. 537.), while the death of the drawer of an ordinary bill does not revoke the authority of the drawee to pay;

(7) A check must be presented for payment within a reasonable time after its issue (Sec. 186.), while an ordinary bill must be presented for payment within a reasonable time after its last negotiation (Sec. 171.);

(8) The drawer of a check not presented within a reasonable time after its issue is discharged from liability thereon to the extent of the loss caused by the delay (Sec. 186.), while the drawer of an ordinary bill is totally discharged (Sec. 70.); and

(9) When a check is accepted or certified, the drawer and indorsers are discharged from liability thereon (Sec. 188.), while in an ordinary bill, they remain liable in spite of the acceptance, (see Sec. 84.)

Bills payable in the future.

Bills payable in the future are of two kinds:

(1) Those bearing the date of their issuance but directing payment on a specified date in the future; and

(2) Postdated checks or those bearing a date subsequent to their delivery and specifying no time for payment.

Specifying a date of payment is a characteristic of an ordinary bill of exchange rather than a check which must be payable on demand. Accordingly, it is held that a written order to a bank to pay a sum of money at a day subsequent to its date, and subsequent to the date of its issue, is a bill of exchange and not a check. (Bull v. First Nat. Bank, 123 US 105.)

Nature of post-dated check.

A postdated check (see Sec. 12.) is nonetheless a check because postdated. It is payable on demand on or at any time after the day of its date. Its effect is the same if it had not been issued until that date. (11 Am. Jur. 2d 48-49.) A postdated check is in effect only a representation by the drawer that he expects to have funds in the bank with which to pay the check on die date named therein.

In this respect, there is no essential difference between a postdated check and a promissory note. (State v. Nelson, 237 NW 766.)

Special types of check.

Checks are usually three-party instruments but on certain types of checks (Nos. 2 and 3), the bank can serve as both the drawer and the drawee. The most common type of check is the *personal check* or check drawn by a depositor of a bank on the bank. The other types are enumerated below.

(1) *Memorandum check*. — It is like an ordinary check except that die word "memorandum/' "mem" or "memo" is written upon the face of the check, signifying that the drawer engages to pay the *bona fide* holder absolutely, and not upon a condition to pay upon presentment at maturity and if due notice of the presentment and non-payment should be given. (Turnball v. Osborne, 12 Abbot Prac. [N.S.] 200; Franklin Bank v. Freeman, 33 Mass. [16 Pick] 539.)

(a) In other words, the drawer may be sued the same as a maker upon a promissory note although it is to be distinguished from the latter which is but a mere promise to pay. Such a check is an evidence of debt againt the drawer, and although may not be intended to be presented, has the same effect as an ordinary check. If the check is presented for payment and the drawer has sufficient funds in the bank to meet it, the bank must honor the same, and if passed to a third person, will be valid in his hands like any other check.

(b) A memorandum check comes within the meaning of Section 185 and, therefore, falls within the ambit of B.P. Big. 22, the Bouncing Checks Law *(infra.),* which does not distinguish between the kinds of check. It is a common practice in commercial transactions to require debtors to issue checks on which creditors must rely as guarantee of payment, or as evidence of indebtedness, if not as mode of payment. (People vs. Nitafan, 215 SCRA 79 [1992].)

(2) *Cashier's check.* — It is a check of the bank's cashier on the bank itself payable on demand to a payee.

(a) It is, in effect, a bill of exchange drawn by the cashier of a bank upon the bank itself, committing its total resources, integrity and honor behind the check. A cashier's check is a primary obligation of the issuing bank and accepted in advance by the act of its issuance. (10 C.J.S. 409; Tan vs. Court of Appeals, 239 SCRA 310 [1994]; International Corporate Bank vs. Gueco, 351 SCRA 516 [2001].) Hence, it is not subject to countermand by the payee after indorsement and has the same legal effect as a certificate of deposit or a certified check. (Walker v. Sellers, 21 Ala. 189.) It is really the bank's own check and may be treated as a promissory note with the bank as the maker (see Sec. 130.) and, therefore, the holder need not prove presentment for payment or present the bill to the drawee for acceptance. It operates as an assignment of funds represented by die check to the credit of the payee or holder. (Sec. 189.)

(b) A cashier's check issued on request of a depositor is the substantial equivalent of a certified check *(infra.)* and the deposit represented by the check passes to the credit of the checkholder who is, therefore, a depositor to that amount. (Lummus Cotton Gin Co. v. Walker, 195 Ala. 552; Republic vs. Phil. National Bank, 3 SCRA 851 [1961].) It is payable either to the person who purchases the check from the bank, or to the person who is to cash it. It is a well-known and accepted practice in the business sector that a cashier's check is deemed as cash (New Pacific Timber & Supply Co., Ins. vs. Seneris, 101 SCRA 680 [1980].) or "regarded substantially to be as good as the money which it represents/' (Tan vs. Court of Appeals, *supra.)* In transactions involving sale of property, the seller may require the purchaser (or bidder) to submit cashier's (or manager's) checks if he wants to have guaranteed payment of the price.

If the check is drawn by a bank upon another bank in which it has funds on deposit, in favor of a third party, it is called *bank draft.*

(3) *Manager's check.* — It is one drawn by the bank's manager upon the bank itself.

(a) It is like a cashier's check and certified check *(infra.)* both as to effect and use, which, in the commercial world, is regarded substantially to be as good as the money it represents. (Bank of the Phil. Islands vs. Court of Appeals, 326 SCRA 641 [2000]; Rizal Commercial Banking Corp. vs. Security Bank & Trust Co., 577 SCRA407 [2009].) The mere fact that a manager's check does not bear the payee's signature at the back does not negate deposit thereof in payee's account. (Citibank vs. Sabeniano, 504 SCRA 378 [2006].)

(b) A *demand draft* is very different from a cashier's or manager's check. The former is an order upon a third party purporting to be drawn upon a deposit of funds. The latter is a primary obligation of the bank which issues it and constitutes its written promise to pay upon demand. (Republic vs. Phil. National Bank, *supra.)*

(4) *Traveler's check.* — It is one upon which the holder's signature must appear twice; one, to be affixed by him at the time it is issued and the second, for counter-signature, to be affixed by him in the presence of the payee before it is paid, otherwise, it is incomplete.

(a) Its purpose is to provide the traveler safe and convenient method by which to supply himself with funds in almost all parts of the civilized world without the hazard of carrying the money on his person. Anyone finding or stealing traveler's checks cannot use them, for only the purchaser may negotiate them. The bank or company issuing the instrument has the right to refuse to pay it when it does not bear the countersign agreed upon and the owner of the check also has the right to insist that it shall not be paid when not countersigned. (Samberg Express Co., 99 N.W. 879.)

(b) Traveler's checks differ from ordinary checks in that they are sold by banks and express companies and require both signature and counter-signature by the purchaser. They constitute a complete purchase and sale of credit, have the characteristics of a cashier's check when issued by a bank, and are foreign bills of exchange. (11 Am. Jur. 2d 47.) Technically, most traveller's checks are not checks but drafts (see Sec. 126.) because the drawee *(e.g.,* American Express) is ordinarily not a bank.

(5) *Certified check.* — It is one which bears upon its face an agreement by the drawee-bank that the check will be paid on presentation. The usual practice is by stamping or writing the word "certified" upon the check. In some respects it is similar to a certificate of deposit, (see Sec. 184.)

(6) *Crossed check.* — It is one which bears across its face two parallel lines diagonally, usually on the upper left corner between which are either the name of a bank or the words "and company" in full or abbreviated. The Negotiable Instruments Law does not contain any provision on the subject of crossed checks although the practice has been given judicial cognizance.

(a) A check may be crossed either specially or generally.[3]

(1) If *crossed specially,* the name of a particular bank or company is written or appears between the parallel lines in which case the drawee-bank must pay the check only upon presentment by such bank or company (Chan Wan vs. Tan Kim, 109 Phil. 706 [I960].) on penalty of being made to pay again by the rightful owner should the first

■The Negotiable Instruments Law does not mention "crossed checks" although Article 541 of the Code of Commerce refers to such instruments. It provides: 'The maker or any legal holder of a check shall be entitled to indicate therein that it be paid to a certain banker or institution which he shall do by writing across the face die

payment prove to have been erroneous. In the absence of proper presentment by the bank or company to which the check has been crossed specially, liability will not attach to the drawer, *(ibid.;* see Sec. 61.) Consequently, no right of recourse is available against the drawer of the check to the indorsee who presented the same for payment since the latter is not the proper party authorized to make the presentment. (State Investment House vs. Intermediate Appellate Court, 175 SCRA 310 [1989].)

(2) If *crossed generally,* only the words "and Co." are written between the parallel lines or when none at all is written at all between said lines. In such case, the drawee- bank must pay the check through the intervention of some bank or banker. Issuing a crossed check imposes no legal obligation on the drawee not to honor such a check. It is more of a warning to the holder that the check cannot be presented to the drawee-bank for payment in cash. Instead, the check can only be deposited with the payee's bank which in turn must present it for payment against the drawee-bank in the course of normal banking transactions between banks. The crossed check cannot be presented for payment but it can only be deposited and the drawee-bank may only pay to another bank in the payee's or indorser's account. (Gempesaw vs. Court of Appeals, 218 SCRA 682 [1993]; Citibank, NA vs. Sabeniano, 504 SCRA 378 [2006].)

In actual practice, the check crossed generally is deposited with a bank by the holder where he keeps an account and the bank takes charge of the collection. If the check is crossed specially, he deposits it with the bank indicated between the diagonal lines.

(b) The purpose of crossing a check is to insure payment to the rightful person, the payee, particularly when it is forwarded by mail or when it is entrusted to an agent. A crossed check can only be deposited but may not be converted into cash by the drawee. Crossing a check, either generally or specially, does not destroy its negotiability but the check may be negotiated only once — to one who has an account with a bank; the check may not be encashed but only deposited in the bank; and the act of crossing the check serves as warning to the holder that the check has been issued for a definite purpose so that he must inquire if he has received the check pursuant to that purpose; otherwise, he is not a holder in due course. Failing in this respect, the payee is guilty of gross negligence amounting to legal absence of good faith. (De Ocampo vs. Gatchalian, 3 SCRA 596 [1961].)

(c) One who exchanges for cash crossed checks, notwithstanding that they are bearer checks, payable to a corporation, which can act only by agents, from an individual without making any inquiry, as to his authority, is negligent, and must abide by the consequences if the individual who indorses the same is without authority. (Jai-Alai Corp. of the Phil. vs. Bank of P.I., 66 SCRA 29 [1975]; State Investment House vs. Intermediate Appellate Court, *supra.)*

(d) The crossing of a check with the phrase "Payee's Account Only" is a warning that the check should be deposited in the account of the payee. Thus, it is the duty of the collecting bank to ascertain that the check be deposited in payee's account only. It is bound to scrutinize the check and to know its depositors before it can make the clearing indorsement "all prior indorsements and/or lack of indorsement guaranteed." (Philippine Commercial International Bank vs. Court of Appeals, 350 SCRA 446 [2001].)

(e) The effects, therefore, of crossing a check relate to the mode of its presentment for payment. Under Section 72, presentment for payment, to be sufficient, must be made by the holder or by some person authorized to receive payment on his behalf. Who the holder or authorized person is depends on the instruction stated on the face of the check. The payee has a cause of action against a bank for encashing and paying a crossed check to another person, and liability attaches whether or not the bank was aware of the unauthorized indorsement to the encasher, for it is the duty of the bank, by reason of the nature of the check, to verify the indorser's authority. (Associated Bank vs. Court of Appeals, 208 SCRA 465 [1992].)

EXAMPLE:

(1) Check crossed specially.

VB

A 92 —10230
December 4,2010

PAY TO THE
ORDER OF *Jaime de La Rosa* P10,000.00/xx PESOS
One thousand only

Francisco Adriano, Jr. The

Metropolitan Commercial and Coconut Bank

(2) Check crossed generally.

and Co.

Face of check same
as above

or

Face of check same
as above

Stale check.

It is one which has not been presented for payment within a reasonable time after its issue. It is valueless and, therefore, should not be paid, (see Sees. 71,186.)

(1) In a case, a check, payable on demand, Which was long overdue by about 21/2 years, was considered a stale check, (see Montinola vs. Phil. National Bank, 88 Phil. 178 [1951].) Current banking practice presently regards as stale, checks outstanding for more than six (6) months or 180 days. Banks will normally

not pay such a check without consulting the depositor (drawer). However, the drawer is not discharged by the mere delay in the presentation of the check for payment if he does not suffer any loss from the delay, (see Sec. 186.) For a check to be dishonored upon presentment, on the one hand, and to be stale for not being presented at all in time, on the other, are incompatible developments that naturally have variant legal consequences. (Crystal vs. Court of Appeals, 71 SCRA 443 [1976]; see Wong vs. Court of Appeals, 351 SCRA 100 [2001].)

(2) A bank has no obligation to a customer having a checking account to pay a check, other than a certified check, which is presented more than six (6) months after its date. Under the (U.S.) Uniform Commercial Code, a bank may charge its customer's account for a payment made thereafter in good faith. (Sec. 4-404 thereof.) Thus, a depositor should give instructions to his bank regarding uncashed checks.

Check payable to bearer.

(1) *Indorsement of drawer not necessary.*—By uniform practice, banks require the indorsement of the drawer before honoring a check payable to bearer ***(e.g.,*** to "cash"). But there are cases too where no such requirement had been made. It depends upon the circumstances of each transaction. Under Section 9 (d), a check drawn payable to the order of "cash" is a check payable to bearer, and a bank may pay it to the person presenting it for payment without the drawer's indorsement. (Ang Tek Lian vs. Court of Appeals, 87 Phil. 383 [1950].)

(2) *Identification of bearer not required.* — A check payable to bearer is authority for payment to the holder. Where a check is in the ordinary form and is payable to bearer, so that no indorsement is required, a drawee-bank to which it is presented for payment, need not have the holder identified and ordinarily may not be charged with negligence in failing to do so. If the bank has no reasonable cause for suspecting any irregularity, it will be protected in paying a bearer instrument no matter what facts unknown to it may have occurred prior to presentment. *(ibid.,* citing Mitchie on Banks and Banking, 3rd Ed., Vol. 5, p. 343, and 1 Morse, Bank and Banking, Sec. 393.)

(3) *Satisfactory proof of identity may be required*. — Although a bank is entitled to pay the amount of a bearer check without further inquiry, it is entirely reasonable for the bank to insist that the holder give satisfactory proof of his identity, *(ibid.,* citing Paton's Digest, Vol. 1, p. 1089.) As a standard practice, a bank may require for its protection, the indorsement of the drawer or the person presenting the check for payment or some other person known to it to assure itself against possible complications, for instance, forgery of drawer's signature, loss of the check by the rightful owner, raising of the amount payable, etc. *(ibid.)*

Duty of depositor to reconcile bank's statement with his own records.

When a person opens a checking account with a bank, he is given blank checks which he may fill out arid use whenever he wishes. Each time he issues a check, he should also fill out the record slip provided in the checkbook. The slips, if properly kept, will contain the numbers of the checks, the dates of their issue, the names of the payees, the amounts of deposits or withdrawal, and the account balance. The drawer would, therefore, have a complete record of the checks he issues.

(1) *Duty of diligence of depositor to depository bank.* — It is the accepted banking procedure for a depository bank to furnish its depositors a monthly statement of the status of their accounts, together with all the cancelled checks which have been cashed by their respective holders. If the depositor has filled out his record slips properly, a comparison between them and cancelled checks will reveal any forged check not taken from his checkbook.

It is the duty of a depositor to carefully examine the bank's monthly statement of account, his cancelled checks, his record slips and other pertinent records within a reasonable time, and to report any errors without unreasonable delay. If this negligence should cause the bank to honor a forged check or prevent it from recovering the amount it may already have paid on such check, he cannot later complain should the bank refuse to recredit his account with the amount of such check, (see Metropolitan Waterworks and Sewerage System vs. Court of Appeals, 143 SCRA 20 [1986].)

(2) *No duty of diligence by drawer to collecting bank.* — The negligence of the drawer constitutes no defense to the collecting bank. The reasons are that there is no privity between the drawer and the collecting bank and the former owes no duty of diligence to the latter (except of seasonably examining his passbooks and returned checks as a protection against the payment by the depository bank against forged checks). While the drawer generally owes no duty of diligence to the collecting bank, the law imposes a duty of diligence on the collecting bank to scrutinize checks, deposited with it for the purpose of determining their genuineness.[4]

The collecting bank being primarily engaged in banking holds itself out to the public as the expert and the law holds it to a high standard of conduct. (Banco de Oro Savings & Mortgage Bank vs. Equitable Banking Corp., 157 SCRA 188 [1988].)

Sec. 186. ***Within what time a check must be presented.*** **— A check must be presented for payment within a reasonable time after its issue or the drawer will be discharged from liability thereon to the extent of the loss caused by the delay.**

When drawer of check discharged from liability.

(1) Under Section 186, there are three requisites in order that the drawer may be discharged from liability:

(a) The check is not presented within a reasonable time (see Sees. 71,193.) after its issue;

(b) The drawer suffers loss; and

(c) The loss suffered by the drawer is attributable to the delay.

(2) The holder of a check may either cash it immediately or he may hold it over for a reasonable time. Even if the check is

[4]When a checking account is opened, the bank requires the depositor to fill out a signature card which is kept on file at the bank. The bank is held to know the depositor's signature and is liable if it wrongfully pays any forged or altered check.

presented for payment within a reasonable time after its issue, the drawer will be discharged altogether from liability thereon if he is not given notice of dishonor within the prescribed time, (see Sees. 89,103,104.)

Checks intended for immediate use.

A check, unlike an ordinary bill of exchange, is supposed to be drawn against a previous deposit of funds for it is ordinarily designed for immediate payment and not to be retained or kept by the holder for such time as he may want. For this reason it is of greater importance than in the case of bill that a check shall be promptly presented, and the drawer notified of non-payment, so that he may speedily inquire into the cause of the refusal, and take prompt action to secure his funds deposited in the bank. (Gifford vs. Hardell, 60 N.W. 1064.)

Hence, the special rule set forth in Section 186.

Risk of loss for drawee's insolvency.

While delivery of a check produces the effect of payment only when it is encashed, the rule is otherwise if the drawer (debtor) was prejudiced by the holder's/payee's (creditor's) unreasonable delay in presentment, (see Pio Barretto Realty Dev. Corp. vs. Court of Appeals, 360 SCRA 127 [2001].)

The drawer of a check assumes the risk of the drawee's insolvency only during a reasonable period for presentment. (Keenan v. McClure, 252 N.W. 204.) So, the holder should exercise his rights to obtain payment within a reasonable time after its issue in order to preserve his right of recourse on the drawer in case of non-payment by the drawee, (see Capital Ins. and Surety Co. vs. Plastic Era Co., 65 SCRA 134 [1975].) If he fails to do so, the loss from non-payment must fall on him. (Saeger v. Dauphines, 187N.E.94.)

No transfer or series of transfer can prolong the risk of the borrower (or indorser) beyond this period though each party is allowed the same period as between himself and his immediate predecessor, that the payee had, as between himself and the drawer; for no transferee can stand on any better footing than his transferor, in respect to the time within which the check must be presented in order to render the drawer's (or previous indorser's) liability absolute in the event of the failure of the bank. (Gifford v. Hardell, 60 N.W. 1064, citing Daniel, Neg. Inst.; Sec. 1595; see Sec. 71.)

Discharge of drawer and indorser in case presentment delayed.

(1) Only to the extent of loss caused by the delay in case of drawer. — Failure to present the check on time does not totally wipe out the original obligation. The only loss which would be sustained by the *drawer* in case presentment was not made within a reasonable time would be caused by the insolvency of the bank subsequent to the delivery and prior to the presentment of the check. (Peninsula Nat. Bank v. Mans Penderson Co., 158 Pac. 246; Keenan v. McClure, 252 N.W. 204.) But the drawer will be discharged from liability only to the extent of the loss caused by the delay in presentment. (Sec. 186.)

Where no loss is shown, the drawer is not discharged; and the burden of proving loss is on the drawer. (German-American Bank v. Wright, 148 Pac. 769; see however, Papa vs. A.U. Valencia and Co., Inc., 284 SCRA 643 [1998], *infra.)*

EXAMPLE:

The drawee-bank fails, the drawer's account having been at all times sufficient to meet the check had it been presented for payment. " '

If the bank pays a dividend of, say, 50% to its depositors, the drawer is liable to the holder for only 1 / 2 the face amount of the check But the indorser of a check, whether or not he is in fact prejudiced by the delay in presentment, has a complete defense therein.

The drawer of a check is regarded as the principal debtor and is, therefore, not entirely discharged by lack of diligence in making presentment for payment (unless, of course, presentment is delayed for so long that an action on the check is barred by the Statute of Limitations), but only to the extent of actual loss or injury caused by the delay. (Babb & Martin, *op. ext.,* p. 202.)

(2) *Wholly discharged in case of indorser.* — An indorser is wholly discharged thereby irrespective of any question of loss or injury by delay in presentment (Phil. National Bank vs. Seeto, 91 Phil. 756 [1952].) unless presentment is excused or dispensed with, (see Sees. 80,82.)

The reason for the difference between the liability of the drawer and that of the indorser in case of dishonor is that the drawer is not probably or necessarily prejudiced thereby, while an indorser is, actually or by legal presumption. Section 186 is silent as to the discharge of the indorser from liability. This is due to the fact that his discharge is already expressly covered by Section 84, the indorser being a person secondarily liable on the instrument. Section 186 expressly requires that a check must be presented for payment within a reasonable time after issue. *(Ibid.)*

ILLUSTRATIVE CASE:

At the time of negotiation by indorser of check, drawee had sufficient funds but it was dishonored for insufficient funds when presented far payment by indorsee one month later.

Facts: P presented at the Surigao branch of Phil. National Bank a check payable to bearer dated March 10 and drawn by R against the Cebu branch of PBC, drawee-bank.

P made a general and unqualified indorsement of the check which was accepted and paid by PNB's agency on March 13. P gave assurances at the time of the negotiation of the check that he would refund the amount thereof in case of dishonor. It was mailed to PNB Cebu branch 7 days thereafter, *i.e.,* March 20, or 10 days after issue, and was presented to PBC, drawee- bank, for payment on April 14, but the check was dishonored for "insufficient funds/[7] So the check was returned to PNB's Surigao agency which demanded immediate refund of the value of the check.

At the time of the negotiation of the check, R had sufficient funds in PBC and had the PNB's Surigao agency not delayed to forward the check until R's funds were exhausted, the same would have been paid. No excuse was given for the delay.

Issue: Was there unreasonable delay in the presentation of the check for payment at the drawee-bank?

Held: Yes, and as a consequence of the delay, P, indorser, was thereby discharged. P's assurances of refund in case of dishonor of the chedc are precisely the ordinary obligations of an indorser (see Sec. 66.) and these obligations are, under the law (see Sees. 84,186.), considered discharged by an unreasonable delay in the presentation of the check for payment. *(National Bank vs. Seato, supra.)*

(3) Where the check is not presented at all, the drawer is under no liability to the holder or payee whether or not the latter suffers loss or injury (Rodriguez v. Hardouin, 131 So. 593; see Pio Barretto Realty Dev. Corp. vs. Court of Appeals, 360 SCRA 127 [2001].) because Section 186 does not dispense with presentment for payment unless excused or dispensed with, (see Sees. 79, 82.) But if after drawing the check and before its presentment for payment and dishonor, the drawer withdraws his funds, he remains liable to pay the check (for the full period covered by the statute of limitations), notwithstanding the unreasonable delay, inasmuch as he suffers no loss attributable to the delay.

ILLUSTRATIVE CASE:

Seller did not encash the check for more than 10 years, contending that by reason thereof, no sale was consummated.

Facts: Petitioner MP, acting as attorney-in-fact of the late AMB sold to respondent FP, a parcel of land. FP had given MP the amounts of P5,000 in cash on May 24,1973 and P40,000 in check on June 16,1973 in payment of the purchase price of the subject lot. " o-

MP, while admitting having received only P5,000 and issued receipts for both amounts, asserts that he never encashed the aforesaid check and, therefore, the sale was not consummated. There was no evidence at all that MP did not, in fact, encash said check. On the other hand, respondent FP testified in court that petitioner MP had received the amount of P45,000.00 and issued receipts therefor. According to respondent court, the presumption is that the check was encashed, especially since the payment by check was not denied by defendant-appellant (herein petitioner) who, in his Answer, merely alleged that he "can no longer recall the transaction which is supposed to have happened 10 years ago."

MP contends that such a conclusion is based on the erroneous presumption that the check (in the amount of P40,000.00) had been cashed, citing Art. 1249 of the Civil Code, which provides, in part, that payment by checks shall produce the effect of payment only when they have been cashed or when through the fault of the creditor they have been impaired. He insists that he never cashed said check; and, such being the case, its delivery never produced the effect of payment. While admitting that he had issued receipts for the payments, he asserts that said receipts, particularly the receipt of the check in the amount of P40,000, do not prove payment. He avers that there must be a showing that said check had been encashed. If, according to petitioner, the check had been encashed, respondent FP should have presented the check duly stamped received by the payee, or at least its microfilm copy.

Issue: Was there a consummation of the sale of the subject property?

Held: Yes. (1) *Presumption is that check had been cashed.* — "Petitioner's assertion that he never encashed the aforesaid check is not subtantiated and is at odds with his statement in his answer that "he can no longer recall the transaction which is supposed to have happened 10 years ago." After more than ten (10) years from the payment in part by cash and in part by check, the presumption is that the check had been encashed. As already stated, he even waived the presentation of oral evidence."

(2) *Petitioner's fault resulted in the impairment of check.* — "Granting that petitioner had never encashed the check, his failure to do so for more than ten (10) years undoubtedly resulted in the impairment of the check through his unreasonable and unexplained delay.

While it is true that the delivery of a check produces the effect of payment only when it is cashed, pursuant to Art. 1249 of the Civil Code, the rule is otherwise if the debtor is prejudiced by the creditor's unreasonable delay in presentment. The acceptance of a check implies an undertaking of due diligence in presenting it for payment, and if he, from whom it is received, sustains loss by want of such diligence, it will be held to operate as actual payment of the debt or obligation for which it was given.

It has, likewise, been held that if no presentment is made at all, the drawer cannot be held liable irrespective of loss or injury unless presentment is otherwise excused. This is in harmony with Article 1249 of the Civil Code under which payment by way of check or other negotiable instrument is conditioned on its being cashed, except when through the fault of the creditor, the instrument is impaired. The payee of a check would be a creditor under this provision and if its non-payment is caused by his negligence, payment will be deemed effected and the Obligation for which the check was given as conditional payment will be discharged/' *(Papa vs. A.U. Valencia and Co., Inc., 284 SCRA 643 [1998].)*

When presentment for payment of check within a reasonable time.

Again, what constitutes a reasonable time depends upon the circumstances.[5] (see Sec. 193.) The test is whether the payee employed such diligence as a prudent person exercises in his own affairs. This is because the nature and theory behind the use of a check points to its immediate use and payability. (International Corporate Bank vs. Gueco, 351 SCRA 516 [2001].) Thus, the delay is excused when the bank told the payee to return and the bank failed before the check was again presented (Empire-Arizona Copper Co. v. Shaw, 181 Pac. 464.); or where it is attributable to the fault of the drawer or where the drawer did not maintain sufficient funds to meet it after the day of its date (Philadelphia L. Ins. Co. v. Hayworth, 296 Ped. 339.); or where a farmer living eight miles from town, presented the check after four days. (Henry vs. Harrie, 334 S.W. 289.)

As a general rule, where the payee and the drawee reside or are located in the same place, the holder must present the check not later than the day succeeding that on which it was issued. (Gordon v. Levine, 80 N.E. 505.) Thus, even a delay of two days has been held unreasonable. (National Plumbing Supply Co. v. Stevenson, 213 111. App. 49.)

% current banking practice, a check becomes stale after more than six (6) months or 180 days.

As a check is intended for immediate use, its transfer to successive holders does not extend the time for presentment. If not presented within a reasonable time, the drawer is discharged to the extent of the loss sustained by reason of the failure to present. (Gordon v. Levine, *supra;* Campbell v. Sherk, 67 Pac. 458.) In applying the rule, however, regard must be given to the circumstances under which the holder received the check and not merely to the precise age of the instrument — that is, the good or bad faith exercised is the prime consideration. (Bigelow, Bills, Notes and Checks, 3rd ed., p. 377; see Sec. 71.)

The Bouncing Checks Law.

(1) *Act penalized.* — Under *Batas Pambansa Big.* 22, "the making, drawing and issuing of a check payment of which is refused by the drawee because of insufficient funds in or credit (an arrangement or understanding with a bank for die payment of such credit) with such bank, when presented within ninety (90) days from the date of the check, shall *be prima facie* evidence of knowledge of such insufficiency of funds or credit unless such maker or drawer pays the holder thereof the amount due thereon, or makes arrangements for payment in full by the drawee of such check within five (5) banking days after receiving notice that such check has not been paid by the drawee." (Sec. 2 thereof.)

(a) This law took effect on June 29, 1979, fifteen days after its publication *(i.e.,* when it was officially released for circulation) on June 14, 1979, as provided in its effectivity clause. It penalizes the act of making, drawing, or issuing a bouncing or bum check and not only the fact of its dishonor. (People vs. Veridiano II, 132 SCRA 523 [1984].)

(b) Where the check is drawn by a corporation, company or entity, the person or persons who actually signed the check in behalf of such drawer is /are liable under B.P. Big. 22. (Sec. 1 thereof.) A person charged with a transitory or continuing crime under which violation of B.P. Big. 22 is categorized may be validly tried in any municipality or city where the offense was in part committed, it being understood that the first court taking cognizance of the case, excludes the other. (Uy vs. Court of Appeals, 276 SCRA 367 [1997].)

(c) Conviction for violation of B.P. Big. 22 "imports deceit" and "certainly relates to and affects the moral character of a person/' (People vs. Tuanda, 181 SCRA 692 [1990].) Deceit, however, is not an essential element of the offense; malice or criminal intent is immaterial, *(infra.)*

(d) It has been held that B.P. Big. 22 is not a bill of attainder,[6] for under it, every element of the crime is still to be proven before the trial court to warrant a conviction for violation thereof. (Recuerdo vs. People, 395 SCRA 638 [2003].)

(2) *Elements of the offense punishable under the law.* — They are:

(a) The making, drawing and issuance of any check to apply on account or for value;

(b) The knowledge of the maker, drawer, or issuer that at the time of issue he does not have sufficient funds in, or credit with the drawee-bank for the payment of such check *in full* upon its presentment; and

(c) Subsequent dishonor of the check by the drawee-bank for insufficiency of funds or credit, or dishonor for the same reason had not the drawer, *without any vaiid cause,* ordered the bank to stop payment. (People vs. Laggui, 171 SCRA 305 [1989]; Llamado vs. Court of Appeals, 270 SCRA 423 [1997]; see Tan vs. People, 349 SCRA 777 [2001]; Danao vs. Court of Appeals, 358 SCRA 450 [2001];) Marigomen vs. People, 459 SCRA 169 [2005].)

(3) *Ways of violating the law.* — There are actually two (2) ways of violating B.P. Big. 22 or two (2) distinct acts punished:

(a) by making or drawing and issuing a check to apply on account or for value knowing at the time of issue that the check is not sufficiently funded; and

(b) by failing to keep sufficient funds or to maintain a credit to cover the full amount of the check when presented

[6]It is one which inflicts punishment without trial and the essence of which is the substitution of a legislative for a judicial determination of guilt. (People vs. Ferrer, 48 SCRA 382 [1972].)

to the drawee bank within a period of 90 days from the date of the check for which reason it is dishonored by the drawee banks. (Cueme vs. People,334 SCRA 795 [2000]; Nagrampa vs. People, 386 SCRA 412 [2002].)

(4) *Presumption of prima face evidence of knowledge of insufficient funds.* — B.P. No. 22 creates a presumption *juris tantum* that the second element of *prima facie* evidence of knowledge of insufficient funds exists when the first and third elements of the offense are present, *(supra;* see Ting vs. Court of Appeals, 344 SCRA 551 [2000]; Wong vs. Court of Appeals, 351 SCRA 100 [2001].)

(a) *Requisites.* — For this presumption to arise, the prosecution must prove the following:

1) The check is presented within 90 days from the date of the check;

2) The drawer or maker of the check receives notice that such check has not been paid by the drawee; and

3) The drawer or maker of the check fails to pay the holder of the check the amount due thereon, or to make arrangements for its payment in five (5) working days after receiving notice that such check has not been paid by the drawee.

(b) *Notice of non-payment.* - This presumption or *prima facie* evidence of knowledge cannot arise if no notice of nonpayment is sent to the drawer or maker, or there is no proof as to when such notice was received by the drawer since there could simply be no way of reckoning the crucial 5-day period. (Ongson vs. People, 466 SCRA 656 [2005]; Tan vs. People, 500 SCRA 172 [2006].)

(c) *Evidence to the contrary.*—If not rebutted, the presumption suffices to sustain a conviction. But such presumption cannot hold if there is evidence to the contrary. This is illustrated in *Sycip, Jr. vs. Court of Appeals (328 SCRA 447 [2000].)* where it was ruled:

"As the evidence for the defense showed, the closure of petitioner's Account No. 845515 with Citibank was not for insufficiency of funds. It was made upon the advice of

> the drawee bank, to avoid payment of hefty bank charges each time petitioner issued a 'stop payment' order to prevent encashment of postdated checks in private respondent's possession. Said evidence contradicts the *prima facie* presumption of knowledge of insufficiency of funds. But it establishes petitioner's state of mind at the time said checks were issued on August 24,1989.

Petitioner definitely had no knowledge that his funds or credit would be insufficient when the checks would be presented for encashment. He could not have foreseen that he would be advised by his own bank in the future, to close his account to avoid paying the hefty banks charges that came with each 'stop payment[7] order issued to prevent private respondent from encashing the 30 or so checks in its possession. What the prosecution has established is the closure of petitioner's checking account. But this does not suffice to prove the second element of the offense under B.P. Big. 22, which explicitly requires 'evidence of knowledge of insufficient funds' by the accused at the time the check or checks are presented for encashment."

(d) *Novation theory.* — This theory, recognized in certain cases, does not apply where the offer to pay by the debtor (10% of the amount of the check within a certain period and the balance to be rolled over for 90 days), turned out only to be an empty promise which effectively delayed the complainant's filing of a case for violation of BP Big. 22 against the accused. (Llamado vs. Court of Appeals, *supra.)* Even if another check was intended to replace a bad one, its issuance 15 days after the drawer had been notified of the previous check cannot negate the presumption that the drawer knew of the insufficiency of funds to cover the amount of the previous check. (Vaca vs. Court of Appeals, 298 SCRA 658 [1998].)

(e) *Presentment of check within 90 days.* — Nowhere in Section 2 of the law does it require a maker to maintain funds in his bank account for only 90 days. That the check must be deposited within 90 days is simply one of the conditions for the *prima facie* presumption of knowledge of lack of funds to arise. It is not an element of the offense. Neither does it discharge the drawer from his duty to maintain sufficient funds in his account within a reasonable time thereof, (see Sec. 186.) Since by banking practice, a check becomes stale after more than six (6) months, or 180 days, a check deposited within said period, cannot be considered stale. The only consequence of the failure to present the check for payment within the 90-day period is that there arises no *prima facie* presumption of knowledge of insufficiency of funds. The prosecution may still prove such knowledge through other evidence. (Wong vs. Court of Appeals, 351 SCRA 100 [2001]; Nagrampa vs. People, 366 SC 4(2) [2000].)

(5) *Gravamen of the offense.* — It is knowingly issuing a worthless check or a check that is dishonored uponits presentment for payment and not the non-payment of the obligation that is being punished.

(a) Section 2 of B.P. Big. 22 establishes a *prima facie* evidence of knowledge of insufficient funds, because knowledge involves a state of mind which is difficult to establish. (Cruz vs. Court of Appeals, 251 SCRA 408 [1995]; Danao vs. Court of Appeals, *supra;* Sia vs. People, 428 SCRA 206 [2004]; Rico vs. People, 392 SCRA 61 [2002]; Ongson vs. People, 466 SCRA 656 [2005].) The drawer can overcome the *prima facie* presumption by proving payment of the value of the check either by the drawer or by the drawee or that arrangements were made for its payment within five (5) banking days from notice of the dishonor but such check has not been paid by the drawee bank. Such fact is a complete defense. This defense lies regardless of the strength of the evidence of the prosecution to prove the elements of the offense. *(Ibid.;* Ting v. Court of Appeals, 344 SCRA 551 [2000]; Lao vs. Court of Appeals, 347 SCRA 75 [2000]; Cabrera vs. People, 407 SCRA247 [2003]; Abarquez vs. Court of Appeals, 408 SCRA 500 [2003].)

(b) Only a *full payment* of the face value of the check at the time of its presentment or during the five-day grace period can exonerate the drawer from criminal liability. (Macalaglag vs. People, 511 SCRA 400 [2006].)

(e) The *subsequent payment* by the drawer of the check after criminal liability had already attached or incurred, can affect only his civil, not criminal, liability, *(ibid.)*

In a case, considering that more than the money value of the two subject checks issued by the petitioner had already been effectively paid two years before the informations against him were filed, it was held that the petitioner could not be validly and justiy convicted or sentenced for violation of B.P. Big. 2. "We must find if the application of the law is consistent with the purpose of and reason for the law. x x x. It is not the latter alone but the spirit of the law that gives it life. This is especially in this case where a debtor's criminalization would not serve the ends of justice but in fact subvert it." (Griffith vs. Court of Appeals, 379 SCRA 94 [2002].)

In *Cruz vs. Cruz* (515 SCRA 89 [2007].), the complaint was filed by the respondent almost six (6) months after the accused had paid the amount of the check: In reversing the resolution of the Court of Appeals directing the Secretary of the Justice to file the proper information against the accused, the Supreme Court explained, thus: "While indeed the gravamen of violation of B.P. Big. 22 is the act of issuing worthless checks, nonetheless, courts should not apply the law strictiy or harshly. Its spirit and purpose must be considered. In *Lozano v. Martinez*, we held that the Bouncing Checks Law is aimed at putting a stop to or curbing the practice of issuing worthless checks or those that end up being dishonored for payment because of the injury it causes to the public interests.

In *Sia v. People,* (428 SCRA2006 [2004].), we explained that the law is intended to safeguard die interests of the banking system and the legitimate checking account users. Considering that petitioner had paid the amount of the check even before respondent filed his complaint, we believe and so hold that no injury was claused to the public interests or the banking system, or specifically to herein respondent."

(d) The knowledge of the payee of the insufficiency or lack of funds of the drawer with the drawee bank is immaterial as deceit is not an essential element of the offense, the gravamen of which is the issuance of a bad check; hence, malice and intent in the issuance thereof is inconsequential.[7] (Ty vs. People, 459 SCRA 220 [2004].)

(e) The barefaced fact that the drawer is the signatory to the check that was subsequently dishonored, merely gives rise to the presumption, that he knew of the insufficiency of funds. It does not render him automatically liable for violating the law. The prosecution has the burden to prove all the elements of the crime beyond reasonable doubt. (Cabrera vs. People, 407 SCRA 247 [2003].)

(6) *Identification of the dishonored check.* — The first element (No. 2, a) requires that the check be properly described in the Information to inform the accused of the nature and cause of the accusation against him.

Without a sufficient identification of the dishonored check in the Information, the conviction of the accused should be set aside for being violative of the constitutional requirement of due process. Thus, where the date of the check and the amount thereof as stated in the Information vaiy with the exhibits submitted by the prosecution, such inconsistency violates the accused's constitutional right to be informed of the nature of the offense charged. (Ongson vs. People, 466 SCRA 656 [2005].)

(7) *Presumption of valuable consideration.* — Upon issuance of a check, in the absence of evidence to the contrary, it is presumed that the some was issued for valuable consideration, (see Sec. 24.) The consideration may consist either of some right, interest, profit, or benefit accruing to the party who makes the contract, or some forebearance, detriment, loss, or some responsibility, act, or labor or service given, suffered or undertaken by the other side.

Tn this case, the subject checks were issued to cover the receipt of an actual "account or for value" *{i.e.,* payment of the hospital bills of T/s worker). *In Magno vs. Court of Appeals* (210 SCRA 471 [1992].), bounced checks were issued to cover a "warranty deposit" in a lease contract, where the lessor-supplier was also the financier of the deposit. It was a *modus operandi* whereby the supplier was able to sell or lease the goods while privately financing those in desperate need so they may be accommodated. The maker of the check thus became an unwilling victim of a lease agreement under the guise of a lease-purchase agreement. The maker did not benefit at all from the deposit, since the checks were used as collateral for an accommodation and not to cover the receipt of an

It is an obligation to do or not to do in favor of the party who makes the "contract/' such as the maker or indorser. *(ibid.)*

It devolves upon the accused who claims there was no consideration for the subject check to present convincing evidence to overthrow the presumption and prove that indeed the check was issued without consideration. (Bayani vs. People, 530 SCRA 84 [2007].)

(8) *Notice of dishonor.* — The presumption that the issuer had knowledge of die insufficiency of funds is brought into existence only after it is proved that the issuer had received a notice of dishonor and that within five (5) days from receipt thereof, he failed to pay the amount of the check or make arrangement for its payment. (Del Rosario vs. Cedillo, 441 SCRA 70 [2004].)

(a) Where no notice of dishonor was actually sent to and received by the drawer, the *prima facie* presumption of knowledge of insufficiency of funds cannot apply. The absence of a notice of dishonor necessarily deprives an accused an opportunity to preclude a criminal prosecution. (Lao vs. Court of Appeals, 274 SCRA 572 [1997].) The presumption cannot arise since there would simply be no way of reckoning the crucial 5-day period. (Danao vs. Court of Appeals, *supra.)*

(b) The notice gives the accused an opportunity to satisfy the amount indicated in the check and thus avert criminal prosecution. It serves to mitigate the harshness of the law in its application. This opportunity, however, can be used only upon receipt by the accused of the notice of dishonor. (King vs. People, 319 SCRA 154 [1999]; Rico vs. People, 392 SCRA 61 [2002]; Lozano vs. Martinez, 146 SCRA 324 [1986].)

(c) Both the spirit and letter of the law require for the act to be punished that the accused must have actually been *notified in writing* of the fact of dishonor. While Section 2 of B.P. Big. 22 does not state that the notice of dishonor be in writing, this must be taken in conjunction with Section 3 of the law, *i.e.,* "that where there are no sufficient funds in or credit with such drawee bank, such fact *shall always be explicitly stated in the notice of dishonor or refusal*" absent proof of which a prosecution under the law cannot prosper. Hence, a mere oral notice or demand to pay would be insufficient compliance with the law. (Domagsang vs. Court of Appeals, 347 SCRA 75 [2000]; Yu Oh vs. Court of Appeals, 403 SCRA 300 [2003]; Cabrera vs. People, *supra.);* Marigomen vs. People, 459 SCRA [2005].)

(d) It's not enough for the prosecution to prove that a notice of dishonor was sent to the drawee of the check. It must also prove actual receipt of said notice by the drawer to satisfy the basic requirement of procedural case process.

The rule is that receipts for registered letters and return receipts do not prove themselves. They must be properly authenticated in order to serve as *proof of receipt* of letters claimed to be a notice of dishonor. The presentation of the registered letter and the registry receipt with an unauthenticated signature, do not meet the required proof beyond reasonable doubt that the issuer of the check received such notice, especially where he denied receipt thereof. In such case, the criminal aspect of the action must be dismissed. (Rico vs. People, 392 SCRA 61 [2002]; Del Rosario vs. Cedillo, 441 SCRA 70 [2004]; Svendsen vs. People, 546 SCRA 659 [2008]; see Ting Court of Appeals, 366 SCRA 55 [2007].)

(9) *Complainant as sole witness.* — The prosecution in B.P. Big. 22 violations may present only the complainant as a witness to prove all the elements of the offense charged.

(a) If s not required much less indispensable for the prosecution to present drawee's representative as a witness to testify on the dishonoring check. The complainant is competent and qualified to testify that upon presentment, the subject check was dishonored by the drawee bank. (Recuerdo vs. People, 395 SCRA 638 [2003]; Ongson vs. People, 466 SCRA 656 [2005.)

(b) The complainant's sole testimony suffices to identify the dishonored checks with the drawee^bank's notation stamped or written on the dorsal side "drawn against insufficient funds" or in a notice attached thereto and such notice of dishonor given to the drawer. A legal presumption arises that the drawer had knowledge of the making of the checks, the due presentment to the drawee-bank for payment, the dishonor and the reason therefor written or stamped, or notice of dishonor attached by the drawee-bank to the returned check. Such *prima facie* presumption proves that the drawer has knowledge of the insufficiency of funds, *(infra.)* Unless rebutted by the drawer, the presumption would be sufficient basis to convict. (Tadeo vs. People, 300 SCRA 744 [1998].)

(10) *Act, a malum prohibitum.* — The law makes the mere act of issuing a worthless check punishable as a special offense provided the other elements of the offense are proved beyond reasonable doubt. The act is a *malum prohibitum* — an act deemed by the legislature pernicious and inimical to public welfare — and as such, it is committed by the very fact of its performance. (People vs. Manzanella, 156 SCRA 279 [1987]; Que vs. People, 154 SCRA 161 [1987].)

(a) What B.P. Big. 22 punishes is the issuance of the bouncing check and putting it into circulation, regardless of the intent of the parties. The payee and the purpose, cause, or reason, for which it was issued, the terms and conditions relating to its issuance, and whether or not malice or criminal content attended such issuance are unimportant or irrelevant in determining culpability. (Dichaves vs. Apalit, 333 SCRA 54 [2000]; Lim vs. People, 340 SCRA 497 [2000]; Marte vs. Court of Appeals, 434 SCRA 336 [2004]; Josef vs. People, 475 SCRA 417 [2005]; Nuguid vs. Nicdao, 502 SCRA 93 [2006]; Mejia vs. People, 525 SCRA 209 [2007].) Thus, even if there had been payment through compensation or set-off, or some other means, there could still be prosecution for violation of BP. Big. 22 (Ongson vs. People, 466 SCRA 656 [2005]; Tan vs. Mendez, Jr., 383 SCRA 202 [2002]; Lunaria vs. People, 570 SCRA 572 [2008]; see, however, Griffith vs. Court of Appeals, 379 SCRA 94 [2002], *supra.)*

(b) Once a check is presented for payment, the drawee bank gives it the usual course whether issued in payment of an obligation or just a guaranty of an obligation. B.P. Big. 22 does not concern itself with what might actually be envisioned by the parties its primordial intention being to ensure the stability and commercial value of checks as being vertical substitutes for money. It is a policy that can easily be eroded if one has yet to determine the reason for which checks are issued, or the claims and conditions for their issuance before an application of B.P. Big. 22 can be made. (Abarquez vs. Court of Appeals, 408 SCRA 500 [2003]; Ngo vs. People, 434 SCRA 522 [2004].)

(c) The law does not require that the payee of a check be the same as the obligee of the obligation in consideration for which the check has been issued. The check may have been issued in payment of a pre-existing obligation or an obligation contracted at the time of the issuance of the check. For example, R issues a check on account or for value in favor of P, as payee, and agent of T to settle R's obligation to T, P's principal. The payee of the bounced check is the injured party. One who is neither the payee nor holder of a bad check has neither the personality to sue nor a cause of action against the drawer.

(d) Although the offense charged is *malum prohibitum,* the prosecution is not thereby excused from its responsibility of proving beyond reasonable doubt all the elements of the offense, one of which is knowledge of the insufficiency of funds. (Lao vs. Court of Appeals, *supra;* Tan vs. Phil. Commercial International Bank, 552 SCRA 532 [2008.])

(11 *)Presumption of malice or intent.* — Knowledge on the part of the maker or drawer of the check of the insufficiency of his funds is the essential element of the offense. The defense of good faith is unavailing. Malice and intent are immaterial. They are legally presumed from the dishonor of his check for insufficiency or lade of funds. (People vs. Laggui, *supra;* Caram Resources Corp. vs. Contreras, 237 SCRA 724 [1994]; Palana vs. People, 534 SCRA 296 [2007].)

(a) In an earlier case, however, the Supreme Court held that no violation of B.P. Big. 22 is committed where complainant was actually told by the drawer that he does not have sufficient funds in the bank. (Magno vs. Court of Appeals, 210 SCRA 471 [1992]; Pacheco vs. Court of Appeals, 319 SCRA 595 [1999]; Macalaglag vs. People, 511 SCRA 400 [2006].)

(b) No criminal liability is incurred where the check was signed by the wife without any knowledge of its issuance by her husband much less of the transaction of her husband and the fact of dishonor. (Dingle vs. Intermediate Appellate Court, 148 SCRA 595 [1987].)

(c) The presumption is unavailing in the presence of a valid cause to stop payment, thereby negating the third element of the crime. Thus, the Supreme Court has upheld a buyer's reliance on Section 23 of Pres. Decree No. 957 (Subdivision and Condominium Buyer's Protective Decree) to suspend payments until such time as the owner or developer had fulfilled its obligations to the buyer. This exercise of statutory right to suspend installment payments is a valid defense against the purported violation of B.P. Big. 22. (Sycip, Jr. vs. Court of Appeals, 328 SCRA 447 [2000].)

(12) *Offense distinct from estafa.* — The offense of estafa under Article 315 (par. 2, d.) of the Revised Penal Code[8] is *malum in se* requiring proof of criminal intent on the part of the offender as an essential ingredient focusing mainly on the damage caused to the property rights of the victim. They are different offenses, having different elements.

(a) *Different evidence.* — Under *Batas Pambansa Big.* 22, the mere act of issuing a worthless check is presumed and considered a violation thereof as one committed against public interest. There is, therefore, no identity of offenses between the two for which legal jeopardy in one case may be invoked in the other considering that the two offenses are perfectly distinct in point of law however nearly they may be connected in point of fact. The evidence required to prove one offense is not the same evidence required to prove the other. (Ada vs. Virola, 172 SCRA 336 [1989].)

'Estafa, under this provision of the Revised Penal Code, has the following elements: (1) postdating or issuance of a check in payment of an obligation contracted at the time the check was issued; (2) lack of sufficiency of funds to coyer the check; and (3) damage to the payee thereof. The postdating of a check simply means that on the date indicated, the check would be properly funded, not that the check should be deemed as issued only on said date. (People vs. Tongko, 290 SCRA 595 [1998].) Deceit and damage are essential elements of the offense and must be established with satisfactory proof to warrant conviction. The false pretense or fraudulent act must be committed prior to, or simultaneously with,s the issuance of the bad check. (People vs. Sabio, Jr., 86 SCRA 568 [1978]; see People vs. Panganiban, 335 SCRA 354 [2000].)

While in the case of a bouncing check under B.P. Big. 22, failure of the drawee to deposit the amount necessary to cover his check within three (3) days from notice of its dishonor shall be *prima facie* evidence of fraud or deceit, under Article 315 of the Revised Penal Code mere failure to make such deposit cannot be the basis for conviction if the surrounding circumstances tend to show the absence of bad faith or deceit. (People vs. Singson, 215 SCRA 534 [1992]; see Nagrampa vs. People, 386 SCRA 412 [2002]; People vs. Cuyugan, 392 SCRA 140 [2002].)

(b) *Replacement checks.* — In a case, the accused (debtor), with the consent of the complainant (creditor), issued four (4) personal checks and indorsed two (2) checks issued by another, to replace six (6) original post-dated checks which had become due. It was held that the accused should be acquitted in the case for estafa. Since the replacement checks were issued in payment of an obligation long contracted and incurred, the accused could not have committed fraudulent acts in the issuance and indorsement of said checks.

In short, the replacement checks were by no means the device used by the accused to induce the complainant to extend the loan without which the transaction would not have been consummated. It appeared that what transpired between the parties was a simple loan transaction, the principal of which was payable at a future time with interest and that what motivated the complainant to lend money was not the issuance of the original post-dated checks but the expectation that he would receive interest for the amount borrowed from him. However, the accused was held liable under B.P. Big. 22 for issuing the four (4) replacement checks. (People vs. Chua, 315 SCRA 326 [1999].)

(c) *Different elements.*— The crimes of estafa and violation of the Bouncing Checks Law are two (2) different offenses having different elements and necessarily, for a court to acquire jurisdiction, each of the essential ingredients of each crime has to be satisfied. (Uy vs. Court of Appeals, 276 SCRA 367 [1997].) To establish, however, a person's culpability both under B.P. Big. 22 and Article 315 (par. 2, d.) of the Revised

Penal Code, it is indispensable that the checks he or she issued for which he or she was subsequently charged be offered in evidence because the gravamen of the offense charged is the act of knowingly issuing a check with insufficient funds. (Gutierrez vs. Palattao, 292 SCRA 26 [1998].)

(d) *One civil liability.* — While the single act of issuing a bouncing check may give rise to two distinct criminal offenses — estafa and violation of B.P. Big. 22 — it involves only one liability for the offended party since he sustains only a single injury. The civil action in a B.P. Big. 22 case is not a bar to a civil action in an estafa case, and *vice versa.* However, a recovery by the offended party under one remedy, necessarily bars that under the other in view of the proscription under our law against double recovery for the same act or omission. (Rodriguez vs. Ponferada, 465 SCRA 338 [2005]; Cheng vs. Sy, 592 SCRA 155 [2009].)

Under the 2000 Rules of Criminal Procedure (Sec. 1 [b], Rule HI thereof), the criminal action for violation of B.P. Big. 22 shall be deemed to include the corresponding civi action. The resolution to file a separate civil action is no longer needed.

(e) *Drawee against uncollected deposit.* — Like Article 315 of the Revised Penal Code, B.P. Big. 22 also speaks only of insufficiency of funds and does not treat of uncollected deposits. In a case when the check was presented for payment, it was dishonored by the bank because the dieck deposit made by the petitioner which would make his bank account balance more than enough to cover the face value of the subject check had not been collected by the bank. Petitioner was exonerated for issuing the check which was dishonored for the reason DAUD or Drawn against uncollected deposit. He had issued the check with full ability to abide by his commitment to pay his purchases. (Dy vs. People, 571 SCRA 59 [2008]; Tan vs. People, 369 SCRA 777 [2001].)

(13) *Checks covered.* —The language of *Batas Pambansa Big.* 22 is broad enough to cover all kinds of checks drawned against banks and issued in the Philippines.

(a) It makes no difference whether the check is present- dated or post-dated, cross or restricted, or whether issued in payment of pre-existing obligations, though not intended for encashment, or merely to guarantee said obligations; or as replacement for post-dated checks previously issued, or in the form of a deposit and not as actual payment, or given in mutual or simultaneous exchange of something of value. When a check is presented for payment, the drawee-bank will generally accept the same regardless of the terms and conditions relating to its issuance.

(b) A memorandum check *(supra.)* falls within die ambit of B.P. Big. 22. For purposes of the law, it is not a promissory note which is but a mere promise to pay. Ih the business community, a promissory note, certainly, has less impact and persuadability than a check. What the law punishes is the issuance of a bouncing check and not die purpose for which it was issued nor the terms and conditions relating to its issuance. The mere act of issuing a worthless check whether as a deposit, as a guarantee, or an accommodation, or even as an evidence of a pre-existing debt, is *malum prohibitum.* (People vs. Nitafan, 215 SCRA 79 [1952]; Llamado vs. Court of Appeals, 270 SCRA 423 [1997]; Lozano vs. Martinez, 146 SCRA 323 [1986]; Yu Oh vs. Court of Appeals, 403 SCRA 300 [2003]; Saguiguit vs. People, 494 SCRA 128 [2006].)

(c) It also includes within its coverage the making and issuing of a check by one who has no account with a bank or where such account was already closed when the check was presented for payment. (Ruiz vs. People, 475 S 476 [2005].)

(d) Under the law, foreign checks, provided they were drawn and issued in the Philippines though payable outside thereof, are within the coverage of the law. itie law does not distinguish the currency involved in the case. (De Villa vs. Court of Appeals, 195 SCRA 722 [1991].)

(14) *Aim of Act. — Batas Pambansa Big.* 22 is aimed at putting a stop to or curbing the practice of issuing checks that are worthless, *i.e.,* checks that end up being rejected or dishonored for payment. It does not make any distinction.

(a) It is not the non-payment of an obligation which the law punishes. The law is not intended or designed to coerce a debtor to pay his debt. The thrust of the law is to prohibit, under pain of penal sanctions, the making of worthless checks and putting diem in circulation. Because of its deleterious effects on the public interest, the practice is proscribed by law. The mistake it creates is not only a wrong to the payee or holder, but also an injury to the public since the circulation of valueless commercial papers "can very well pollute the channels of trade and commerce, injure the banking system and eventually hurt the welfare of society and the public interest."

(b) The law punishes the act not as an offense against property but as an offense against public order. The enactment of the law is a valid exercise of the police power and is not repugnant to the constitutional inhibition against imprisonment for debt. (Lozano vs. Martinez, 146 SCRA 323 [1986]; People vs. Reyes, 228 SCRA 13 [1993]; Cruz vs. Court of Appeals, 233 SCRA 301 [1994]; People vs. Tuanda, 181 SCRA 6921 [1990]; Santos-Tan vs. Robiso, 582 SCRA 556 [2009].)

(c) The agreement surrounding the issuance of the dishonored check need not be looked into since the law has clearly provided that the mere issuance of any kind of such check regardless of the intent of the parties makes the person who issued the check liable. The intent of the law is to curb the proliferation of worthless checks and to protect the stability and integrity of checks as a means of payment of obligations. (Lazaro vs. Court of Appeals, 227 SCRA 723 [1993]; Mejia vs. People, 525 SCRA 209 [2007]; Dreamwork Construction, Inc. vs. Janiola, 591 SCRA 466 [2009].)

(d) The deleterious and pernicious practice of issuing checks with insufficient funds is demed a public nuissance, a crime against public order to be abated. (Lozano vs. Martinez, 146 S 323 [2005]; Ruiz vs. People, 475 S 476 [2005].) Hence, the private understanding that a memorandum check is not to be presented at the bank but will be redeemed by the maker himself when the loan falls due, may not prevail to exempt it from penal sanction imposed by the law; otherwise, the very purpose for which die law was enacted to stem the proliferation of unfunded checks would be frustrated. (People vs. Nitafan, *supra.;* Llamado vs. Court of Appeals, *supra*; Cueme vs. People, 334 SCRA 795 [2000]; Recuerdo vs. People, 395 SCRA 638 [2003].) In fact, the issue of lack of valuable consideration for the issuance of checks which were later on dishonored for insufficient funds is immaterial to the success of a prosecution for violation of B.P. Big. 27. (Lee vs. Court of Appeals, 448 SCRA 455 [2005].)

(e) B.P. Big. 22, however, was not intended to shelter or favor nor encourage users of the banking system to enrich themselves through the manipulation and circumstances of the noble purpose and objectives of the law. Such manipulation is manifest when payees of the checks issued as security in loans present such check for payment even after the payment of such loans. (Macalaglag vs. People, 511 SCRA 400 [2006].)

Damage to complainant — The fine provided in B.P. Big. 22 is intended as an additional penalty. Prejudice or damage to the complainant is not a prerequisite for conviction. (Lazaro vs. Court of Appeals, *supra.;* Ong vs. People, 346 SCRA 117 [2000].) It is not an element of the crime punished in B.P. Big. 22. The damage resulting from the issuance of a bouncing check is to the integrity of the banking system. (Vaca vs. Court of Appeals, 298 SCRA 656 [1998].)

A person aggrieved by the issuance of a bouncing check has an interest in die civil aspect of the case. (Santos vs. Court of Appeals, 319 SCRA 609 [1999].) Under the Rules of Court, the criminal action for violation of B.P. Big. 22 shall be deemed to include the corresponding civil action. It is no longer allowed to make a reservation to file a separate civil action. (Sec. 1, Rule III thereof.)

Penalties. — Under Section 1 of *Batas Pambansa Big.* 22, the violation thereof "shall be punished by imprisonment of not less than thirty days but not more than one (1) year or by a fine of not less than but not more than double the amount of the check which fine shall in no case exceed Two hundred thousand pesos, or both such fine and imprisonment at the discretion of the court/' B.P. Big. 22 is a special law.[9] The Supreme Court

[9]Act No. 3326 (An Act to Establish Prescription for Violations'of Specified Acts and Municipal Ordinances and to provide When Prescription Shall Begin) is the law appli-

has, on several occasions, imposed subsidiary imprisonment in case of insolvency to pay the fine for violation of special laws, notwithstanding the absence of such provision in said laws.[10] (Diongzon vs. Court of Appeals, 321 SCRA 479 [1999]; Tan vs. Mendez, Jr., 383 SCRA 202 [2002].)

(17) *Rule of preference in the imposition of penalty.* — Under Supreme Court Administrative Circular No. 12-2000, as (clarified by Adm. Cir. No. 13-2001), which took effect on November 21, 2000, the Court pronounced a policy preference for fine on the matter of the imposition of penalties for violation of the law. Instead of imprisonment, a fine of not less than but not more than double the amount of the check dishonored may be imposed by the judge in the exercise of sound discretion.

In *Aguirre vs. People* (363 SCRA 672 [2001]), the Supreme Court modified the penalty (3 separate 1 year imprisonment) imposed on the petitioner in view of the Court's ruling in *Vaca vs. Court of Appeals (supra.)* and *Lim vs. People (supra.)* that:

> "It would best serve the ends of oriminal justice if in fixing the penalty within the range of discretion allowed by Sec. 1, par. 1, the same philosophy underlying the Indeterminate

cable to offenses render special laws that do not provide their own prescriptive periods. It applies to offenses under B.P/Blg. 22. Under Act No. 3326, a violation of B.P. Big. 22 prescribe in four (4) years from the commission of die offense or, if the same be not known at the time, from the discovery thereof, (see Panaguton vs. Department of Justice, 271 SCRA 529 [2008].)

"'Supreme Court Adm. Circular No. 12-2000 (as clarified by SC Adm. Cir. No. 132000) establishes a rule of preference in die application of the penal provisions of B.P. Big. 22 such that where the circumstances of both die offense and the offender clearly indicate good faith or a clear mistake of fact without taint of negligence, the imposition of a fine alone should be considered as the more appropriate penalty. The determination of whether the peculiar circumstances of each case warrant die imposition of fine alone rests solely upon the judge. Adm. Circular No. 12-2000 does not remove imprisonment as an alternative penalty for violation of B.P. Big. 22.

In *Vaca vs. Court of Appeals* (298 SCRA 658 [1998].), the Supreme Court held that in determining the penalty to be imposed for violation of B.P. Big. 22, the philosophy underlying the Indeterminate Sentence Law applies. The philosophy is to redeem valuable human material, and to prevent unnecessary deprivation of personal liberty and economic usefulness with due regard to the protection of the sodal order. There, the Supreme Court deleted the prison sentence imposed on petitioners. It imposed on them only a fine double the amount of the check issued. We

Sentence Law is observed, namely, that of redeeming valuable human material and preventing unnecessary deprivation of personal liberty and economic usefulness with due regard to the protection of the social order/[7]

Absent showing that petitioner (where there is neither proof nor allegation that accused is not a first time offender) acted in bad faith *(e.g.,* issuing a check by a drawer who had closed his account with the drawee-bank), the deletion of the penalty of imprisonment was held proper. Thus, in lieu of imprisonment, a fine equivalent to the value of the three (3) subject checks was imposed on the petitioner, (see Villaber vs. Commission on Elections, 369 SCRA 126 [2001]; Lagman vs. People, 371 SCRA 686 [2001]; Nagrampa vs. People, 361 SCRA 412 [2002]; So vs. Court of Appeals, 388 SCRA 107 [2002]; Garcia vs. Court of Appeals, 393 SCRA 79 [2002]; Recuerdo vs. People, 395 SCRA 638 [2003]; Singson vs. People, 466 SCRA 656 [2005].)

As clarified by Administrative Circular 13-2001, the clear tenor and intention of Administrative Circular No. 12-2000 is not to remove imprisonment as an alternative penalty, but to lay down a *rule of preference* in the application of the penalties provided for in B.P. Big. 22. Where the circumstances of the case, for instance, clearly indicate good faith or a clear mistake of fact without taint of negligence, the imposition of a fine alone may be considered as the more appropriate penalty. This *rule of preference* is not equivalent to decriminalizing violations of B.P. Big. 22 for it does not foreclose the possibility of imprisonment for violators of B.P. 22. Neither does it defeat the legislative intent behind the law. Needless to say, the determination of whether the circumstances warrant the imposition of a fine alone rests solely upon the judge. Should the judge decide that imprisonment is the more appropriate penalty, Administrative Circular No. 12-2000 ought not to be deemed a hindrance based on his assessment of the offender and the facts. Should only a fine be imposed and the accused be unable to pay the fine, there is no legal obstacle to the application of the Revised Penal Code provisions oh subsidiary imprisonment. (Tan vs. Mendez, 383 SCRA 202 [2002]; Abarquez vs. Court of Appeals, 408 SCRA 500 [2003]; De Joya vs. The Jail Warden, 417 SCRA 636 [2003]; Narte vs. Court of Appeals, 434 SCRA 336 [2004]; Go vs. Dimagiba, 460 SCRA 451 [2005]; Go vs.

Josef vs. People, 475 SCRA 417 [2005]; Bernardo vs. People, 520 SCRA 332 [2007]; Lunaria vs. People, 570 S 572 [2008].)

Sec. 187. ***Certification of check; effect of.*** **— Where a check is certified by the bank on which it is drawn, the certification is equivalent to an acceptance.**

Right of holder to certification.

Certification is, in effect, an agreement by the bank against whom a check is drawn that the check will be paid when presented for payment. (Wachtel v. Rosen, 221 N.Y. Supp. 710.)

It is done by stamping the word "certified" on the face of the check, together with the name of the bank, the date, and the handwritten signature or initials of the officer making the certification.

A check, being payable on demand, the contract of the drawer is that it will be paid on presentment and not that it will be certified. Hence, a refusal to certify is not a dishonor of the check and the holder has no right to sue the drawer as if payment had been refused, *(ibid.)* This view, however, is criticized on the ground that certification of a check clearly falls within the drawer's undertaking under Sections .61 and 185; and if not, then a practical matter, it inferentially indicates dishonor by nonpayment. (Beutel's Brannan, *op. cit.,* p. 1305.)

A bank must certify if it has agreed with the drawer to do so.

Form of certification.

Certification must be in writing either on the check itself or on a separate instrument, (see Sees. 134 arid 135.)

The usual form is by stamping or writing upon the check the word "certified" and underneath it is the signature of the proper bank officer and date of the certification. It has been held that the certificate by a bank of a check being "good" is sufficient. (Liberty Trust Co. v. Hahherty, 113 Atl. 596.) But the letters "O.K." with the initials of a cashier of bank is not under modern banking practice, according to our Supreme Court, a sufficient certification of a check. (Panlilio vs. David, 50 Phil. 105 [1927].)

Since certification must be in writing, a promise of the drawee-bank by wire to pay a check is equivalent to an acceptance (Bulliet v. Allegheny Trust Co., 42 A.L.R. 1133.) but not, if done orally (Ramboo v. First Nat. Bank of Argentina, 129 Pac. 192.) or by telephone. (Atchison Bank v. Garretson, 51 Fed. 168.)

Effects of certification of checks.

The following are the effects of certification:

(1) It is equivalent to acceptance (Sec. 187.), making the bank primarily liable on the instrument;

(2) It discharges persons secondarily liable if procured by the holder (see Sec. 188.);

(3) It operates as an assignment of the funds of the drawer in the hands of the drawee-bank (see Sec. 189.) and, therefore, the drawer cannot draw out the funds then in the bank necessary to meet the certified check;

(4) The payee or holder, for all intents and purposes, becomes the depositor of the drawee-bank with rights and duties of one in such a situation (New Pacific Timber & Supply Co., Inc. vs. Seneris, 101 SCRA 686 [1980].);

(5) The bank becomes the primary debtor, and cannot thereafter refuse to pay it; and

(6) The drawer may not issue a stop payment order on the certified check.

Said certification implies that the check is drawn upon sufficient funds in the hands of the drawee, that they have been set apart for its satisfaction, and that they shall be so applied whenever the check is presented for payment. It is an understanding that the check is good then, and shall continue good and this agreement is as binding on the bank as its notes in circulation, a certificate of deposit, payable to the order of the depositor or any other obligation it can assume, *(ibid.,* citing PNB vs. National City Bank of New York, 63 Phil. 711 [1936].)

Liability of certifying bank.

Since certification is equivalent to acceptance (see Sees. 139 and 142.), its effect is to make the certifying bank an acceptor with all the liabilities stated in Section 62. Consequently, the bank is estopped as against a holder in due course:

(1) to dispute the genuineness of the drawer's signature (Farmers and Mechanics Bank v. Butchers & Drivers Bank, 16 N.Y. 125.); or

(2) to set up the defense that the drawer's fund is insufficient (Nat. Bank of Commerce v. Baltimore Commercial Bank, 29 H.L.R. 135.); or that the check is without funds (National City Bank v. Titlow, 233 Fed. Rep. 838.);

(3) or to allege that the drawer is indebted to the bank for more than the amount of the check. (Nat. Mechanics Bank v. Schmelz Nat. Bank, 116 S.E. 380.)

A bank certifying a check is not responsible for material alterations (see Sec. 124.) to it after certification. Thus, if a certified check for P500.00 is altered by the drawer so that the check appears to be P5,000.00 when accepted by the payee, the bank is liable only for P500.00.

When check may be certified and by whom.

A check cannot be certified before it is payable. Thus, if a check is post-dated, the bank would not be bound by a certification made before the date on which the check is payable. (Clarke Nat. Bank v. Bank of Albion, 52 Barb. 593.)

And the certification must be made by the officer of the bank having the express or implied authority to certify checks. The officers having implied power are the president, cashier and tellers. The board of directors, as the governing body of the bank, may, however, delegate this power to other officers having no implied authority. (Merchant Bank v. State Bank, 10 Wall. 604; Cookie v. State Nat. Bank, 52 N.Y. 96.)

Object of certifying checks.

The certification of checks enables persons not well acquainted with each other to close promptly business- transactions since the holder knows that he can compel the drawee-bank to cash it. It thus avoids the delay and risks of receiving, counting, and passing from hand to hand large sums of money.

Thus, the object of certifying a check, as regards both parties, is to enable the holder to use it as money. When the holder procures a check to be certified, the check operates as an assignment to him of the amount certified. (New.Pacific Timber & Supply Co., Inc. vs. Seneris, *supra.)*

Sec. 188. *Effect where the holder of a check procures it to be accepted or certified.* — Where the holder of a check procures it to be accepted or certified, the drawer and all indorsers are discharged from liability thereon.

Effect where certification obtained by holder.

If the holder procures the certification of a check, the drawer and the indorsers are discharged on the theory that "the drawer's credit deposit with the drawee is, to the extent of the check, taken from his control and appropriated for the payment of the check." (Lipten v. Columbia Trust Co., 185 N.Y. Supp. 198.) The certification has the same effect as if the holder had drawn the money, redeposited it and taken a certificate of deposit for it. (Times Square Automobile Co. v. Rutherford Nat. Bank, 73 Atl. 479.) By his own act, he makes the bank his debtor and releases the drawer of the check. Thus, the drawer is discharged both on the check and on the original debt. (Krikovien v. Fermanian, 196 N.Y. Supp. 629.)

But Section 188 applies only to indorsers at the time of certification. Hence, indorsers subsequent to the certification are not released. (John J. Felin Co. v. Petrex, 167 N.Y. Supp. 1073.)

Effect where certification obtained by others.

If the certification is obtained not by the holder but by others, the secondary parties are not discharged as when it is obtained by the drawer (Deal v. Atlantic Coast Line R. Co., 86 A.L.R. 455.) even at the request of the payee (Randolph Nat. Bank v. Hornblower, 35 N.E. 850.) or even though the drawer is also the payee. (Strauss v. Multenberger, 197 N.Y. Supp. 599.) The reason is tihat the holder has not yet received payment.

The obvious purpose of certifying checks is to assure the persons to whom they are offered that they are genuine, and will be paid; not that the bank that certifies them is solvent. It cannot, therefore, be implied that the acceptance of the check by the creditor, *ipso facto,* releases die drawer and imposes upon the creditor the risk of the insolvency of the bank by which the check was certified. (Borne v. First Nat. Bank, 24 N.E. 173.)

In the Philippines, the practice is to certify only at the request of the drawer. A cashier's check or manager's check stands on the same footing as a certified check. Most banks charge for the service.

Sec. 189. *When check operates as an assignment* —A check of itself does not operate as an assignment of any part of the funds to the credit of the drawer with the bank, and the bank is not liable to the holder, unless and until it accepts or certifies the check.

Right before acceptance or certification of check.

A check drawn in die ordinary form, not accepted or certified by the bank, does not of itself, as between the drawer and the payee or holder, constitute a transfer of any money of the drawer to the credit of the holder. It is simply an order by the drawer to pay the amount of the check on presentment.

Hence, before acceptance or certification, die drawer may countermand payment (Tremont Trust Co. v. Bierack, 126 N.E. 782.); the bank may refuse to honor the check and the holder cannot for lack of privity, sue the bank (Phil. National Bank vs. Relativo, 92 Phil. 203 [1952].); and the holder cannot claim priority as to the amount of the check over general creditors of the drawer in a fund received from such bank by an assignee under a general assignment (Bryan London Co. vs. American Bank, 7 Phil. 255 [1906].) or over other creditors of the bank in case it becomes insolvent. For the same reason, a check is revoked by the death of the drawer before acceptance. (Spellacy v. Dauterman, 10 P. [2] 114.)

There may be implied acceptance of a check by a bank, (see Sumacad vs. Province of Samar, 100 Phil. 72 [1956]; see Sec. 62.)

Liability in case of non-payment or wrong payment.

(1) *Liability of drawer to holder.* — For refusing to honor the drawer's order, the remedy of the holder is against the drawer while the latter may sue the bank for damages for wrongful dishonor of the bill or check. A bank is not liable to the holder for not honoring a check even on the assumption that the check is in fact genuine, negotiable, and drawn against the bank, that the holder is in reality the payee, and that the drawer has sufficient funds in the hands of the bank unless the check has been accepted or certified, or the bank, by any other act or conduct, has made itself directly liable to the holder. (Phil. National Bank vs. Relativo, *supra.)* A bank has no contractual obligation to pay the holder. There is no priority of contract between the drawee- bank and the payee, (see Art. 1311, Civil Code.)

(2) *Liability of bank to drawer!depositor.* — Bank transactions pass through a succession of bank personnel whose duty is to check and counter check transactions for possible errors. Depositors do not pretend to be past masters of banking technicalities, much more of clearing procedures. As soon as their deposits are accepted by the bank's teller, they wholly repose trust in the bank's personnel's mastery of banking, their and the bank's profession of diligence and meticulousness in giving irreproachable service. (Tan vs. Court of Appeals, 239 SCRA 310 [1994].)

(a) The bank is also liable to the drawer for paying a check in disregard of a countermand or stop-payment order. The rule holds true although the check is certified if the certification is procured by the drawer but not if procured by the holder because the drawer is already discharged under Section 188. Wrongful payment may also result from payment of altered checks or upon a forged signature of a drawer or indorser.

Banks handle daily transactions involving millions of pesos. By the very nature of their work, the degree of responsi bility, care and trustworthiness expected of their employees and officials is far greater than those of ordinary clerks and employees. For obvious reasons, the banks are expected to exercise the highest degree of diligence in the selection and supervision of their employees (Bank of the Phil. Islands vs. Court of Appeals, 216 SCRA 51 [1992].), a degree of diligence in the handling of its affairs hijgher than expected of an ordinary business firm. (Ibaan Rural bank, Inc. vs. Court of Appeals, 321 SCRA 88 [1999]; Bank of the Phil. Islands vs. Court of Appeals, 326 SCRA 641 [2000]; Far East Bank and Co. vs. Querimit, 373 SCRA 665 [2002].) Its liability as obligor is not merely vicarious but primary wherein the defense of exercise of due diligence in the selection of its employees is of no moment. (Gempesaw vs. Court of Appeals, 218 SCRA 282 [1993].)

(b) A bank acts at its peril when it pays deposits evidenced by a certificate of deposit, without its production and surrender after proper indorsement. Even where plaintiff (holder of the certificate) must allege non-payment, the general rule is that the burden rests on the defendant (bank) to prove payment rather than oh the plaintiff to prove payment. (Far East Bank and Co. vs. Querimit, SM^ra.)

(c) The law imposes a duty of diligence on a bank to scrutinize checks deposited with it, for the purpose of determining their genuineness and regularity. Being primarily engaged in banking, it holds itself out to the public as the expert on this field and the law holds it to a high standard of conduct. The taking of a check by a collecting bank on a forged or unauthorized indorsement is the same as if it had taken the check and collected without indorsement at all. There is no substantial difference between an actual forging of a name to a check as an indorsement by a person not authorized to make the signature and the affixing of a name to a check as an indorsement by a person not authorized to indorse it. The act of the bank amounts to a conversion of the check. (Associated Bank vs. Court of Appeals, 208 SCRA 465 [1992]; see City Trust Banking Corp. vs. Intermediate Appellate Court, 232 SCRA579 [1994].)

In the *Associated Bank* case, there was no evidence that the crossed checks were actually received by the payee. It was held that she would have a right of action against the drawer companies, which, in turn, could go against their respective drawee-banks, which, in turn, could sue the collecting bank which paid the checks. However, to simplify the proceedings, the payee of the illegally encashed checks was allowed to recover directly from the collecting bank responsible for the encashment, regardless of whether or not the checks were actually delivered to the payee.

(d) A bank is liable for dishonoring a check presented to it for payment because of its failure to send for clearing deposited checks proceeds of which would answer for the dishonored check. It is the duty of the bank to faithfully and diligently send all deposited checks for clearing at the appointed time; otherwise, it shall be liable to pay for the damages caused to its depositor. (Bank of the Phil. Islands vs. Intermediate Appellate Court, 219 SCRA 644 [1993].)

(e) A bank cannot exculpate itself from liability for the consequences of the use of wrong deposit slip (local deposit slip, instead of a regional check deposit slip) by a depositor resulting in the "missending" of a cashier's check deposited by him with the bank, to the Central Bank (instead of the issuing bank) and dishonor of his checks in view of the fact that his cashier's check had not yet been cleared. The teller should not have accepted the local deposit slip with the cashier's check that on its face was clearly a regional check without calling the depositor's attention to the mistake at the very moment this was presented to him. A bank is not expected to be infallible but, in this instance, it must bear the blame for not discovering the mistake of its teller despite the established procedure requiring the papers and bank books to pass through a battery of bank personnel whose duty it is to check and countercheck them for possible errors. (Tan vs. Court of Appeals, *supra.)*

(4) *Liability of bank to depositor for damages and attorney's fees.* — The banking industry is impressed with public interest. Consequently, the highest degree of diligence is expected, high

standards of integrity and performance are even required of it. By the nature of its functions, a bank is under obligation to treat the accounts of its depositors with meticulous care and always to have in mind the fiduciary nature of its relationship with them. (SoUdbank Corporation vs. Arrieta, 451 SCRA 711 [2005].)

(a) A bank's gross negligence in dishonoring well-funded check, aggravated by its unreasonable delay in repairing the error, calls for ah award of moral and exemplary damages. The resulting injury to the check writer's reputation and peace of mind needs to be recognized and compensated. Treating a depositor's account as closed merely because the ledger could not be found is a reckless act that cannot simply be brushed off as an honest mistake. *(Ibid.)* Article 1172 of the Civil Code ordains that responsibility arising from negligence in the performance of an obligation is demandable. The failure of the bank's employees to credit the amount deposited to the depositor's savings account resulting in the dishonor of the latter's checks constitutes actionable negligence in law. (Prudential Bank vs. Lim, 474 SCRA 485 [2005].)

(b) A depositor has the right to recover reasonable moral damages even if the bank's negligence may not have been attended with malice and bad faith, if the former suffered mental anguish, serious anxiety, embarrassment and humiliation. (Art. 2217, Civil Code.) Moral damages are not meant to enrich a complainant at the expense of the defendant. It is only intended to alleviate the moral suffering he has undergone. Accordingly, the award of moral damages could not be said in error nor in grave abuse of discretion where the bank dishonored the check issued by the depositor who turned out to have sufficient funds with it.

The award of exemplary damages is not justified in the absence of malice, bad faith or gross negligence.

The award of reasonable attorney's fees is proper where exemplary damages are awarded. It is also proper where the depositor was compelled to litigate to protect his interest. (Tan vs. Court of Appeals, *supra;* Prudential Bank vs. Court of Appeals, 328 SCRA 264 [2000].)

(c) The respondent bank was held grossly negligent when it allowed the sum of P220,000 to be withdrawn through falsified withdrawal slips without petitioner's authority and knowledge and its failure to comply with petitioner's instruction to apply their deposits on their loan. Settled is the rule, that gross negligence of a bank in the handling of its clients' deposits amounts to bad faith that call for an award of moral damages. (Cagurangan vs. Planters Development Bank, 473 SCRA 259 [2005].)

(d) A bank does not have a unilateral right to freeze the accounts of a depositor based on its mere suspicion that the funds therein were proceeds of the "multi-million peso scam" the depositor was allegedly involved in. To grant any bank the right to take whatever action it pleases on deposits which it supposes are derived from shady transactions would open the floodgates of public distrust in the banking industry. In the absence, however, of fraud or bad faith, moral damages and exemplary damages (see Art. 2220,2229,2232, 2234, Civil Code.) cannot be awarded. Attorney's fees may be awarded when a party is compelled to litigate or incur expenses to protect his interest or when the court deems it just or equitable. (BPI Family Bank vs. Franco, 538 SCRA 184 [2007].)

When check operates as an assignment of drawer's funds.

The moment a check is certified, the funds cease to be under the control of the drawer. They are no longer his. It is the same as if the bank had paid the money upon the check. Under banking laws and practice, by the certification, the funds represented by the check are transferred from the credit of the drawer to that of the payee or holder and, for all intents and purposes, the latter becomes the depositor of the drawee-bank with rights and duties of one in such relation. (Gregorio Araneta, Inc. vs. Paz Tuazon de Paterno & Jose Vidal, 91 Phil. 786 [1952].)

In a case, where the certification stated that the checks certified were to be void if not presented for payment at the certifying bank within ninety (90) days from date of acceptance, it was held that the transfer of the corresponding funds from the credit of the depositor to that of the payee had to be co-extensive with the life of the checks, *i.e.,* which in this case was 90 days, so that if the checks were not presented for payment within that period, they became invalid and the funds were automatically restored to the credit of the drawer though not as a current deposit but as special deposit, *(ibid.)*

Payment and acceptance distinguished.

"Acceptance, which under the law must be in *writing* (see Sec. 132.), is not payment, and payment is not acceptance. Acceptance and certification are radically different transactions. It has been held, however, that the payment of a bill or check by the drawee amounts to more than acceptance x x x upon the principle that the greater includes the less." (First Nat. Bank v. Bank of Cottage Grove, 59 Ore. 388,117 Pac. 293.)

But on this point, it has also been said that "x x x there is no similarity between acceptance and payment; payment discharges the instrument and no one else is expected to advance anything on the faith of it. Acceptance contemplates further circulation, induced by the fact of acceptance. The rule that the acceptor makes certain admissions which will inure to the benefit of subsequent holders, has no applicability to payment of the instrument where subsequent holders never exist." ("Commercial Law," by Sulpicio Guevarra, Survey of Phil. Law and Jurisprudence, 1968, published by the U.P.L.C., 1969, pp. 359-360, citing Guevarra, Phil. Commercial Laws & Code of Commerce, Coordinated, Integrated, and Annotated, 479-480 [12 ed., 1969].)

"The essential distinction between *payment* and *acceptance* must be maintained, otherwise, a drawee-bank may even be precluded from recovering from the forger himself, on the ground of estoppel or legal admission of the genuineness of the instrument itself." *(ibid.,* p. 359.)

On the same topics, the Supreme Court says:

> "With the purview of the law, 'acceptance' and 'payment[7] are essentially different things, for the former is a promise to perform an act, whereas the latter is the actual performance thereof. Under Section 132, 'the acceptance of a bill is the

signification by the drawee of his *assent* to the order of the drawer, which in the case of checks is the payment on demand of a given sum of money. Upon the other hand, actual payment of the amount of the check implies *not only* an assent to said order of the drawer and a recognition of the drawer's obligation to pay the aforementioned sum, but also, a *compliance* with such obligation." (Phil. National Bank vs. Court of Appeals, 25 SCRA 693 [1968].)

Cases when bank may refuse payment.

In any of the following cases, a bank may rightfully refuse to pay checks drawn against it:

(1) The bank is insolvent;

(2) The drawer's deposit is insufficient or he has no account with the bank or said account had been closed or garnished;

(3) The drawer is insolvent and proper notice is received by the bank;

(4) The drawer dies and proper notice is received by the bank;

(5) The drawer has countermanded payment;

(6) The holder refuses to identify himself;

(7) The bank has reason to believe that the check is a forgery; or

(8) The check is stale or postdated.

A bank is under no obligation to make part payment on a check up to only the amount of the drawer's funds, where the check is drawn for an amount larger than what the drawer has on deposit. Upon partial payment, the check holder could not be called upon to surrender the check and the bank would be without a voucher affording a certain means of showing payment. The rule is based on commercial convenience. (Moran vs. Court of Appeals, 230 SCRA 799 [1994].)

Relation between depositor and bank.

(1) *Fiduciary in nature*. — The Supreme Court had occasion to stress the fiduciary nature of the relationship between a bank

and its depositors and the extent of diligence expected of the former in handling the accounts entrusted to its care, thus:

(a) "In every case, the depositor expects the bank to treat his account with the utmost fidelity, whether such account consists only of a few hundred pesos or of millions. The bank must record every single transaction accurately, down to the last ceritavo, and as promptly as possible. This has to be done if the account is to reflect at any given time the amount of money the depositor can dispose of as he sees fit, confident that the bank will deliver it as and to whomever he directs. A blunder on the part of bank, such as the dishonor of a check without good reason, can cause the depositor not a littie embarrassment if not also financial loss and perhaps even civil and criminal litigation. The point is that as a business affected with public interest and because of the nature of its functions, the bank is under obligation to treat the account of its depositors with meticulous care, always having in mind the fiduciary nature of their relationship/[7] (Prudential Bank vs. Court of Appeals, 328 SCRA 264 [2000]; Simex International [Manila], Inc. vs. Court of Appeals, 183 SCRA 360 [1990]; Bank of the Philippine Islands vs. Intermediate Appellate Court, 206 SCRA 408 [1992].)

(b) "Since the banking business is impressed with public interest, of paramount importance thereto is the trust and confidence of the public in general — the highest degree of diligence is expected, and high standards of integrity and performance are even required of it. A bank is bound to know the signatures of its customers, and if it pays a forged check, it must be considered as making the payment out of own funds, and cannot adversely charge the amount so paid to the accout of the depositor whose name was forged." (Bank of the Phil. Islands vs. Casa Montessori Internationale, 430 SCRA 261 [2004]; Associated Bank vs. Tan, 446 SCRA 282 [2004].

(c) "Every bank that issues checks for the use of its customers should know whether or not the drawer's signature thereon is genuine, whether there are sufficient funds in the drawers account to cover checks issued, and it should be able to detect alterations, erasures, superimpositions or intercalations thereon, for these instruments are prepared, printed and issued by itself, it has control of the drawer's account, and it is supposed to be familiar with the drawer's signature. It should possess appropriate detecting devices for uncovering forgeries and/or alterations on these instruments. Unless a forgery or alteration is attributable to the fault or negligence of the drawer himself, the remedy of the drawee bank that negligently clears a forged and/or altered check for payment is against the party responsible for the forgery or alteration, otherwise, it bears the loss." (BPI Family Banks vs. Buenaventura, 471 SCRA 431 [2005].)

(2) *Creditor and debtor.* — A deposit is constituted from the moment a person receives a thing belonging to another with the obligation of safely keeping it and returning the same. (Art. 1962, Civil Code.) But the contract between a banker and a depositor is not that of a deposit: A bank deposit is really a loan which creates the relationship of debtor and creditor. (Gullas vs. Phil. National Bank, 62 Phil. 519 [1935].)

Accordingly, our Civil Code provides: "Fixed, savings and current deposits of money in banks and similar institution shall be governed by the provisions concerning simple loan." (Art. 1980.) The deposits become part of the general assets of the bank and the bank is bound to honor the checks drawn by its depositor for sums not in excess of the amount of his deposit. Thus, legal compensation under Article 1278 of the Civil Code may take place "when all the requisites mentioned in Article 1279 are present."

(a) Courts have long recognized the business custom of using printed checks where blanks are provided for the date of issuance, the name of the payee, the amount payable and the drawer's signature. All the drawer has to do when he wishes to issue a check is to properly fill up the blanks and sign it. However, the mere fact that he has done these does not give rise to any liability on his part, until and unless the check is delivered to the payee or his representative. A negotiable instrument, of which a check is, is not only a written evidence of a contract right but is also a species of property. Just as a deed to a piece of land must be delivered in order to convey title to the grantee, so must a negotiable instrument be delivered to the payee in order to evidence its existence as a binding contract. (Development Bank of the Philippines vs. Sima Usi, 219 SCRA 736 [1993].)

(b) According to universal banking practice, the daily balance in a current account is ascertained by deducting the amount of the check drawn from the amount of money the drawer or depositor had deposited in the bank for that purpose, and if there is no balance in the depositor's deposit or the amount thereon is insufficient to pay his check, the latter is returned to him, or not honored. The payment by a bank of the amount of the depositor's check is not a loan to the latter by the former which may be satisfied by a subsequent deposit, but a payment by the bank as debtor to the depositor as creditor. Such payment extinguishes so much of the obligation of the bank as is represented by the check paid or honored by the bank out of the latter's deposit. (Hilado vs. De La Costa, 83 Phil. 471 [1949].) Abank generally has a right of set-off over the deposits thereon for the payment of any withdrawal on the part of a depositor. (Associated Banks vs. Tan, 446 SCRA 282 [2004].)

(c) It is considered improper banking practice for a bank to credit postdated checks to the current account of the depositor (see Ongsip vs. Prudential Bank and Trust Co., 122 SCRA 456 [1983].) although a depositor may be granted overdraft (OD) and/or drawn against uncollected deposit (DAUD) privileges by a bank. (People vs. Jalandoni, 122 SCRA 588 [1992].) As between the bank and the depositor, an overdraft is a loan from the former to the latter, an advance by the bank of its own money, which the depositor must pay with interest.

(d) The notice in the monthly statements issued by the bank that if no error is reported in 10 days, the account will be correct cannot be considered a waiver, even if the depositor failed to report the error. The depositor is not estopped from questioning the mistake after the lapse of the ten-day period. Such notice is a simple confirmation or "circularization" in accounting parlance, that requests client-depositors to affirm the accuracy of items recorded by the bank. (Bank of the Phil. Islands vs. Casa Montessoi Internationale, *supra.)*

(3) *Principal and agent.*—Where checks are received by a bank merely for collection and deposit, the nature of the relationship created *at this stage,* is one of agency, that is, the bank is to collect from the drawees of the checks the corresponding proceeds. (Jai- alai Corp. vs. Bank of P.I., 66 SCRA 29 [1975].)

The holder of a check may indorse it, cash it with the drawee- bank, or deposit it. If he deposits the check with the drawee- bank, the latter would credit the amount thereof, to his account, and this would have the effect of payment which discharges the instrument. (Sec. 119[a].)

If the check is deposited with a bank other than the drawee- bank, he would have to negotiate the check to the bank by indorsing it (see Sees. 30-31.) thereby making the bank the holder thereof, (see Sec. 191.)

(a) If the indorsement is "for collection," the indorsement is restrictive. (Sec. 36[b].) If the indorsement is "for deposit," courts differ on whether it is restrictive (see First Nat. Bank of Sioux City v. John Morrel & Co., 221 N.W. 95; Nat. Commercial Bank v. Miller & Co., 50 Am. Rep. 50.) or non-restrictive, (see Fourth Nat. Bank of Cincinnati v. Mayer, 14 S.E. 891; U.S. Nat. Bank v. Green, 73 N.W. 266.) In the second view, the bank is deemed to have paid for the check in cash to the extent of the amount credited to the account of the depositor.

A collecting bank has the right to debit a client's account for the value of a dishonored check that has previously been credited. (Associated Bank vs. Tan, *supra.)*

(b) In our jurisdiction, the deposit slip which the depositor is required to fill up before making the deposit states the conditions (at the back thereof) tinder which the deposits are accepted one of which is that the bank "acts only as the depositor's collecting agent and assumes no responsibility beyond the exercise of due care in selecting correspondents." This condition makes the bank a mere collecting agent.

However, the reservation is not enough to insulate the bank from any liability "Doubt has been expressed about the binding force of such condition unilaterally imposed by a bank without the consent of the depositor. It is indeed arguable that "in signing the deposit slip the depositor does not so only to identify himself and not to agree to the conditions set forth at the back of the deposit slip." (Associated Bank vs. Tan, *supra.;* Metropolitan Bank & Trust Company vs. Court of Appeals, 194 SCRA 169 [1991].)

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TITLE IV

CHAPTER XVII GENERAL PROVISIONS

Sec. 190. *Short title.* — This Act shall be known as the Negotiable Instruments Law.

Sec. 191. *Definitions and meaning of terms.* — In this Act, unless the context otherwise requires —

"Acceptance" means an acceptance completed by delivery or notification;

"Action" includes counterclaim and set-off;

"Bank" includes any person or association of persons carrying on the business of banking, whether incorporated or not;

"Bearer" means the person in possession of a bill or note which is payable to bearer;

"Bill" means bill of exchange, and "note" means negotiable promissory note;

"Delivery" means transfer of possession, actual or constructive, from one person to another;

"Holder" means the payee or indorsee of a bill or note, who is in possession of it, or the bearer thereof;

"Indorsement" means an indorsement completed by delivery;

"Instrument" means negotiable instrument;

"Issue" means the first delivery of the instrument, complete in form, to a person who takes it as a holder;

"Person" includes a body of persons, whether incorporated or not;

place of acceptance, were then in operation and the holder's agent could have transmitted the bill to the drawee, (see Behn, Meyer & Co. vs. Hongkong & Shanghai Banking Corp., 93 Phil. 963 [1953].)

Sec. 194. ***Time, how computed; when last day falls on holiday.*****—Where the day, or the last day, for doing any act herein required or permitted to be done falls on Sunday or on a holiday, the act may be done on the next succeeding secular or business day.**

Computation of time.

So under this section, if an instrument falls on Sunday, it is payable on Monday. If Monday is a holiday, it would be payable on Tuesday.

Sec. 195. ***Application of Act*** **— The provisions of this Act do not apply to negotiable instruments made and delivered prior to the taking effect hereof.**

Application of Act.

The meaning of this section is that the Act was not intended to make any instrument negotiable which was not negotiable prior thereto and the legislature had no power to do so because of the provision of the Constitution forbidding the passage of laws which impair the obligations of a contract. (Adams v. Thurmond, 149 Pac. 1141.)

All inquiries concerning the rights and liabilities of indorsers and indorsees, as well as of makers and payees, are governed by the date written upon the instrument. Therefore, the negotiability of a note made before but transferred after the Act took effect (Sec. 198.) is not governed by the Act. (Mackintosh v. Gibbs, 81 NIL 577.)

Sec. 196. ***Cases not provided for in Act*** **—Any case not provided for in this Act shall be governed by the provisions of existing legislation, or in default thereof; by the rules of the law merchant.**

accounting parlance, that requests client-depositors to affirm the accuracy of items recorded by the bank. (Bank of the Phil. Islands vs. Casa Montessoi Internationale, *supra.)*

(3) *Principal and agent.*—Where checks are received by a bank merely for collection and deposit, the nature of the relationship created *at this stage*, is one of agency, that is, the bank is to collect from the drawees of the checks the corresponding proceeds. (Jai- alai Corp. vs. Bank of P.I., 66 SCRA 29 [1975].)

The holder of a check may indorse it, cash it with the drawee- bank, or deposit it. If he deposits the check with the drawee- bank, the latter would credit the amount thereof, to his account, and this would have the effect of payment which discharges the instrument. (Sec. 119[a].)

If the check is deposited with a bank other than the drawee- bank, he would have to negotiate the check to the bank by indorsing it (see Sees. 30-31.) thereby making the bank the holder thereof, (see Sec. 191.)

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A collecting bank has the right to debit a client's account for the value of a dishonored check that has previously been credited. (Associated Bank vs. Tan, *supra.)*

(b) In our jurisdiction, the deposit slip which the depositor is required to fill up before making the deposit states the conditions (at the back thereof) under which the deposits are accepted one of which is that the bank "acts only as the depositor's collecting agent and assumes no responsibility beyond the exercise of due care in selecting correspondents." This condition makes the bank a mere collecting agent.

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"Instrument" means negotiable instrument;

"Issue" means the first delivery of the instrument, complete in form, to a person who takes it as a holder;

"Person" includes a body of persons, whether incorporated or not;

"Value" means valuable consideration;

"Written" includes printed, and "writing" includes print.

Definition of terms.

The definitions in Section 191 do not apply if the context of any particular portion of the law otherwise requites. (Smith v. Nelson Land & Cadle Co., 212 Fed. 56,128 C.C.A. 512.)

Sec. 192. *Person primarily liabie on instrument.* — The person "primarily" liable on an instrument is the person who by the terms of the instrument is absolutely required to pay the same. All Other parties are "secondarily" liable.

Persons liable on instrument.

Under this section, both principal and surety (in reality an accommodation co-maker) are primarily liable on the note, and the rule is the same, although the note recites that one of the two was a principal and the other a surety. (In *re* Nashville Laundry Co., 240 Fed. 795.) An accommodation maker is a person primarily liable even though he adds the word "surety" to his signature or the fact that an accommodation guarantor signing on the back of a note is only secondarily liable. (Noble v. Beernan-Spaulding Co., 131 Pac. 1006.)

The liability of a surety or guarantor of a negotiable paper is not fixed by the Negotiable Instruments Law in the sense of being expressly provided therein. However, where a person signs a contract of surety or guaranty written on a negotiable instrument, there is no doubt that his liability must be detennined by looking to both the law of suretyship or guaranty and the Negotiable Instruments Law. (Winston v. Sullivan, 104 Colo. 450.)

Sec. 193. *Reasonable time, what constitutes.* — In determining what is a "reasonable time" or an "unreasonable time," regard is to be had to the nature of the instrument, the usage of trade or business (if any) with respect to such instruments, and the facts of the particular case.

Reasonable time.

The definition of a reasonable time in this section does not modify the specific words of Section 103 but it is applicable to cases like those described in Section 144 and perhaps others. (Jones v. California Nat. Bank, 103 S.E. 27.)

(1) Where an instrument was payable "30 days after arrival" of a car and there was a local custom at the point of arrival that such drafts were presented as sight draft, it was held that presentment for acceptance before die arrival of the car was a proper presentment within the time authorized. (New York, N.H. & H.R. Co. v. First Nat. Bank, 134 Ad. 223.)

(2) In a case, the action to demand payment of negotiable promissory notes which expressed no date for payment and, therefore, payable on demand (see Sec. 7.) and should be presented for payment within a reasonable time after their issue (see Sec. 71.), was claimed to have already prescribed because more than ten (10) years had elapsed from the making of the notes, (see Art. 1144[1], Civil Code.) It appearing that the notes were secured by a chattel mortgage contract which provided that the money represented by said notes was to be used during the agricultural year 1943-1944 and that, by this provision, the parties intended that the loans would not be repaid until after said agricultural year was over, the Supreme Court concluded that the prescriptive period did not begin to run until after the expiration of the agricultural year, and deducting the period covered by the Moratorium Law then in force, less dian ten (10) years had passed from the end of said agricultural year till the filing of the complaint; hence, the action had not yet prescribed. (Gaston vs. Republic, 19 SCRA 684 [1967].)

(3) In another case, the Supreme Court found that "there was an unreasonable delay in the delivery of the bill of exchange to the drawee for acceptance" one month and five days having been allowed to elapse without valid excuse, from the date die bill was received by the holder's agent for transmission to the drawee to the date the same was actually delivered to the latter. It appeared that notwithstanding the declaration of war between England and Germany the airmail and steamer services between New York, where the holder's agent was, and Amsterdam, the

place of acceptance, were then in operation and the holder's agent could have transmitted the bill to the drawee, (see Behn, Meyer & Co. vs. Hongkong & Shanghai Banking Corp., 93 Phil. 963 [1953].)

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Computation of time.

So under this section, if an instrument falls on Sunday, it is payable on Monday. If Monday is a holiday, it would be payable on Tuesday.

Sec. 195. ***Application of Act.*** **— The provisions of this Act do not apply to negotiable instruments made and delivered prior to the taking effect hereof.**

Application of Act.

The meaning of this section is that the Act was not intended to make any instrument negotiable which was not negotiable prior thereto and the legislature had no power to do so because of the provision of the Constitution forbidding the passage of laws which impair the obligations of a contract. (Adams v. Thurmond, 149 Pac. 1141.)

All inquiries concerning the rights and liabilities of indorsers and indorsees, as well as of makers and payees, are governed by the date written upon the instrument. Therefore, the negotiability of a note made before but transferred after the Act took effect (Sec. 198.) is not governed by the Act. (Mackintosh v. Gibbs, 81 NIL 577.)

Sec. 196. Cases ***not provided for in Act.*** **— Any case not provided for in this Act shall be governed by the provisions of existing legislation, or in default thereof; by the rules of the law merchant.**

Cases not covered by Act.

Where the Negotiable Instruments Law is silent, resort must be had to existing legislations, like the Civil Code, Code of Commerce, Rules of Court, and others which may be applicable and in default thereof, by the rules of the law merchant. The law merchant cannot prevail against specific prohibitions of the Negotiable Instruments Law. (President, etc., of Manhattan Co. v. Morgan, 150 N.E. 594.)

(1) *Right of accommodation maker.* — Since the Negotiable Instruments Law does not define the right of an accommodation maker, this deficiency should be supplied by Article 2073 of the Civil Code which deals with a situation where one surety had paid the debt and is seeking contribution from his co-sureties. Under Article 2073, a solidary accommodation maker (1) may demand from the principal debtor reimbursement of the amount which he paid on the promissory note and (2) he may demand contribution from his co-accommodation maker, without first directing his action against the principal debtor provided that: (a) he made the payment by virtue of a judicial demand, or (b) the principal debtor is insolvent. (Intestate Estate of Victor Sevilla; Simeon Sadaya v. Francisco Sevilla, 19 SCRA 924 [1967]; see Sec. 29.)

(2) *Breach by drawee-bank of its contractual obligations.* — The fact that the drawer's (depositor's) negligence was found to be the proximate cause of his loss does not necessarily preclude him from recovering damages from the drawee-bank where the drawer cannot point to the negligence of the drawee-bank in the selection and supervision of its employees as being the cause of the loss because his negligence is the proximate cause thereof. Under Article 2179 of tile Civil Code, he may not be awarded damages. However, under Article 1170' of the same Code, the bank may be held liable for damages.

There is no question that there is a contractual relation between the depositor (obligee) and the drawee-bank as the

'"Those who in the performance of their obligations are guilty of fraud, negligence or delay, and those who in any manner contravene the tenor thereof, are liable for damages."

obligor. In the performance of its obligation, the drawee-bank is bound by its internal banking rules and regulations which form part of any contract it enters into with any of its depositors. (Gempesaw vs. Court of Appeals, 218 SCRA 682 [1993].) In the cited case, the drawee-bank violated its internal rules that second indorsements are not to be accepted without the approval of its branch managers and it did accept the 82 checks in question upon the mere approval of a chief accountant. It was held that the bank contravened the tenor of its obligation at the very least> if it were not actually guilty of fraud or negligence. "Furthermore, the fact that the respondent drawee-bank did not discover the irregularity with respect to the acceptance of checks with second indorsements for deposit even without the approval of the branch manager despite periodic inspection conducted by a team of auditors from the main office constitutes negligence on the part of the bank in carrying out its obligations to its depositors under Article 1173.[2] Premises considered, respondent drawee-bank is adjudged liable to share the loss with the petitioner on a fifty- fifty ratio in accordance with Article 1172."[3]

(3) *Rules relating to crossed checks.* — The Negotiable Instruments Law, while regulating the issuance of negotiable checks and the rights and the liabilities arising therefrom, does not mention "crossed checks/' However, Article 541 of the Code of Commerce refers to such instruments. The Bill of Exchange Act of England of 1882 (see Introduction.) contains several provisions about them. In at least two cases, the Supreme Court applied some provisions of said Bill of Exchange Act because our Negotiable Instruments Law, originating from England and codified in the United States, permits resort thereto in matters not covered by it and local legislation. (Chan Wan vs. Tan Kim, 109 Phil. 706 [I960]; Phil. National Bank vs. Zulueta, 101 Phil. 1071 [1957].)

(4) *Award of interest.* — Damages are not provided for in the Negotiable Instruments Law (NIL). Under Article 2 of the

"'The fault or negligence of the obligor consists in the omission of that diligence which is required by the nature of the obligation and corresponds with the circumstance of the persons, of the time and of the

"'Responsibility arising from negligence in the performance of every kind of obligation is also demandable, but such liability may be regulated by the courts, according to the circumstances."

Code of Commerce, acts of commerce shall be governed by its provision and "in the absence by the usages of commerce generally observed in each place; and in the absence of both rules, by those of the civil law." The Code of Commerce is silent on damages, Article 18 of the Civil Code states that "in matters which are governed by the Code of Commerce and special laws, their deficiency shall be supplied by its provisions. These three laws unmistakenlly show that the award of interest under our civil law for the persistent refusal of a bank to satisfy the claim under the negotiable instruments law of a depositor to recredit the lat- ter's account for the value of forged checks is justified. (Bank of the Phil. Islands vs. Casa Montessori, 430 SCRA 261 [2004].)

History and meaning of law merchant.

(1) During the medieval period, merchants who engaged in foreign trade adopted the plan of transferring credit through the use of negotiable paper rather than transferring the physical money. This practice was really based on necessity, owing to the inconvenience and danger of transporting money itself from one country to another or between distant points. About the twelfth century, this custom was widely used by the merchants of Italy. Later it was introduced into France and then into England where it became a part of the law merchant, (see Kerr, Business Law: Principles and Cases, 2nd ed., p. 579.)

(2) The law *merchant* (or the custom of merchants) from which developed the rules of bills and notes, sales of goods, partnerships, guaranty, insurance, and agency, originated in the unwritten customs of merchants in different commercial countries. It consisted of usages of trade in different departments of commerce proved in court and ratified by legal decisions, upon the assumption that persons entering upon transactions in different departments of trade dealt with each other on the footing of any custom or usage generally prevailing in those departments, so that the usage, is "engrafted upon or incorporated with" the law and accordingly binding on the courts, (see Babb & Martin, *op. cit,* pp.5,13-14.)

(3) From the thirteenth century, maritime and commercial cases were determined in accordance with the customs of merchants and by merchant courts. It was not until the eighteenth

century that merchants were encouraged, if not compelled, to try their causes in the common law courts, *(ibid.,* 14.) The usage adopted by the courts is the origin of the so-called law merchant as to negotiable instruments. (8 C.J. 33.)

(4) The law merchant in the United States followed closely that of England. With the tremendous extension of commerce and its instrumentalities during the iast quarter of the nineteenth century, the imperative need of uniformity in the law of negotiable instruments found expression in the Negotiable Instruments Law of 1897, which has been adopted by every state in the Union, the last being Georgia in 1924. (Babb & Martin, *op. ext.,* pp. 1415.)

Sec. 197. *Repeals.* — All acts and laws and parts thereof inconsistent with this Act are hereby repealed.

Repeals.

Repeals by implication are not favored. In order that a law may operate to repeal another law by implication, the two laws must be so repugnant that they cannot stand together or be consistently reconciled, (see U.S. v. Palacio, 33 Phil. 208 [1916].) Thus, it is held that statutes enacted under the police power which declares void (not just "void as between the parties") instruments given in prohibited transactions are not impliedly repealed by the Negotiable Instruments Law and such instruments are not enforceable even in the hands of an innocent holder or holder in due course. (Burnes v. Scott, 117 U.S. 582; see 11 Am. Jur. 2d 737740.)

Sec. 198. *Time when Act takes effect.* — This Act shall take effect ninety days after its publication in the Official Gazette of the Philippine Islands shall have been completed.

Effectivity.

The Act was published in its entirety in the Official Gazette of March 4,1911. (pp. 534-544 thereof.) Hence, it took effect on June 2,1911.

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PART II

DOCUMENTS OF TITLE

INTRODUCTION

Nature and function of documents of title.

(1) *Receipts of, or orders upon, a bailee with respect to goods.* — Documents of title refer to goods and not to money. They all have this in common: that they are receipts of a bailee, or orders upon a bailee. A different name is given in popular speech to the document when it is issued by a carrier and when it is issued by a warehouseman, but in substance, the nature of the document is the same in both cases. (2 Williston on Sales, p. 505.)

(2) *Evidence of transfer of title and possession and of contract with respect to goods.* — A document of title is a symbol of the goods covered by it, serving as evidence of transfer of title and transfer of possession. It also serves as an evidence of the contract between the parties who are bound by its terms. So far as concerns the transfer of property between the parties, their intention would be effectual without the document; but where third parties' rights are involved, the form of the document becomes important.

Most common forms of documents of title.

There are three most common forms of documents of title, namely:

(1) *Bill of lading.* — It is a contract or receipt for the transport of goods and their delivery to the person named therein, to his order, or to bearer. A bill of lading usually involves three persons

— the carrier, the shipper, and the consignee. The shipper and the consignee may be one and the same person;

(2) *Dock warrant.* — It is an instrument given by dock owners to an importer of goods warehoused on the dock recognizing the importer's title to the said goods; and

(3) *Warehouse receipt.* — It is a contract or receipt for goods deposited with a warehouseman containing the latter's undertaking to hold and deliver the said goods to a specified person, to his order, or to bearer. *Quedan* is a warehouse receipt usually for sugar, received by a warehouseman.

Laws governing documents of title.

They are as follows:

(1) The Civil Code (in Arts. 1507 to 1520, 1532 [2nd par.], 1535 [2nd par.], and 1749.) primarily governs documents of title other than warehouse receipts;

(2) The Warehouse Receipts Law (Act No. 2137.) primarily governs warehouse receipts; and

(3) The Code of Commerce subsidiarily governs bills of ladings issued by common carriers (in Arts. 350 to 354 for land carriers and in Arts. 706 to 718 for maritime carriers), (see Part III.)

The provisions in the Civil Code on documents of title are reproduced practically *verbatim* from the Uniform Sales Act which is in force in many states in the United States.

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A. CIVIL CODE PROVISIONS

Article 1507. A document of title in which it is stated that the goods referred to therein will be delivered to the bearer, or to the order of any person named in such document is a negotiable document of title.

Definition of terms.

(1) *Document of title to goods.* — Includes any bill of lading, dock warrant, "quedan," or warehouse receipt or order for the delivery of goods, or any other document used in the ordinary course of business in the sale or transfer of goods, as proof of the possession or control of the goods, or authorizing or purporting to authorize the possessor of the document to transfer or receive, either by indorsement br by delivery. (Art. 1636[1], Civil Code.)

A pawn ticket is not a document of title much less a negotiable instrument, even if it states that the pawn is redeemable by the bearer. (Serrano vs. Court of Appeals, 196 SCRA 107 [1991]; see Introduction.)

(2) *Goods.* — Includes all chattels personal but not things in action or money of legal tender in the Philippines. The term includes growing fruits or crops, *(ibid.)*

(3) *Order.* — Relating to documents of tide means an order by indorsement on the documents, *(ibid.)*

Classes of documents of title.

Documents of tide may be either:

(1) *Negotiable documents of title* or those by the terms of which the bailee undertakes to deliver the goods to the bearer and those by the terms of which the bailee undertakes to deliver the goods to the order of a specified person (Art. 1508.); or

(2) *Non-negotiable documents of title* or those by the terms of which the goods covered are deliverable to a specified person. (Art. 1511.)

Art. 1508. A negotiable document of title may be negotiated by delivery:

(1) Where by the terms of the document the carrier, warehouseman or other bailee issuing the same undertakes to deliver the goods to the bearer; or

(2) Where by the terms of the document the carrier, warehouseman or other bailee issuing the same undertakes to deliver the goods to the order of a specified person, and such person or a subsequent indorsee of the document has indorsed it in blank or to bearer.

Where by the terms of a negotiable document of title the goods are deliverable to bearer or where a negotiable document of title has been indorsed, in blank or to bearer, any holder may indorse the same to him or to any specified person, and in such case the document shall thereafter be negotiated only by the indorsement of such indorsee.

Negotiation of negotiable document by delivery.

The manner of transferring negotiable documents of title by negotiation is the same as in the negotiation of promissory notes and bills of exchange under the Negotiable Instruments Law.

A negotiable document of title is negotiable by delivery if the goods are deliverable to the bearer or when it is indorsed in blank or to the bearer by the person to whose order the goods are deliverable or by a subsequent indorsee.

An indorsement is in blank when the holder merely signs his name at the back of the receipt without specifying to whom the goods are to be delivered. If the document is specially indorsed, it becomes an order document of title and negotiation can only be effected by the indorsement of the indorsee. A special indorsement specifies the person to whom, or to whose order, the goods are to be delivered, (see Sec. 37, Warehouse Receipts Law.)

Art. 1509. A negotiable document of title may be negotiated by the indorsement of the person to whose order the goods are by the terms of the document deliverable. Such indorsement may be in blank, to bearer or to a specified person. If indorsed to a specified person, it may be again negotiated by the indorsement of such person in blank, to bearer or to another specified person. Subsequent negotiations may be made in like manner.

Negotiation of negotiable document by indorsement.

A negotiable document of title by the terms of which the goods are deliverable to a person specified therein may be negotiated only by the indorsement of such person.

(1) If indorsed in blank or to bearer, the document becomes negotiable by delivery. (Art. 1508.)

(2) If indorsed to a specified person, it may be again negotiated by the indorsement of such person in blank, to bearer or to another specified person, (see Sec. 38, Warehouse Receipts Law.) Delivery alone is not sufficient.

A party is liable only as guarantor and not as indorser if his indorsement is made for the purpose of identification only, (see American Bank vs. Macondray & Co., 4 Phil. 695 [1905].)

Art. 1510. If a document of title which contains an undertaking by a carrier, warehouseman or other bailee to deliver the goods to bearer, to a specified person or order of a specified person or which contains words of like imports, has placed upon it the words "not negotiable," "non- negotiable" or the like, such document may nevertheless be negotiated by the holder and is a negotiable document of title within the meaning of this Title. But nothing in this Title contained shall be construed as limiting or defining the effect upon the obligations of the carrier, warehouseman, or other bailee issuing a document of title or placing thereon the words "not negotiable," "non-negotiable," or the like.

Negotiable documents of title marked "non-negotiable."

Under Article 1510, the words "non-negotiable," "notne- gotiable" and the like when placed upon a document of titlie in which the goods are to be delivered to "order" or to "bearer" have no effect and the document continues to be negotiable. (Roman vs. Asia Banking Corp., 46 Phil. 705 [1924].) Under the Warehouse Receipts Law, any provision inserted in a negotiable receipt that it is non-negotiable, is declared void. (Sec. 5, par. 2.)

When the document of title is to order, the bailee is obliged to take it up before delivering the goods. Accordingly, he is liable to the holder of an order document if the goods are delivered to the consignee without surrender of the document even though the latter was marked "not negotiable."

Note: The first sentence should read — "to a specified person or order, *or to the order* of a specified person." This is how Section 30 of the Uniform Sales Act, from which Article 1510 was adopted, is worded.

Art. 1511. A document of title which is not in such form that it can be negotiated by delivery may be transferred by the holder by delivery to a purchaser or donee. A non-negotiable document cannot be negotiated and the indorsement of such a document gives the transferee no additional right.

Transfer of non-negotiable documents.

A non-negotiable document of title cannot be negotiated. Nevertheless, it can be transferred or assigned by delivery. In such case, the transferee or assignee acquires only the rights stated in Article 1514.

Even if the document is indorsed, the transferee acquires no additional right, (see Sec. 39, Warehouse Receipts Law.)

Art. 1512. A negotiable document of title may be negotiated:

By the owner thereof; or

By any person to whom the possession or custody of the document has been entrusted by the owner, if, by

the terms of the document the bailee issuing the document undertakes to deliver the goods to the order of the person to whom the possession or custody of the document has been entrusted, or if at the time of such entrusting the document is in such form that it may be negotiated by delivery.

Persons who may negotiate a document.

It will be noticed that the provision does not give a power to negotiate documents of title equal to that allowed by law in the case of bills of exchange and promissory notes inasmuch as neither a thief nor a finder is within the terms of the article.

. However, if the owner of the goods permits another to have the possession or custody of negotiable receipts running to the order of the latter or to bearer, it is a representation of title upon which *bona fide* purchasers for value are entitled to rely despite breaches of trust or violations of agreement on the part of the apparent owner. As between two innocent persons, the loss must fil upon him whose misplaced confidence made the loss possible. (Siy Cong Bieng & Co. vs. Hongkong & Shanghai Banking Corp., 56 Phil. 598 [1932]; see Sec. 40, Warehouse Receipts Law.)

Art. 1513. A person to whom a negotiable document of title has been duly negotiated acquires thereby:

(1) Such title to the goods as the person negotiating the document to him had or had ability to convey to a purchaser in good faith for value and also such title to the goods as the person to whose order the goods were to be delivered by the terms of the document had or had ability to convey to a purchaser in good faith for value; and

(2) The direct obligation of the bailee issuing the document to hold possession of the goods for him according to the terms of the document as fully as if such bailee had contracted directly with him.

Rights of person to whom document has been negotiated.

This article specifies the rights of a person to whom a negotiable document of title has been duly negotiated, either by delivery, in the case of a document of title to bearer, or by indorsement and delivery, in the case of a document of title to order. The rights acquired by such person are:

(1) The title of the person negotiating the document over the goods covered by the document;

(2) The title of the person (depositor or owner) to whose order by the terms of the document the goods were to be delivered over such goods; and

(3) The direct obligation of the bailee (warehouseman or carrier) to hold possession of the goods for him, as if the bailee directly contracted with him.

One who purchases, therefore, a negotiable document of title issued to a thief acquires no rights over the goods as the thief has no right to transfer, notwithstanding that such purchaser is innocent. But the purchaser acquires a good title where the owner, by his conduct, is estopped from asserting his title, (see Sec. 41, Warehouse Receipts Law.)

Art. 1514. A person to whom a document of title has been transferred, but not negotiated, acquires thereby, as against the transferor, the title of the goods, subject to the terms of any agreement with the transferor.

If the document is non-negotiable, such person also acquires the right to notify the bailee who issued the document of the transfer thereof, and thereby to acquire the direct obligation of such bailee to hold possession of the goods for him according to the terms of the document.

Prior to the notification to such bailee by the transferor or transferee of a non-negotiable document of title, the title of the transferee to the goods and the right to acquire the obligation of such bailee may be defeated by the levy of an attachment of execution upon the goods by a creditor of the transferor, or by a notification to such bailee by the transferor or a subsequent purchaser from the transferor of a subsequent sale of the goods by the transferor.

Rights of person to whom document has been transferred.

This article refers to the rights of a person to whom a nego tiable document of title (not duly negotiated) has been transferred (par. 1.) or of the transferee of a non-negotiable document, (pars. 2 and 3.) The rights of such person are:

(1) The title to the goods as against the transferor;

(2) The right to notify the bailee of the transfer thereof; and

(3) The right, thereafter, to acquire the obligation of the bailee to hold the goods for him.

The right of the transferee is not absolute as it is subject to the terms of any agreement with the transferor. He merely steps into the shoes of the transferor.

Attachment of goods covered by document transferred.

(1) *Receipt negotiable.* — The transfer of a non-negotiable document of title does not effect the delivery of the goods covered by it. Accordingly, before notification, the bailee is not bound to the transferee whose right may be defeated by a levy of an attachment or execution upon the goods by the creditor of the transferor or by a notification to such bailee of the subsequent sale of the goods, (see Sec. 42, Warehouse Receipts Law.)

(2) *Receipt non-negotiable.*—If the document is negotiable, the goods cannot be attached or be levied under an execution unless the document be first surrendered to the bailee or its negotiation enjoined. (Art. 1519.)

Note: The word "of" between "attachment" and "execution" in the second paragraph should more properly read "or." This is how Section 34 of the Uniform Sales Act from which Article 1514 was adopted, is worded.

Art. 1515. Where a negotiable document of title is transferred for value by delivery, and the indorsement of the transferor is essential for negotiation, the transferee acquires a right against the transferor to compel him to indorse the document unless a contrary intention appears. The negotiation shall take effect as of the time when the indorsement is actually made.

Transfer of order document without indorsement.

This article specifies the rights of a person to whom an order document of tide, which may not be properly negotiated by mere delivery, has been delivered, without indorsement. They are:

(1) The right to the goods as against the transferor (Art. 1514.); and

(2) The right to compel the transferor to indorse the document.

If the intention of the parties is that the document should be merely transferred, the transferee has no right to require the transferor to indorse the document.

Rule where document subsequently indorsed.

For the purpose of determining whether the transferee is a purchaser for value in good faith without notice (see Arts. 1506, 1513.), the negotiation shall take effect as of the time when the indorsement is actually made, not at the time the document is delivered.

The reason is because the negotiation becomes complete only at the time of indorsement. So if by that time the purchaser already had notice that the tide of the seller was defective, he cannot be considered a purchaser in good faith though he had no such notice when he bought the document, (see Sec. 43, Warehouse Receipts Law; Sec. 49/ Negotiable Instruments Law.)

Art. 1516. A person who for value negotiates or transfers a document of title by indorsement or delivery, including one who assigns for value a claim secured by a document of title Urtless a contrary intention appears, Warrants:

(1) that the document is genuine;

(2) That he has a legal right to negotiate or transfer it;

(3) That he has knowledge of no fact which would impair the validity or worth of the document; and

(4) That he has a right to transfer the title to the goods and that the goods are merchantable or fit for a particular purpose, whenever such warranties would have been implied if the contract of the parties had been to transfer without a document of title the goods represented thereby.

Warranties on sale of document.

This article treats of the warranties or liabilities of a person negotiating or transferring a document. They are similar to that of a person negotiating an instrument by delivery or by a qualified indorsement under the Negotiable Instilments Law. (see Sec. 65 thereof.) The liability is limited only to a violation of the four warranties set forth in Article 1516. (see Art. 1517.) Thus, the person negotiating or transferring a document was a forger or he had stolen it, or he had knowledge that the document was invalid for want of consideration, or that the goods had been damaged.

One who assigns for value a claim secured by a document of title is also liable for the violation of any of the four warranties enumerated unless a contrary intention appears, (see Sec. 44, Warehouse Receipts Law.)

It is the duty of every indorsee to know that all previous indorsements are genuine, otherwise, he will not acquire a valid title to the instrument. (Great Eastern Life Ins. Co. vs. Hongkong & Shanghai Banking Corporation, 43 Phil. 678 [1922].) Under the Negotiable Instruments Law (see Sees. 65, 66 thereof.), the last indorser warrants that all previous indorsements are genuine.

Art. 1517. The indorsement of a document of title shall not make the indorser liable for any failure on the part of the bailee who issued the document or previous indorsers thereof to fulfill their respective obligations.

Indorser not a guarantor.

The indorsement of a negotiable instrument has a double effect. It is at the same time a conveyance of the instrument and a contract of the indorser with the indorsee that on certain conditions the indorser will pay the instrument if the party primarily liable fails to do so.

The indorsement of a document of title amounts merely to a conveyance by the indorser, not a contract of guaranty, (see 2 Williston on Sales, pp. 627-628.) Accordingly, an indorser of a document of title shall not be liable to the holder if, for example, the bailee fails to deliver the goods because they were lost due to his fault or negligence, (see Sec. 45, Warehouse Receipts Law.)

Art. 1518. The validity of the negotiation of a negotiable document of title is not impaired by the fact that the negotiation was a breach of duty on the part of the person making the negotiation, or by the fact that the owner of the document was deprived of the possession of the same by loss, theft, fraud, accident, mistake, duress, or conversion, if the person to whom the document was negotiated or a person to whom the document was subsequently negotiated paid value therefor in good faith without notice of the breach of duty, or loss, theft, fraud, accident, mistake, duress or conversion.

When negotiation not impaired by fraud, mistake, duress, etc.

Under this article, a negotiable document may be negotiated by any person in possession of the same, however such possession may have been acquired, (see National Bank vs. Producer's Warehouse Association, 42 Phil. 608 [1922]; Hill vs. Veloso, 31 Phil. 160 [1975].) In other words, it may be negotiated even by a thief or finder and the holder thereof would acquire a good title thereto if he paid value therefor in good faith without notice of the seller's defect of title. (Art. 1506.) It will be remembered that under Article 1512, neither a thief nor a finder may negotiate a negotiable document of title. The two provisions thus appear contradictory to each other.

Under the Warehouse Receipts Law, it is provided:

"Sec. 47. *When negotiation not impaired by fraud,, mistake, or duress.* — The validity of the negotiation of a receipt is not impaired by the fact that such negotiation was a breach of duty on the part of the person making the negotiation or by the fact that the owner of the receipt *was induced by fraud, mistake* *or duress to entrust the possession or custody of the receipt to such person,* if the person to whom the receipt was negotiated or a person to whom the receipt was subsequently negotiated, paid value therefor, without notice of the breach of duty or fraud, mistake or duress/' (underscoring supplied.)

Clearly, under Section 40 (see Art. 1512.) and Section 47 of the Warehouse Receipts Law, the negotiation is invalidated by the fact that the owner of the document was deprived of its possession by loss or theft.

It should be noted that Article 1518 speaks of theft of the *document,* and not of the *goods* covered by such document. In the latter case, it needs no argument to show that even a *bona fide* holder of a document issued over such stolen goods cannot acquire title.

Art. 1519. If goods are delivered to a bailee by the owner or by a person whose act in conveying the title to them to a purchaser in good faith for value would bind the owner and a negotiable document of title is issued for them they cannot thereafter, while in possession of such bailee, be attached by garnishment or otherwise or be levied under an execution unless the document be first surrendered to the bailee or its negotiation enjoined. The bailee shall in no case be compelled to deliver up the actual possession of the goods until the document is surrendered to him or impounded by the court.

Attachment or levy upon goods covered by a negotiable document.

The bailee has the direct obligation to hold possession of the goods for the original owner or for the person to whom the negotiable document of title has been duly negotiated, (see Art. 1513.) While in possession of such bailee, the goods cannot be attached or levied under an execution unless: (1) the document be first surrendered, or (2) its negotiation is enjoined, or (3) the document is impounded by the court.

The bailee cannot be compelled to deliver up the possession of the goods until the document is surrendered to him or impounded by the court. This prohibition is for the protection of the bailee since he could be made liable to a subsequent purchaser for value in good faith, (see Sec. 25, Warehouse Receipts Law.)

Where depositor not owner.

The provisions of Article 1519 do not apply if the person depositing is not the owner of the goods (like a thief) or one who has no right to convey title to the goods binding upon the owner. Neither does it apply to actions for recovery or manual delivery of goods by the real owner nor to cases where the attachment is made before the issuance of the negotiable document of title.

The rights acquired by attaching creditors cannot be defeated by the issuance of a negotiable document of title thereafter, (see International Bredding Co. v. Terminal Warehouse Co., 126 Atl. 902.)

Art. 1520. A creditor whose debtor is the owner of a negotiable document of title shall be entitled to such aid from courts of appropriate jurisdiction by injunction and otherwise in attaching such document or in satisfying the claim by means thereof as is allowed at law or in equity in regard to property which cannot readily be attached or levied upon by ordinary legal process.

Creditor's remedies to reach negotiable document.

Inasmuch as the goods themselves in the bailee's possession cannot readily be attached or levied upon by ordinary legal process, as limited by the preceding article, this article expressly gives the court full power to aid by injunction and otherwise a creditor seeking to get a negotiable document covering such goods. However, if an injunction is issued but the negotiable document of title is negotiated to an innocent person, the transfer is nevertheless effectual, (see Sec. 26, Warehouse Receipts Law.)

Art. 1532. The unpaid seller may exercise his right of stoppage *in transitu* either by obtaining actual possession of the goods or by giving notice of his claim to the carrier of other bailee in whose possession the goods are. Such notice may be given either to the person in actual possession of the goods or to his principal. In the latter

case, the notice, to be effectual, must be given at such time and under such circumstances that the principal, by the exercise of reasonable diligence, may prevent a delivery to the buyer.

When notice of stoppage *in transitu* is given by the seller to the carrier, or other bailee in possession of the goods, he must redeliver the goods to, or according to the directions of, the seller. The expenses of such delivery must be borne by the seller. If, however, a negotiable document of title representing the goods has been issued by the carrier or other bailee, he shall not be obliged to deliver or justified in delivering the goods to the seller unless such document is first surrendered for cancellation.

Unpaid seller's right to stop in transitu.

The unpaid seller may exercise the right of stoppage *in transitu* either by taking actual possession of the goods or by giving notice of his claim to the carrier or bailee. This right includes not only the right to counter delivery to the buyer but to order redelivery to himself.

If, however, the goods are covered by a negotiable document of title, the carrier has no obligation to deliver the goods to the seller unless such document is first surrendered for cancellation, (par. 2; see Art. 1519.) Should the carrier surrender the goods to the seller and afterwards the bill of lading be negotiated to an innocent purchaser for value, the latter would be entitled to demand delivery of the goods. (Art. 1518.) The only way in which the carrier can be assured that no subsequent purchaser can arise is by requiring a surrender of the document of title. The right of the purchaser for value in good faith to whom such document has been negotiated is superior to the seller's lien or stoppage *in transitu* even when he acquired the same after notice of stoppage to the carrier or other bailee. (Art. 1535,2nd par.)

Art. 1535. Subject to the provisions of this Title, the unpaid seller's lien or right of stoppage *in transitu* is not affected by any sale or other disposition of the goods which the buyer may have made, unless the seller has assented hereto.

If, however, a negotiable document of title has been issued for goods, no seller's lien or right of stoppage *in transitu* shall defeat the right of any purchaser for value in good faith to whom such document has been negotiated, whether such negotiation be prior or subsequent to the notification to the carrier, or other bailee who issued such document, of the seller's claim to a lien or right of stoppage *in transitu.*

Effect of issuance of a negotiable document on seller's lien or right of stoppage.

An unpaid seller of goods has a lien on the goods or right to retain them for the price while he is in possession of them (Art. 1526[1].); and in case of insolvency of the buyer, a right of stopping the goods *in transitu* after he has parted with the possession of them *(ibid.,* [2].), that is to say, he may resume possession of the goods at any time while they are in transit, and he will then become entitled to the same right in regard to the goods as he would have had if he had never parted with the possession. (Art. 1530.)

It is fundamental, as a general rule, that a seller can give no larger right than he has. When, therefore, goods are subject to a right of lien or right of stoppage *in transitu,* a purchaser from the original buyer can acquire only such right as that buyer then had. (3 Williston on Sales, 3rd ed., pp. 188-189.) If, however, the goods are covered by a negotiable document of title, the seller's lien or right of stoppage *in transitu* cannot prevail against the rights of a purchaser for value in good faith td whom the document has been indorsed, (see Arts. 1506,1518.) The reason for this provision rests upon the nature of a negotiable document of title which in legal fiction operates as a delivery of the goods described therein when indorsed.

The term "purchaser" as used in Article 1535 includes mortgagee and pledgee. (Roman vs. Asia Banking Corp., 46 Phil. 705 [1924].)

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

Stipulation limiting common carrier's liability to an agreed valuation.

Three kinds of stipulation have often been made in a bill of lading, to wit:

(1) That exempting die carrier from any and all liability for loss or damage occasioned by its own negligence (see Art. 1745[3].);

(2) That providing for an unqualified limitation of such liability to an agreed valuation; and

(3) That limiting the liability of the carrier to an agreed valuation unless the shipper declares a higher value and pays a higher rate of freight. (Art. 1749.)

The first and second kind of stipulations are invalid as being contrary to public policy but the third is valid and enforceable. (Heacock vs. Macondray, 42 Phil. 205 [1921].)

Stipulation No. 2 is void because the liability of the common carrier in case of loss or damage to the goods due to its negligence is the full value of the said goods plus damages which may be more than the agreed valuation.

Stipulation No. 3 is valid as it is but fair to allow the carrier to charge a higher rate of freight for assuming a liability based on the value of the goods. It is contrary to plain principle of justice that a shipper may understate value in order to reduce the rate and then recover a larger value in case of loss, *(ibid.)* A contract limiting liability upon an agreed valuation does not offend against the policy of the law forbidding one from contracting against his own negligence/' (Ong Yui vs. Court of Appeals, 91 SCRA 223 [1979].)

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B. THE WAREHOUSE RECEIPTS LAW (ACT NO. 2137, AS AMENDED.)

INTRODUCTION

Scope of the law.

The Warehouse Receipts Law is a full and complete treatise on the subject. It covers all warehouses whether public or private. (Citizen's State Bank of Vici v. Galtig, 187 R 217.) bonded or not. Thus, it has been held to be applicable to warehousemen licensed under Act No. 3469, as superseded by Act No. 3893, as amended by Republic Act No. 247, now known as General Bonded Warehouse Act, of special application to those engaged in the business of receiving commodities *(e.g., palay* and rice) for storage.[1] (see People vs. Goco, 35 O.G. 2618; also Phil. Tobacco Flue Curing and Redrying Corp. vs. Pablo, 66 SCRA 136 [1975].)

The Act applies to warehouse receipts issued by a warehouseman as defined in Section 58(a) of the Act, while the Civil Code, to other cases where the receipts are not issued by a warehouseman as defined in said section.

Purposes of the law.

The law has been enacted:

(1) To regulate the status, rights, and liabilities of the parties in a warehousing contract;

'Bonded warehouses are regulated and supervised by the Bureau of Trade Regula-
tion and Customer Protection under the Department of Trade and

(2) To protect those who, in good faith and for value, acquire negotiable warehouse receipts by negotiation;

(3) To render the tide to, and right of possession of, property stored in warehouses more easily convertible;

(4) To facilitate the use of warehouse receipts; and

(5) In order to accpmplish these, to place a much greater responsibility on the warehouseman. (93 C.J.S. 400.)

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CHAPTER I

THE ISSUE OF WAREHOUSE RECEIPTS

Section 1. ***Persons who may issue receipts.*** **— Warehouse receipts may be issued by any warehouseman.**

Who may issue receipts.

A *warehouseman* is a person lawfully engaged in the business of storing goods for profit. (Sec. 58[a].)

Under this section, only a warehouseman may issue warehouse receipts. Hence, receipts not issued by a warehouseman are not warehouse receipts although in the form of warehouse receipt. (National Bank of Commerce v. Kansas City, 188 S.W. 117.) But a duly authorized officer or agent of a warehouseman may validly issue a warehouse receipt. (National Bank vs. Producers' Warehouse Association, 42 Phil. 609 [1923]; see Sec. 2[2].)

Meaning of warehouse.

The law does not define what "warehouse" is. In keeping with the definition of "warehouseman," a *warehouse* means the building or place where goods are deposited and stored for profit.

Sec. 2. ***Form of receipts; essential terms.*****—Warehouse receipts need not be in any particular form but every such receipt must embody within its written or printed terms:**

(a) The location of the warehouse where the goods are stored;

(b) The date of issue of the receipt;

(c) The consecutive number of the receipt;

(d) A statement whether the goods received will be delivered to the bearer, to a specified person, or to a specified person or his order;

(e) The rate of storage charges;

(f) A description of the goods or of the packages containing them;

(g) The signature of the warehouseman which may be made by his authorized agent;

(h) If the receipt is issued for goods of which the warehouseman is owner, either solely or jointly or in common with others, the fact of such ownership; and

(i) A statement of the amount of advances made and of liabilities incurred for which the warehouseman claims a lien. If the precise amount of such advances made or of such liabilities incurred is, at the same time of the issue of the receipt, unknown to the warehouseman or to his agent who issues it, a statement of the fact that advances have been made or liabilities incurred and the purpose thereof is sufficient.

A warehouseman shall be liable to any person injured thereby, for all damages caused by the omission from a negotiable receipt of any of the terms herein required.

Definition and nature of warehouse receipt.

(1) The Act does not also define a warehouse receipt.

(a) It has been defined as a *written acknowledgment* by a warehouseman that he has received and holds certain goods therein described in store for the person to whom it is issued. (Vannet v. Reilly-Herr Automobile Co., 173 N.W. 466.)

(b) It has also been defined as a simple *written contract* between the owner of the goods and the warehouseman to pay the compensation for that service. (Hale v. Milwaukee Dock Co., 29 Wis. 482,67 C.J. 463.)

(2) A warehouse receipt is a *bilateral contract.* It imports that goods are in the hands of a warehouseman and is a symbolical

representation of the property itself. It is not a negotiable instrument within the meaning of the Negotiable Instruments Law in the technical sense that a bill of exchange or promissory note is negotiable, even though the Warehouse Receipts Act declares it negotiable. Negotiability is provided for by the Act. (see 11 Am. Jur. 2d 35.) As contracts, obligations arising from warehouse receipts have the force of law between the contracting parties and must be complied with in good faith pursuant to Article 1159 of the Civil Code. (Phil. National Bank vs. Se, Jr., 70 SCAD 323,256 SCRA 380 [1996].)

Form and contents of the receipt.

Although the Act does not require or specify any particular form for warehouse receipts, it has provided for certain essential terms which must be embodied in every warehouse receipt. Together with their importance, they are enumerated below.

(1) *Location of warehouse.* — The requirement is for the benefit of the holders of warehouse receipts to enable them to determine where the goods are deposited especially when the warehouseman has more than one warehouse located in different places.

(2) *Date of issue of receipt.* — Although a warehouse receipt is not essential to create a contract of storage (which is one of deposit and is perfected at the time of delivery of the goods deposited, Art. 1316, Civil Code). The date of issue appearing in a warehouse receipt is *prima facie* the date of perfection of the contract. Furthermore, unless otherwise agreed upon, storage charges, begin to run against the depositor from the said date. The statement of the date is moreover essential to compute the date of the delivery of the goods, (see A. Tolentino, Commercial Laws of the Philippines, 8th ed., Vol. II, p. 411.)

(3) *Consecutive number of receipt.* — The purpose of this requirement is to identify each receipt with the goods for which it was issued. There is no express requirement as to when the consecutive numbering shall begin. Thus, a warehouseman may issue a receipt numbered "99" although it is not in fact the ninety- ninth receipt issued by such warehouseman. (Smith Bros. Co. v. Reichheimer & Co., 83 So. 145 La. 1066.)

(4) *Person to whom goods are deliverable.* — This requirement determines the person or persons who shall *prima facie* be entitled lawfully to the possession of the goods deposited. Thus, if by the terms of the receipt the goods are to be delivered to order or to bearer, then it is a negotiable warehouse receipt. The requirement, however, does not determine the negotiability of the receipt because notwithstanding the omission of words of negotiability, the receipt may still be considered negotiable. This can be deduced from the last paragraph of the section. (Manufacturer's Mercantile Co. v. Monarch Refrigerator Co., 107 N.E. 585; see Sees. 5,7.)

(5) *Rate of storage charges.* — This states the consideration for the contract from the viewpoint of the warehouseman. In the absence of express agreement, the law presumes that the depositor shall pay the customary or reasonable compensation for the services of the warehouseman. (Devereux v. Fleming, 53 F. 401.)

(6) *Description of goods or packages.* — The general object of giving a description of the goods in the receipt is for identification so that the identical property delivered to the warehouseman may be delivered back by him upon the return of the warehouse receipt. (Dean v. Driggs, 33 N.W. 326.) However, the mere fact that the goods deposited are incorrectly described does not make ineffective the receipt when the identity of the goods is fully established by the evidence. In such case, its indorsement and delivery shall constitute a sufficient transfer of the title to the goods. (American Foreign Banking Corporation vs. Herridge, 49 Phil. 975 [1927].)

(7) *Signature of warehouseman.* — The warehouseman's signature furnishes the best evidence of the fact that the warehouseman has received the goods described in the receipt and has bound himself to assume all obligations in connection therewith.

(8) *Warehouseman's ownership of or interest in goods.* — The purpose behind the provision is to prevent abuses which in the past had arisen from warehousemen issuing receipts on their goods. It seems wise that where they issue negotiable receipts in this way, the document should carry notice of the fact on its face.

(Cowley Country National Bank v. Rawlings Dobbs Elevator Co., 152 Pac. 647.)

Under Section 53, the omission to state his ownership of the goods in the receipt issued by him, may render the warehouseman criminally liable.

(9) *Statement of advances made and liabilities incurred.* — The purpose of this requirement is to preserve the lien of the warehouseman over the goods stored or the proceeds thereof in his hand, (see Sees. 27-30.) An example of an advance made is money advanced by the warehouseman to a carrier or to a depositor to enable the latter to transport the goods to the warehouse. Liabilities may be in the form of any obligation or undertaking assumed by die warehouseman in connection with the goods stored, as for die payment of insurance, for weighing, and other similar expenses. (A. Tolentino, *op. cit.,* p. 412.)

Of course, where the warehouseman does not make any advance or does not incur any liability, there would be nothing to state on the receipt concerning advances or liabilities. (Smith Bros. Co., Ltd. v. Reinheimer & Co., 145 La. 1066,83 So. 255.)

Effect of omission of any of essential terms.

The terms prescribed in Section 2 are required for the protection of the depositor and those succeeding to his right.

(1) *Validity of receipt not affected.* — Any omission of any of the requirements will not affect the validity of the warehouse receipt.

(2) *Warehouseman liable for damages.* — It will only render the warehouseman liable for damages to those injured by his omission. (Wordson v. Davenport Mill & Elevator Co., 13 P. [2d] 478.)

(3) *Negotiability of receipt not affected.* — Section 2 does not . deal with negotiability of warehouse receipts. Note that the last paragraph of Section 2 refers expressly to "omission from a negotiable receipt of any of the terms herein required" and not from a receipt which would otherwise be negotiable.

(Manufacturer's Mercantile Co. v. Monarch Refrigerating Co., 107 N.E. 885.)

(4) *Contract converted to ordinary deposit.* — The issuance of a warehouse receipt in the form provided by the law is merely permissive and directive and not mandatory in the sense that if the requirements are not observed, then the goods delivered for storage become ordinary deposits. (Gonzales vs. Go Tiong and Luzon Surety Co., 104 Phil. 492 [1958].)

Sec. 3. *Form of receipts. What terms may be inserted.* — A warehouseman may insert in a receipt issued by him, any other terms and conditions, provided, that such terms and conditions shall not:

(a) Be contrary to the provisions of this Act.

(b) In any wise impair his obligation to exercise that degree of care in the safekeeping of the goods entrusted to him which a reasonably careful man would exercise in regard to similar goods of his own.

Terms that cannot be included in a warehouse receipt.

Under Section 3, the warehouseman is given the power to insert additional terms or conditions in receipts issued by him subject to the two limitations stated in subsections (a) and (b). Of course, in addition to those limitations, the stipulations in the receipt must not be contrary to law, moral, good customs, public order or public policy. (Art. 1306, Civil Code.)

(1) *Exemptionfrom liability for misdelivery.*—Under Subsection (a) , a warehouseman is not authorized to insert terms exempting him from liability for misdelivery of goods because such would be against Section 10 of the Act or for not giving statutory notice in case of sale of goods because such would be contrary to Sections 33 and 34.

(2) *Exemptionfrom liability for negligence.* — Under Subsection (b) , the warehouseman cannot insert any term which would relieve him from the consequences of his own negligence, such as "For account and at the risk of the depositor/' The warehouse

man is required by law "to exercise that degree of care in the safekeeping of the goods entrusted to him which a reasonable careful man would exercise in regard to similar goods of his own."

Sec. 4. ***Definition of non-negotiable receipt.*** **— A receipt in which it is stated that the goods received will be delivered to the depositor or to any other specified person, is a non-negotiable receipt.**

Sec. 5. ***Definition of negotiable receipt.*** **— A receipt in which it is stated that the goods received will be delivered to the bearer or to the order of any person named in such receipt is a negotiable receipt.**

No provision shall be inserted in a negotiable receipt that it is non-negotiable. Such provision, if inserted, shall be void.

Meaning of "negotiable" under the Act.

The word "negotiable" is not used in the sense in which it is applied to bills of exchange or promissory notes but only as indicating that in the passage of warehouse receipts through the channels of commerce, the law regards the property which they describe as following them and gives to their regular transfer by indorsement the effect of manual delivery of the things specified in them. (Vannett v. Reilly-Hertz Automobile Co., 173 N.W. 466.) A warehouse receipt is in no sense a negotiable instrument because it does not comply with Section 1(b) of the Negotiable Instruments Law which requires an unconditional promise or order to pay a sum certain in money.

Article 1507 of the Civil Code is the same as Section 5 except for the use of "document of tide" instead of "receipt" and for paragraph 2 of Section 5 which is not contained in Article 1507 but in a more extended form in Article 1510.

Sec. 6. ***Duplicate receipts must be so marked.*** **— When more than one negotiable receipt is issued for the same goods, the word "duplicate" shall be plainly placed upon the face of every such receipt, except the one first issued.**

A warehouseman shall be liable for all damages caused by his failure so to do so to any one who purchased the subsequent receipt for value supposing it to be an original, even though the purchase be after the delivery of the goods by the warehouseman to the holder of the original receipt.

Sec. 7. *Failure to mark "non-negotiable."*—A non-negotiable receipt shall have plainly placed upon its face by the warehouseman issuing it "non-negotiable," or "not negotiable." In case of the warehouseman's failure so to do, a holder of the receipt who purchased it for value supposing it to be negotiable, may, at his option, treat such receipt as imposing upon the warehouseman the same liabilities he would have incurred had the receipt been negotiable.

This section shall not apply, however, to letters, memoranda, or written acknowledgments of an informal character.

Application of Sections 6 and 7.

Section 6 refers only to negotiable receipts. Section 7 applies only to non-negotiable receipts, (see Sec. 52 for criminal liability of warehouseman.)

Effect of failure to mark "negotiable" or "non-negotiable."

(1) The word "negotiable" is usually written or printed on the face of a negotiable warehouse receipt and the failure to so mark it does not render it non-negotiable if it contains words of negotiability. (Sec. 5.)

(2) In the case of non-negotiable receipts, the law imposes upon the warehouseman the duty to mark them "non-negotiable" or "not negotiable" otherwise, they shall be considered negotiable provided the holder of such unmarked receipt purchased it for value supposing it to be negotiable.

Construction of warehouse receipts.

As instruments of credit, warehouse receipts play an important role in modern commerce and the present day tendency is towards a liberal construction of the law in favor of the *bona fide* holders of such receipts. (Bank of P.I. vs. Herridge, 47 Phil. 57 [1924].)

The rule, however, has no application to actions against any party to the transactions other than a warehouseman. Thus, the purchaser of a non-negotiable receipt not marked "non- negotiable" or "not negotiable" from one who had stolen or found it cannot interpose the defense against the owner of the goods that the receipt is negotiable and has given him title to the goods, the warehouseman not being a party to the action. (Alexander Eccles & Co. v. Munn., 210 S.W. 626.)

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CHAPTER II

OBLIGATIONS AND RIGHTS OF WAREHOUSEMEN UPON THEIR RECEIPTS

Sec. 8. ***Obligation of warehouseman to deliver.*** **— A warehouseman, in the absence of some lawful excuse provided by this Act, is bound to deliver the goods upon a demand made either by the holder of a receipt for the goods or by the depositor; if such demand is accompanied with:**

(a) An offer to satisfy the warehouseman's lien;

(b) An offer to surrender the receipt, if negotiable, with such indorsements as would be necessary for the negotiation of the receipt; and

(c) A readiness and willingness to sign, when the goods are delivered, an acknowledgment that they have been delivered, if such signature is requested by the warehouseman.

In case the warehouseman refuses or fails to deliver the goods in compliance with a demand by the holder or depositor so accompanied, the burden shall be upon the warehouseman to establish the existence of a lawful excuse for such refusal.

Principal obligations of the warehouseman.

The following are the principal obligations of the warehouseman: (1) to take care of the goods entrusted to his safekeeping (Sec. 21.); and (2) to deliver them to the holder of the receipt or to the depositor, provided the conditions under Section 8 are fulfilled.

Necessity of demand.

Generally speaking, a demand should be made on the warehouseman in order that the duty to deliver the goods will arise. But where demand is evidently useless as when the warehouseman has rendered it beyond his power to deliver the goods (see Art. 1169[3], Civil Code.), demand is dispensed with.

Offer to satisfy warehouseman's lien.

A warehouseman having a lien valid against the person demanding the goods may refuse to deliver the goods to him until the lien is satisfied. (Sec. 31.) He loses his lien upon the goods by surrendering possession thereof. (Sec. 29[a].)

The offer to satisfy the warehouseman's lien is, therefore, required before the warehouseman is bound to deliver or return the goods. When, however, an offer is vain or useless, a formal tender is not required.

Offer to surrender receipt.

The offer to surrender the receipt is required for the protection of the warehouseman since the receipt represents the goods described therein, (see Sec. 11.) Furthermore, the warehouseman will be criminally liable if he delivers the goods without obtaining possession of such receipt. (Sec. 54.)

The warehouseman's right to require production of the receipt as a condition precedent to delivery is subject to waiver, as where he refuses to deliver on other grounds than its non- production. (67 C.J. 532.)

Lawful excuses for refusal to deliver goods.

Even if the demand is accompanied by the three conditions provided in Section 8, a warehouseman may still refuse delivery of goods covered by a warehouse receipt on some lawful excuses provided in the Act. (see Sees. 10, 16, 18, 21, 31, 36.) But the existence of a lawful excuse for such refusal is an affirmative defense which the warehouseman must prove. (Sec. 8, par. 2.)

Thus, in an action to recover the value of goods described in a quedan (warehouse receipt), the owner of the warehouse, having alleged that the quedan, which was issued by his manager in the latter's name and later pledged as a collateral to the plaintiff, was invalid and wrongfully issued and that the goods are not in his warehouse, is estopped to claim or assert that the plaintiff did not comply with any condition precedent. In this kind of action, a person has no legal right to deny the existence of the instrument on which it is based and then claim that plaintiff has not complied with the provisions of the instrument. (Phil. National Bank vs. Producers' Warehouse Association, 42 Phil. 608 [1922].)

Sec. 9. *Justification of warehouseman in deiivering.* — A warehouseman is justified in delivering the goods, subject to the provisions of the three following sections, to one who is:

(a) The person lawfully entitled to the possession of the goods, or his agent;

(b) A person who is either himself entitled to delivery by the terms of a non-negotiable receipt issued for the goods, or who has written authority from the person so entitled, either indorsed upon the receipt or written upon another paper; or

(c) A person in possession of a negotiable receipt by the terms of which the goods are deliverable to him or order, or bearer, or which has been indorsed to him or in blank by the person to whom delivery was promised by the terms of the receipt or by his mediate or immediate indorser.

Person to whom goods must be delivered.

The warehouseman is justified in delivering the goods and, therefore, will not be liable for misdelivery, to any person specified in Section 9.

(1) Person lawfully entitled to possession of goods or his agent — Under subsection (a), the warehouseman is justified in delivering

the goods to the person to whom a competent court has ordered the delivery of the goods (see Sees. 14, 17.); or to an attaching creditor (see Sec. 25.), or to the purchaser in case of sale of the goods by the warehouseman to enforce his lien (see Sec. 33.) or where the goods are perishable or hazardous, (see Sec. 34.)

(2) *Person entitled to delivery under a non-negotiable receipt or authority given.* — Under subsection (b), an oral authority is sufficient as the section does not provide that the warehouseman is justified in making delivery only on the written authority of the party entitled to possession; and to give it that meaning would open the door to fraud by enabling an unscrupulous owner to repudiate his express verbal authorization and thereby reap the fruits of his own wrong. Moreover, such construction would be giving the provision the effect of a rule of evidence or statute of frauds under which the authority of the owner could not be proved except by writing.

(3) *Person in possession of negotiable instrument.* — Under subsection (c), the warehouseman is liable for misdelivery to a mere possessor of a negotiable receipt by the terms of which the goods covered by it are deliverable to the order of another, not being an indorsee thereon.

In a case where the warehouseman delivered the goods to one who acquired custody of the same through the use of falsified delivery permit, it was held that the warehouseman cannot sue for the value of the goods unless he had been sued by the depositor or the consignee who are the real parties in interests, not the warehouseman. The warehouseman is not the owner of the goods. He would have a course of action had the depositor or consignee sued him for damages or for recovery of the goods. (Consolidated Terminals, Inc. vs. Artex Dev. Co., Inc., 63 SCRA 56 [1975].)

Sec. 10. ***Warehouseman's liability for misdelivery.*** **— Where a warehouseman delivers the goods to one who is not in fact lawfully entitled to the possession of them, the warehouseman shall be liable as for conversion to all having a right of property or possession in the goods if he delivered the goods than as authorized by subdivisions (b)**

and (c) of the preceding section, and though he delivered the goods as authorized by said subdivisions he shall be so liable, if prior to such delivery he had either:

(a) Been requested, by or on behalf of the person lawfully entitled to a right of property or possession in the goods, not to make such delivery; or

(b) Had information that the delivery about to be made was to one not lawfully entitled to the possession of the goods.

Warehouseman's liability for forged check.

(1) *Liability similar to a bank paying forged check.* — The responsibility of a warehouseman for delivering to a person other than those specified in Section 9 is the same as that of a bank paying a forged check. As the party liable for misdelivery, the duty rests upon the warehouseman of devising appropriate means by which deception can be avoided. The depositor is not obliged to volunteer or offer any suggestion calculated to afford protection to the warehouseman. (Osaka Boeki Kaisha v. Luzon Brokerage Co., [CA] 40 O.G., 5th Suppl. 130, Aug. 30,1941.)

(2) *Liability for conversion.* — Where the delivery is otherwise than as authorized by subsections (b) and (c) of Section 9, the liability of the warehouseman for misdelivery is as for conversion. *Conversion* is unauthorized assumption and exercise of the right of ownership over goods belonging to another to the alteration of their condition or the exclusion of the owner's rights. (Bouvier's Law Dictionary, p. 669.) And even if the warehouseman delivers the goods to the persons entitled under subsections (b) and (c) of Section 9, he may still be liable for conversion if, prior to delivery, he had been requested not to make such delivery (subsec. [a], Sec. 10.) or he had received notice of the adverse claim or title of a third person, (subsec. [b], *ibid.)*

Sec. 11. ***Negotiable receipts must be cancelled when goods delivered.*** **— Except as provided in section thirty- six, where a warehouseman delivers goods for which he had issued a negotiable receipt, the negotiation of which would transfer the right of the possession of the goods, and fails to take up and cancel the receipt, he shall be liable**

to any one who purchases for value In good faith such receipt, for failure to deliver the goods to him, whether such purchaser acquired title to the receipt before or after the delivery of the goods by the warehouseman.

Sec. 12. ***Negotiable receipts must be cancelled or marked when part of goods delivered.*** **Except as provided in Section thirty-six, where a warehouseman delivers part of the goods for which he had issued a negotiable receipt and fails either to take up and cancel such receipt or to place plainly upon it a statement of what goods or packages have been delivered, he shall be liable to any one who purchases for value in good faith such receipt, for failure to deliver all the goods specified in the receipt whether such purchaser acquired title to the receipt before or after the delivery of any portion of the goods by the warehouseman.**

Cancellation of receipts on delivery of goods.

The above provisions are not applicable to non-negotiable receipts because the warehouseman may make delivery without requiring their surrender and cancellation.

Under Section 11, the receipt must be cancelled and under Section 12, the receipt must be either cancelled or marked as to the part of the goods delivered. Note that under Section 11, the negotiable receipt must be one "the negotiation of which would transfer the right to the possession of the goods." So, the warehouseman who delivers the goods to the real owner without taking up and cancelling the receipt is not liable to the purchaser for value in good faith of such receipt from a thief for failure to deliver the goods to him as the thief has no title to the goods, (see Sec. 41[a].)

Sec. 13. ***Altered receipts.*** **— The alteration of a receipt shall not excuse the warehouseman who issued it from any liability if such alteration was:**

(a) Immaterial;

(b) Authorized; or

(c) Made without fraudulent intent.

If the alteration was authorized, the warehouseman shall be liable according to the terms of the receipt as aj- tered. If the alteration was unauthorized but made without fraudulent intent, the warehouseman shall be liable according to the terms of the receipt as they were before alteration.

Material and fraudulent alteration of a receipt shall not excuse the warehouseman who issued it from liability to deliver, according to the terms of the receipt as originally issued, the goods for which it was issued, but shall excuse him from any other liability to the person who made the alteration and to any person who took with notice of the alteration. Any purchaser of the receipt for value without notice of the alteration shall acquire the same rights against the warehouseman which such purchaser would have acquired if the receipt had not been altered at the time of the purchase.

Effects of alteration on liability of warehouseman.

The liability of a warehouseman under a warehouse receipt which has been altered depends on the nature of the alteration as follows:

(1) If the alteration is *immaterial* (the tenor of the receipt is not changed like the substitution of the real name of a party), whether fraudulent or not, authorized or not, the warehouseman is liable on the altered receipt according to its original tenor;

(2) If the alteration is *material* (the tenor of the receipt is changed like the erasure of the name of a party and the insertion of another), *but authorized,* the warehouseman is liable according to the terms of the receipt as altered;

(3) If the alteration is *material but innocently made* though unauthorized, the warehouseman is liable on the altered receipt according to its original tenor; and

(4) If the alteration is *material and fraudulently made,* the warehouseman is liable according to the original tenor of the receipt to a purchaser of the receipt for value without notice, and even to the alterer and subsequent purchasers with notice except that

as regards to the last two, the warehouseman's liability is limited only to delivery as he is excused from any other liability. However, "it is difficult to conceive what liability the draftsman intended to excuse." (Commissioners' note.)

Under this section, it is clear that even a fraudulent alteration cannot divest the title of the owner of stored goods and the warehouseman is, therefore, liable to return them to the owner. *(ibid.)* But a *bona fide* holder acquires no right to the goods under a negotiable receipt which has been lost or stolen or to which the indorsement of the depositor has been forged. (67 C.J. 480.)

Sec. 14. ***Lost or destroyed receipts.*** **— Where a negotiable receipt has been lost or destroyed, a court of competent jurisdiction may order the delivery of the goods upon satisfactory proof of such loss or destruction and upon the giving of a bond with sufficient sureties to be approved by the court to protect the warehouseman from any liability or expense, which he or any person injured by such delivery may incur by reason of the original receipt remaining outstanding. The court may also, in its discretion, order the payment of the warehouseman's reasonable costs and counsel fees.**

The delivery of the goods under an order of the court as provided in this section, shall not relieve the warehouseman from liability to a person to whom the negotiable receipt has been or shall be negotiated for value without notice of the proceedings or of the delivery of the goods.

Liability of warehouseman in case of lost or destroyed receipts.

Under Sections 8 and 11, the warehouseman is not liable for non-delivery without the surrender of the receipt. Indeed, even if the receipt is claimed to have been lost or destroyed, it is essential that the court shall pass upon the question and make sure that the receipt is really lost or destroyed, before the goods are delivered or a new receipt is issued for the rights of possible innocent purchasers of the original receipt may be involved. (Commissioner's note; see Sec. 52.)

Under Section 14, a competent court may order the delivery of the goods only: (1) upon proof of the loss or destruction of the receipt; and (2) upon the giving of a bond with sufficient sureties to be approved by the court. Note, however, that by virtue of the second paragraph, the warehouseman is still liable to a holder of the receipt for value without notice since the warehouseman can secure himself on the bond given.

Sec. 15. ***Effect of duplicate receipts.*** **— A receipt upon the face of which the word "duplicate" is plainly placed is a representation and warranty by the warehouseman that such receipt is an accurate copy of an original receipt properly issued and uncancelled at the date of the issue of the duplicate, but shall impose upon him no other liability.**

Liability of warehouseman as to duplicate.

When more than one negotiable receipt is issued for the same goods, the word "duplicate" must be plainly placed by the warehouseman upon the face of every such receipt, except the one first issued. (Sec. 6.) In such case, the warehouseman warrants: (1) that the duplicate is an accurate copy of the original receipt; and (2) such original receipt is uncancelled at the date of the issue of the duplicate.

Except for breach of this warranty, the duplicate imposes no other liability upon the warehousemen. It results that the warehousemen may not be compelled to deliver the goods by virtue of the duplicate only unless the procedure provided for in Section 14 is followed.

Sec. 16. ***Warehouseman cannot set up title in himself.*** **— No title or right to the possession of the goods, on the part of the warehouseman, unless such title or right is derived directly or indirectly from a transfer made by the depositor at the time of or subsequent to the deposit for storage, or from the warehouseman's lien, shall excuse the warehouseman from liability for refusing to deliver the goods according to the terms of the receipt.**

Ownership not a defense for refusal to deliver.

The warehouseman cannot refuse to deliver the goods on the ground that he has acquired ownership or right to the possession of the goods unless such title or right is derived: (1) directly or indirectly from a transfer made by the depositor at the time of the deposit or subsequent thereto; or (2) from the warehouseman's lien. Section 16 is based on the doctrine of estoppel.

Sec. 17. ***Interpleader of adverse claimants.*** **— If more than one person claims the title or possession of the goods, the warehouseman may, either as a defense to an action brought against him for non-delivery of the goods or as an original suit, whichever is appropriate, require all known claimants to interplead.**

Sec. 18. ***Warehouseman has reasonable time to determine validity of claims.*** **— If someone other than the depositor or person claiming under him has a claim to the title or possession of the goods, and the warehouseman has information of such claim, the warehouseman shall be excused from liability for refusing to deliver the goods, either to the depositor or person claiming under him or to the adverse claimant until the warehouseman has had a reasonable time to ascertain the validity of the adverse claim or to bring legal proceedings to compel all claimants to interplead.**

Duty of warehouseman where there are several claimants.

If there are several claimants to the goods, the warehouseman (1) must determine within a reasonable time the validity of the conflicting claims (Sec. 18.), and deliver to the person whom he finds is entitled to the possession of the goods. However, he is not excused from liability in case he made a mistake, (see Sec. **10.)**

For his own protection, the warehouseman must bring a complaint in interpleader (Sec. 1, Rule 62, Rules of Court.) and require the different claimants to litigate among themselves. (Sec. 17.) In such case, the warehouseman will be relieved from liability in delivering the goods to the person whom the court finds to have a better right.

Sec. 19. ***Adverse title is no defense except as above provided.* — Except as provided in the two preceding sections and in sections nine and thirty-six, no right or title of a third person shall be a defense to an action brought by the depositor or persons claiming under him against the warehouseman for failure to deliver the goods according to the terms of the receipt.**

Adverse title of third person not a defense for refusal to deliver.

The warehouseman cannot set up title in himself as an excuse for his failure or refusal to deliver the goods. (Sec. 16.) Neither can the warehouseman, as a depository for hire, set up an adverse title in another as an excuse for his failure to deliver property to his bailor on demand. (Wetherington v. Laurens County Farmer's Corp. Warehouse Co., 98 S.E. 228.)

The exceptions to the above rule are the cases provided for in Sections 9,17,18, and 36.

Sec. 20. ***Liability of warehouseman for non-existence or misdescription of goods.* — A warehouseman shall be liable to the holder of a receipt for damages caused by non-existence of the goods or by the failure of the goods to correspond with the description thereof in the receipt at the time of its issue. If, however, the goods are described in a receipt merely by a statement of marks of labels upon them, or upon packages containing them, or by a statement that the goods are said to be goods of a certain kind or that the packages containing the goods are said to contain goods of a certain kind, or by words of like import, such statements, if true, shall not make liable the warehouseman issuing the receipt, although the goods are not of the kind which the marks or labels upon them indicate or of the kind they were said to be by the depositor.**

Liability of warehouseman for non-existence or misdescription of goods;

As a general rule, the warehouseman is under obligation to deliver the identical property stored with him and if he fails to do so, he is liable directly to the owner. (67 C.J. 522-523.)

As against a *bona fide* purchaser of a warehouse receipt, the warehouseman is estopped, whether the receipt is negotiable or not, to deny that he has received the goods described in it. *(ibid.,* 483.) But if the description consists merely of marks or labels upon the goods or upon the packages containing them, etc., the warehouseman is not liable even if the goods are not of the kind as indicated in the marks or labels. "Anyone at all familiar with the business of a warehouseman knows that he could not transact business if he were required to examine the contents of each package, barrel or box of merchandise which was delivered to him and so packed as to cover and conceal the real nature of the goods delivered/' (Dean v. Driggs, 33 N.E. 326.)

Sec. 21. ***Liability for care of goods.*****—A warehouseman shall be liable for any loss or injury to the goods caused by his failure to exercise such care in regard to them as reasonably careful owner of similar goods would exercise, but he shall not be liable, in the absence of an agreement to the contrary, for any loss or injury to the goods which could not have been avoided by the exercise of such care.**

Liability of warehouseman for loss due to lack of care.

The warehouseman is required to exercise ordinary or reasonable care in the custody of the goods, that is, the care a reasonably careful owner would exercise over similar goods of his own. Such care is also known *As* "the diligence of a good father of a family." (Art. 1163, Civil Code.)

Irt the absence of any agreement to the contrary, the warehouseman is not liable for any loss or injury to the goods which could not have been avoided by the exercise of such care. Of course, what constitute ordinary or reasonable care depends upon the circumstances such as the character and value of the property and the character and location of the warehouse. (67

C.J. 498.) While the warehouseman may limit his liability to an agreed value of the property received in case of loss, he cannot, however, stipulate with the depositor that he would not be responsible for any loss even if caused by his negligence. Such stipulation is void under Section 3.

Sec. 22. ***Goods must be kept separate.*** **— Except as provided in the following section, a warehouseman shall keep the goods so far separate from goods of other depositors and from other goods of the same depositor for which a separate receipt has been issued, as to permit at all times the identification and redelivery of the goods deposited.**

Sec. 23. ***Fungible goods may be commingled if warehouseman authorized.*** **— If authorized by agreement or by custom, a warehouseman may mingle fungible goods with other goods of the same kind and grade. In such case, the various depositors of the mingled goods shall own the entire mass in common and each depositor shall be entitled to such portion thereof as the amount deposited by him bears to the whole.**

Sec. 24. ***Liability of warehouseman to depositors of commingled goods.*** **— The warehouseman shall be severally liable to each depositor for the care and redelivery of his share of such mass to the same extent and under the same circumstances as if the goods had been kept separate.**

Commingling of deposited goods.

As a general rule, a warehouseman may not mingle goods belonging to depositors. (Sec. 22.) In the case of the fungible goods (see Sec. 58.), like rice, sugar, etc., the warehousemen may mingle them with the goods of the same kind and grade provided that he is authorized by agreement or custom. (Sec. 23.) In that case, the different owners become co-owners of the whole mass. (Sec. 24.)

Sections 22 and 23 are intended for die benefit of the holders of the receipts and not for the benefit of the warehouseman. It would, indeed, be strange if the warehouseman could escape his liability to the owner of the goods by the simple process of commingling them without authorization. (Bank of P.I. vs. Herridge, 47 Phil. 57 [1924].)

Under the Civil Code, "unless there is a stipulation to the contrary/ the depository may commingle grain or other articles of the same kind and quality/' (Art. 1976.)

Sec. 25. ***Attachment or levy upon goods for which a negotiable receipt has been issued.*** **— If goods are delivered to a warehouseman by the owner or by a person whose act in conveying the title to them to a purchaser in good faith for value would bind the owner, and a negotiable receipt is issued for them, they cannot thereafter, while in the possession of the warehouseman, be attached by garnishment, or otherwise* or be levied upon under an execution unless the receipt be first surrendered to the warehouseman or its negotiation enjoined. The warehouseman shall in no case be compelled to deliver up the actual possession of the goods until the receipt is surrendered to him or impounded by the court.**

When negotiable receipt may be attached.

This section is evidently for the protection of the warehouseman. (see annotations under Art. 1519 of the Civil Code which is substantially the same as Sec. 25.)

Sec. 26. ***Creditor's remedies to reach negotiable receipts.*** **— A creditor whose debtor is the owner of a negotiable receipt shall be entitled to such aid from courts of appropriate jurisdiction, by injunction and otherwise, in attaching such receipt or in satisfying the claim by means thereof as is allowed at law or in equity in these islands in regard to property which can not readily be attached or levied upon by ordinary legal process.**

Right of creditor of owner of negotiable receipt.

Here, what is attached by the creditor is the negotiable receipt in the debtor's possession and not the goods covered by such receipt, (see annotations under Art. 1520 of the Civil Code which is substantially the same as Sec. 26; also Sees. 32,35.)

Sep. 27. ***What claims are included in the warehouseman's lien.*** **— Subject to the provisions of section thirty, a warehouseman shall have a lien on goods deposited or on the proceeds thereof in his hands, for all lawful charges for storage and preservation of the goods; also for all lawful claims for money advanced, interest, insurance, transportation, labor, weighing, coopering and other charges and expenses in relation to such goods, also for all reasonable charges and expenses for notice, and advertisements of sale, and for sale of the goods where default has been made in satisfying the warehousing lien.**

Extent of warehouseman's lien.

The warehouseman's lien over the goods deposited with him is his security, just like a pledge or mortgage, for the payment of the charges, money advanced, and other expenses enumerated under Section 27. The lien exists for the benefit of a warehouseman as defined in Section 58, and not of a casual bailee (Alton v. New York Taxicab Co., 121 N.Y. Supp. 271.) and even though the receipt is non-negotiable.

Section 30 prescribes the. extent of lien when the receipt is negotiable.

Sec. 28. ***Against what property the lien may be enforced.*** **— Subject to the provisions of Section thirty, a warehouseman's lien may be enforced:**

(a) Against all goods, whenever deposited, belonging to the person who is liable as debtor for the claims in regard to which the lien is asserted, and

(b) Against all goods belonging to others vyhich have been deposited at any time by the person who is liable as debtor for the claims in regard to which the lien is asserted if such person had been so entrusted with the possession of the goods that a pledge of the same by him at the time of the deposit to one who took the goods in good faith for value would have been valid.

Goods subject to lien.

Under Section 28, the warehouseman may enforce his lien: (1) against the goods of the depositor who is liable as debtor whenever such goods are deposited; and (2) against goods of other persons stored by the depositor who is liable as debtor with authority to make a valid pledge.

There is nothing in the Act giving a warehouseman a lien on goods belonging to another and stored by a stranger in fraud of the true owner's rights. If such were the effect of die Act, then a warehouseman could become a legalized receiver of stolen goods at least to the extent of the charges. (Farrell v. Harlem Terminal Storage Warehouse, 127 N.Y. Supp. 306;-see Sec. 31.)

Sec. 29. ***How the lien may be lost*** **— A warehouseman loses his lien upon goods:**

(a) By surrendering possession thereof, or

(b) By refusing to deliver the goods when a demand is made with which he is bound to comply under the provisions of this Act.

Loss and waiver of lien upon goods.

(1) *By surrendering possession of goods.* — Under subsection (a), a warehouseman loses his lien upon goods by voluntarily surrendering the possession thereof without requiring payment of his lien because a warehouseman's lien is possessory in nature. (Phil. National Bank vs. Se, Jr., 70 SCAD 323, 256 SCRA 380 [1996].)

(a) It will be presumed that the lien has been waived or abandoned where the warehouseman permits a depositor to remove die goods but not where the property is taken without the warehouseman's consent or by force or under a legal process, as by a replevin suit. (Zahrier v. Harnish, 24 S.W. [2d] 641.)

(b) A warehouseman who has released his lien by the surrender of the goods may not thereafter claim a lien on *other* goods of the same depositor for unpaid charges on the goods surrendered if the goods were delivered to him under *different* bailments (covered by separate receipts). But he has a lien on retained goods for charges on surrendered goods where all goods were received under one and in the same bailment. (67 C.J. 554.)

(2) *By wrongfully refusing to deliver goods.* — Under subsection (b), the warehouseman also loses his lien by refusing to deliver the goods where the holder of the receipt offers to comply with the requirements of Section 8.

Sec. 30. *Negotiable receipt must state charges for which lien is claimed.* — If a negotiable receipt is issued for goods, the, warehouseman shall have no lien thereon except for charges for storage of those goods subsequent to the date of the receipt unless the receipt expressly enumerates other charges for which a lien is claimed. In such case, there shall be lien for the charges enumerated so far as they are within the terms of Section twenty-seven although the amount of the charges so enumerated is not stated in the receipt.

Lien where receipt negotiable.

With the exception of the charges for storage and preservation of goods for which a negotiable receipt has been issued, the lien exists only for the other charges expressly enumerated in the receipt so far as they are written within the terms of Section 27 although the amount of the said charges is not stated.

As to claims not specified in the receipt, the warehouseman share *pro rata* with the other creditors of the depositor the balance of the proceeds of the sale for the satisfaction of said claims (Sees. 33,34.) after deducting the charges for storage.

Sec. 31. *Warehouseman need not deliver until lien is satisfied.* —A warehouseman having a lien valid against the person demanding the goods may refuse to deliver the goods to him until the lien is satisfied.

Sec. 32. *Warehouseman's lien does not preclude other remedies.* — Whether a warehouseman has or has not a lien upon the goods, he is entitled to all remedies allowed

by law to a creditor against his debtor, for the collection from the depositor of all charges and advances which the depositor has expressly or impliedly contracted with the warehouseman to pay.

Sec. 33. *Satisfaction of lien by sale.* — A warehouseman's lien for a claim which has become due may be satisfied as follows:

The warehouseman shall give a written notice to the person on whose account the goods are held, and to any other person known by the warehouseman to claim an interest in the goods. Such notice shall be given by delivery in person or by registered letter addressed to the last known place of business or abode of the person to be notified. The notice shall contain:

(a) An itemized statement of the warehouseman's claim, showing the sum due at the time of the notice and the date or dates when it became due,

(b) A brief description of the goods against which the lien exists,

(c) A demand that the amount of the claim as stated in the notice, and of such further claim as shall accrue, shall be paid on or before a day mentioned, not less than ten days from the delivery of the notice if it is personally delivered, or from the time when the notice should reach its destination, according to the due course of post, If the notice is sent by mail, and

(d) A statement that unless the claim is paid within the time specified, the goods will be advertised for sale and sold by auction at a specified time and place.

In accordance with the terms of notice so given, a sale of the goods by auction may be had to satisfy any valid claim of the warehouseman for which he has a lien on the goods. The sale shall be had in the place where the lien was acquired, or, if such place is manifestly unsuitable for the purpose, at the nearest suitable place. After the time for the payment of the claim specified in the notice of the depositor has elapsed, an advertisement of the sale, describing the goods to be sold, and stating the name of the owner or person on whose account the goods are held, and the time and place of the sale, shall be published once a week for two consecutive weeks in a newspaper published in the place where such sale is to be held. The sale shall not be held less than fifteen days from the time of the first publication. If there is no newspaper published in such place, the advertisement shall be posted at least ten days before such sale in not less than six conspicuous places therein.

From the proceeds of such sale, the warehouseman shall satisfy his lien including the reasonable charges of notice, advertisement and sale. The balance, if any, of such proceeds shall be held by the warehouseman and delivered on demand to the person to whom he would have been bound to deliver or justified in delivering the goods.

At any time before the goods are so sold, any person claiming a right of property or possession therein may pay the warehouseman the amount necessary to satisfy his lien and to pay the reasonable expenses and liabilities incurred in serving notices and advertising and preparing for the sale up to the time of such payment. The warehouseman shall deliver the goods to the person making payment if he is a person entitled under the provisions of this Act, to the possession of the goods on payment of charges thereon. Otherwise, the warehouseman shall retain possession of the goods according to the terms of the original contract of deposit.

Sec. 34. *Perishable and hazardous goods.* — If goods are of a perishable nature, or by keeping will deteriorate greatly in value, or by their odor, leakage, inflammability or explosive nature, will be liable to injure other property, warehouseman, may give such notice to the owner or to the person in whose name the goods are stored, as is reasonable and possible under the circumstances, to satisfy the lien upon such goods and to remove them from the warehouse, and in the event of the failure of such person to satisfy the lien and to remove the goods within the time so specified, the warehouseman may sell the goods at public or private sale without advertising. If the warehouseman, after a reasonable effort, is unable to sell such goods, he may dispose of them in any lawful manner and shall incur no liability by reason thereof.

The proceeds of any sale under the terms of this section shall be disposed of in the same way as the proceeds of sales made under the terms of the preceding section.

Sec. 35. ***Other methods of enforcing lien.*****—The remedy for enforcing a lien herein provided does not preclude any other remedies allowed by law for the enforcement of a lien against personal property nor bar the right to recover so much of the warehouseman's claim as shall not be paid by the proceeds of the sale of the property.**

Sec. 36. ***Effect of sale.*** **— After goods have been lawfully sold to satisfy a warehouseman's lien, or have been lawfully sold or disposed of because of their perishable or hazardous nature, the warehouseman shall not thereafter be liable for failure to deliver the goods to the depositor or owner of the goods, or to a holder of the receipt given for the goods when they were deposited, even if such receipt be negotiable.**

Enforcement of warehouseman's lien.

The remedies available to a warehouseman for enforcing his lien are as follows:

(1) By refusing to deliver the goods until the lien is satisfied (Sec. 31.);

(2) By causing the extrajudicial sale of the property and applying the proceeds to the value of the lien (Sees. 33,34.); and

(3) By filing a civil action for the unpaid charges. (Sees. 32, 35.)

In case of sale of goods, the warehouseman is not liable for non-delivery even if the receipt given for the goods when they were deposited be negotiated. (Sec. 36.) This rule necessarily qualifies the right of a purchaser of a negotiable receipt. (Commissioner's note.)

Acts for which warehouseman is liable.

The following are acts for which a warehouseman may be held liable:

(1) Failure to stamp "duplicate" on copies of a negotiable receipt (Sec. 6.);

(2) Failure to place "non-negotiable" or "not negotiable" on a non-negotiable receipt (Sec. 7.);

(3) Misdelivery of the goods (Sec. 10.);

(4) Failure to effect cancellation of a negotiable receipt upon delivery of the goods (Sec. 11.);

(5) Issuing receipt for non-existing goods or misdescribed goods (Sec. 20.);

(6) Failure to take care of die goods (Sec. 21.); and

(7) Failure to give notice in case, of sale of goods to satisfy his lien (Sec. 33.) or because the goods are perishable or hazardous. (Sec. 34.)

CHAPTER III

NEGOTIATION AND TRANSFER OF RECEIPTS

Sec. 37. ***Negotiation of negotiable receipt by delivery.*** **—A negotiable receipt may be negotiated by delivery:**

(a) Where, by the terms of the receipt, the warehouseman undertakes to deliver the goods to the bearer, or

(b) Where,bythetermsofthereceipt,thewarehouseman undertakes to deliver the goods to the order of a specified person, and such person or a subsequent indorsee of the receipt has indorsed it in blank or to bearer.

Where, by the terms of a negotiable receipt, the goods are deliverable to bearer or where a negotiable receipt has been indorsed in blank or to bearer, any holder may indorse the same to himself or to any other specified person, and, in such case the receipt shall thereafter be negotiated only by the indorsement of such indorsee.

Sec. 38. ***Negotiation of negotiable receipt by indorse- ment.*** **— A negotiable receipt may be negotiated by the indorsement of the person to whose order the goods are, by the terms of the receipt, deliverable. Such indorsement may be in blank, to bearer or to a specified person. If indorsed to a specified person, it may be again negotiated by the indorsement of such person in blank, to bearer or to another specified person. Subsequent negotiation may be made in like manner.**

Sec. 39. ***Transfer of receipt.*** **— A receipt which is not in such form that it can be negotiated by delivery may be transferred by the holder by delivery to a purchaser or donee.**

A non-negotiable receipt can not be negotiated, and the indorsement of such a receipt gives the transferee no additional right.

Negotiation and transfer of receipts.

See annotations under Articles 1508, 1509, and 1511 of the Civil Code which ate substantially the same as Sections 37, 38, and 39, respectively.

Advantages of a negotiable warehouse receipt.

Some of the advantages of a negotiable warehouse receipt over one which is non-negotiable are the following:

(1) It protects a purchaser for value and in good faith (Sec. 41.); : - •• •;■ •

(2) The goods covered by it cannot be garnished or levied upon under execution unless it is surrendered, or impounded, or its negotiation enjoined (Sec. 25.);

(3) In case of negotiation, the holder acquires the direct obligation of the warehouseman to hold possession of the goods for him without notice to such warehouseman (Sec. 41.); and

(4) The goods it covers are not subject to seller's lien or stoppage *in transitu.* (Sec. 49.)

Sec. 40. ***Who may negotiate a receipt.*** **— A negotiable receipt may be negotiated:**

(a) By the owner thereof, or

(b) By any person to whom the possession or custody of the receipt has been entrusted by the owner, if by the terms of the receipt, the warehouseman undertakes to deliver the goods to the order of the person to whom the possession or custody of the receipt has been entrusted, or if, at the time of such entrusting, the receipt is in such form that it may be negotiated by delivery.

Persons who may negotiate a receipt.

See annotations under Article 1512 of the Civil Code which is substantially the same as Section 40.

Sec. 41. *Rights of person to whom a receipt has been negotiated.* —A person to whom a negotiable receipt has been duly negotiated acquires thereby:

Such title to the goods as the person negotiating the receipt to him had or had ability to convey to a purchaser in good faith for value, and also such title to the goods as the depositor or person to whose order the goods were to be delivered by the terms of the receipt had or had ability to convey to a purchaser in good faith for value, and

The direct obligation of the Warehouseman to hold possession of the goods for him according to the terms of the receipt as fully as if the warehouseman had contracted directly with him.

Sec. 42. *Rights of person to whom receipt has been transferred.* — A person to whom a receipt has been transferred but not negotiated acquires thereby, as against the transferor, the title of the goods subject to terms of any agreement with the transferor.

If the receipt is non-negotiable, such person also acquires the right to notify the warehouseman of the transfer to him of such receipt and thereby to acquire the direct obligation of the warehouseman to hold possession of the goods for him according to the terms of the receipt.

Prior to the notification of the warehouseman by the transferor or transferee of a non-negotiable receipt, the title of the transferee to the goods and the right to acquire the obligation of the warehouseman may be defeated by the levy of an attachment or execution upon the goods by the creditor of the transferor or by notification to the warehouseman by the transferor or a subsequent purchaser from the transferor of a subsequent sale of the goods by the transferor.

Sec. 43. *Transfer of negotiable receipt without indorsement.* — Where a negotiable receipt is transferred for value by delivery and the indorsement of the transferor is essential for negotiation, the transferee acquires a right against the transferor to compel him to indorse the receipt unless a contrary intention appears. The negotiation shall take effect as the time when the indorsement is actually made.

Rights of indorsee or transferee of a receipt.

See annotations under Articles 1513, 1514, and 1515 of the Civil Code which are substantially the same as Sections 41, 42, and 43, respectively.

Ownership of goods covered by receipt negotiated or transferred.

(1) *Indorsee or transferee.* — For purposes of facilitating commercial transactions, the indorsee or transferee of a warehouse receipt should be regarded as the owner of the goods covered by it. In other words, as regard the indorser or transferor, even if he were the owner of the goods, he may not take possession and dispose of the goods without the consent of the indorsee or transferee of the warehouse receipt, and *as regards, third persons,* the holder of a warehouse receipt is the owner of the goods covered by it. (Martinez vs. Phil. National Bank, 93 Phil. 765 [1953].)

(2) *Indorser or transferor.* — Where, however, a warehouse receipt is indorsed or transferred to a creditor only to secure the payment of a loan or debt, the indorsee or transferee does not automatically become the owner of the goods covered by the warehouse receipt but he merely retains the right to keep and with the consent <of the owner to sell them so as to satisfy the obligation from the proceeds of the sale, this for the simple reason that the transaction involved is not a sale but only a mortgage or pledge. Therefore, if the property covered by the warehouse receipt is lost without the fault of die mortgagee or pledgee or die indorsee or transferee of the warehouse receipt, the said goods are to be regarded as a lost on account of the real owner/mortgagor or pledgor, *(ibid.)*

(3) *Innocent third persons.* — Where the rights of innocent third persons are involved, the indorsee-pledgee of a warehouse receipt is considered the owner of the goods covered by it whenever necessary for their protection, (see Sec. 41; Siy Cong Bieng & Co., Inc. vs. Hongkong & Shanghai Banking Corp., 56 Phil. 598 [1932]; Phil. Trust Co. vs. Phil. National Bank, 42 Phil. 413 [1921]; Bank of the Phil. Islands vs. Herridge, 47 Phil. 57 [1924]; Roman vs. Asia Banking Corp., 16 Phil. 705 [1910].)

Sec. 44. ***Warranties of a sale of receipt* —A person who, for value, negotiates or transfers a receipt by indorsement or delivery, including one who assigns for value a claim secured by a receipt, unless a contrary intention appears, warrants:**

(a) That the receipt is genuine,

(b) That he has a legal right to negotiate or transfer it,

(c) That he has knowledge of no fact which would impair the validity or worth of the receipt, and

(d) That he has a right to transfer the title to the goods and that the goods are merchantable or fit for a particular purpose whenever such warranties would have been implied, if the contract of the parties had been to transfer without a receipt of the goods represented thereby.

Sec. 45. ***Indorser not a guarantor.*** **— The indorsement of receipt shall not make the indorser liable for any failure on the part of the warehouseman or previous indorsers of the receipt to fulfill their respective obligations.**

Liability of person negotiating or transferring receipt.

See annotations under Articles 1516 and 1517 of the Civil Code which are substantially the same as Sections 44 and 45, respectively.

Sec. 46. ***No warranty implied from accepting payment of debt*** **— A mortgagee, pledgee, or holder for security of a receipt who, in good faith, demands or receives payment of the debt for which such receipt is security, whether from a party to a draft drawn for such debt or from any other person, shall not, by so doing, be deemed to represent or to warrant the genuineness of such receipt or the quantity or quality of the goods therein described.**

Liability of mortgagee, pledgee, or holder for security.

Under this section, a holder for security of a receipt who in good faith accepts payment of the debt from a person does not thereby warrant the genuineness of the receipt nor the quality or quantity of the goods therein described.

Thus, if C receives from D a warehouse receipt as security for D's debt and C delivers it to T who plays him for D, C, assuming he acts in good faith, is not liable to T in case T cannot obtain possession of the goods because they do not exist or because the receipt is not genuine.

Sec. 47. *When negotiation not impaired by fraud, mistake or duress.* — The validity of the negotiation of a receipt is not impaired by the fact that such negotiation was a breach of duty on the part of the person making the negotiation or by the fact that the owner of the receipt was induced by fraud, mistake, or duress to entrust the possession or custody of the receipt to such person, if the person to whom the receipt was negotiated or a person to whom the receipt was subsequently negotiated, paid value therefor, without notice of the breach of duty, or fraud, misitake or duress.

Validity of negotiation.

See annotations under Article 1518 of the Civil Code which is somewhat different from Section 47.

Sec. 48. *Subsequent negotiation.* — Where a person having sold, mortgaged, or pledged goods which are in a warehouse and for which a negotiable receipt has been issued, or having sold, mortgaged, or pledged the negotiable receipt representing such goods, continues in possession of the negotiable receipt, the subsequent negotiation thereof by that person under any sale or other disposition thereof to any person receiving the same in good faith, for value and without notice of the previous sale, mortgage or pledge, shall have the same effect as if the first purchaser of the goods or receipt has expressly authorized the subsequent negotiation.

Effect of subsequent negotiation by seller, etc.

This section imposes a duty upon the purchaser, mortgagee or pledgee of goods for which a negotiable receipt has been issued, or of the negotiable receipt itself, to require the negotiation of the receipt to him, otherwise, his failure will have the same effect as an express authorization on his part to the seller, mortgagor or pledgor in possession of such receipt to make any subsequent negotiation.

The subsequent purchaser, however, must have taken the receipt in good faith and for value in order to acquire a better right.

Sec. 49. *Negotiation defeats vendor's lien.* — Where a negotiable receipt has been issued for goods, no seller's lien or right of stoppage *In transitu* shall defeat the rights of any purchaser for value in good faith to whom such receipt has been negotiated, whether such negotiation be prior or subsequent to the notification to the warehouseman who issued such receipt of the seller's claim to a lien or right of stoppage *in transitu.* Nor shall the warehouseman be obliged to deliver or justified in delivering the goods to an unpaid seller unless the receipt is first surrendered for cancellation.

Indorsee's right superior to vendor's lien.

Under this section, an innocent holder of a negotiable warehouse receipt has a better right to the goods for which the receipt is given than the vendor who has a vendor's lien upon goods, (see Sec. 47.) So, the warehouseman is not obliged to deliver or justified in delivering the goods to an unpaid seller unless the receipt is first surrendered for cancellation. (Sees. 49, 54.)

See annotations under Article 1535, par. 2 of the Civil Code which is substantially the same as Section 49.

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CHAPTER IV

CRIMINAL OFFENSES

Sec. 50. ***Issue of receipt for goods not received.*** **— A warehouseman, or an officer, agent, or servant of a warehouseman who issues or aids in issuing a receipt knowing that the goods for which such receipt is issued have not been actually received by such warehouseman, or are not under his actual control at the time of issuing such receipt, shall be guilty of a crime, and, upon convictions shall be punished for each offense by imprisonment not exceeding five years, or by a fine not exceeding ten thousand pesos, or both.**

Possession of goods by warehouseman.

In accordance with the definition of warehouseman, generally, warehouse receipts are issued for the goods or merchandise of others stored with the warehouseman, (see Sec. 58[a].) But it is essential to the validity of a warehouse receipt that the goods or merchandise, for which the receipt is issued, shall be in the warehouseman's possession, that is, stored in his warehouse, under his care and control at the time the receipt is issued, and a receipt is a nullity as to goods described therein which are not in existence, or not in the warehouse, when the receipt is given. (93 C.J.S. 421-422.)

Under Section 50, it is made an offense to issue a receipt unless the property is actually in storage.

Sec. 51. ***Issue or receipt containing false statement.*** **— A warehouseman, or any officer, agent, or servant of a warehouseman who fraudulently issues or aids in fraudulently issuing a receipt for goods knowing that it contains any false statement, shall be guilty of a crime,**

and upon conviction, shall be punished for each offense by imprisonment not exceeding one year, or by a fine not exceeding two thousand pesos, or by both.

Sec. 52. *Issue of duplicate receipt not so marked.* — A warehouseman, or any officer, agent, or servant of a warehouseman who issues or aids in issuing a duplicate or additional negotiable receipt for goods knowing that a former negotiable receipt for the same goods or any part of them is outstanding and uncancelled, without plainly placing upon the face thereof the word "duplicate" except in the case of a lost or destroyed receipt after the proceedings as provided for in section fourteen, shall be guilty of a crime, and, upon conviction, shall be punished for each offense by Imprisonment not exceeding five years, or by a fine not exceeding ten thousand pesos, or by both.

Sec. 53. *Issue for warehouseman's goods or receipts which do not state that fact.* — Where there are deposited with or held by a warehouseman goods of which he is owner, either solely or jointly or common with others, such warehouseman, or any of his officers, agents, or servants who, knowing this ownership, issues or aids in issuing a negotiable receipt for such goods does not state such ownership, shall be guilty of a crime, and, upon conviction shall be punished for each offense by imprisonment not exceeding one year, or by a fine not exceeding two thousand pesos, or by both.

Sec. 54. *Delivery of goods without obtaining negotiable receipt* — A warehouseman, or any officer, agent, or servant of a warehouseman, who delivers goods out of the possession of such warehouseman, knowing that a negotiable receipt the negotiation of which would transfer the right to the possession of such goods is outstanding and uncancelled, without obtaining the possession of such receipt at or before the time of such delivery, shall, except in the,cases provided for in sections fourteen and thirty-six, be found guilty of a crime, and upon conviction, shall be punished for each offense by imprisonment not exceeding one year, or by a fine not exceeding two thousand pesos, or by both.

Sec. 55. *Negotiation of receipt for mortgaged goods.* — Any person who deposits goods to which he has no title,

or upon which there is a lien or mortgage, and who takes for such goods a negotiable receipt which he afterwards negotiates for value with intent to deceive, and without disclosing his want of titl? or the existence of the lien or mortgage, shall be guilty of a crime, and, upon conviction shall be punished for each offense by imprisonment not exceeding one year, or by a fine not exceeding two thousand pesos, or by both.

Offenses criminally punishable by the Act.

Sections 50, 51, 52, 53, 54, and 55 enumerate offenses which are criminally punishable under the Act.

Ingredients of offense punished by Section 54.

The offense punished under Section 54 consists in the following ingredients:

(1) There is delivery of goods out of the possession of the warehouseman, by the warehouseman himself or by any officer, agent, or servant of the warehouseman;

(2) The person who causes the delivery has knowledge that a negotiable receipt for the goods, which would transfer the right to the possession thereof, is outstanding and uncancelled; and

(3) The person causing the delivery does so without obtaining possession of the receipt at or before the time of delivery. (People vs. Dichupa, [C.A.] 71 O.G., No. 8, p. 974 [1975].)

Nature of criminal responsibility under Section 54.

(1) *Participation in the withdrawal of goods in question*. — Under Section 54, may a warehouseman be held criminally liable, irrespective of whether he is a warehouseman in name only, and irrespective of whether the duties of a warehouseman are actually performed by somebody else? No, if the accused had nothing to do with the withdrawal of the goods in question.

(2) *Violations by some other persons.* — A reading of Section 54 shows that other persons than warehouseman may be held

liable for violations thereof. The disjunctive use of die word "or" in the phrase "A warehouseman or any other officer, agent, or servant of a warehouseman," imparts an alternative sense. The criminal responsibility punished by the law is individual, not attributive, so that the warehouseman should not be punished even for violations which some other officer, agent, or servant of the warehouseman may have committed. It is fundamental in criminal law that unless conspiracy be shown, no one should be made to suffer for offenses committed by another. (People vs. Dichupa*, supra.)*

(3) *Possibility that right to goods could have been transferred to a third person.* — In order that a warehouseman may be punished under Section 54, for having delivered goods from his warehouse to a person other than the one entitled thereto according to the corresponding securities, it is not necessary that the right of possession to such stored goods have been transferred to a third person. It is sufficient that such right could have been transferred to said third person in the course of his transactions with die depositor in whose name the receipt of the stored goods was issued. (People vs. Goco, 35 O.G. 2618.)

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CHAPTER V

INTERPRETATION

Sec. 56. *Case not provided for in Act* — Any case not provided for in this Act shall be governed by the provisions of existing legislation, or in default thereof, by the rule of the law merchant.

Sec. 57. *Name of Act* — This act may be cited as the Warehouse Receipts Act.

Sec. 58. *Definitions.* — (a) In this Act, unless the contract or subject matter otherwise requires:

"Action" includes counterclaim, set-off, and suits in equity as provided by law In these islands.

"Delivery" means voluntary transfer of possession from one person to another.

"Fungible goods" means goods of which any unit is, from its nature or by mercantile custom, treated as the equivalent of any other unit.

"Goods" means chattels or merchandise in storage, or which has been or is about to be stored.

"Holder" of a receipt means a person who has both actual possession of such receipt and a right of property therein.

"Order" means an order by indorsement on the receipt.

"Owner" does not include mortgagee.

"Person" includes a corporation or partnership or two or more persons having a joint or common interest.

To "purchase" includes to take as mortgagee or as pledgee.

"Purchaser" includes mortgagee and pledgee.

"Receipt" means a warehouse receipt.

"Value" is any consideration sufficient to support simple contract. An antecedent or pre-existing obligation, whether for money or not, constitutes value where a receipt is taken either in satisfaction thereof or as security therefor.

"Warehouseman" means a person lawfully engaged in the business of storing goods for profit.

(b) A thing is done "in good faith" within the meaning of this Act when tt is in fact done honestly, whether it be done negligently or not.,

Sec. 59. *Application of Act* — The provisions of this Act do not apply to receipts made and delivered prior to the taking effect hereof.

Sec. 60. *Repeal?.* —All acts and laws and parts thereof inconsistent with this Act are hereby repealed.

Sec. 61. *Time when Act takes effect* — This Act shall take effect ninety days after its publication in the Official Gazette of the Philippines shall have been completed;.

ENACTED, FEBRUARY 5,1912.

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PART (II

ALLIED SPECIAL LAWS

A. CODE OF COMMERCE

BOOK ONE
MERCHANTS AND COMMERCE
IN GENERAL

TITLE I

MERCHANTS AND ACTS
OF COMMERCE

ARTICLE 1. For purposes of this Code, merchants are:

1. Those who, having legal capacity to engage in commerce, habitually devote themselves to it;

2. The commercial or industrial companies which may be created in accordance with [this Code] existing legislation.

1. *Meaning of commercial law.* — The term has been defined as the body of laws and jurisprudence which governs the rights, intercourse and relations of persons, whether natural or juridical, engaged in commerce, trade and mercantile pursuits, (see Black's Law Dictionary.)

2. *Sources of commercial law.* — They are as follows: (a)

Direct or principal sources:

1) Legislation;

2) Contracts;

3) Commercial usages and practices; and

4) Decisions of local courts; and (b) *Indirect or auxiliary sources:*

1) Natural Law;

2) Scientific Law;

3) Explanatory notes and preambles to laws, etc.;

4) Foreign legislation;

5) Professional opinions; and

6) Decisions of foreign tribunals.

3. *Principal characteristics of commercial law.* — They are the following:

(a) *Universality.*—It exists and is observed in all civilized countries;

(b) *Progressiveness.* — It keeps up with modern trends by incorporating new practices and discarding obsolete ones; and

(c) *Equitableness.* — It seeks to give parties to the transactions justice and equity, (see Del Viso, Derecho Mercantile, p. 30.)

4. *Meaning of commerce.* — The term refers to the intercourse by way of trade and traffic between different peoples or states and the citizens or inhabitants thereof. (Black's Law Dictionary.)

5. *Scope of commerce.* — The term includes the following: . (a) Purchase, sale and exchange of commodities;

(b) Instrumentalities and agencies by which it is promoted;

(c) Ways and means by which it is carried on; and

(d) Transportation of persons and goods by land, sea, and water, (see *ibid.)*

6. *Commerce distinguished from trade.* — The former relates to intercourse or dealing with foreign nations or states, while

the latter denotes business intercourse within the limitations of a nation or state, or the buying, selling, and exchange of goods between members of the same community, *(ibid.)*

In practice and in law, however, the terms are used interchangeably and without distinction.

7. *Subjects of commercial law.* — The subjects of commercial law are merchants and acts of commerce. No. 1 of Article 1 refers to natural persons as merchants and states the two main requisites for a natural person to be considered a merchant. The Corporation Code (B.P. Big. 68.) and the Civil Code (see Arts. 45, 2270[2].) govern the organization of corporations and partnerships, respectively.

8. *Provisions of the Code of Commerce which are still in force.* — They are the following:

(a) In Book One, those governing merchants and commerce in general, commercial registers, books and bookkeeping of commerce and the general provisions relating to commercial contracts except such portions thereof as have been repealed or modified by subsequent legislations;

(b) In Book Two, those governing joint accounts, transfers of non-negotiable credits, commercial contracts on transportation overland and letters of credit except such portions thereof as have been repealed or modified by subsequent legislations; and

(c) In Book Three, those governing maritime commerce except those relating to marine insurance.

9. *Special laws.* — The most important special laws which repealed, either expressly or impliedly, certain portions of the Code of Commerce are:

(a) The *Corporation Law* (Act No. 1459, as amended, now the Corporation Code of the Philippines, B.P. Big. 68.) which repealed the provisions on *sociedad anonimas* in Book Two of the Code;

(b) The *Negotiable Instruments Law* (Act No. 2031.) which repealed the provisions on Promissory Notes and Bills of Exchange in Book Two of the Code;

(c) The *Securities Act* (C.A. No. 83, as amended, by the Revised Securities Act, B.P. Big. 178, now the repealed Securities Regulation Code, R.A. No. 8799, approved July 19, 2000.) which repealed the provisions on Commercial Houses in Book Two of the Code;

(d) The *Civil Code* (R.A. No. 386, Art. 2270.) which repealed the provisions on Partnership, Agency, Sales, Loan, Deposit, and Guaranty in Book Two of the Code;

(e) The *Insurance Code* (Pres. Decree No. 612, as amended, now the Insurance Code of 1978, Pres. Decree 1460.) which repealed the provisions on Fire and Marine Insurance in Book Two and Three, respectively; and

(f) The *Insolvency Law* (Act No. 1956, as amended.) which repealed the provisions on Suspension of Payments and Bankruptcy in Book Two of the Code.

10. *Others.* — In addition, we have among others, the following fcpedal laws which now form part of the commercial law of the Philippines:

(a) The Chattel Mortgage Law (Act No. 1508, as amended.);
(b) The Usury Law* (Act No. 2855, as amended.);
(c) The Warehouse Receipts Law (Act No. 2137, as amended.);
(d) The Bulk Sales Law (Act No. 3952, as amended.);
(e) The Central Bank Law (R.A. No. 265, as amended.);
(f) The General Banking Act (R.A. No. 337, as amended.);
(g) the Rural Banks Act (R.A. No. 720, as amended.);
(h) The Intellectual Property Code (R.A. No. 8293, as amended.); and
(i) The Business Names Law (Act No. 3883, as amended.)

***With the promulgation of Central Bank Resolution No. 224 (Dec. 3, 1982) and Circular No. 905 (Dec. 10,1982), under the authority granted to the Monetary Board of the Central Bank by the Usury Law, usury has become legally non-existent as die lender and borrower can legally agree on any interest that may be charged on a loan.**

Art. 2. Acts of commerce, whether those who execute them be merchants or not, and whether specified in this Code or not, should be governed by the provisions contained in it, in their absence, by the usages of commerce generally observed in each place; and in the absence of both rules, by those of the civil law>

Those acts contained in this Code and all others of analogous character shall be deemed acts of commerce.

Art. 3. The legal presumption of habitually engaging in commerce shall exist from the moment the person who intends to engage therein announces through circulars, newspapers, handbills, posters exhibited to the public, or in any other manner whatsover, an establishment which has for its object some commercial operation.

1. The presumption of law provided is rebuttable by evidence to the contrary.

Art. 4. Persons who possess the following qualifications shall have legal capacity to habitually engage in commerce:

1. Having Completed the age of twenty-one years.

2. Not being subject to the authority of the father or of the mother nor to marital authority.

3. Having the free disposition of their property.

1. See Article 39, Civil Code. Under the old Civil Code, the age of majority was 23 years (see Art. 320, thereof.); lowered to 21 years by the present Civil Code (Art. 402 thereof,); and further reduced to 18 years by the Family Code. (Art. 234, Executive Order No. 209, as amended by R.A. No. 6809.)

Art. 5. Those under twenty-one years of age and those incapacitated may continue, through their guardians, the business engaged in by their parents or their predecessors. If the guardians do not have legal capacity to trade or are under some disqualifications, they shall be obliged to appoint one or more factors having the legal qualifications who shall substitute them in conduct of the business.

1. Note that the article speaks of the *continuation* of the business engaged in by the parents or their predecessors.

Arts. 6-12 (Repealed.) '

1. These provisions have been impliedly repealed by Article 117 of the Civil Code, now Article 73 of the Family Code, (see also Art. 39, Civil Code.)

Art 13. The following may not engage in commerce nor hold office or have any direct administrative or financial intervention in commercial or industrial companies:

1. Those sentenced to the penalty of civil interdiction, while they have not served their sentence or have not been amnestied or pardoned.

2. Those declared bankrupt, while they have not obtained their discharge or have not been authorized, by virtue, of an agreement accepted at a general meeting of creditors and . approved by judicial authority, to continue at the head of the establishment, the authority being understood in such case as limited to that expressed In the agreement.

3. Those who on account of special laws or provisions cannot trade.

Art. 14. The following cannot engage in the mercantile profession, in person or through another, nor hold office or have any direct administrative or financial intervention in commercial or industrial associations, within the limits of the districts, provinces or towns in which they discharge their duties.

1. Justices, judges and officials of the fiscals' office in active service.

This provision shall not be applicable to the municipal mayors,'judges and prosecuting attorneys, nor to those who may temporarily discharge judicial or prosecution duties.

2. Administrative, economic or military heads of districts, provinces, or posts.

3. Those employed in the collection and administration of funds of the State, appointed by the Government.

Those who administer and collect under contract and their representatives are excepted.

4. Stock and commercial brokers of whatever class they may be.

5. Those who, under special laws and provisions, cannot trade in specified territory.

1. *Two kinds of incapacity to trade.* — They are:

(1) *Absolute incapacity.* — It extends throughout the Philippines, and if notorious or apparent, the act is null and void; if not apparent, that is, one party concealed his incapacity, the other shall have the option to annul or enforce the contract; and

(2) *Relative incapacity.* — It is only co-extensive with the province or town where the officer incapacitated is exercising his functions; and its effect is merely to subject the person violating the prohibition to such disciplinary action or punishment as may be imposed by special laws.

2. Those enumerated in Article 13 are absolutely incapacitated to engage in commerce, while those mentioned in Article 14 are relatively incapacitated. It has been held that Article 14 partakes of the nature of the political law as it regulates the relationship between the government and certain public officers and employees, and upon the transfer of sovereignty from Spain to the United States and later to the Republic of the Philippines, it must be deemed to have been abrogated because where there is a change of sovereignty, the political laws of the former sovereign, whether compatible or not with those of the new sovereign, are automatically abrogated, unless they are expressly reenacted by affirmative act of the new sovereign. (Macariola vs. Asuncion, 114 SCRA 77 [1982].)

3. For other prohibitions, see the new Constitution, Civil Service Decree (Pres. Decree No. 807, as amended.), Anti-Graft and Corrupt Practices Act (R.A. No. 3019, as amended.), and Code of Conduct and Etiiical Standards. (R.A. No. 6713.)

Art. 15. Foreigners and companies created abroad may engage in commerce in the Philippines, subject to the laws of their country with respect to their capacity to contract, and to the provisions of this Code as regard the creation of their establishments in Philippine territory, their mercantile operations, and the jurisdiction of the courts of the nation.

The provisions of the article shall be understood to be without prejudice to what, in particular cases, may be established by treaties or agreements with other powers.

1. This provision is an exception to Article 4 which applies only to Filipino citizens.

2. The right of foreign companies to engage in business in the Philippines is subject to restrictions imposed by special laws such as the Corporation Code of the Philippines (B.P. Big. 68.), the General Banking Act (R.A. No. 337, as amended.), the Insurance Code (Pres. Decree No. 1460, as amended.), etc.

TITLE II

COMMERCIAL REGISTRIES

Art. 16. In all the capitals of provinces shall be opened a mercantile registry composed of two independent books in which shall be inscribed: «

1. Individual merchants.

2. Associations.

3. In the coastal provinces and in the interior ones where it is considered convenient because of the presence of navigation, the registry shall include a third book for the registration of vessels.

1. This airticle has been impliedly superseded by subsequent laws, *(supra.)* Among others, the commercial registries in our jurisdiction are:

(1) *Bureau of Trade Regulation and Consumer Protection.* — For registration of business names;

(2) *Office of the Register of Deeds.* — For registration of chattel mortgages (except vessels) and real mortgages and other transactions relative to real property;

(3) *Securities and Exchange Commission.* — For registration of partnerships and corporations domiciled anywhere in the Philippines, securities, stock exchanges and brokers, dealers and salesmen of securities;

(4) *Bureau of Customs.*—For registration of vessels having their home port in Manila, and the *Office of the Collector of Customs* of the home port for vessels having their home port in another district;

(5) *Land Transportation Office*. — For registration of motor vehicles used or operated, on or upon any public highway of the Philippines;

(6) *Air Transportation Office.* — For registration of civil aircrafts owned by citizens of the Philippines and all transactions affecting the title or interest to any civil aircraft of Philippine registry;

(7) *National Library.* — For registration of copyrights;

(8) *Intellectual Property Office.* — For registration of patents and designs, trademarks, tradenames and service marks;

(9) *Board of Investments.* — For registration of registered and pioneer industries, enterprises; and . ,.

(10) *Office of the Municipal Treasurer.* — For registration of brands of large cattle (municipality where owner is resident) and issuance of certificates of transfer (municipality where contract of sale is made and consummated by the delivery of the cattle).

Art. 17. Registration in the mercantile registry shall be optional for individual merchants and compulsory for associations which are created in accordance with this Code or with special laws, and for vessels.

1. This article has been impliedly superseded by subsequent legislation, *(supra.)* Registration in the commercial registry is compulsory in the case of corporations (Sec. 14, B.P. Big. 68.), limited partnerships irrespective of capital (Art. 1846, Civil Code.), general partnerships with capital of P3,000 or more (Art. 1772, *ibid.),* and vessels of more than three (3) tons gross used in Philippine waters, not being transient of foreign register, (see Sees. 1167 and 1169, Rev. Adm. Code; Sec. 802, Tariff and Customs Code of 1978, Pres. Decree No. 1460, as amended.) For individual merchants, registration is optional.

Art. 18. The unregistered merchant cannot request the inscription of any document in the mercantile registry, nor take advantage of its legal effects.

Art. 19. The register shall keep the books necessary for registration, stamped, folioed and with a memorandum on the first page of the number of pages which each book contains, signed by the justice of the peace.

Where there are several justices of the peace, any one of them may sign the memorandum.

Art. 20. The register shall enter in chronological order in the registry and general index all the merchants and companies which are registered, giving each sheet the correlative number which corresponds to it.

Art. 21. On the record sheet of each merchant or company shall be entered:

1. The name, firm name, or title.
2. The class of commerce or transactions in which engaged.
3. The date on which the transactions shall commence or have commenced.
4. The domicile, with a specification of the branches which may have been established, without prejudice to the registration of the branches in the registry of the province in which they may be domiciled.
5. Instruments for the creation of commercial associations, whatever their object or denomination may be, as well as those for the modification, rescission or dissolution of such associations.
6. (Repealed by Art. 2270[2], Civil Code.)
7. (Impliedly repealed by Art. 117, Civil Code, now Art. 73, Family Code.)
8. (Impliedly repealed by Art. 117, Civil Code, now Art. 73, Family Code.)
9. [Dotal instrument], marriage settlement and the title which prove the ownership of the paraphernal property of the wives of merchants.
10. The issue of shares, certificates, and bonds of railroads and of all classes of associations, be they associations for public works, credit companies, or others, stating the series and number of the certificates of each issue,

their participation, interest, payment and premium, should they have one of the other, the total amount of the issue, and the property, works, rights or,mortgages, should there be any, by which their payment is secured.

The issues which may be made by individuals shall also be recorded in accordance with the provisions of the preceding paragraph.

" 11. (Impliedly repealed by the Central Bank Act [R.A. No. 265, as amended], and the General Banking Act [R.A. No. 337, amended].)

12. (Impliedly repealed by the Patent Law [R.A. No. 167, as amended.] and Trade Mark Law [R.A. No. 166, as amended].)

Foreign associations which desire to establish themselves or create branches in the Philippines shall present and record in the registry, besides their by-laws and the documents required of Filipinos, a certificate issued by the Philippine consul that they are constituted and authorized in accordance with the laws of their respective countries.

Art. 22. ***(Superseded.)***

1. Justices of the peace are now known as judges presiding over Metropolitan Trial Courts, Municipal Trial Courts, or Municipal Circuit Trial Courts. (Judiciary Reorganization Act of 1980, B.P. Big. 129.)

2. Some of the provisions of Article 21 have been impliedly repealed or modified (last par.) by subsequent legislation, *(supra.)*

3. Article 22 has been impliedly superseded by Sections 804805 of the Tariff and Customs Code. (R.A. No. 1937, as amended, now, the Tariff and Custpms Code of 1978, Pres. Decree No. 1460.)

Art. 23. As a general rule, the registration shall be made by virtue of notarial copies of the documents which the interested party may present.

The registration of notes, bonds, or order and bearer instruments which do not carry mortgages of immovable

property shall be made upon presentation of the certified minutes wherein appears the resolution of the person or persons who made the issue, and the conditions, requisites and guaranties thereof.

When these guaranties consist of mortgage of immovables, the corresponding instrument shall be presented for annotation in the mercantile registry.

Art. 24. Unregistered articles of association shall produce effect among the members who execute them, but they shall not prejudice third person who, however, may make use thereof in so far as favorable.

1. Article 24 has been impliedly superseded by the former Corporation Law (Act No. 1459, as amended, now the Corporation Code of the Philippines, B.P. Big. 68; see Sec. 6.) as to corporations and by the Civil Code (R.A. No. 386; see Arts. 1768, 1772, and 1844.) as to partnerships.

Art. 25. All the resolutions or acts which effect an increase or reduction in the capital of commercial associations, whatever their denomination may be, and those which modify or alter the conditions of recorded instruments, shall also be recorded in the mercantile registry.

The omission of this requisite shall produce the effects mentioned in the preceding article.

(1) The above provision has been impliedly repealed by the fonner Corporation Law (see Sees. 17-18.) and by the Civil Code. As to *limited* partnerships, it may still apply, (see Arts. 1864-1865, Civil Code.)

Art. 26. Registered documents shall produce legal effect to the prejudibe Of third persons only from the date of their registration, ahd cannot be invalidated by prior or subsequent unregistered documents.

1. This provision gives the effects of registration in a commercial registry. It refers only to registered documents which are required by law to be registered. (Sp. Sup. Court, Dec., Jan. 8, 1886.) The registration of other documents will not prejudice third persons.

Art. 27. [Dotal] instruments [and those] referring to paraphernal property or the merchant's wife, not registered in the mercantile registry, shall have no right of preference over other credits.

Immovable property and real rights over them, acquired by the wife prior to the creation of the concurrent credits, shall be excepted.

Art. 28. If a merchant should fail to make in the registry the inscription of the [dotal or] paraphernal property of his wife, the latter herself may request it or it may be done for her by her parents, by brothers or uncles by consanguinity, as well as by those who discharge or may have discharged the duties of guardians or curators of the wife, [or who constitute or may have constituted the dowry].

1. As to dotal property, it shall be understood to be no longer included in the above articles, dowries having been eliminated by the Civil Code.

Art. 29. (Repealed by Art. 2270[2], Civil Code.)

Art. 30. The mercantile registry shall be public. The registrar shall furnish those who may request it any data referring to what may appear on the registration sheet of each merchant, association or vessel. Likewise, he shall issue true copies of the whole or part of said sheet to anyone who may ask for it in a signed request.

Arts. 31 and 32. (Impliedly repealed by Arts. 31 and 32, the Securities Act [C.A. No. 83, as amended.], repealed by the Revised Securities Act [B.P. Big. 178], now the Securities Regulation Code, R.A. No. 8799, approved July 19,2000.)

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TITLE III

BOOKS AND BOOKKEEPING OF COMMERCE

Art. 33. Merchants shall necessarily keep:

1. A book of inventories and balances.
2. A journal.
3. A ledger.
4. A book or books for copies of letters and telegrams.
5. Other books which may be required by special laws.

Associations and companies shall also keep a book or books of minutes, in which shall be entered all resolutions referring to the progress and operations of the entities, approved at general meetings or at those of managing boards.

Art. 34. They may also keep other books which they may deem convenient, according to the system of bookkeeping they may adopt.

These books shall not be subject to the provisions of Article 36; but they may legalize those which they may consider proper.

Art. 35. Merchants may keep their books personally or through persons whom they authorize for the purpose.

If a merchant does not keep his books personally, authorization shall be presumed granted to him who keeps them unless there is proof to the contrary.

Art. 36. Merchants shall present the books referred to in Article 33, bound, ruled, and folioed, to the justice of the peace of the municipality in which they have their commercial establishments in order that he may put on the first page of each one a signed memorandum of the number of pages which the book contains.

The seal of the justice of the peace legalizing it shall, furthermore, be stamped on all the pages of each book.

Art. 37. The book of inventories and balance shall begin with the inventory which the merchant must prepare at the time he starts his operations, and shall contain:

1. An exact statement of the money, securities, credits, notes receivable, movable and immovable property, merchandise and goods of all kinds, appraised at their true value, and which constitute his assets.

2. An exact statement of the debts and all kinds of pending obligations, should there be any, and which form his liabilities..

3. He shall determine, in proper cases, the exact difference between the assets and the liabilities, which shall be the capital with which he begins his operations.

The merchant shall, furthermore, prepare annually and enter in the same book the general balance of his business, with the details mentioned in this article, and in accordance with the entries in the journal, without any reservations or omissions, under his signature and responsibility.

Art. 38. In the journal shall be entered as the first item the result of the inventory mentioned in the preceding article, divided into one or various consecutive accounts, according to the system of bookkeeping adopted.

Thereafter, all his operations shall follow day by day, each entry stating the credit and debit of the respective accounts.

When the operations are numerous, whatever their importance may be, or when they have taken place outside the domicile, those referring to each account and which have taken place in each day may be included in a single entry, but observing in their statement, if itemized, the same order in which they took place.

Likewise, the amounts which the merchant uses for his household expenses shall be entered on the date on which they are withdrawn from the funds, and they shall be carried into a special account to be opened for that purpose in the ledger.

Art. 39. The accounts referring to each object or person in particular shall, furthermore, be opened with Debit and Credit in the ledger, and to each of these accounts shall be transferred, in strict order of dates, the entries in the journal referring to them.

Art. 40. In the book of minutes which each association shall carry shall be entered verbatim the resolutions agreed upon at its meetings or at those of its managers, stating the date of each one, those present in them, the votes cast, and other matters conductive to an exact knowledge of what was agreed upon, authenticated with the signatures of the managers, directors or administrators charged with the management of the association or designated by the by-laws or regulations by which it is governed.

Art. 41. All the letters which a merchant may write regarding his business and the telegraphic dispatches which he may send shall be transferred, either by hand or by any mechanical means, to the book for copies, fully and successively by order of dates, including the subscribing clause and the signatures.

Art. 42. Merchants shall carefully keep, in bundles and in proper order, the letters and telegraphic dispatches which they may receive relative to their transactions.

Art. 43. Besides complying with and fulfilling the conditions and formalities prescribed in this title, merchants must keep their books with clearness, in the order of dates, without blanks, interpolations, erasures or blots, and without showing signs of having been altered by substituting or tearing out folios, or in any other manner whatsoever.

Art. 44. Merchants shall correct the errors or omissions which they may make in entering in their books, immediately upon noticing them, explaining clearly in what they consisted, and writing the entry as it should have been written.

If some time should have elapsed since the error was committed or since the omission was incurred, they shall make the proper entry of correction, adding on the margin of the erroneous entry a memorandum indicating the correction.

Art. 45. No judge or court or authority may, oh his own initiative, make an inquiry to ascertain if merchants keep their books in accordance with the provisions of this Code, nor make a general investigation or examination of the bookkeeping in the offices or counting-houses of merchants.

Art. 46. Neither may the communication, delivery or general examination of the books, correspondence and other documents of merchants, be decreed at the instance of a party, except in the cases of liquidation, universal succession or bankruptcy.

Art. 47. Outside of the cases mentioned in the preceding article, the exhibition of the books and documents of merchants may be decreed at the instance of a party or at the initiative of the court, only when the person to whom they belong has an interest or responsibility in the case in which the exhibition is made.

[The examination shall be made in the counting-house of the merchant, in his presence or in that of the person whom he commissions, and shall be limited to the points related to the question at issue; these being the only ones that may be verified.]

Art. 48. In order to measure the probative force of the books of merchants, the following rules shall be observed:

1. The books of merchants shall be evidence against themselves, no proof to the contrary being admissible; but the adverse party cannot accept the entries which may be favorable to him and reject those which may prejudice him, but having accepted this means of proof, he shall be bound by the result which it may show in its entirety, taking into equal consideration all the entries: relative to the question in litigation.

2. If there should be a conflict in the entries of the books kept by two merchants, and those of one should have been kept with all the formalities mentioned in this title, and those of the other should suffer from any defect or should lack the requisites prescribed by this Code,

the entries of the books properly kept shall be admitted against those of the defective one, unless the contrary is shown by means of other evidence admissible in law.

3. If one of the merchants should not present his books or should manifest that he does not have them, those of his adversary, kept with all the legal formalities, shall be admitted against him, unless it is shown that the absence of such books is due to *force majeure*, and always saving proof by other means admissible in suits against the entries exhibited.

4. If the books of the merchants should have all the legal requisites and should be contradictory, the court shall decide by the other proofs, weighing them according to the general rules of law.

Art. 49. Merchants and their heirs or successors shall keep the books, telegrams, and correspondence of their business in general, during all the time that this may last for five years after the liquidation of all their business and commercial affairs.

Documents which specially concern specific acts or transactions may be rendered useless or destroyed upon the lapse of the prescriptive period of the actions which may arise therefrom, unless some questions referring directly or indirectly to them should be pending, in which case, they must be kept until conclusion thereof.

1. Article 33 enumerates the books which merchants are required to keep. The keeping of books is likewise required by the Corporation Code of the Philippines (see Sec. 74, B.P. Big. 68.) and the National Internal Revenue Code, (see Sec. 319, Pres. Decree No. 1158, as amended.) The keeping of optional or subsidiary book is allowed. (Art. 34; see Sees. 272-273, NIRC.)

2. Article 46 and the second paragraph of Article 47 should be deemed superseded by Section 1, Rule 27 of the Rules of Court. A director, member, or stockholder, or a partner has the right to inspect and examine the books of a corporation (see Sec. 74, B.P. Big. 68.) or a partnership, (see Art. 1805, Civil Code.)

3. Under the National Internal Revenue Code, all books of accounts must be preserved for a period beginning from the last entry in each book, until the last day prescribed within which the Commissioner of Internal Revenue is authorized to make a tax assessment, (see Sees. 275, 266, Pres. Decree No. 1158, as amended.)

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TITLE IV

GENERAL PROVISIONS RELATING TO COMMERCIAL CONTRACTS

Art. 50. Commercial contracts, in everything relative to their requisites, modifications, exceptions, interpretations and extinction and to the capacity of the contracting parties, shall be governed in all matters not expressly provided for in this Code or in special laws, by the general rules of the civil law.

Art. 51. Commercial contracts shall be valid and shall give rise to obligations and causes of action in suits, whatever the form and language in which they may be executed, the class to which they may belong, and the amount they may involve, provided their existence is shown by any means established by the civil law. However, the testimony of witness alone shall not be sufficient to prove the existence of a contract which involves an amount exceeding 1,500 pesetas unless supported by some other evidence.

Art. 52. From the provisions of the preceding article shall be excepted:

1. Contracts which, in accordance with this Code or with special laws, must be reduced to writing or require forms or formalities necessary for their efficacy.

2. Contracts executed in a foreign country in which the law requires certain instruments, forms or formalities for their validity, although Philippine law does not require them.

In either case, contracts which do not satisfy the circumstances respectively required shall not give rise to obligations or causes of action.

Art. 53. Illicit agreements do not give rise to obligations or causes of action even if should they refer to commercial transactions.

Art. 54. Contracts entered into by correspondence shall be perfected from the moment an answer is made accepting the offer or the conditions by which the latter may be modified.

Art. 55. Contracts in which an agent or broker intervenes shall be perfected when the contracting parties shall have accepted his offer.

Art. 56. In a commercial contract in which a penalty for indemnification against the party failing to comply therewith is fixed, the injured party may demand through legal means the fulfillment of the contract or the penalty stipulated; but the recourse to one of these actions shall extinguish the other unless the contrary is stipulated.

Art. 57. Commercial contracts shall be executed and complied with in good faith, according to the terms in which they were made and drawn up, without evading through arbitrary Interpretations the plain, proper and usual meaning of the spoken or written words, or limiting the effects which are naturally derived from the manner in which the contracting parties may have expressed their will and contracted their obligations.

Art. 58. If a discrepancy should appear between the copies of a contract which the contracting parties present, and, in its execution, an agent or broker should have intervened, that which appears in the books of the latter shall prevail provided they are kept in accordance with law.

Art. 59. If doubts which cannot be decided in accordance with what is provided in Article 2 of this Code should arise, the question shall be decided in favor of the debtor.

Art. 60. In all computations of days, months and years, it shall be understood that a day has twenty[four hours, the months as designated in the Gregorian calendar, and the year has three hundred sixty-five days.

Bills of exchange, promissory notes, and loans, with respect to which that specially provided for them by this Code shall govern, are expected.

Art. 61. Days of grace, courtesy or other which under any name whatsoever defer the fulfillment of commercial obligations, shall not be recognized, except those which the parties may have previously fixed in the contract or which are based on a definite provision of law.

Art. 62. Obligations which do not have a period previously fixed by the parties or by the provisions of this Code, shall be demandable ten days after having been contracted if they give rise only to an ordinary action, and on the next day if they involve immediate execution.

Art. 63. The effect of default in the performance of commercial obligations shall commence:

1. In contracts with a day for performance fixed by the will of the parties or by the law, on the day following their maturity.

2. In those which do not have such day fixed, from the day on which the creditor makes a judicial demand on the debtor or notifies him of the protest for loss and damages made against him before a judge, notary or other public official authorized to admit the same.

1. The above articles have been modified or superseded by subsequent legislation *(supra.)* and should, therefore, be deemed applicable only to commercial contracts governed by the provisions of the Code of Commerce which are still in force but not to those covered by such legislation, (see Arts. 13,17-18,1159,11691170, 1197, 1227, 1306, 1319, 1322-1323, 1356-1358, 1370-1379, 1402[2], 1409, and 2252-2270, Civil Code.)

2. It has been held that an action based on an oral contract of transportation of goods by Water is an action in admiralty which comes under the original and exclusive jurisdiction of the Court of First Instance (now Regional Trial Court) irrespective of the value of the cargo. And where the action is brought principally for the enforcement of maritime lien against the property of the defendants who failed to pay the charter hire fee, the fact that one of the defendants is a non-resident alien is not essential to the court's acquisition of jurisdiction over the *res* in question

since the action is in the nature and character of a proceeding *quasi in rem.* An action *quasi in rem* has been defined as "an action between parties where the direct object is to reach and dispose of property owned by them or of some interest therein. In such action, the jurisdiction of the court is based exclusively on the power which, under die law, it possesses over the property. If a non-resident defendant remaining beyond die range of the personal process of the court, refuses to come in voluntarily, the court never acquires jurisdiction over his person at all. But any discussion relative to die jurisdiction of die court over his person is entirely apart from die case. (Quasha Asperilla Ancheta Valmonte Pena & Marcos vs. Juan, 118 SCRA 505 [1982].)

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BOOKTWO

SPECIAL COMMERCIAL CONTRACTS

TITLE VII

COMMERCIAL CONTRACTS OF TRANSPORTATION OVERLAND

Article 349. A contract of transportation by land or water ways of any kind shall be considered commercial:

1. When it has for its object merchandise or any article of commerce.

2. When, whatever its object may be, the carrier is a merchant or is habitually engaged in transportation for the public.

Art. 350. The shipper as well as the carrier of merchandise or goods may mutually demand that a bill of lading be made, stating:

1. The name, surname and residence of the shipper.

2. The name, surname and residence of the carrier.

3. The name, surname and residence of the person to whom or to whose order the goods are to be sent or whether they are to be delivered to the bearer of said bill.

4. The description of the goods, with a statement of their kind, of their weight, and of the external marks or signs of the packages in which they are contained.

5. The cost of transportation.

6. The date on which shipment is made.

7. The place of delivery to the carrier.

8. The place and the time at which delivery to the consignee shall be made.

9. The indemnity to be paid by the carrier in case of delay, if there should beany agreement on this matter.

Art. 351. In transportation made by railroads or other enterprises subject to regulation rate and time schedules, it shall be sufficient for the bills of lading or the declaration of shipment furnished by the shipper to refer, with respect to the cost, time and special conditions of the carriage, to the schedules and regulations the application of which he requests; and if the shipper does not determine the schedule, the carrier must apply the rate of those which appear to be the lowest, with the conditions inherent thereto, always including a statement or reference to in the bill of lading which he delivers to the shipper.

Art. 352. The bills of lading, or tickets in cases of transportation of passengers, may be diverse, some for persons and others for baggage; but all of them shall bear the name of the carrier, the date of shipment, the points of departure and arrival, the cost, and, with respect to the baggage, the number and weight of the packages, with such other manifestations which may be considered necessary for their easy identification.

Art. 353. The legal evidence of the contract between the shipper and the carrier shall be the bills of lading, by the contents of which the disputes which may arise regarding their execution and performance shall be decided, no exceptions being admissible other than those of falsity and material error in the drafting.

After the contract has been complied with, the bill of lading which the carrier has issued shall be returned to him, and by virtue of the exchange of this title with the thing transported, the respective obligations and actions shall be considered cancelled, unless in the same act the claim which the parties may wish to reserve be reduced to writing, with the exception of that provided for in Article 366.

In case the consignee, upon receiving the goods, cannot return the bill of lading subscribed by the carrier, because of its loss or of any other cause, he must give

the latter a receipt for the goods delivered, this receipt producing the same effects as the return of the bill of lading.

Art. 354. In the absence of a bill of lading, disputes shall be determined by the legal proofs which the parties may present in support of their respective claims, according to the general provisions established in this Code for commercial contracts.

1. For comments on bills of lading, see pp. 602-612.

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TITLE XIII

LETTERS OF CREDIT

Art. 567. Letters of credit are those issued by one merchant to another or for the purpose of attending to a commercial transaction.

Art. 568. The essential conditions of letters of credit shall be:

To be issued in favor of a definite person and not to order.

To be limited to a fixed and specified amount, or to one or more undetermined amounts, but within a maximum the limits of which has to be stated exactly.

Those which do not have any of these last circumstances shall be considered as mere letters of recommendation.

Art. 569. The drawer of a letter of credit shall be liable to the person on whom it was issued, for the amount paid by virtue thereof, within the maximum fixed therein.

Letters of credit may not be protested even should they not be paid, nor shall the bearer thereof acquire any right of action by reason of such non-payment against the person who issued it.

The person paying shall have the right to demand the proof of the identity of the person in whose favor the letter of credit was issued.

Art. 570. The drawer of a letter of credit may annul it, informing the bearer and the person to whom it is addressed of such revocation.

Art. 571. The bearer of a letter of credit shall pay the amount received to the drawer without delay.

Should he not do so, an action involving execution may be brought to recover it, with legal interest and the current exchange in the place where payment was made on the place where it is repaid.

Art. 572. If the bearer of a letter of credit does not make use thereof within the period agreed upbn with the drawer, or, in default of a period fixed, within six months, counted from its date, in any point in the Philippines, and within twelve months outside thereof, it shall be void in fact and in law.

Letter of credit defined.

A *letter of credit* is a letter from a merchant or bank or banker in one place, addressed to another, in another place or country, requesting the addressee to pay money or deliver goods to a third party named, therein the writer of the letter undertaking to provide him the money for the goods or to repay him.

It is a letter requesting one person to make advances to a third person on the credit of the writer, (see Bouvier's Law Dictionary, 3rd, pp. 1933-1934.)

Contracts involved in a letter of credit.

In a letter of credit, there are three distinct and independent contracts:

(1) the contract of sale between the buyer and the seller,
(2) the contract of the buyer with the issuing bank, and
(3) the letter of credit proper in which the bank promises to pay the seller pursuant to the terms and conditions stated therein.

"Few things are more clearly settled in law than that the three contracts which make up the letter of credit arrangement are to be maintained in a state of perpetual separation." A transaction involving the purchase of goods may also require, apart from a letter of credit, a contract of transportation specially when the seller and the buyer are not in the same locale or country, and the goods purchased have to be transported to the latter.

Hence, a contract of carriage stipulated in a bill of lading must be treated independently of the contract of sale between the seller and the buyer, and the contract for the issuance of a letter of credit between the buyer and the issuing bank. Any discrepancy between the amount of the goods described in the commercial invoice in the contract of sale and the amount allowed in the letter of credit will not affect the validity and enforceability of the contract of carriage as embodied in the bill of lading. As the bank cannot be expected to look beyond the documents presented to it by the seller pursuant to the letter of credit, neither can the carrier be expected to go beyond the representations of the shipper in the bill of lading and to verify their accuracy *vis-avis* the commercial invoice and the letter of credit. Thus, the discrepancy between the amount of goods indicated in the invoice and the amount in the bill of lading cannot negate the consignee's obligation to the carrier arising from the contract of transportation. The consignee's remedy lies against the seller/ shipper, not against the carrier. (Keng Hua Paper Products Co., Inc. vs. Court of Appeals, 286 SCRA 257 [1998].)

Parties to a letter of credit.

Parties to a commercial letter of credit include:

(1) the buyer or importer;

(2) the seller, also referred to as beneficiary;

(3) the opening bank which is usually the buyer's bank which actually issues the letter of credit;

(4) the notifying bank which is the correspondent bank of the opening bank through which it advises the beneficiary of the letter of credit;

(5) negotiating bank which is usually any bank in the city of the beneficiary. The services of the notifying bank must always be utilized if the letter of credit is to be advised to the beneficiary through cable;

(6) the paying bank which buys or discounts the drafts contemplated by the letter of credit, if such draft is to be drawn on the opening bank or on another designated bank not in the city of the beneficiary. As a rule, whenever the facilities of the opening bank are used, the beneficiary is supposed to present his drafts to the notifying bank for negotiation; and

(7) the confirming bank which, upon the request of the beneficiary, confirms the letter of credit issued by the opening bank. (Lee vs. Court of Appeals, 375 SCRA 579 [2002].)

Nature of a letter of credit.

(1) A letter of credit is nothing more than a commitment by the issuer that the party in whose favor it is issued and who can collect upon it, will have his credit against the applicant of the letter duly paid in the amount therein specified. A letter of credit which states that the bill shall be duly honored on presentation is not a contract between the applicant and the issuing bank or between the applicant and the Central Bank. The contract in which the applicant is a party and on which he can claim a violation of vested rights is his application for the issuance of the letter of credit. (Climaco vs. Central Bank of the Phils., Vol. 8, Court of Appeals Reports 414, No. 34, 691-R, Sept. 16,1965.)

(2) It is in the nature of a guaranty and has been said to partake of a negotiable instrument so far as it is a contract to accept bills or drafts to be drawn in the future in accordance with the terms of the letter.[1] (11 Am. Jur. 2d p. 56.)

(3) Letters of credit under the Code of Commerce, however, are not negotiable instruments being issued in favor of a specified person and not to order, (see Art. 568.)

(4) The bearer of the letter of credit is not considered bound to receive die money; he may use the letter as he pleases, and the contracts an obligation only by receiving the money. (Bouvier's Law Dictionary, 3rd, p. 1934; see Art. 572.)

(5) Letters of credit were developed for the purpose of insuring to a seller payment of a definite amount upon the presentation of documents and is thus a commitment by the issuer that the party in whose favor it is issued and who can collect upon it will have his credit against the applicant of the letter, duly paid in the amount specified in the letter. They are in effect absolute undertakings to pay the money advanced or the amount for which credit is given on the faith of the instrument. They

'It is not to be distinguished from a trust receipt, (see 'Trust Receipt Law," *infra.)*

are primary obligations and not accessory contracts and while they are security arrangements, they are not converted thereby into contracts of guaranty. What distinguishes letters of credit from other accessory contracts, is the engagement of the issuing bank to pay the seller once the draft and other required shipping documents are presented to it. They are definite undertakings to pay at sight once the documents stipulated therein are presented.

Purpose of a letter of credit.

Modern letters of credit are usually not made between natural persons. They involve bank to bank transactions. Historically, the letter of credit was developed to facilitate the sale of goods between distant and unfamiliar buyers and sellers. It was an arrangement under which a bank, whose credit was acceptable to die seller, would at the instance of the buyer agree to pay drafts drawn on it by the seller, provided that certain documents are presented such as bills of lading accompanied the corresponding drafts. Expansion in the use of letters of credit was a natural development in commercial banking. (Lee vs. Court of Appeals, 375 SCRA 579 [2002].)

The typical setting and purpose of a letter are described as follows:

> "Commercial letters of credit have come into general use in international sales transactions where much time necessarily elapses between the sale and die receipt by a purchaser of the merchandise, during which interval great price charges may occur. Buyers and sellers struggle for the advantage of position. The seller is desirous of being paid as surely and as soon as possible, realizing that the vendee at a distant point has it in his power to reject on trivial grounds merchandise on arrival, and cause considerable hardship to the shipper. Letters of credit meet this condition by affording celerity and certainty of payment. Their purpose is to insure to a seller payment of a definite amount upon presentation of documents. The bank deals only with documents. It has nothing to do with the quality of the merchandise. Disputes as to the merchandise shipped may arise and be litigated

later between vendor and vendee, but they may not impede acceptance of drafts and payment by the issuing bank when the proper documents are presented." (Prudential Bank vs. Intermediate Appellate Court, 216 SCRA 257 [1992], citing Hibernia Bank & Trust Co. vs. J. Aron & Co., Inc., 134 Misc. 18,21-22,233 N.Y. 480,490-491.)

Failure to open letter of credit within the period agreed upon.

Such failure suffices to prevent a binding juridical tie from being created. To bind the offeror, the offeree must comply with the conditions of the offer. (Sycip vs. National Coconut Corp. & Board of Liquidators, [unrep.] 98 Phil. 1012 [1956]; Namarco vs. Alto Surety & Ins. Co., Inc., 21 SCRA 359 [1967].)

Nature of legal relations arising from letter of credit.

Such letter may be made conditional. It is absolutely necessary for the protection of the banking and mercantile community diat all conditions contained in the letter be strictiy complied with, however, onerous they may be. The seller should strictly observe the terms and conditions under which the credit is to become available, and unless he does this, he will have no cause of action against the bank for refusing to honor his draft.

Where, therefore, legal relations arise from a letter of credit, such letter contains the entire contract of the parties, and their resulting obligations should be measured by its provisions. It constitutes the complete agreement and is independent of the contract of sale between the buyer and the seller, and is unaffected by any breach of contract on the part of die seller or the buyer or by any controversy which may arise between the buyer and the seller or by any other transaction between the buyer and seller. (Namarco vs. Adas Trading Dev. Corp., *supra.,* citing Zollman on Banks and Banking, pp. 11-12,24-25.)

A material variance between what was provided for in the contract of sale and the letter of credit which, under the contract had to be opened, and the effectivity of which required that "all conditions contained [in it] be strictly complied with, however onerous they may be," would excuse non-performance by the seller. (Namarco vs. Atlas Trading Dev. Corp., *supra.)*

When letter of credit considered consummated contract.

An irrevocable letter of credit granted by a bank, which authorized a creditor in a foreign country to draw upon a debtor of another and to negotiate die draft through the agent or correspondent bank or any bank in the country of the creditor, is consummated contract, when the agent or correspondent bank or any bank in the country of the creditor pays or delivers to the latter the amount in foreign currency, as authorized by the bank in the country by the debtor in compliance with the letter of credit granted by it.

It is the date of the payment of the amount in foreign currency to the creditor in his country by the agent or correspondent bank of the bank in the country of the debtor that turns from executory to executed or consummated contract. It is not the date of payment by the debtor to the bank in his country of the amount of foreign exchange sold that makes the contract executed or consummated, because the bank may grant the debtor extension of time to pay such debt. (Belman Compania Incorporada vs. Central Bank of the Phil., 104 Phil. 877 [1958].)

ILLUSTRATIVE CASES:

1. Correspondent bank was held liable by the lower court under a letter of credit despite non-compliance by the beneficiary with the terms thereof

Facts: BV agreed to sell lawn logs FOB to AC who after inspecting the same issued a purchase order. On arrangements made and upon the instructions of the consignee, HTD of California, SPN Bank, also of California, issued an irrevocable letter of credit at sight in favor of BV for the sum of $54,000, the total purchase price of the logs. The letter was mailed to petitioner FTBC (bank), with instruction to the latter that it "forward the enclosed letter of credit to the beneficiary." It further provided that the draft to be drawn is on SPN and that it be accompanied by the documents specified therein. Also incorporated by reference is the Uniform Customs and Practice for Documentary Credits (1962 Revision).

The logs were thereafter loaded in a vessel chartered by AC. After the logs were inspected by customs inspectors who certified to their good condition and exportability and the loading was completed, AC refused to issue the certification as required in paragraph 4 of the letter of credit despite several requests made by BV. Because of the absence of the certification, FBTC refused to advance the payment on the letter of credit which lapsed without BV receiving any certification from AC.

Meanwhile, the logs arrived in Korea and were received by the consignee, HTO to whom AC sold the logs at a profit. HTD sold the logs to a lumber company in Korea.

BV instituted an action for mandamus and specific performance against AC and FBTC. The latter was impleaded as defendant only to afford complete relief should the court order AC to execute the required certification. While the case was pending, AC left the Philippines. Hence, BV filed an amended complaint to make FBTC solidarity liable with AC.

Issue: The principal issue in this case is whether or not a correspondent bank is to be held liable under the letter of credit despite non-compliance by the beneficiary with the terms thereon.

(1) Commercial transactions involving letters of credit governed by the rule of strict compliance.—"It is a settled rule in commercial transactions involving letters of credit that the documents tendered must strictly conform to the terms of the letter of credit. The tender of documents by the beneficiary (seller) must include all documents required by the letter. A correspondent bank which departs from what has been stipulated under the letter of credit, as when it accepts a faulty tender, acts on its own risks and it may not thereafter be able to recover from the buyer or the issuing bank, as the case may be, the money thus paid to the beneficiary. Thus, the rule of strict compliance.

In the United States, commercial transactions involving letters of credit are governed by the rule of strict compliance. In the Philippines, the same holds true. The same rule must also be followed.

The case of *Anglo-South American Trust Co. v. Uhe, et al* (184 N.E. 741 [1933].) expounded clearly on the rule of strict compliance.

'We have heretofore held that these letters of credit are to be strictly complied with, which documents, and shipping documents must be followed as stated in the letter. There is no discretion in the bank or trust company to waive any requirements. The terms of the letter constitute an agreement between the purchaser and the bank'

Although in some American decisions, banks are granted a little discretion to accept a faulty tender as when the other documents may be considered immaterial or superfluous, this theory could lead to dangerous precedents. Since a bank deals only with documents, it is not in a position to determine whether or not the documents required by the letter of credit are material or superfluous. The mere fact that the document was specified therein readily means that the document is of vital importance to the buyer.

Moreover, the incorporation of the Uniform Customs and Practice for Documentary Credit (U.C.P. for short) in the letter of credit resulted in the applicability of the said rules in the governance of the relations between the parties."

(2) *U.C.P. applicable.* — "And even if the U.C.P. was not incorporated in the letter of credit, we have already ruled in the affirmative as to the applicability of the U.C.P. in cases before us.

In *Bank of P.I. v. De Nery* (35 SCRA 256 [1970].), we pronounced that the observance of the U.C.P. in this jurisdiction is justified by Article 2 of the Code of Commerce. Article 2 of the Code of Commerce enunciates that in the absence of any particular provision in the Code of Commerce, commercial transactions shall be governed by the usages and customs generally observed.

There being no specific provision which governs the legal complexities arising from transactions involving letters of credit not only between the banks themselves but also between banks and seller and /or buyer, the applicability of the U.C.P. is undeniable.

The pertinent provisions of the U.C.P. (1962 Revision) are:

'Article 3. An irrevocable credit is a definite undertaking on the part of the issuing bank and constitutes the engagement of that bank to the beneficiary and *bona fide* holders of drafts drawn and /or documents presented thereunder, that the provisions for payment, acceptance or negotiation contained in the credit will be duly fulfilled, *provided that all the terms and conditions of the credit are complied with.*

An irrevocable credit may be advised to a beneficiary through another bank (the advising bank) without engagement on the part of that bank, but when an issuing bank authorizes or requests another bank to confirm its irrevocable credit and the latter does so, such confirmation constitutes a definite undertaking of the confirming bank.. /

'Article 7. Banks must examine all documents with reasonable care to ascertain that they appear on their face to be in accordance with the terms and conditions of the credit.'

'Article 8. Payment, acceptance or negotiation against documents which appear on *their face to be in accordance with the terms and conditions of a credit* by a bank authorized to do so, binds the party giving the authorization to take up documents and reimburse the bank which has effected the payment, acceptance or negotiation.' (Emphasis Supplied.)"

(3) *Refusal of FBTC to pay beneficiary justified.* — "Under the foregoing provisions of the U.C.P., the bank may only negotiate, accept or pay, if the documents tendered to it are on their face in accordance with the terms arid conditions of the documentary credit. And since a correspondent bank, like the petitioner, principally deals only with documents, the absence Of any document required in the documentary credit justifies the refusal by the correspondent bank to negotiate, accept or pay the beneficiary, as it is not its obligation to look beyond the documents. It merely has to rely on the completeness of the documents tendered by the beneficiary."

(4) *Irrevocable credit different from confirmed credit.* — "In regard to the ruling of the lower court and affirmed by the Court of Appeals that the petitioner is not a notifying bank but a confirming bank, we find the same erroneous. The trial court wrongly mixed up the meaning of an irrevocable credit with that of a confirmed credit. In its decision, the trial court ruled that the petitioner, in accepting the obligation to notify the respondent that the *irrevocable credit* has been transmitted to the petitioner on behalf of the private respondent, has confirmed

the letter. The trial court appears to have overlooked the fact that an irrevocable credit is not synonymous with a confirmed credit. These types of letters have different meanings and the legal relations arising from them varies. A credit may be an irrevocable credit and at the same time a confirmed credit or *vice versa.*

An *irrevocable credit* refers to the duration of the letter of credit. What it simply means is that the issuing bank may not, without the consent of the beneficiary (seller) and the applicant (buyer), revoke his undertaking under the letter. The issuing bank does not reserve the right to revoke the credit. On the other hand, *a confirmed letter of credit* pertains to the kind of obligation assumed by the correspondent bank. In this case, the correspondent bank gives an absolute assurance to the beneficiary that it will undertake the issuing bank's obligation as its own according to the terms and conditions of the credit. (Agbayani, Commercial Laws of the Philippines, Vol. 1, pp. 8183.)

Hence, the mere fact that a letter of credit is irrevocable does not necessarily imply that the correspondent bank in accepting the instructions of the issuing bank has also confirmed the letter of credit."

(5) *Functions assumed by correspondent bank.* — "Another error which the lower court and the Court of Appeals made was to confuse the obligation assumed by the petitioner.

In commercial transactions involving letters of credit, the functions assumed by a correspondent bank are classified according to the obligations taken up by it. The correspondent bank may be called a notifying bank, a negotiating bank, or a confirming bank.

In case of a *notifying bank,* the correspondent bank assumes no liability except to notify and/or transmit to the beneficiary the existence of the letter of credit (Kronman and Co., Inc. v. Public National Bank of New York, 218 N.Y.S. 616 [1926]; Shaterian, Export-Import Banking, p. 292, cited in Agbayani, Commercial Laws of the Philippines, Vol. 1, p. 76.) A *negotiating bank,* on the other hand, is a correspondent bank which buys or discounts a draft under the letter of credit. Its liability is dependent upon the stage of the negotiation. If before negotiation, it has no liability with respect to the seller but after negotiation, a contractual relationship will then prevail between the negotiating bank and the seller. (Scanlon v. First National Bank of Mexico, 162 N.E. 567 [1928]; Shaterian, Export-Import Banking, p. 293, cited in Agbayani, Commercial Laws of the Philippines, Vol. 1, p. 76.)

In the case of a *confirming bank,* the correspondent bank assumes a direct obligation to the seller and its liability is a primary one as if the correspondent bank itself had issued the letter of credit. (Shaterian, Export-Import Banking, p. 294, cited in Agbayani Commercial Laws of the Philippines, Vol. 1, p. *77.)"*

(6) *FBTC is only a notifying bank.* — "In this case, the letter merely provided that the petitioner forward the enclosed original credit to the beneficiary. Considering the aforesaid instruction to the petitioner by die issuing bank, the Security Pacific National Bank, it is indubitable that the petitioner is only a notifying bank and not a confirming bank as ruled by the courts below.

If the petitioner was a confirming bank, then a categorical declaration should have been stated in the letter of credit that the petitioner is to honor all drafts drawn in conformity with the letter of credit. What was simply stated therein was the instruction that the petitioner forward the original letter of credit to the beneficiary.

Since the petitioner was Only a notifying bank, its responsibility was solely to notify and/or transmit the documentary of credit to the private respondent and its obligation ends there.

The notifying bank may suggest to the seller its willingness to negotiate, but this fact alone does not imply that the notifying bank promises to accept the draft drawn under the documentary credit.

A notifying bank is not a privy to the contract of sale between the buyer and the seller, its relationship is only with that of the issuing bank and not with the beneficiary to whom he assumes no liability. It follows, therefore, that when the petitioner refused to negotiate with the private respondent, the latter has no cause of action against the petitioner for the enforcement of his rights under the letter, (see Kronman and Co., Inc. v. Public National Bank of New York, *supra.)"*

(7) *No evidence that FBTC confirmed the letter of credit.* — "In order that the petitioner may be held liable under the letter,

there should be proof that the petitioner confirmed the letter of credit.

The records are, however, bereft of any evidence which will disclose that the petitioner has confirmed the letter of credit. The only evidence in this case, and upon which the private respondent premised his argument, is the P75,000.00 loan extended by the petitioner to him.

The private respondent relies on this loan to advance his contention that die letter of credit was confirmed by the petitioner. He claims that the loan was granted by the petitioner to him, 'in anticipation of the presentment of die letter of credit.'

The proposition advanced by the private respondent has no basis in fact or law. That the loan agreement between them be construed as an act of confirmation is rather far-fetched, for it depends principally on speculative reasoning.

As earlier stated, there must have been an absolute assurance on the part of the petitioner that it will undertake the issuing bank's obligation as its own. Verily, the loan agreement it entered into cannot be categorized as an emphatic assurance that it will carry out the issuing bank's obligation as its own.

The loan agreement is more reasonably classified as an isolated transaction independent of the documentary credit."

(8) *FBTC at most a negotiating bank.* — "Of course, it may be presumed that the petitioner loaned the money to the private respondent in anticipation that it would later be paid by the latter upon the receipt of the letter. Yet, we would have no basis to rule definitely that such "act" should be construed as an act of confirmation.

The private respondent no doubt was in need of money in loading the logs on the ship 'Zenlin Glory' and the only way to satisfy this need was to borrow money from the petitioner which the latter granted. From these circumstances, a logical conclusion that can be gathered is that the letter of credit was merely to serve as a collateral.

At the most, when the petitioner extended the loan to the private respondent, it assumed the character of a negotiating bank. Even then, the petitioner will still not be liable, for a negotiating bank before negotiation has no contractual relationship with the seller."

(9) *Relationship between the seller and the negotiating bank.* — "The case of *Scanlon v. First National Bank (supra.)* perspicuously explained the relationship between the seller and the negotiating bank, *viz.:*

> 'It may buy or refuse as it chooses. Equally, it must be true that it owes no contractual duty toward the person for whose benefit the letter is written to discount or purchase any draft drawn against the credit. No relationship of agent and principal, or of trustee and cestui, between the receiving bank and the beneficiary of the letter is established/

Whether, therefore, the petitioner is a notifying bank or a negotiating bank, it cannot be held liable. Absent any definitive proof that it has confirmed the letter of credit or has actually negotiated with the private respondent, the refusal by the petitioner to accept the tender of the private respondent is justified/'

(10) *FBTC did not become a trustee in relation to BV.* — "In regard to the finding that the petitioner became a 'trustee in relation to the plaintiff (private respondent) as the beneficiary of the letter of credit/the same has no legal basis.

A *trust* has been defined as the 'right, enforceable solely in equity, to the beneficial enjoyment of property the legal title to which is vested to another.' (89 C.J.S. 712.)

The concept of a trust presupposes the existence of a specific property which has been conferred upon the person for the benefit of another. In order, therefore, for the trust theory of the private respondent to be sustained, the petitioner should have had in its possession a sum of money as specific fund advanced to it by the issuing bank and to be held in trust by it in favor of the private respondent. This does not obtain in this case.

The mere opening of a letter of credit, it is to be noted, does not involve a specific appropriation of a sum of money in favor of the beneficiary. It only signifies that the beneficiary may be able to draw funds upon the letter of credit up to the designated amount specified in the letter. It does not convey the notion that a particular sum of money has been specifically reserved or has been held in trust.

What actually transpires in an irrevocable credit is that the correspondent bank does not receive in advance the sum of money from the buyer or the issuing bank. On the contrary, when the correspondent bank accepts the tender and pays the amount stated in the letter, the money that it doles out comes not from any particular fund that has been advanced by the issuing bank, rather it gets the money from its own funds and then later seeks reimbursement from the issuing bank.

Granting that a trust has been created, still, the petitioner may not be considered a trustee. As the petitioner is only a notifying bank, its acceptance of the instructions of the issuing bank will not create estoppel on its part resulting in the acceptance of the trust. Precisely, as a notifying bank, its only obligation is to notify the private respondent of the existence of the letter of credit. How then can such create estoppel when that is its only duty under the law?"

(11) *FBTC did not act as guarantor of SPN and AC.* — "We also find erroneous the statement of the Court of Appeals that the petitioner 'acted as a guarantor of the issuing bank and in effect also of the latter's principal or client, AC/

It is a fundamental rule that an irrevocable credit is independent not only of the contract between the buyer and the seller but also of the credit agreement between the issuing bank and the buyer. The relationship between the buyer (AC) and the issuing bank (SPN) is entirely independent from the letter of credit issued by the latter. The contract between the two has no bearing as to the non-compliance by the buyer with the agreement between the latter and the seller. Their contract is similar to that of a contract of services (to open the letter of credit) and not that of agency as was intimated by the Court of Appeals. The unjustified refusal, therefore, by AC to issue the certification under the letter of credit should not likewise be charged to the issuing bank.

As a mere notifying bank, not only does the petitioner not have any contractual relationship with the buyer, it has also nothing to do with the contract between the issuing bank and the buyer regarding the issuance of the letter of credit/'

(12) *Concept of guarantee and concept of an irrevocable letter of credit inconsistent with each other.* — "The theory of guarantee relied upon by the Court of Appeals has to necessarily fail. The concept of guarantee *vis-a-vis* the concept of an irrevocable credit are inconsistent with each other.

In the first place, the guarantee theory destroys the independence of file bank's responsibility from the contract upon which it was opened. In the second place, the nature of both contracts is mutually in conflict with each other. In contracts of guarantee, the guarantor's obligation is merely collateral and it arises only upon the default of the person primarily liable. On the other hand, in an irrevocable credit the bank undertakes a primary obligation, (see National Bank of Eagle Pass, Tex v. American National Bank of San Francisco, 282 F. 73 [1922].)"

(13) *Relationship between FBTC and SPN similar to that of an agency.* — "The relationship between the issuing bank and the notifying bank, on the contrary, is more similar to that of an agency and not that of a guarantee. It may be observed that the notifying bank is merely to follow the instructions of die issuing bank which is to notify or to transmit the letter of credit to the beneficiary, (see Kronman v. Public National Bank of New York, *supra.)* Its commitment is only to notify the beneficiary. It does not undertake any assurance that the issuing bank will perform what has been mandated to or expected of it. As an agent of the issuing bank, it has only to follow the instructions of the issuing bank and to it alone is it obligated and not to the buyer with whom it has no contractual relationship.

In fact the notifying bank, even if the seller tenders all the documents required under the letter of credit, may refuse to negotiate or accept the drafts drawn thereunder and it will still not be held liable for its only engagement is to notify and/or transmit to the seller the letter of credit."

(14) *Even as confirming bank, FBTC not liable.* — "Finally, even if we assume that the petitioner is a confirming bank, the petitioner cannot be forced to pay the amount under the letter. As we have previously explained, there was a failure on the part of the private respondent to comply with the terms of the letter of credit.

The failure by him to submit the certification was fatal to his case. The U.C.P. which is incorporated in the letter of credit ordains that the bank may only pay the amount specified under the letter if all the documents tendered are on their face in compliance with the credit. It is not tasked with the duty of ascertaining the reason or reasons why certain documents have not been submitted, as it is only concerned with the documents. Thus, whether or not the buyer has performed his responsibility towards the seller is not the bank's problem.

We are aware of the injustice committed by AC on the private respondent but we are deciding the controversy on the basis of what the law is, for the law is not meant to favor only those who have been oppressed, the law is to govern future relations among people as well. Its commitment is to all and not to a single individual. The faith of the people in our justice system may be eroded if we are to decide not what the law states but what we believe it should declare. *Dura lex sed lex.*

Considering the foregoing, the materiality of ruling upon the validity of the certificate of approval required of the private respondent to submit under the letter of credit, has become insignificant/' *(Feati Bank & Trust Company vs. Court of Appeals, 196 SCRA 576 [1991].)*

2. Following dishonor of letter of credit by alleged issuer bank, advising bank seeks recovery from seller the amount partially availed of by the latter as beneficiary under the disowned letter of credit.

Facts: Petitioner bank BA, Manila, received by registered mail an irrevocable letter of credit purportedly issued by bank BS, Thailand (issuing bank) for the account of GCL of Thailand (Buyer) in the amount of US$2,782,000 to cover the sale of certain goods with BA, as advising bank, and private respondent IRIC (Seller), as beneficiary. Upon receipt of the letter of advice with the letter of credit, IRIC sent its lawyer to BA to have the letter of credit confirmed. BA's employee in charge of letters of credit explained that there was no need for confirmation because the letter of credit would not have been transmitted if it were not genuine.

IRIC sought to make a partial availment under the letter of credit covering shipment of goods to GCL valued at US$1,320,600. After being satisfied that the documents IRIC submitted conformed with the conditions expressed in the letter of credit, BA issued in favor of IRIC a cashier's check for the peso equivalent of the draft. BA adversed BS of the availment and sought corresponding reimbursement therefor.

When IRIC tried to make a second availment, BA stopped the processing of IRIC's documents upon receipt of telex from BA declaring the letter of credit fraudulent. BA sued IRIC for recovery of the peso equivalent of the draft of the US$1,320,000 on the partial availment of the now disowned letter of credit.

The trial court ruled for IRIC. On appeal, the Court of Appeals sustained the trial court; hence, the recourse of BA to the Supreme Court.

Issues: The following issues are raised by BA:

(1) Whether it has warranted the genuineness and authenticity of the letter of credit and, corollarily, whether it has acted merely as an advising bank or as a confirming bank;

(2) Whether IRIC has actually shipped the goods (ropes) specified by the letter of credit; and

(3) Following the dishonor of the letter of credit by BS, whether BA may recover against IRIC under the draft executed in its partial availment of die letter of credit.

Held: (1) *Concept and modern use of letter of credit.* — "A letter of credit is a financial device developed by merchants as a convenient and relatively safe mode of dealing with sales of goods to satisfy the seemingly irreconcilable interests of a seller, who refuses to part with his goods before he is paid, and a buyer, who wants to have control of the goods before paying. To break the impasse, the buyer may be required to contract a bank to issue a letter of credit in favor of the seller so that, by virtue of the letter of credit, the issuing bank can authorize the seller to draw drafts and engage to pay them upon their presentment simultaneously with the tender of documents required by die letter of credit.[2] The buyer and the seller agree on what documents are to be presented for payment, but ordinarily they are documents of tide evidencing or attesting to the shipment of the goods to the buyer.

[2]Article 10 of the U.CJP. defines an *irrevocable letter of credit* as one that "constitutes a definite undertaking of the issuing bank, provided that the stipulated documents are presented and that the terms and conditions of the credit are complied with: (i) if the credit provides for sight payment—to pay, or that payment will be made; (ii) if the credit provides for deferred payment — to pay, or that payment will be made, on the date(s) determinable in accordance with the stipulations of die credit; (iii) if the credit provides for acceptance — to accept drafts drawn by the beneficiary if the credit stipulates that they are to be drawn on the issuing bank, or to be responsible for their

Once the credit is established, the seller ships the goods to the buyer and in the process secures the required shipping documents or documents of title. To get paid, the seller executes a draft and presents it together with the required documents to the issuing bank. The issuing bank redeems the draft and pays cash to the seller if it finds that the documents submitted by the seller conform with what the letter of credit requires. The bank then obtains possession of the documents upon paying the seller. The transaction is completed when the buyer reimburses the issuing bank and acquires the documents entitling him to the goods.

Under this arrangement, the seller gets paid only if he delivers the documents of title over the goods, while the buyer acquires the said documents and control over the goods only after reimbursing the bank."

(2) *Letters of credit distinguished from other accessory contracts.* — "What characterizes letters of credit, as distinguished from other accessory contracts, is the engagement of the issuing bank to pay the seller once the draft and the required shipping documents are presented to it In turn, this arrangement assures the seller of prompt payment, independent of any breach of the main sales contract. By this so-called 'independence principle,' the bank determines compliance with the letter of credit only by examining the shipping documents presented; it is precluded from determining whether the main contract is actually accomplished or not."[3]

[3]Article 17 of the U.C.P. states: "Banks assume no liability or responsibility for the form, sufficiency, accuracy, genuineness, falsification or legal effect of any documents, or for the general and/or particular conditions stipulated in the documents or superimposed thereon; nor do they assume any liability or responsibility for die description, quantity, weight quality, condition, packing, delivery, value or existence of the goods represented by any documents, or for die good faith or acts and/or omissions, solvency, performance or standing of the consignor die carriers, or the insurers of the goods, or any other person whomsoever."

According to White and Summers, *op. tit.:* "x x x the letter of credit is not a guarantee. In a typical guarantee, die guarantor will agree to make payments.

(3) *Parties to a letter of credit.* — "There would at least be three (3) parties: (a) the *buyer** who procures the letter of credit and obliges himself to reimburse the issuing bank upon receipt of the documents of title; (b) the *bank issuing* the letter of credit,[5] which undertakes to pay the seller upon receipt of the draft and proper documents of titles and to surrender the documents to the buyer upon reimbursement; and (c) the *seller*[6] who, in compliance with the contract of sale, ships the goods to the buyer and delivers the documents of title and draft to the issuing bank to recover payment."

(4) *Other parties.* — "The number of the parties, not infrequently and almost invariably in international trade practice, may be increased. Thus, the services of an *advising (notifying) bank*[7] may be utilized to convey to the seller the existence of the credit; or, of a *confirming bank** which will lend credence to the

***The buyer of die merchandise, who is also the buyer of the credit instrument, is the party who initiates the operation. His contract is with the bank which is to issue the instrument and is represented by the Commercial Credit of Agreement**

[5]"The Opening Bank, usually the buyer's bank, is the bank which actually issues the instrument. It is also known as the *Issuing Bank.* The selection of the opening banks is important. It should be a strong bank, well-known and well-regarded in international trading circles. This is the reason x x x smaller banks do not attempt to issue their own commercial credit instruments but take advantage of the facilities of x x x much larger, stronger, and better known correspondent banks x x x. The purposes of commercial credit may not be readily accomplished unless the opening

[6]"The seller of the merchandise is called the *Beneficiary* of the credit instrument. The instrument is addressed to him and is in his favor. It is the written contract of the bank which has created the instrument. While the bank cannot compel the beneficiary to ship and avail himself of the benefits of the instrument, the seller may recover from the bank the value of his shipment if made within the terms of the instrument, even though he had not given the bank any direct consideration for the bank's promises contained in die instrument By a stretch of imagination, and in order to support the instrument as a two-sided contract, supported by mutually given considerations, the courts seem to hold that the commission paid or

[7]"Whenever the instrument is not delivered to the buyer and by him mailed to the beneficiary, the opening bank will advise the existence of the credit to die beneficiary through its correspondent bank operating in die same locality as the seller. Such correspondent bank becomes the Notifying Bank. The services of a notifying bank must always be utilized if the credit is to be advised to die beneficiary by cable x x x." (Shaterian, *op. cit.,* p. 292.)

[8]"Whenever the beneficiary stipulates that the obligation of die opening bank shall also be made the obligation of a bank to himself, we

letter of credit issued by a lesser known issuing bank; or, of a *paying bank?* which undertakes to encash the draft drawn by the exporter. Further, instead of going to the place of the issuing bank to claim payment, the buyer may approach another bank, termed the *negotiating bank,*[w] to have the draft discounted."

view of the fact that commercial credits issued by American banks in favor of foreign sellers are invariably issued only by x x x larger well-known banks, no seller requests that they be confirmed by another bank. The standing of the x x x opening bank is good enough. But many foreign banks are not particularly strong or well-known, compared with x x x banks issuing these credit instruments. Indeed, many banks operating abroad are only known through the Banker's Almanac. They serve a useful purpose in their own small communities and perhaps maintain dollar accounts with the larger x x x banks. But their names are quite meaningless to the x x x exporters, and when the foreign buyer offers to his x x x seller a credit instrument issued by such a bank, the seller may not receive the protection and other facilities which an instrument issued by a large, strong, and well-known bank will give him. To overcome this, he requests that the

[9] "The *Paying Bank* is the bank on which the drafts are to be drawn. It may be the opening bank, it may be a bank other than the opening bank and not in the city of the beneficiary, or it may be a bank in the city of the beneficiary, usually the advising bank. If the beneficiary is to draw and receive payment in his own currency, the notifying bank will be indicated as the paying bank also. When the draft is to be paid in this manner, the paying bank assumes no responsibility but merely pays the beneficiary and debits the payment immediately to the account which the opening bank has with it If the opening bank maintains no account with the paying bank, the paying bank reimburses itself by drawing a bill of exchange on the opening bank, in dollars, for the equivalent of the local currency paid to the beneficiary, at its buying rate for dollar exchange. The beneficiary is entirely out of the transaction because his draft is completely discharged by payment; and the credit arrangement between the paying bank and the opening bank does not

(5) *Dearth of national law-governing letters of credit.* — "Being a product of international commerce, the impact of this commercial instrument transcends national boundaries, and it is thus not uncommon to find a dearth of national law that can adequately provide for its governance. This country is no exception. Our own Code of Commerce basically introduces only its concept under Articles 567-572, inclusive, thereof. It is no wonder then why great reliance has been placed on commercial usage and practice, which, in any case, can be justified by the universal acceptance of the autonomy of contracts rale. The rules were later developed into what is now known as the Uniform Customs and Practice for Documentary Credits ("U.C.P.") issued by the International Chamber of Commerce. It is by no means a complete text by itself, for, to be sure, there are other principles, which, although part of *lex mercatoria,* are not dealt with in the U.C.P."

(6) *Suppletory application of U.C.P.* — "In *FEATI Bank and Trust Company vs. Court of Appeals* (196 SCRA 576 [1991].), we have accepted, to the extent of their pertinency, the application in our jurisdiction of this international commercial credit regulatory set of rules." In *Bank of Phil. Islands vs. De Nery* (35 SCRA 256 [1970].), we have said that the observance of the U.C.P. is justified by Article 2 of the Code of Commerce which expresses that, in the absence of any particular provision in the Code of Commerce, commercial transactions shall be governed by usages and customs generally observed. We have further observed that there being no specific provisions which govern the legal complexities arising from transactions involving

""The Uniform Customs and Practices for documentary credits were first published in 1933. The current versions was adopted by the International Chamber of Commerce Council in 1983 and published as Publication No. 400 in July of that year. This current version has the blessing of the United Nations Commission on International Trade Law (UNCITRAL). The Uniform Customs and Practices are not 'law' because of the act of any legislature or court, but because they have been explicitly and implicitly made part of the contract of letters of credit, xxx [M]any of the letters of credit in the United States are governed by the Uniform Customs and Practices and not by the UCC (Uniform Commercial Code), x x x

In general, the UCP is much more detailed than the UCC. It clearly shows the tracks of many bankers and bank lawyers walking back and forth across its surface, x x x

Every lawyer who deals at any time with a letter of credit should have read the UCP at least once. The lawyer who deals routinely with

letters of credit not only between or among banks themselves but also between banks and the seller or the buyer, as the case may be, the applicability of the U.G.P. is undeniable.

The first issue raised by the petitioner, i.e., that it has in this instance merely been an advising bank, is outrightly rejected by Inter-Resin [IRIC] and is thus sought to be discarded for having been raised only on appeal. We cannot agree. The crucial point of dispute in this case is whether under the "letter of credit," Bank of America [BA] has incurred any liability to the "beneficiary" thereof, an issue that largely is dependent on the bank's participation in that transaction; as a mere advising or notifying bank, it would not be liable, but as a confirming bank, had this been the case, it could be considered as having incurred that liability."

(7) *BA, merely an advising, not confirming bank.* — "It cannot seriously be disputed, looking at this case, that Bank of America has, in fact, only been an advising, not confirming, bank, and this much is clearly evident, among other things, by the provisions of the letter of credit itself, the petitioner bank's letter of advice, its request for payment of advising fee, and the admission of Inter-Resin that it has paid the same. That Bank of America has asked Inter-Resin to submit documents required by the letter of credit and eventually has paid the proceeds thereof, did not obviously make it a confirming bank. The fact, too, that the draft required by the letter of credit is to be drawn under the account of General Chemicals (buyer) only means that the same had to be presented to Bank of Ayudhya (issuing bank) for payment. It may be significant to recall that the letter of credit is an engagement of the issuing bank, not the advising bank, to pay the draft.

No less important is that Bank of America's letter of 11 March 1981 has expressly stated that "[t]he enclosure is *solely an advise* of credit opened by the abovementioned correspondent and *conveys no engagement by us."* This written reservation by Bank of America in limiting its obligation only to being an advising bank is in consonance with the provisions of U.C.P."

(8) *BA's obligation limited to notifying seller of letter of credit.* — "As an advising or notifying bank, Bank of America did not incur any obligation more than just notifying Inter-Resin of the letter of credit issued in its favor, let alone to confirm the letter of credit.[12] The bare statement of the bank employee, aforementioned, in responding to the inquiry made by Atty. Tanay, Inter-Resin's representative, on the authenticity of the letter of credit certainly did not have the effect of novating the letter of credit and Bank of America's letter of advise,[13] nor can it justify the conclusion that the bank must now assume total liability on the letter of credit. Indeed, Inter-Resin itself cannot claim to have been all that free from fault As the seller, the issuance of the letter of credit should have obviously been a great concern to it.[14] It would have, in fact, been strange if it did not, prior to the letter of credit, enter into a contract, or negotiated at the very least, with General Chemicals." In the ordinary course of business, the perfection of contract precedes the issuance of a letter of credit.

Bringing the letter of credit to the attention of the seller is the primodial obligation of an advising bank. The view that Bank of America should have first checked the authenticity of the letter of credit with Bank of Ayudhya, by using advanced mode of business communications, before dispatching the same to Inter-Resin finds no real support in U.C.R Article 18 of the U.C.R states that: 'Banks assume no liability or responsibility for the consequences arising out of the delay and/or loss in transit of any messages, letters or documents, or for delay, mutilation or other errors arising in the transmission of any telecommunication x x x.' As advising bank, Bank of America is bound only to check the 'apparent authenticity' of the letter of

[12]"The banks involved charge a modest commission for their various services. The higher the risk that the bank assumes, the higher the commission *(e.g.,* to confirm an L / C

"Article 1878(9) and (11) of the Civil Code, respectively, provides that a special power of attorney is required "[T]o bind the principal to render some service without compensation" and "[T]o obligate the principal as a guarantor or surety." Article 1887 states that "the agent shall act in accordance with the instructions of the principal." Moreover^ Article 1888 enjoins die agent from carrying out "an agency if its execution would

""In fact Inter-Resins's *pro forma* invoice sent to General Chemicals, on the basis of which the letter of credit was apparently issued, demanded for a confirmed and irrevocable letter of credit"

[15]"The suspicion that no contract of sale was perfected between Inter-Resin and General Chemicals may find support in die absence of a written memorandum of the sale or any other document showing that General Chemicals ordered the goods, and the Comment of Inter-Resin detailing the material events of this case but, surprisingly, failed to

credit, which it did.[16] Clarifying its meaning, Webster's Ninth New Collegiate Dictionary explains that the word APPARENT suggests appearance to unaided senses that is not or may not be borne out by more rigorous examination or greater knowledge."

(9) *Right of recourse of negotiating bank against issuing bank and seller.* — "May Bank of America then recover what it has paid under the letter of credit when the corresponding draft for partial availment thereunder and the required documents therefor were later negotiated with it by Inter-Resin? The answer is yes. This kind of transaction is what is commonly referred to as a *discounting arrangement.* This time, Bank of America, has acted independently as a negotiating bank, thus saving Inter- Resin from the hardship of presenting the documents directly to Bank of Ayudhya to recover payment. (Inter-Resin, of course, could have chosen other banks with which to negotiate the draft and the documents.) As a negotiating bank, Bank of America has a right of recourse against the issuer bank and until reimbursement is obtained, Inter-Resin, as the drawer of the draft, continues to assume a contingent liability thereon.

While Bank of America has indeed failed to allege material facts in its complaint that might have likewise warranted the application of the Negotiable Instruments Law and possibly then allowed it to even go after the indorsers of the draft, this failure,[17] nonetheless, does not preclude petitioner bank's right (as a negotiating bank) of recovery from Inter-Resin itself. Inter-Resin admits having received P10,219,093.20 from Bank of America on the letter of credit transaction and in having executed the corresponding draft That payment to Inter-Resin has given, as aforesaid, Bank of America the right of reimbursement from the issuing bank, Bank of Ayudhya which, in turn, could then seek indemnification from the buyer (the General Chemicals of Thailand). Since Bank of Ayudhya disowned the

"Article 8 of U.C.P. states: "A credit may be advised to a beneficiary through another
bank (the advising bank) without engagement on the part of the advising bank, but that

"In this respect, its belated theory before us and in its motion for reconsideration of die assailed decision should be rejected for being iniquitous under the circumstances. In fact, Bank of America has failed to present the draft and, more substantially, Inter-Resin has not been afforded full opportunity to refute by evidente this new argument of Bank of America. In short, we find the records insufficient to arrive at a just

letter of credit, however, Bank of America may now turn to Inter-Resin for restitution.

'Between the seller and the negotiating bank there is the usual relationship existing between a drawer and purchaser of draft. Unless drafts drawn in pursuance of the credit are indicated to be without recourse therefore, the negotiating bank has the ordinary right of recourse against the seller in the event of dishonor by the issuing bank x x x. The fact that the correspondent and the negotiating bank may be one and the same does not affect its rights and obligations in either capacity, although a special agreement is always a possibility x x x."

(10) *Involved banks deal only with documents.* — "The additional ground raised by the petitioner, *i.e.,* that Inter-Resin sent waste instead of its products, is really of no consequence. In the operation of a letter of credit, the involved banks deal only with documents and not on goods described in those documents."[18] *(Bank of America, NT & SA vs. Court of Appeals, 228 SCRA 357 [1993].)*

3. *Issuing bank released the amounts due under two (2) standby letters of credit opened by petitioner as security in favor of respondent after being informed by petitioner that respondent's call thereon was unlawful or fraudulent and of the pendency of the arbitration proceedings regarding the issue of default on the part of petitioner in the performance of its contract.*

Facts: Petitioner TPI and respondent LHC entered into a Turnkey Contract whereby petitioner, as Turnkey Contractor,

[18]"x x x Neither can the interested banks assume responsibility for the character or quality of the goods shipped nor for the terms of the sale contract not incorporated and made part of the credit instrument. How could they? While the parties to the sale contract may be experts as to the involved merchandise, the banks are not generally speaking, sufficiently versed in the fine points of each and every class of merchandise which they finance. Even assuming the bank has men in its employ who can qualify as experts in certain lines of merchandising, it would not wish to extend this sort of service without adequate compensation but such service is not a banking function.

x x x Because of this, the credit should describe die goods in general undertook to construct, on a turnkey basis, a 70-Megawatt hydro-electric power station at the Bakun River in the provinces of Benguet and Ilocos Sur (hereinafter, the Project). Petitioner was given the sole responsibility for the design, construction, commissioning, testing and completion of the Project.

To secure performance of petitioner's obligation on or before the target completion date, or such time for completion as may be determined by the parties' agreement, petitioner opened in favor of LHC two (2) standby letters of credit (hereinafter referred to as "the Securities")/ one with the local branch of respondent ANZ Bank and the other, with respondent Security Bank Corporation (SBC) each in the amount of US$8,988,907.00.

In the course of the construction of the project, petitioner sought various extensions of time (EOT) to complete the Project. The extensions were requested allegedly due to several factors which prevented the completion of the Project on target date, such as *force majeure* occasioned by typhoon Zeb, barricades and demonstrations. LHC denied tine requests, however. This gave rise to a series of legal actions between the parties which culminated in the instant petition.

Petitioner contends that the courts below improperly relied on the "independence principle" on letters of credit when this case falls squarely within the "fraud exception rule and that" respondent LHC deliberately misrepresented the supposed existence of delay despite its knowledge that the issue was still pending arbitration.

Petitioner asserts that LHC should be ordered to return the proceeds of the Securities pursuant to the principle against unjust enrichment and that, under the premises, injunction was the appropriate remedy obtainable from the competent local courts.

Refuting petitioner's contentions, LHC claimed that petitioner had no right to restrain its call on and use of the Securities as payment for liquidated damages. It averred that the Securities are independent of the main contract between them as shown on the face of the two Standby Letters of Credit which both provide that the banks have no responsibility to investigate the authenticity or accuracy of the certificates or the declarant's capacity or entitlement to so certify.

Respondent SBC in its Memorandum, contends that the Court of Appeals correctly dismissed the petition for certiorari.

Invoking the independence principle, SBC argues that it was under no obligation to look into the validity or accuracy of the certification submitted by respondent LHC or into the latter's capacity or entitlement to so certify. It adds that the act sought to be enjoined by petitioner was already fait accompli and the present petition would no longer serve any remedial purpose. In a similar fashion, respondent ANZ Bank in its Memorandum dated 13 March 2003 posits that its actions could not be regarded as unjustified in view of the prevailing independence principle under which it had no obligation to ascertain the truth of LHC's allegations that petitioner defaulted in its obligations. Moreover, it points out that since the Standby Letter of Credit No. E001126/8400 had been fully drawn, petitioner's prayer for preliminary injunction had been rendered moot and academic.

Issues: The petitioner raised, among others, the following issues for resolution —

(1) Whether the "independence principle" on letters of credit may be invoked by a beneficiary thereof where the beneficiary's call thereon is wrongful or fraudulent.

(2) Whether LHC has the right to call and draw on the securities before the resolution of petitioner's and LHC's disputes by the appropriate tribunal.

(3) Whether ANZ bank and SBC are justified in releasing the amounts due under the securities despite being notified that LHC's call thereon is wrongful.

(1) *Nature and use of letters of credit.* — "At the core of the present controversy is the applicability of the "independence principle" and "fraud exception rule" in letters of credit. Thus, a discussion of the nature and use of letters of credit, also referred to simply as "credits," would provide a better perspective of the case.

The letter of credit evolved as a mercantile specialty, and the only way to understand all its facets is to recognize that it is an entity unto itself. The relationship between the beneficiary and the issuer of a letter of credit is not strictly contractual, because both privity and a meeting of the minds are lacking, yet strict compliance with its terms is an enforceable right. Nor is it a third-party beneficiary contract, because the issuer must honor drafts drawn against a letter regardless of problems subsequently arising in the underlying contract. Since the bank's customer cannot draw on the letter, it does not function as an assignment by the customer to the beneficiary. Nor, if properly used> is it a contract of suretyship or guarantee, because it entails a primary liability following a default. Finally, it is not in itself a negotiable instrument, because it is not payable to order or bearer and is generally conditional, yet the draft presented under it is often negotiable:

In commercial transactions, a letter of credit is a financial device developed by merchants as a convenient and relatively safe mode of dealing with sales of goods to satisfy the seemingly irreconcilable interests of a seller, who refuses to part with his goods before he is paid, and a buyer, who wants to have control of the goods before paying. The use of credits in commercial transactions serves to reduce the risk of nonpayment of the purchase price tinder the contract for the sale of goods. However, credits are also used in non-sale settings where they serve to reduce the risk of nonperformance. Generally, credits in the non-sale settings have come to be known as standby credits."

(2) *Differences between commercial on standby credits.*—"There are three significant differences between commercial and standby credits. First, commercial credits involve the payment of money tinder a contract of sale. Such credits become payable upon the presentation by the seller-beneficiary of documents that show he has taken affirmative steps to comply with the sales agreement. In the standby type, the credit is payable upon certification of a party's nonperformance of the agreement. The documents that accompany the beneficiary's draft tend to show that the applicant has not performed. The beneficiary of a commercial credit must demonstrate by documents that he has performed his contract. The beneficiary of the standby credit must certify that his obligor has not performed the contract.

By definition, a letter of credit is a written instrument whereby the writer requests or authorizes the addressee to pay money or deliver goods to a third person and assumes responsibility for payment of debt therefor to the addressee. A letter of credit, however, changes its nature as different transactions occur and if carried through to completion ends up as a binding contract between the issuing and honoring banks without any regard or relation to the underlying contract or disputes between the parties thereto." .

(3) *Applicability of the Uniform Customs and Practices for Documentary Credits.* — "Since letters of credit have gained general acceptability in international trade transactions, the International Chamber of Commerce (ICC) has published from time to time updates on the Uniform Customs and Practice (UCP) for Documentary Credits to standardize practices in the letter of credit area. The vast majority of letters of credit incorporate the UCP. First published in 1933, the UCP for Documentary Credits has undergone several revisions, the latest of which was in 1993.

In *Bank of the Philippine Islands v. De Reny Fabric Industries, Inc.* (35 SCRA 256 [1970].), this Court ruled that the observance of the UCP is justified by Article 2 of the Code of Commerce which provides that in the absence of any particular provision in the Code of Commerce, *commercial transactions* shall be governed by usages and customs generally observed. More recently, in *Bank of America, NT & SA v. Court of Appeals* (228 SCRA 357 [993].), this Court ruled that there being no specific provisions which govern the legal complexities arising from transactions involving letters of credit, not only between or among banks themselves but also between banks and the seller or the buyer, as the case may be, the applicability of the UCP is undeniable.

Article 3 of the UCP provides that credits, by their nature, are separate transactions from the sales or other contract(s) on which they may be based and banks are in no way concerned with or bound by such contract(s), even if any reference whatsoever to such contract(s) is included in the credit. Consequently, the undertaking of a bank to pay, accept and pay draft(s) or negotiate and/or fulfill any other obligation under the credit is not subject to claims or defenses by the applicant resulting from his relationships with the issuing bank or the beneficiary. A beneficiary can in no case avail himself of the contractual relationships existing between the banks or between the applicant and the issuing bank."

(4) *Independence principle "on letters of credit."* — "Thus, the engagement of the issuing bank is to pay the seller or beneficiary of the credit once the draft and the required documents are presented to it. The so-called "independence principle" assures the seller or the beneficiary of prompt payment independent of any breach of the main contract and precludes the issuing bank from determining whether the main contract is actually

accomplished or not. Under this principle, banks assume no liability or responsibility for the form, sufficiency, accuracy, genuineness, falsification or legal effect of any documents, or for the general and/or particular conditions stipulated in the documents or superimposed thereon, nor do they assume any liability or responsibility for file description, quantity, weight, quality> condition, packing, delivery, value or existence of the goods represented by any documents, or for the good faith or acts and/or omissions, solvency, performance or standing of the consignor, the carriers, or the insurers of the goods, or any other person whomsoever.

The independent nature of the letter of credit may be: (a) independence *in toto* where the credit is independent from the justification aspect and is a separate obligation from the underlying agreement like for instance a typical standby; or (b) independence may be only as to the justification aspect like in a commercial letter of credit or repayment standby, which is identical with the same obligations under the underlying agreement. In both cases the payment may be enjoined if in the light of the purpose of the credit the payment of the credit would constitute fraudulent abuse of the credit."

(5) *Principle works to benefit both issuing bank and beneficiary.* — "Can the beneficiary invoke the independence principle?

Petitioner insists that the independence principle does not apply to the instant case and assuming it is so, it is a defense available only to respondent banks. LHC, on the other hand, contends that it would be contrary to common sense to deny the benefit of an independent contract to the very party for whom the benefit is intended. As beneficiary of the letter of credit, LHC asserts it is entitled to invoke the principle, xxx

Given the nature of letters of credit, petitioner's argument—that it is only the issuing bank that may invoke the independence principle on letters bf credit—does not impress this Court. To say that the independence principle may only be invoked by the issuing banks would render nugatory the purpose for which the letters of credit are used in commercial transactions. As it is, the independence doctrine works to the benefit of both the issuing bank and the beneficiary.

Letters of credit are employed by the parties desiring to enter into commercial transactions, not for the benefit of the issuing bank but mainly for the benefit of the parties to the original transactions. With the letter of credit from the issuing bank, the party who applied for and obtained it may confidently present the letter of credit to the beneficiary as a security to convince the beneficiary to enter into the business transaction. On the other hand, the other party to the business transaction, *i.e.,* the beneficiary of die letter of credit, can be rest assured of being empowered to call on the letter of credit as a security in case the commercial transaction does not push through, or die applicant fails to perform his part of the transaction. It is for this reason that the party who is entitied to the proceeds of the letter of credit is appropriately called 'beneficiary.'"

(6) *Distinction between a letter of credit and a guarantee.*— "Petitioner's argument that any dispute must first be resolved by the parties, whether through negotiations or arbitration, before die beneficiary is entitled to call on die letter of credit in essence would convert the letter of credit into a mere guarantee. Jurisprudence has laid down a clear distinction between a letter of credit and a guarantee in that the settiement of a dispute between the parties is not a pre-requisite for the release of funds under a letter of credit. In other words, the argument is incompatible with die very nature of the letter of credit. If a letter of credit is drawable only after settiement of the dispute on the contract entered into by the applicant and die beneficiary, there would be no practical and beneficial use for letters of credit in commercial transactions.

Professor John F. Dolan, the noted authority on letters of credit, sheds more light on the issue:

"The standby credit is an attractive commercial device for many of the same reasons that commercial credits are attractive. Essentially, these credits are inexpensive and efficient. Often they replace surety contracts, which tend to generate higher costs than credits do and are usually triggered by a factual determination rather than by the examination of documents.

Because parties and courts should not confuse the different functions of the surety contract on the one hand and the standby credit on the other, the distinction between surety contracts and credits merits some reflection. The two commercial devices share a common purpose. Both ensure against the obligor's nonperformance. They function, however, in distinctly different ways.

Traditionally, upon the obligor's default, the surety undertakes to complete the obligor's performance, usually by hir ing someone to complete that performance. Surety contracts, then, often involve costs of determining whether the obligor defaulted (a matter over which the surety and the beneficiary often litigate) plus the cost of performance. The benefit of the surety contract to the beneficiary is obvious. He knows that the surety, often an insurance company, is a strong financial institution that will perform if the obligor does not. The beneficiary also should understand that such performance must await the sometimes lengthy and costly determination that the obligor has defaulted. In addition, the surety's performance takes time.

The standby credit has different expectations. He reasonably expects that he will receive cash in the event of nonperformance, that he will receive it promptly, and that he will receive it before any litigation with the obligor (the applicant) over the nature of the applicant's performance takes place. The standby credit has this opposite effect of the surety contract: it reverses the financial burden of parties during litigation.

In the surety contract setting, there is no duty to indemnify the beneficiary until the beneficiary establishes the fact of the obligor's performance. The beneficiary may have to establish that fact in litigation. During the litigation, the surety holds the money and the beneficiary bears most of the cost of delay in performance.

In the standby credit case, however, the beneficiary avoids that litigation burden and receives his money promptly upon presentation of the required documents. It may be that the applicant has, in fact, performed and that the beneficiary's presentation of those documents is not rightful. In that case, the applicant may sue the beneficiary in tort, in contract, or in breach of warranty; but, during the litigation to determine whether the applicant has in fact breached the obligation to perform, the beneficiary, not the applicant holds the money. Parties that use a standby credit and courts construing such a credit should understand this allocation of burdens. There is a tendency in some quarters to overlook this distinction between surety contracts and standby credits and to reallocate burdens by permitting the obligor or the issuer to litigate the performance question before payment to the beneficiary.'

While it is the bank which is bound to honor the credit, it is the beneficiary who has the right to ask the bank to honor the credit by allowing him to draw thereon. The situation itself emasculates petitioner's posture that LHC cannot invoke the independence principle and highlights its puerility, more so in this case where the banks concerned were impleaded as parties by petitioner itself.

Respondent banks had squarely raised the independence principle to justify their releases of the amounts due under the Securities. Owing to the nature and purpose of the standby letters of credit, this Court rules that the respondent banks were left with litde or no alternative but to honor the credit and both of them in fact submitted that it was "ministerial" for them to honor the call for payment.

Furthermore, LHC has a right rooted in the Contract to call on the Securities. The relevant provisions of the Contract read, thus: xxx xxx

A contract once perfected, binds the parties hot only to the fulfillment of what has been expressly stipulated but also to all the consequences which according to their nature, may be in keeping with good faith, usage, and law. A careful perusal of the Turnkey Contract reveals the intention of the parties to make the Securities answerable for the liquidated damages occasioned by any delay on the part of petitioner. The call upon the Securities, while not an exclusive remedy on the part of LHC, is certainly an alternative recourse available to it upon the happening of the contingency for which the Securities have been proffered. Thus, even without the use of the 'independence principle,' the Turnkey Contract itself bestows upon LHC the right to call on the Securities in the event of default."

(7) *Petitioner cannot invoke fraud as an exception to "independence principle."* — "Next, petitioner invokes the 'fraud exception' principle. It avers that LHC's call on the Securities is wrongful because it fraudulently misrepresented to ANZ Bank and SBC that there is already a breach in the Turnkey Contract knowing fully well that this is yet to be determined by the arbitral tribunals. It asserts that the 'fraud exception' exists when the beneficiary, for the purpose of drawing on the credit, fraudulentiy presents to the confirming bank, documents that contain, expressly or by implication, material representations of fact that to his knowledge are untrue. In such a situation, petitioner insists, injunction is recognized as a remedy available to it. xxx

It is worthy of note that the propriety of LHC's call on the Securities is largely intertwined with the fact of default which is the self-same issue pending resolution before the arbitral tribunals. To be able to declare the call on the Securities wrongful or fraudulent, it is imperative to resolve, among others, whether petitioner was in fact guilty of delay in the performance of its obligation. Unfortunately for petitioner, this Court is not called upon to rule upon the issue of default—such issue having been submitted by the parties to the jurisdiction of the arbitral tribunals pursuant to the terms embodied in their agreement."

(8) *Requisites for granting injunctive relief against payment.* — "Would injunction then be the proper remedy to restrain the alleged wrongful draws on the Securities?

Most writers agree that fraud is an exception to the independence principle. Professor Dolan opines that the untruthfulness of a certificate accompanying a demand for payment under a standby credit may qualify as fraud sufficient to support an injunction against payment. The remedy for fraudulent abuse is an injunction. However, injunction should not be granted unless: (a) there is clear proof of fraud; (b) the fraud constitutes fraudulent abuse of the independent purpose of the letter of credit and not only fraud under the main agreement; and (c) irreparable injury might follow if injunction is not granted or the recovery of damages would be seriously damaged. xxx

In the instant case, petitioner failed to show that it has a clear and unmistakable right to restrain LHC's call on the Securities which would justify the issuance of preliminary injunction. By petitioner's own admission, the right of LHC to call on the Securities was contractually rooted and subject to the express stipulations in the Turnkey Contract. Indeed, the Turnkey Contract is plain and unequivocal in that it conferred upon LHC the right to draw upon the Securities in case of default, xxx

The pendency of the arbitration proceedings would not per se make LHC's draws on the Securities wrongful or fraudulent for there was nothing in the Contract which would indicate that the parties intended that all disputes regarding delay should first be settled through arbitration before LHC would be allowed to call upon the Securities. It is therefore premature and absurd to conclude that the draws on the Securities were outright fraudulent given the fact that the ICC and CIAC have not ruled with finality on the existence of default, xxx

At any rate, should petitioner finally prove in the pending arbitration proceedings that LHC's draws upon the Securities were wrongful due to the non-existence of the fact of default, its right to seek indemnification for damages it suffered would not normally be foreclosed pursuant to general principles of law." (*Transfield Philippines, Inc. vs. Luzon Hydro Corporation, 443 SCRA 307 [2004].* see Land Bank of the Philippines vs. Monef s Export and Manufacturing Corp., 453 SCRA 173 [2005].)

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BOOKTHREE MARITIME COMMERCE TITLE III

SPECIAL CONTRACTS OF MARITIME COMMERCE

Section One. — Charter Parties Part 6. — Bills of Ladings

Article 706. The captain of the vessel and the shipper shall have the obligation of drawing up the bill of lading in which shall be stated:

1. The name, registry, and tonnage of the vessel.

2. The name of the captain and his domicile.

3. The port of loading and that of unloading.

4. The name of the shipper.

5. The name of the consignee, if the bill of lading is issued in the name of a specified person.

6. The quantity, quality, number of packages and marks of the merchandise.

7. The freightage and the primage stipulated.

The bill of lading may be issued to bearer, to order, or in the name of a specified person, and must be signed within twenty-four hours after the cargo has been received on board, the shipper being entitled to demand the unloading at the expense of the captain should the latter not sign it, and, in every case, the losses and damages suffered thereby.

Art. 707. Four true copies of the original bill of lading shall be made, and all of them shall be signed by the captain and the shipper. Of these, the shipper shall keep one and send another to the consignee; the captain shall take two, one for himself and another for the ship agent.

There may also be drawn up as many copies of the bill of lading as may be considered necessary by the person interested; but when they are issued to order or to bearer, they shall be stated in all the copies, be they the first four or the subsequent ones, the destination of each one, stating whether it is for the agent, for the captain, for the shipper, or for the consignee. If the copy sent to the latter should have a duplicate, this circumstance and the fact that it is not valid except in default of the first one must be stated therein.

Art. 708. Bills of lading issued to bearer and sent to the consignee shall be transferable by actual delivery of the instrument; and those issued to order, by virtue of an indorsement.

In either case, the person to whom the bill of lading is transferred shall acquire all the rights and actions of the transferor or indorser with regard to the merchandise mentioned in the same.

Art. 709. A bill of lading drawn up in accordance with the provisions of this title shall be proof as between all those interested in the cargo and between the latter and the insurers, proof to the contrary being reserved for the latter.

Art. 710. If the bills of lading do not agree, and no change or erasure can be observed in any of them, those possessed by the shipper or consignee signed by the captain shall be proof against the captain or ship agent in favor of the consignee or shipper; and those possessed by the captain or ship agent signed by the shipper shall be proof against the shipper or consignee in favor of the captain or ship agent.

Art. 711. The legitimate holder of a bill of lading who fails to present it to the captain of the vessel before the unloading obliging the latter thereby to unload it and place it in deposit, shall be responsible for the expenses of warehousing and other expenses arising therefrom.

Art. 712. The captain may not, by himself change the destination of the merchandise. In admitting this change at the instance of the shipper, he must first take up the bill of lading which he may have issued, under pain of being liable for the cargo to the legitimate holder of the same.

Art. 713. If before the delivery of the cargo a new bill of lading should be demanded of the captain, on the allegation that the failure to present the previous ones is due to their loss or to any other just cause, he shall be obliged to issue it, provided that security for the value of the cargo is given to his satisfaction, but without changing the consignment, and stating therein the circuiristances prescribed in the last paragraph of Article 707, under penalty, should he not so state, of being liable for said cargo if improperly delivered through his fault.

Art. 714. If before the vessel puts to sea the captain should die or should cease to hold his position through any cause, the shippers shall have the right to demand of the new captain the ratification of the first bills of lading, and the latter must do so, provided that all the copies previously issued be presented or returned to him, and it should appear from all examination of the cargo that they are correct.

The expenses arising from the examination of the cargo shall be defrayed by the ship agent, without prejudice to the right of action of the latter against the first captain if he ceased to be such through his own fault. Should said examination not be made, it shall be understood that the new captain accepts the cargo as it appears from the bills of lading issued.

Art. 715. Bills of lading will give rise to a most summary action or to judicial, compulsion *("accion sumarisima o de apremios"),* according to the case, for the delivery of the cargo and the payment of the freightage and expenses thereby incurred.

Art. 716. If several persons should present bills of lading issued to bearer or to order, indorsed in their favor, demanding the same merchandise, the captain shall prefer, in making delivery the person who presents the copy first issued, except when the latter one was issued on proof of

the loss of the first, and both are presented by different persons.

In such case, as well as when only second orsubsequent copies, issued without this proof, are presented, the captain shall apply to the judge of court, so that he may order the deposit of the merchandise and their delivery, through him, to the proper person.

Art 717. The delivery of the bill of lading shall effect the cancellation of all the provisional receipts of prior date given by the captain or his subordinates for partial deliveries of the cargo which may have been made.

Art. 718. After the cargo has been delivered the bill of lading which the captain signed, or at least the copy by reason of which the delivery is made, shall be returned to him, with the receipt for the merchandise mentioned therein.

The delay on the part of the consignee shall make him liable for the damages which such delay may cause the captain.

Bill of lading defined.

Generally speaking, a *bill ofladingis* a written acknowledgment of the receipt of goods and an agreement to transport and to deliver them at a specified place to a person named or on his order. Such instruments are sometimes called "shipping receipts," "forwarders receipts/' and "receipts for transportation." (13 Am. Jur. 2d 771-772.)

The designation, however, is not material, and neither is the form of the instrument. If it contains an acknowledgment by the carrier of the receipt of goods for transportation, it is in legal effect a bill of lading. (Mindanao Bus Co. vs. Coll. of Internal Revenue, 1 SCRA 538 [1961], citing 9 Am. Jur. 662.)

Forms of air transportation.

The term "bill of lading" is frequently defined especially by the older authorities as a writing signed by the master of a vessel acknowledging the receipt of goods onboard to be transported to a certain port and there delivered to a designated person or on his order. (9 Am. Jur. 662.) Bills of ladings, in modern jurisprudence, are not those issued by masters of vessels alone; they now comprehend all forms of transportation, whether by sea or land, and include the receipts for cargo transported. Freight tickets issued by bus companies may be regarded as bills of ladings. (Mindanao Bus Co. vs. Coll. of Internal Revenue, *supra.)*

A contract of transportation by air may be regarded as commercial. The reason is that the transportation company is a common carrier; besides air transportation is clearly similar or analogous to land and water transportation. The obvious reason for its non-inclusion in the Code of Commerce was that at the time of its promulgation, transportation by air on a commercial basis was not yet known. (Mendoza vs. Phil. Air Lines, 90 Phil. 836 [1952].) The principle which governs carriers by other means such as railroad or motor bus governs carriers by aircraft. (*ibid.,* citing 64 Am. Jur. 33.)

Under the Tariff and Customs Code of 1978, a "bill of lading" includes airway bill of lading. (Sec. 3514, Pres. Decree No. 1464, as amended.)

Kinds of bill of lading.

They are:

(1) A *clean bill of lading* or one which contains nothing in the margin qualifying the words in thebill itself;

(2) A *through bill of lading* or one where the carrier agrees to transport the goods from the point of delivery to a designated point of destination, although such transportation extends over the line of a connecting carrier (13 Am. Jur. 2d 772.);

(3) *Negotiable or straight bill of lading* or one by the terms of which the goods are to be delivered to the bearer or to the order of any person named in such bill (see Art. 1508, Civil Code.); and

(4) *Non-negotiable or straight bill of lading* or one by the terms of which the goods are to be delivered to a specified person, (see Art. 1511, *ibid.)*

Functions of bill of lading.

A bill of lading serves three distinct functions, namely:

(1) *As a receipt for the goods shipped,* it recites the date and place of shipment, describes the goods as to quantity, weight, dimensions, identification, marks and conditions, quality, and value;

. (2) *Asa contract for their carriage,, i.e.,* to transport and deliver the same as therein stipulated, it names the contracting parties (shipper and carrier), which includes the consignee, fixes the route, destination and freight rate or charges, and stipulates the rights of and obligations assumed by the parties. Being a contract, it is the law between the parties who are bound by its terms and conditions, provided, they are not contrary to law, morals, good customs, public order and public policy. The bill usually becomes effective upon its delivery and acceptance by the shipper, and it is presumed that the stipulations therein were known to him and he is generally bound by his acceptance whether he reads it or not; and

(3) *As documentary evidence of title to goods*, a non-negotiable bill is evidence of ownership of the goods and a negotiable bill is a document of title to the goods. Where a bill of lading is not delivered to the consignee, it is not evidence of ownership in him. Nor is its delivery evidence of ownership when it is given merely as security for the payment of a draft attached; nor is it evidence of ownership in the transferee if it contains any conditions inconsistent with the passing of absolute title, (see 13 Am. Jur., 2d 782-783; see Phoenix Assur. Co., Ltd. vs. United Lines, 22 SCRA 674 [1968]; Magellan Mfg. Marketing Corp. vs. Court of Appeals, 201 SCRA 102 [1991].)

Form, contents, and execution.

(1) In the absence of statutory requirement, no particular form of words is essential to constitute a bill of lading. (13 Am. Jur. 2d 773.) Articles 350 and 706 state the form and contents of a bill of lading for transportation of goods by land and waterways, respectively. Necessarily, it must be in writing, (see Art. 354.)

The other formalities required for maritime bills of ladings are prescribed in Article 707.

(2) A carrier may insert in a bill of lading issued by him, any other terms and conditions, provided that such terms and conditions are not contrary to law or public policy and do not in any wise impair his obligation to exercise at least that degree of care in the transportation and safekeeping of the goods entrusted to him which a reasonably careful man could exercise in regard to similar goods of his own. (see Arts. 1736,1744, and 1745, Civil Code.) The effect of this rule is to prevent a carrier from inserting in a bill of lading a provision totally exempting him from liability for his negligence. (13 Am. Jur. 2d 773.)

(3) A bill of lading as ordinarily used is signed by the carrier only. In the absence of statutory requirement, it need not be signed by the shipper and its terms and conditions are binding even though the bill is unsigned by the shipper, the signing of the bill only making it easier to prove that he was fully informed of its terms and assented thereto. The bill of lading may be signed by the agent of the carrier who has authority to receipt for freight and to contract for its transportation, *(ibid.,* 773-774.) In a nutshell, the acceptance of a bill of lading by the shipper and the consignee with full knowledge of its contents, gives rise to the presumption that the same was a perfected and binding contract. (Keng Hua Paper Products Co., Inc. vs. Court of Appeals, 286 SCRA 257 [1998].)

(4) A bill of lading is not essential for the creation and validity of a contract of carriage (see Compania Maritima vs. Ins. Co. of North America, 12 SCRA 213 [1964].) but the parties "may mutually demand that a bill of lading be made/' (Art. 350.) In cases where a bill of lading has been issued by a carrier covering goods shipped aboard a vessel under a charter party, and the charterer is also the holder of the bill of lading, "the bill of lading operates as the receipt for the goods, and document of title passing the property of the goods, but not as varying the contract between[1] the charterer and the shipowner." The bill of lading becomes, therefore, only a receipt and not the contract of carriage in a charter of the entire vessel, for the contract is the

charter party. (National Union Fire Insurance Co. of Pittsburg vs. Stolt Nielsen Philippines, Inc., 186 SCRA 682 [1990].)

(5) Where the carrier of a containerized cargo *simply admits* the information furnished by the shipper with regard to the goods it shipped as reflected in the bill of lading ("said to contain"), said such a "said-to-cointain" bill for sealed containers is a "receipt" only of the containers but not of their contents which the carrier was not in a position to verify. (United States Lines, Inc. vs. Comm. of Customs, 151 SCRA 189 [1987].) But this rule does not apply where the carrier of the containerized cargo makes an *explicit admission* as to the weight, measurement, marks, numbers, quality, contents and value, and more so inscribed in these stipulations, in the bill of lading itself, or made them an addendum thereto, to which the carrier affixed its express acknowledgement. Thus, a carrier by signifying in the bill of lading that "it is a receipt x x x in the number of packages shown above/' explicitly admits that the containerized shipments had actually the number of package declared by the shipper in the bill of lading. Therefore, the phrase "said to contain" appearing in the bill of lading must give way to this reality. (Reyna Brokerage, Inc. vs. Phil. Home Assurance Corp., 202 SCRA 564 [1991].)

Tariff schedules.

In connection with the transportation made by carriers subject to regulation rate and time schedules (see Art. 351.), the carriers are generally required by law to publish schedules of charges commonly referred to as "tariff schedules."

They have the duty to adhere to such tariff schedules, and may not charge a greater or less or different compensation for the transportation of passengers or property than die rates, fares, and charges applicable to such transportation as specified in such schedules. Such rates, fares and charges named in the schedule become the legal rate for the service rendered and must be charged by the carrier and paid by the shipper for passenger without deviation therefrom. The purpose of the law is to secure equality of rates to all and destroy favoritism. (13 Am. Jur. 2d 647-648.)

Manifest.

A manifest is different from a bill of lading.

(1) The first is a declaration of the entire cargo while the second is but a declaration of a specific part of the cargo.

(2) The first is absolutely essential to the exportation or importation of property in all vessels, to prevent unlawful entry into the country, while the second is designed to protect the importer or consignee. (Macondray & Co., Inc. vs. Acting Comm. of Customs, 62 SCRA 427 [1975].)

Duty of carrier to notify consignee of goods' arrival.

Article 711 should be deemed modified by Article 1738 of the Civil Code which provides that "the extraordinary liability of the common carrier continues to be operative even during the time the goals are stored in a warehouse of the carrier at the place of destination, until the consignee has been advised of the arrival of the goods and has had reasonable opportunity thereafter to remove them or otherwise dispose of them."

Under Article 1738, the carrier must notify the consignee of the arrival of the goods.

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B. GENERAL BONDED WAREHOUSE ACT

(Act No. 3893, as amended.)

Section 1. This Act shall be known by the short title of "General Bonded Warehouse Act." (Amended by R.A. No. 247.)

Sec. 2. As used in this Act, the term "warehouse" shall be deemed to mean every building, structure, or other protected inclosUre !in which commodity is kept for storage. The word "commodity" shall mean any farm, agricultural or horticultural product; animal and animal husbandry or livestock, dairy Or poultry product; water, marine or fish product; mineral, chemical, drug or medicinal product; and any raw, processed, manufactured or finished product or by-product, goods, article, or merchandise either of domestic or of foreign production or origin, which may be traded or dealth in openly and legally. "Person" includes a corporation or partnership or two or more persons having a joint or common interest; "warehouseman" means a person engaged in the business of receiving commodity for storage; and "receipt" means any receipt issued by a warehouseman for commodity delivered to him. For the purpose of this Act, the business of receiving commodity for storage shall include: (1) any contract or transaction wherein the warehouseman is obligated to return the very same commodity delivered to him or to pay its value; (2) any contract or transaction wherein the commodity delivered is to be milled for and on account of the owner thereof; (3) any contract or transaction wherein the commodity delivered is commingled with commodity delivered by or belonging to other persons, and the warehouseman is obligated to return the commodity of the same kind or to pay its value.

ceived in excess of the quantity of commodityhe is authorized to receive.

Sec. 13. Any person entering into connivance 6r combination with any warehouseman that is not licensed under this Act, with the purpose of evading the provisions of section three of this Act, shall be deemed guilty of a misdemeanor, and, upon conviction thereof, shall be fined not more than Two hundred pesos or imprisoned for not more than one month or both, in the discretion of the court.

Sec. 14. The Director of the Bureau of Commerce may, after opportunity for hearing has been afforded to the license concerned, suspend or revoke any license issued to any warehouseman conducting a warehouse under this Act for any violation of or failure to comply with any provision of this Act or of the rules and regulations made by virtue thereof.

Sec. 15. This Act shall not be applicable to cooperative marketing associations of commodity producers organized under Act Numbered Three Thousand four hundred and twenty-five known as the "Cooperative Marketing Law," provided such associations shall not receive, for storage, commodity from non-members which is greater in quantity than one-half of the total quantity of commodity received from members at any time.

Sec. 16. Act Numbered Three thousand four hundred and sixty-nine known as "Bonded Rice Warehouse Act" is hereby repealed.

Sec. 17. If any clause, sentence, paragraph, or part of this Act shall, for any reason, be adjudged by any court of competent jurisdiction to be invalid, such judgment shall not affect, impair, or invalidate the remainder thereof but shall be confined in its operation to the controversy in which such judgment shall have been rendered.

Sec. 18. This Act shall take effect on January first, nineteen hundred and thirty-two.

APPROVED, NOVEMBER 16,1931.

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Sec. 3. No person shall engage in the business of receiving commodity for storage without first securing a license therefor from the Director of the Bureau of Commerce. Said license shall be annual and shall expire on the thirty-first day of December.

Sec. 4. Any person applying for a license to engage in the business of receiving commodity for storage shall set forth in the application the place where the business and the warehouse are to be established or located and the maximum quantity of commodity to be received. The application shall be accompanied by a cash bond or bond secured by a real estate or signed by a duly authorized bonding company, the amount of which shall be fixed by the Director of the Bureau of Commerce at not less than thirty-three and one-third per cent of the market value of the maximum quantity of commodity to be received. Said bond shall be so conditioned as to respond for the market value of the commodity actually delivered and received at any time the warehouseman is unable to return the commodity or to pay its value. The bond shall be approved by the Director of the Bureau of Commerce before a license shall be issued, and it shall be the duty of said Director, before issuing a license under this Act, to satisfy himself concerning the sufficiency of such bond and to determine whether the warehouse for which such license is applied for is suitable for the proper storage of commodity.

Sec. 5. Whenever the Director of the Bureau of Commerce shall determine that a bond approved by him, is, or for any cause, has become insufficient, he may require an additional bond or bonds to be given by the Warehouseman concerned, conforming with the requirements of the preceding section, and unless the same be given within the time fixed by a written demand therefor, the license of such warehouseman may be suspended or revoked.

Sec. 6. Every person licensed under this Act to engage in the business of receiving commodity for storage shall insure the commodity so received and stored against fire.

Sec. 7. Any person injured by the breach of any obligation to secure which a bond is given, under the provision of this Act, shall be entitled to sue on the bond of his own name in any court of competent jurisdiction to recover the damages he may have sustained by such breach. Nothing contained herein shall exempt any property or assets of any warehouseman licensed under this Act, not exempted by law from attachment and execution, from being sued on, in case the bond given is not sufficient to respond for the full market value of the commodity received by such warehouseman.

Sec. 8. Every warehouseman licensed under this Act shall receive for storage, so far as his license and the capacity of his warehouse permit, any commodity of the kind customarily stored therein by him, which may be tendered to him in a suitable condition for warehousing, in the usual manner and in the ordinary and usual course of business, without making any discrimination between persons desiring to avail themselves of warehouse facilities.

Sec. 9. Every warehouseman licensed under this Act shall keep a complete record of all the commodity received by him of the receipt issued therefor, of the withdrawals, of the liquidation, and of all receipts returned to and cancelled by him. He shall make reports to the Director of the Bureau of Commerce concerning his warehouse and the condition, contents, operation, and business thereof in such form and at such time as the said Director may require, and shall conduct said warehouse in all other respects in compliance therewith.

Sec. 10. The Director of the Bureau of Commerce shall, from time to time make such rules and regulations as he may deem necessary for the efficient execution of the provisions of this Act.

Sec. 11. Any person engaging in the business or receiving commodity for storage in violation of section three of this Act shall be deemed guilty of misdemeanor, and, upon conviction thereof, shall be punished by imprisonment of not less than one month, or by fine of not more than five thousand pesos, or both, in the discretion of the court.

Sec. 12. Any warehouseman licensed under this Act receiving a quantity of commodity greater than that specified in his application and license shall, upon conviction, be fined double the market value of the commodity so re ceived in excess of the quantity of commodity he is authorized to receive.

Sec. 13. Any person entering into connivance or combination with any warehouseman that is not licensed under this Act, with the purpose of evading the provisions of section three of this Act, shall be deemed guilty of a misdemeanor, and, upon conviction thereof, shall be fined not more than Two hundred pesos or imprisoned for not more than one month or both, in the discretion of the court.

Sec. 14. The Director of the Bureau of Commerce may, after opportunity for hearing has been afforded to the license concerned, suspend or revoke any license issued to any warehouseman conducting a warehouse under this Act for any violation of or failure to comply with any provision of this Act or of the rules and regulations made by virtue thereof.

Sec. 15. This Act shall not be applicable to cooperative marketing associations of commodity producers organized under Act Numbered Three Thousand four hundred and twenty-five known as the "Cooperative Marketing Law," provided such associations shall not receive, for storage, commodity from non-members which is greater in quantity than one-half of the total quantity of commodity received from members at any time.

Sec. 16. Act Numbered Three thousand four hundred and sixty-nine known as "Bonded Rice Warehouse Act" is hereby repealed.

Sec. 17. If any clause, sentence, paragraph, or part of this Act shall, for any reason, be adjudged by any court of competent jurisdiction to be invalid, such judgment shall not affect, impair, or invalidate the remainder thereof but shall be confined in its operation to the controversy in which such judgment shall have been rendered.

Sec. 18. This Act shall take effect on January first, nineteen hundred and thirty-two.

APPROVED, NOVEMBER 16,1931.

Salient features of the Act.

They are the following:

(1) Its purpose is to afford protection to persons dealing with a warehouseman engaged in the business of receiving goods for storage (see Sec. 2.);

(2) It applies not only to storage of rice and palay but also to any other goods, articles or merchandise, which may be traded or dealt in openly and legally[1] *(ibid.);*

(3) It requires a person before he shall engage in the business of receiving commodity for storage to first secure a license therefor from the Director of the Bureau of Commerce[2] (see Sec. 3.);

(4) It requires a person applying for such license to file a bond or additional bond or bonds as may be required to be approved by the Director of the Bureau of Commerce for not less than the amount fixed by the Act (see Sees. 4-5.);

(5) It requires every warehouseman to insure the commodity so received and stored against fire (see Sec. 6.); and

(6) It provides penalties including suspension or revocation of any license issued to any warehouseman, for any violation of or failure to comply with any provision of the Act or the rules and regulations made by virtue thereof, (see Sees. 11-14.)

Obligations of a bonded warehouseman.

They are as follows:

(1) To secure the required license;

(2) To file the required bond;

(3) To insure the commodity received and stored against fire;

(4) To issue warehouse receipts for said commodity (see Gonzales vs. Go Tiong, 104 Phil. 492 [1958].);

[1]R.A. No. 247 (approved June 12, 1948.) substituted the word "rice" in each and every section or provision of the Act with the word "commodity", so as to include within the scope and purview of said Act what is embraced by the word according to the definition in Section 2. (see Sec. 1, R.A. No.

[2]Now, Bureau of Trade Regulation and Consumer Protection.

(5) To answer for damages to any person injured by the breach of any obligation to secure which the bond is given (see Sec. 7.);

(6) Not to discriminate between persons desiring to avail themselves of his warehouse facilities (see Sec. 8.);

(7) To keep a complete record of all the commodity received by him, of the receipts issued therefor, of the withdrawals, of the liquidation, and of all receipts returned to and cancelled by him (Sec. 9.);

(8) To make reports to the Director of the Bureau of Commerce concerning his warehouse and the condition, contents, operation and business thereof in such form and at such time as the said Director may require *(ibid.);*

(9) To conduct his warehouse in all other respects in compliance therewith *(ibid.);* and

(10) Not to receive a quantity of commodity greater than that specified in his application and license, (see Sec. 12.)

When bond not necessary.

The intent of the Act in requiring a warehouseman to post a bond is to provide protection to the owner who delivers his goods to the warehouseman for storage.

Where the warehouseman has posted a performance bond as required by the owner, and insured the goods, the owner is already amply protected. To further require him to post an additional bond under the Act would be unreasonable and oppressive. (Phil. Tobacco Flue Curing & Redrying Corp. vs. Pablo, 66 SCRA 136 [1975].)

Prohibition against the use of the word "bonded."

Section 3 of Republic Act No. 247 provides: "The word 'bonded' shall not be used, partly or wholly, as trade name or business name of any person, firm, corporation, partnership, joint-stock company, or association owning, maintaining or operating any warehouse which is neither licensed under this Act nor established under Chapter thirty-nine, Article XIII, section thirteen hundred and two and thirteen hundred and four of the Administrative Code of 1917, as amended, or to name, designate, or advertise such warehouse.

Any person violating the provision of this section shall, upon conviction, be punished with imprisonment for not more than five years or with a fine of not more than five thousand pesos, or with both such fine and imprisonment, in the discretion of the court/'

Annual license fee to be paid.

Section 2 of Republic Act No. 247 provides: "Every person in the business of receiving commodity for storage defined in section two of the said Act Numbered Thirty-eight hundred and ninety-three, as amended, shall pay an annual fee of fifty pesos for the first one thousand square meters of protected enclosure or one thousand cubic meters of storage space or any fraction of such enclosure or space, and two and one-half centavos for each additional square meter or cubic meter/'

Deposit with ordinary receipt.

Act No. 3893 is a special law regulating the business of receiving commodities for storage and defining the rights did obligations of a bonded warehouseman and those transacting business with him. Consequently, any deposit made with him as a bonded warehouseman must necessarily be governed by the provisions of said Act. The kind or nature of the receipts issued by him for the deposits is not very material much less decisive. Though it is desirable that receipts issued by a bonded warehouseman should conform to the provisions of the Warehouse Receipts Law (Act No. 2137, as amended.), said provisions are not mandatory and indispensable in the sense that if they fell short of the requirements of-the law, then the commodities delivered for storage become ordinary deposits and will not be governed by the provisions of the Bonded Warehouse Act.

Under Section 1 of the Warehouse Receipts Law, one would gather the impression that the issuance of a warehouse receipt in the form provided by it is merely permissive and directory and not obligatory, and the Bonded Warehouse Act permits the warehouseman to issue any receipt. Any deposit made with a bonded warehouseman assuchmust necessarily be governed by said Act. (Gonzales vs. Go Tiong & Luzon Surety Co., 104 Phil. 492 [1958].)

A surety cannot avoid liability from the mere failure of the warehouseman to issue the prescribed receipt, *(ibid.)*

Palay received for milling purposes only.

Act No. 3893, as amended, explicitly applies to any warehouse enclosed in a structure where commodity is received and kept for storage.

It has been held that the Act is applicable to an owner or operator of a rice mill engaged in the business of milling *palay* for others, housed in a small structure or "camarin" of mixed materials, used for milling only, not for the storage or deposit of *palay* or rice. In the ordinary course of business, the purpose of milling the *palay* cannot be accomplished without keeping same for some time in the mill and hence, without storing therein said commodity. Hence, one way or the other, there is a form of storage, the duration of which may vary depending on the circumstances. In other words, it is enough that the *palay* is *delivered,* even only to have it milled. In any event, the Court said, the rice mill operator is responsible for the *palay* or rice, while the same is in his possession, and public policy or public interest demands that the rights of the owner of the commodity be duly protected. Hence, the need of securing the license prescribed in the Act in order that the Director of Commerce could determine the conditions under which a warehouse may be authorized to operate conformably with the objectives of said legislation and the amount of the bond to be required for the protection of the people who avail themselves of its services. (People vs. Verzola, 103 Phil. 201 [1958]; Limjoco vs. The Director of Commerce, 15 SCRA 326 [1965].)

Inadequacy of warehouse.

The appellant contended that her "camalig" was neither adequate nor suitable for storage. The Court ruled that the inad equacy of the construction for storage insofar as the safety of the commodity received is concerned is not a valid reason to remove if from the operation of the Act for otherwise, the very fact of non-compliance with the legal requirements in this respect could be its own excuse from the liabilities imposed. (Limjuco vs. The Director of Commerce, *supra.)*

Bonded *palay* and unbonded *palay,* deposited in the warehouse of a rice mill are treated separately for insurance purposes. The law required that bonded *palay* belonging to third persons should be insured against fire. In case of loss, the value therein is payable to the Bureau of Commerce. The warehouse receipts (quedans) may prove the deposit of bonded *palay.* The unbonded *palay* may be determined from the records of purchase of palay and sales of milled rice, (see Bog & Co. v. Hanover Fire Ins. Co. of the City of New York, 1 SCRA 599 [1961].)

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C. TRUST RECEIPTS LAW

(P.D. NO. 115.)

PROVIDING FOR THE REGULATION OF TRUST RECEIPTS TRANSACTIONS.

WHEREAS, the utilization of trust receipts, as a convenient business device to assist importers and merchants solve their financing problems, had gained popular acceptance in international and domestic business practice, particularly in commercial banking transactions;

WHEREAS, there is no specific law in the Philippines that governs trust receipt transactions, especially the rights and obligations of the parties involved therein and the enforcement of the said rights in case of default or violation of the terms of the trust receipt agreement;

WHEREAS, the recommendations contained in the report on the financial system which have been accepted, with certain modifications by the monetary authorities included, among others, the enactment of a law regulating the trust receipt transactions;

NOW, THEREFORE, I, FERDINAND E. MARCOS, President of the Philippines, by virtue of the powers vested in me by the Constitution as Commander-in-Chief of the Armed Forces of the Philippines, and pursuant to Proclamation No. 1081, dated September 21,1972, and General Order No. 1, dated September 22,1972, as amended, and in order to effect the desired changes and reforms in the social, economic, and political structure of our society, do hereby order and decree and make as part of the law of the land the following:

Section 1. ***Short Title.*****—This Decree shall be known as the Trust Receipts Law.**

Sec. 2. ***Declaration of policy.*** **— It is hereby declared to be the policy of the State: (a) to encourage and promote the use of the trust receipts as an additional and convenient aid to commerce and trade; (b) to provide for the regulation of trust receipt transactions in order to assure the protection of the rights and the enforcement of obligations of the parties involved therein; and (c) to declare the misuse and/or misappropriation of goods or proceeds realized from the sale of goods, documents or instruments released under trust receipts as a criminal offense punishable under Article Three Hundred and Fifteen of the Revised Penal Code.**

Sec. 3. ***Definition of terms.*** **— As used in this Decree, unless the context otherwise requires, the term —**

(a) "Document" shall mean written or printed evidence of title of goods.

(b) "Entrustee" shall refer to the person having or taking possession of goods, documents or instruments under a trust receipt transaction, and any successor in interest of such person for the purpose or purposes specified in the trust receipt agreement.

(c) "Entruster" shall refer to the person holding title over the goods, documents, or instruments subject of a trust receipt transaction, and any successor in interest of such person.

(d) "Goods" shall include chattels and personal property other than: money, things in action, or things so affixed to land as to become a part thereof.

(e) "Instrument" means any negotiable instrument as defined in the Negotiable Instruments Law; any certificate of stock, or bond or debenture for the payment of money issued by a public or private corporation, or any certificate of deposit, participation certificate or receipt, any credit or investment instrument of a sort marketed In the ordinary course of business or finance, whereby the entrustee, after the issuance of the trust receipt, appears by virtue of possession and the face of the instrument to be the owner.

"Instrument" shall not include a document as defined in this Decree.

(f) "Purchase" means taking by sale, conditional sale, lease, mortgage, or pledge, legal or equitable.

(g) "Purchaser" means any person taking by purchase.

(h) "Security Interest" means a property interest in goods, documents or instruments to secure performance of some obligations of the entrustee or of some third persons to the entruster and includes title, whether or not expressed to be absolute, whenever such title is in substance taken or retained for security only.

(i) "Person" means, as the case may be, an individual, trustee, receiver, or other fiduciary, partnership, corporation, business trust or other association, and two or more persons having a joint or common interest.

. (j) "Trust Receipt" shall refer to the written or printed document signed by the entrustee in favor of the entruster containing terms and conditions substantially complying with the provisions of this Decree. No further formality of execution or authentication shall be necessary to the validity of a trust receipt.

(k) "Value" means any consideration sufficient to support a simple contract.

Sec. 4. *What constitutes a trust receipt transaction.* — A trust receipt transaction, within the meaning of this Decree, is any transaction by and between a person referred to in this Decree as the entruster, and another person referred to in this Decree as the entrustee, whereby the entruster, who owns or holds absolute title or security interests over certain specified goods, documents or instruments, releases the same to the possession of the entrustee upon the latter's execution and. delivery to the entruster of a signed document called the "trust receipt" wherein the entrustee binds himself to hold the designated goods, documents or instruments in trust for the entruster and to sell or otherwise dispose of the goods, documents or instruments with the obligation to turn over to the entruster the proceeds thereof to the extent of the amount owing to the entruster or as appears in the trust receipt

or the goods, instruments themselves if they are unsold or not otherwise disposed of, in accordance ^vith the terms and conditions specified in the trust receipt, or for other purposes substantially equivalent to any one of the following:

1. In the case of goods or documents: (a) to sell the goods or procure their sale; or (b) to manufacture or process the goods with the purpose of ultimate sale: *Provided*, That in the case of goods delivered under trust receipt for the purpose of manufacturing or processing before its ultimate sale, the entruster shall retain its title over the goods whether in its original or processed form until the entrustee has complied fully with his obligation under the trust receipt; or (c) to load; unload, ship or tranship or otherwise deal with them in a manner preliminary or necessary to their sale; or

2. In the case of instruments: (a) to sell or procure their sale or exchange; or (b) to deliver them to a principal; or (c) to a depository or register; or (d) to effect their presentation, collection or renewal.

The sale of goods, documents or instruments by a person in the business of selling goods, documents or instruments for profit, who at the outset of the transaction, has, as against the buyer, general property rights in such goods, document or instruments, or who sells the same to the buyer on credit, retaining title or other interest as security for the payment of the purchase price, does not constitute a trust receipt transaction and is outside the purview and coverage of this Decree.

Purpose of the law.

The Trust Receipts Law was enacted to safeguard commercial transactions and to offer an additional layer of security to the lending bank.

Trust receipts are indispensable contracts in international and domestic business transactions. The prevalent use of trust receipts, the danger of their misuse and/or misappropriation of the goods or proceeds realized from the sale of goods, documents or instruments held in trust for entruster banks, and the need for regulation of trust receipt transactions to safeguard the rights and enforce the obligations of the parties involved are the main thrusts of the Trust Receipts Law. (Land! & Company [Phil.] Inc. vs. Metropolitan Bank & Trust Company, 435 SCRA 639 [2004].)

Meaning of trust receipt.

A *trust receipt* has also been defined as "a document in which is expressed a security transaction, whereunder the lender, having no prior title in the goods on which the lien is to be given, and not having possession which remains in the borrower, lends his money to the borrower on security of the goods, which the borrower is privileged to sell clear of the lien on agreement to pay all or part of the proceeds of the sale to the lender. (Black's Law Dictionary [1968 ed.], p. 1683.)

"The term is specifically applied to a written instrument whereby a banker having advanced money for purchase of imported merchandise and having taken title in his own name, delivers possession to an importer on agreement in writing to hold the merchandise in trust for the banker till he is paid." *(ibid.)*

Importance and character of trust receipts.

(1) *Originally used in importing transactions.* — "The device first came into general use in importing transactions, where goods were consigned directly to a bank which paid a draft for the price on the credit of the intended buyer who engaged to repay the bank's advances. He is not always able to do this immediately, and the bank is often willing to extend credit if it can retain the security of the goods, but the buyer needs the goods to carry on his business either by reselling them or by using them for purposes of manufacture." (2 Williston on Sales, [3rd ed.], p. 310.)

(2) *Convenient aid to commerce and trade.* — "The utilization of trust receipts, as a convenient business device to assist importers and merchants solve their financing problems, had gained popular acceptance in international and domestic business practice, particularly in commercial banking transactions " (see 1st *whereas* clause.) "By this arrangement (of trust receipt), a

banker advances money to an intending importer, and thereby lends the aid of capital, of credit, or of business facilities and agencies abroad, to the enterprise of foreign commerce. Much of this trade could hardly be carried on by any other means and, therefore, it is of the first importance that the fundamental factor in the transaction, the banker's advance of money and credit, would receive the amplest protection." (People vs. Yu Chai Ho, 53 Phil. 874 [1929], citing *In re* Dunlop Carpet Co., 206 Fed. 726.)

(3) *Full title vested in entruster.* — "Accordingly, in order to secure that the banker shall be repaid at the critical point — that is, when the imported goods finally reach the hands of the intended vendee — the banker takes the full tide to the goods at the very beginning; he takes it as soon as the goods are brought and settled for by his payments or acceptances in the foreign country, and he continues to hold that tide as his indispensable security until the goods are sold and the vendee is called upon to pay to diem." *(ibid.)*

(4) *Title in entruster taken as security only.* — "This security is not an ordinary pledge by the importer to the banker, for the importer has never owned the goods, and moreover, he is not able to deliver the possession; but the security is the complete tide vested originally in the banker, and this characteristic of the transaction has again and again been recognized and protected by the courts. Of course, the tide is at bottom a security as it has sometimes been called, and the banker is always under the obligation to reconvey, but only after his advances have been fully repaid and after die importer has fulfilled the other terms of the contract." *(ibid.;* Prudential Bank vs. Intermediate Appellate Court, 216 SCRA 257 [1992].)

The entruster shall be entitled to the proceeds from the sale of the goods, documents or instruments released under a trust receipt to the entrustee to the extent of die amount owed to the entruster or as appears in the trust receipt; or to die return of the. goods, , documents or instruments in case of non-sale; and to the enforcement of all otiier rights conferred on him in the trust receipt, provided these are not contrary to the provisions of the document. (Metropolitan Bank & Trust Co. vs. Gonzales, 584 SCRA 631 [2009].)

(5) *With both loan and security features.* — A trust receipt does not involve a simple loan transaction between a creditor and a debtor-importer. Apart from a loan feature that is covered by a letter of credit, the trust receipt arrangement has a security feature that is covered by a letter of credit, covered by the trust receipt itself. The second feature is what provides the much needed financial assistance to traders in the importation or purchase of goods or merchandise through the use of the goods or merchandise as collateral for the advancements made by the bank. (Vintola vs. Insular Bank of Asia and America, 151 SCRA 578 [1987]; Samo vs. People, 115 Phil. 346 [1962]; Metropolitan Bank and Trust Company vs. Tonda, 338 SCRA 254 [2000].)

A trust receipt is thus considered a security transaction intended to aid in financing importers and retail dealers who do not have sufficient funds or resources to finance the importation or purchase of merchandise and who may not be able to acquire credit except through utilization, as collaterals, of the merchandise imported or purchased.* (53 Am. Jur. 961, cited in Samo vs. People, 115 Phil. 346 [1962] and People vs. Cuevo, 104 SCRA 312 [1981]; Gonzales vs. Hongkong Shanghai Bank Corp., 53 SCRA 255 [2007].) Section 4 states the undertakings of the entrustee. (see Ching vs. Secretary of Justice, 481 SCRA 609 [2006].)

"A trust receipt, therefore, is a security agreement, pursuant to which a bank acquires a 'security interest in the goods. It secures an indebtedness and there can be no such thing as security interest that secures no obligation." (Abad vs. Court of Appeals, 181 SCRA 191 [1990].) The law does not seek to enforce payment of the loan. Thus, there can be no violation of the constitutional prohibition against imprisonment for non-payment of a debt. (People vs. Nitafan, 207 SCRA 273 [1992].)

Through the trust receipt agreement/the bank theoretically acquires ownership of the imported personal property. (Garcia vs. Court of Appeals, 258 SCRA 446 [1996].) In a certain manner, a trust receipt partakes of the nature of a conditional sale as provided by the Chattel Mortgage Law, that is, the importer becomes absolute owner of the imported mechandise as soon as he has paid its price. The ownership of the merchandise continues to be vested in the owner thereof or in the person who has advanced payment, until he has been paid;in full> or if die merchandise has already been sold, the proceeds of the sale should be turned over to him by the importer or by his representative or successor in interest. (National Bank vs. Viuda & Hijos de Engel Jose, 63 Phil. 814 [1936], cited in Presidential Bank vs. Intermediate Appellate Court, supra.)

Where the debtor received the goods subject of die trust receipt before the trust receipt itself was entered into^ the transaction in question was held to be a simple loan and not a trust receipt agreement, since prior to the date of execution of die trust receipt, ownership over die goods was already transferred to the debtor. This situation is inconsistent witii what normally obtains in a pure trust receipt transaction, wherein the gobds belong in ownership to die bank and are only released to die importer in trust after the loan is granted. (Colinares vs. Court of Appeals, 339 SCRA 609 [2000]; Consolidated Bank and Trust Corporation vs. Court of Appeals, 356 SCRA 671 [2001].) In a trust receipt transaction (see Sec. 4[1], P.D. No. 115.), the release of the goods to die entrustee on his execution of the trust receipt is essentially for the purpose of their sale or is successfully connected with their ultimate or subsequent sale. (Development Bank of the Phils, vs. Prudential Bank, 475 SCRA 623 [2005].)

(6) *Entruster remains a lender and creditor.* — The bank does not become the real owner of die goods. It is merely the holder of a security tide for the advances it had made to the importer. The goods the importer had purchased through the bank financing, remain die importer's property and he holds it at his own risk. The trust receipt arrangement does not convert the bank into, an investor; it remains a lender and creditor. This is so because the bank had previously extended a loan which the letter of credit represents to the importer, and by that loan, the importer should be the real owner of the goods.

If under the trust receipt, the bank is made to appear as the owner, it is but an artificial expedient, more of a legal fiction than fact, for if it were so, it could dispose of the goods in any manner it wants, which it cannot do, just to give consistency with the purpose of the trust receipt of giving a stronger security for the loan obtained by the importer. To consider 3\e bank as the true owner from the inception of the transaction would be to disregard the loan feature involved. (Abad vs. Court of Appeals, *supra.;* Rosario Textile Mills Corp. vs. Home Bankers Services and Trust Co., 462 SCRA 88 [2005].)

(7) *Letter of credit-trust receipt arrangement.* — Such an arrangement is endowed with its own distinctive features and characteristics. Under that set-up, a bank extends to a borrower a loan covered by the letter of credit, with the trust receipt as a security for the loan. In other words, the transaction involves a loan feature represented by the letter of credit, and a security feature which is in the covering trust receipt, *(ibid.;* see Phil. National Bank vs. General Acceptance & Finance Corp., 161 SCRA 449 [1988].) The fact that the entrustee is unable to sell the goods in question does not affect the right of the entruster to recover the advances it had made under the loan covered by the letter of credit, with the trust receipt as a security for the loan. (Vintola vs. Insular Bank of Asia & America, *supra*; Prudential Bank vs. National Labor Relations Commission, 251 SCRA 421 [1995]; Rizal Commercial Banking Corporation vs. Alfa RTW Manufacturing Corporation, 368 SCRA 611 [2001].)

The title of the bank to the security is the one sought to be protected and not the loan which is a separate and distinct agreement. (People vs. Nitafan, *supra.)* The repossession by the bank of the goods pursuant to the trust receipt arrangement giving it the unqualified right to the possession and the letter of credit cannot, by itself, be considered payment of the loan secured by the trust receipt; payment could legally result only after the bank has foreclosed oh said securities and sold the same and applied the proceeds thereof to the loan obligation. (Phil. National Bank vs. Pineda, 197 SCRA 1 [1991].)

Trust receipt and letter of credit distinguished.

A letter of credit is a separate document from a trust receipt. While the trust receipt may have been executed as a security on the letter of credit, still die two documents involve different undertakings and obligations.

A letter of credit is an engagement by a bank or other person made at the request of a customer that the issuer will honor drafts or other demands for payment upon compliance with the conditions specified in the credit. Through a letter of credit, the bank merely substitutes its own promise to pay for the promise to pay of one of its customers who in return promises to pay the bank the amount of funds mentioned in the letter of credit plus credit or commitment fees mutually agreed upon.

By contrast, a trust receipt transaction is one where the entruster, who holds an absolute title or security interests over certain goods, documents or instruments, released the same to the entrustee, who executes a trust receipt binding himself to hold the goods, documents or instruments in trust for the entruster and to sell or otherwise dispose of the goods, documents and instruments with the obligation to turn over to the entruster the proceeds thereof to the extent of the amount owing to the entruster, or as appears in the trust receipt, or return the goods, documents or instruments themselves if they are unsold, or not otherwise disposed of, in accordance with the terms and conditions specified in the trust receipt. (Bank of Commerce vs. Serrano, 451 SCRA 484 [2005].)

Sec. 5. *Form of trust receipts; contents.* —A trust receipt need not be in any particular form, but every such receipt must substantially contain: (1) a description of the goods, documents or instruments subject of the trust receipt; (2) the total invoice value of the goods and the amount of the draft to be paid by the entrustee; (3) an undertaking or a commitment of the entrustee: (a) to hold in trust for the entruster the goods, documents or instruments therein described; (b) to dispose of them in the manner provided for in the trust receipt; and (c) to turn over the proceeds of the sale of the goods, documents or instruments to the entruster or as appears in the trust receipt or to return the goods, documents or instruments in the event of their non-sale within the period specified therein.

The trust receipt may contain other terms and conditions agreed upon by the parties in addition to those hereinabove enumerated provided that such terms and

conditions shall not be contrary to the provisions of this Decree, any existing jaws, public policy or morals, public order or good customs.

Sec. 6. *Currency in which a trust receipt may be denominated.* — A trust receipt may be denominated in Philippine currency or any foreign currency acceptable and eligible as part of international reserves of the Philippines, the provisions any of existing law, executive orders, rules and regulations to the contrary notwithstanding: *Provided, however,* That in the case of trust receipts denominated in foreign currency, payment shall be made in its equivalent in Philippine currency, computed at the prevailing exchange rate on the date of the proceeds of sale of the goods, documents or instruments held in trust by the entrustee are turned over to the entruster or on such other date as may be stipulated in the trust receipt or other agreements executed between the entruster and the entrustee.

Sec. 7. *Right of the entruster.* — The entruster shall be entitled to the proceeds from the sale of the goods, documents or instruments released under a trust receipt to the entrustee to the extent of the amount owing to the entruster or as appears in the trust receipt, or to the return of the goods, documents or instruments in case of non-sale, and to the enforcement of all other rights conferred to him in the trust receipt provided such are not contrary to the provisions of this Decree.

The entruster may cancel the trust and take possession of the goods, documents or instruments subject to the trust or of the proceeds realized therefore at any time upon default or failure of the entrustee to comply with any of the terms and conditions of the trust receipt or any other agreement between the entruster and the entrustee, and the entruster in possession of the goods, documents of instruments may, on or after default, give notice to the entrustee of the intention to sell, and may, not less the goods, documents or instruments at public or private sale, and the entruster may, at a public sale, become a purchaser. The proceeds of any such sale, whether public or private, shall be applied: (a) to the payment of the expenses thereof; (b) to the payment of the expenses of retaking, keeping and storing the goods, documents or instruments; (c) to the satisfaction of the entrustee's indebtedness to the en- truster. The entrustee shall receive any surplus but shall be liable to the entruster for any deficiency. Notice of sale shall be deemed sufficiently given if in writing, and either personally served on the entrustee or sent by post-paid ordinary mail to the entrustee's last known business address.

Sec. 8. *Entruster not responsible on sale by entrustee,* — The entruster holding a security interest shall not, merely by virtue of such interest or having given the entrustee liberty of sale or other disposition of the goods, documents or instruments under the terms of the trust receipt transaction, be responsible as principal or as vendor under any sale or contract to sell made by the entrustee.

Sec. 9. *Obligations of the entrustee.* — The entrustee shall: (1) hold the goods, documents or instruments in trust for the entruster and shall dispose of them strictly in accordance with the terms and conditions of the trust receipt; (2) receive the proceeds in trust for the entruster and turn over the same to the entruster to the extent of the amount owing to the entruster or as appears on the trust receipt; (3) insure the goods for their total value against loss from fire, theft, pilferage or other casualties; (4) keep said goods or proceeds thereof whether in money or whatever form, separate and capable of identification as property of the entruster; (5) return the goods, documents or instruments in the event of non-sale or upon demand of the entruster; and (6) observe all other terms and conditions of the trust receipt not contrary to the provisions of this Decree.

Sec. 10. *Liability of entrustee for loss.* — The risks of loss shall be borne by the entrustee. Loss of goods, documents, or instruments which are the subject of a trust receipt, pending their disposition, irrespective of whether or not it was due to the fault or negligence of the entrustee, shall not extinguish his obligation to the entruster for the value thereof.

Sec. 11. *Right of purchaser for value and in good faith.* —»Any purchaser of goods from an entrustee with right to sell, or of documents or instruments through their customary form of transfer, who buys the goods, documents, or

instruments for value and in good faith from the entrustee, acquires said goods, documents, or instruments for value and In good faith from the entrustee, acquires said goods, documents, or instruments free from the entruster's security interest.

Sec. 12. *Validity of entruster's security interest as against creditors.* — The entruster's security interest in goods, documents, or instruments pursuant to the written terms of a trust receipt shall be valid as against all creditors of the entrustee for the duration of the trust receipt agreement.

Validity of entruster's claim against other creditors.

Owing to the vital role trust receipts play in international and domestic commerce, Section 12 assures the entruster of the validity of his claim against all creditors.

(1) *Nature of security interest of entruster.* — The security interest of the entruster is not merely an empty or idle title. To a certain extent, such interest becomes a "lien" on the goods because the entruster's advances will have to be settled first before the entrustee can consolidate his ownership over the goods. To refuse to recognize the title of the banker under the trust receipt as a security for the advance of the purchase price would be to strike down a *bona fide* and honest transaction of great commercial benefit and advantage.

(2) *Right of entruster to cancel trust optional* — Section 7 (2nd par.) provides a statutory remedy available to an entruster in the event of default or failure of the entrustee to comply with any of the terms and conditions of the trust receipt or any other agreement between the entruster and the entrustee.

The provision uses the word "may" in granting to the entruster the right to cancel the trust and take possession of the goods to be able to enforce his rights under the trust receipts agreement. Consequently, the entruster has the discretion to avail of the right mentioned or seek any alternative action, such as a third-party claim or a separate civil action which it deems best to protect its right, at any time upon default or failure of the entrustee to comply with any of the terms and conditions of the trust agreement.

(3) *Right of entruster to goods as against entrustee and third persons.* — In any case, the law warrants the validity of the entruster's security interest in the goods pursuant to the written terms of the trust receipt as against all creditors of the entrustee for the duration of the trust receipt agreement. The only exception to the rule is when the goods are in the hands of an innocent purchaser for value and in good faith. (Prudential Bank vs. National Labor Relations Commission, 251 SCRA 421 [1995]; South City Homes, Inc. vs. BA Finance Corporation, 341 SCRA 603 [2001].)

After taking possession of the goods covered by the trust receipt, the entrustee and the surety, if any; remain liable for the loan covered by said receipt. (Philippine Blooming Mills, Inc. vs. Court of Appeals, 413 SCRA 445 [2003]; see Vintola vs. Insular Bank of Asia and America, 150 SCRA 578 [1987]; Landl & Company [Phil.], Inc. vs. Metropolitan Bank & Trilst Co., 435 SCRA 639 [2004].)

ILLUSTRATIVE CASES:

1. Entruster (bank) seeks to recover proceeds of sale of gasoline covered by a trust receipt, which were garnished by the judgment creditor of the entrustee (seller).

Facts: Upon petition of X Company, Inc., a mercantile company established in Manila, Y Company of California sent from California to Manila drums of gasoline for $7,000.00, addressed to X, consigning them to PNB (bank). Y requested PNB to collect the amount of the draft from X and to deliver the merchandise in question after X has paid the price thereof. Inasmuch as X then had no money to pay the draft, X requested PNB to pay in its stead to which request PNB acceded on condition that X executed, as it, in fact, executed, a trust receipt under the terms of which, among others, X bound itself to hold the merchandise in storage as the property of PNB with the liberty to sell the same for cash for PNB's account.

To better secure the payment of PNB's credit, X bound itself to have all the merchandise deposited in PNB's warehouse so that not a single drum would be withdrawn therefrom without its knowledge. Subsequently, X entered into a contract with MRR Company to supply it with gasoline which was no other than that sent to X by Y, with agreement that the payment to be made by MRR would be made directly to PNB.

Such was the state of things when J filed an action and obtained judgment for the recovery of a certain credit against X. By virtue of a writ of attachment and of execution, the sheriff garnished the sum of P2,000.00 in the possession of MRR as proceeds of the gasoline supplied to it by X. PNB brought an action dismissed by virtue of the judgment from which it has appealed, for the purpose of recovering the sum in question.

Issue: Who has a superior right to sum garnished, PNB or J?

Held: PNB (1) *Trust receipts partake of the nature of a conditional sale.* — "Contracts contained in trust receipts as the one entered into between X and Y should be recognized and protected by the courts because they are permitted by law, all the more so because there is the cardinal principle that the contracting parties may establish any agreements, terms, and conditions they may deem advisable provided they are not contrary to law, morals, or public policy.

Trust receipts, as contracts, in a certain manner partake of the nature of a conditional sale, that is, the importer becomes absolute owner of the imported merchandise as soon as he has paid its price. The ownership of the merchandise continues to be vested in the owner thereof or in the person who has advanced payment, until he has been paid in full, or if the merchandise has already been sold, the proceeds of the sale should be turned over to him by the importer or by his representative or successor in interest.

(2) *PNB's credit enjoys preference.* — Furthermore, under the provisions of the Civil Code, PNB's credit enjoys preference over any other credit of X and its right to the sum garnished is superior to that of J who was merely the judgment creditor. The credit of J does not enjoy the same privilege enjoyed by that of PNB which is singular and special. It is mentioned third only (now No. 14[b].) in Article 1924, (no\y Art. 2244.) referring to credits which while having preference among themselves have none over the specially privileged ones enumerated in Articles 1922 (now Art. 2241.) and 1923. (now Art. 2242.) *(Phil. National Bank vs. Viuda y Hijos de Angel Jose, 63 Phil. 84 [1936].)*

2. *Buyer of merchandise covered by a trust receipt affixed his signature to the trust receipt, paying, instead of the entruster (bank), the entrustee (seller) who become insolvent*

Facts: X, an importer, executed a trust receipt in favor of PNB bank covering certain merchandise. Y purchased the merchandise from X. Y affixed his signature on the trust receipt because of his strong desire to get the merchandise purchased by him from X and which were duly paid for to X and not to PNB. X became insolvent.

Issue: Is Y liable under the trust receipt?

Held: Yes. He is liable *ex contractu* for its breach, whether he did or he did not "misappropriate, misapply or convert the said merchandise." By signing the trust receipt, Y caused PNB to believe he assumed the obligations thereunder together with his co-signer; and PNB having acted on that assumption, induced by X, the latter cannot in equity be heard, to deny his liability under the principle of estoppel.

It appearing from the stipulation that the merchandise were delivered by X to Y who disposed thereof, it is but right that he should be the one to answer for their value. Y's payments to X cannot diminish the rights of PNB, since the trust receipt expressly obligated Y to pay PNB and not to his co-signer. *(Phil. National Bank vs. Catipon, 98 Phil. 286 [1956].)*

Sec. 13. *Penalty clause.* —The failure of an entrustee to turn over the proceeds of the sale of the goods, documents or instruments covered by a trust receipt to the extent of the amount owing of the entruster or as appears in the trust receipt or to return said goods, documents or instruments if they were not sold or disposed of in accordance with the terms of the tru$t receipt shall constitute the crime of estafa, punishable under the provisions of Article Three Hundred and Fifteen, Paragraph One(b) of Act Numbered Three Thousand Eight Hundred and Fifteen, as amended, otherwise known as the Revised Penal Code. If the violation or offense is committed by a corporation, partnership association or other juridical entities, the penalty provided for in this Decree shall be imposed upon the directors, officers, employees or other officials or persons therein responsible for the offense, without prejudice to the civil liabilities arising from the criminal offense.

Trust receipt violation constitutes estafa. r

(1) *Misappropriation of proceeds of goods involved.* — Orte objective of the Trust Receipts Law is "to declare the misuse and/or misappropriation of goods or proceeds realized from'the sale of goods, documents or instruments released under trust receipts as a criminal offense punishable under Article 315 of the Revised Penal Code." (Sec. 2.) Section 13 removes any doubt as to the criminal liability for estafa of the holder of a trust receipt who misappropriated the proceeds of the sale of the goods covered by the trust receipt. (People vs. Cuevo, 104 SCRA 312 [1981]; Ro- bles vs. Court Of Appeals, 199 SCRA 195 [1991].) The law does not seek to enforce payment of the loan, rather it punishes the dishonesty and abuse of confidence in the handling of money or goods to the prejudice of another. (Colinares vs. Court of Appeals, 339 SCRA 609 [2000]; Gonzales vs. Hongkong & Shanghai Banking Corp., 537 SCRA 255 [2007].)

Acts involving the violation of trust receipt agreements occurring after January 29, 1973 (date of enactment of the law) would make the accused immediately liable for estafa under paragraph 1(b), Article 315 of the Revised Penal Code pursuant to the explicit provision in Section 13. (Lee vs. Rodil, 175 SCRA 100 [1989]; Sia vs: Court of Appeals, 166 SCRA 263 [1988].) In the *Sia* case, the Supreme Court adopted the view that a violation gives rise only to a civil liability as the more feasible view "before the promulgation of Presidential Decree No. 115" notwithstanding prior decisions where it ruled that a breach also gives rise to a liability for estafa.

An act violative of a trust receipt agreement is only one mode of committing esjtafa; it is not the sole baste for incurring liability under Article 315(1, b) of the Revised Penal Code. (Chingv. Court of Appeals, 351 SCRA 16 [2000].)

(2) *Non-payment of amount involved.* — The non-payment of the amount covered by a trust receipt is an act violative of the entrustee's obligation to pay punishable as estafa. Hie law applies to all transactions covered by trust receipts except those expressly excluded. Its penal provision encompasses any act

violative of an obligation covered by a trust receipt; it is not limited to transactions in goods which are to be sold (retailed), reshipped, stored or processed as a component of a product ultimately sold. The act punishable is *malum prohibitum* (Allied Bank Corp. vs. Ordonez, 192 SCRA 246 [1990]; Ching vs. Court of Appeals, 331 SCRA 16 [2000].) regardless of the existence of intent or malice.

(3) *Failure to deliver proceeds of sale or the goods if not sold.* — A mere failure to deliver the proceeds of the sale or the goods if not sold, constitutes a criminal offense that causes prejudice not only to another, but more to the public interest. It is in the context of upholding public interest that the law now specifically designates a breach of a trust receipt arrangement to be an act that "shall" make one liable for estafa. (Vintola vs. Insular Bank of Asia and America, *supra;* People vs. Nitafan, *supra*; Ong vs. Court of Appeals, 401 SCRA 648 [2003]; Gonzales vs. Hongkong & Shanghai Banking Corp., *supra.;* Metropolitan Bank & Trust Co. vs. Gonzales, 584 SCRA 631 [2009].)

(4) *An offense against public order.* — Like *Batas Pambansa Big.* 22, the law punishes the act "not as an offense against property, but as an offense against public order.[1] *(Ibid.)* The offense is punished as a *malum prohibitum* regardless of the existence of intent or malice. (Metropolitan Bank and Trust sCompany vs. Tonda, 338 SCRA 254 [2000].) It has also been held, however, that

'"The old capitalist orientation of putting importers in jail for supposed estafa or swindling for non-payment of the price of the imported goods released to diem under trust receipts (a purely commercial transaction) under the fiction of the trust receipt invoice should no longer be permitted in this day and age." (Teehankee, *C.J.,* dissenting in Ong vs. Court of Appeals, 124 SCRA 578 [1983].)

In *Colinares vs. Court of Appeals (supra.):* The "petitioners are not importers acquiring the goods for re-sale, contrary to the express provision embodied in the trust receipt. They are contractors who obtained the fungible goods for their construction project At no time did title over the construction materials pass to the bank, but directly to the petitioners. x x x The practice of banks of making borrowers sign trust receipts to facilitate collection of loans and place them under the threat of criminal prosecution should they be unable to pay it may be unjust and inequitable, if not reprehensible. Such agreements are contracts of adhesion which borrowers have no option but to sign lest their loan be disapproved. The resort to this scheme leaves poor and hapless borrowers at the mercy of banks, and is prone to misinterpretation, as had happened

what is being punished by the law is dishonesty and abuse of confidence in the handling of money or goods to the prejudice of another regardless or whether the latter is the owner. The *mala prohibita* nature of the offense notwithstanding, the intent to misuse or misappropriate the goods or their proceeds must be established by the records. (Pilipinas Bank vs. Qng, 387 SCRA 37 [2002], citing Colinares vs. Court of Appeals, *supra.)*

Civil liability arising from the criminal offense.

After commencing a criminal action for violation of the trust receipts law, the entruster may enforce the civil liability arising out of the trust receipt in a separate civil action.[2] Under Article 33 of the Civil Code, a civil action for damages, entirely separate and distinct from the criminal action, may be brought by die injured party in cases of defamation, fraud, and physical injuries. Estafa falls under fraud. (Prudential Bank vs. Intermediate Appellate Court, 216 SCRA 257 [1992].)

Since corporations, partnerships, associations and other juridical entities cannot be imprisoned, it is these entities which are made liable for the tivil liability arising from the criminal offense. This is the import of the clause "without prejudice to the civil liabilities arising from the criminal offense" in Section 13. *(ibid jliihe* entrustee is a corporation, etc., the law makes the officers or employees or other persons responsible for the offense liable to suffer the penalty of imprisonment.

Sec. 14. Cases *not covered by this Decree.* — Cases not provided for in this Decree shall be governed by the applicable provisions of existing laws.

Sec. 15. *Separability clause.* — If any provision or section of this Decree or the application thereof of any person or circumstance is held invalid, the other provisions or sections hereof and the application of such provisions

The enactment of Presidential Decree No. 115 is a valid exercise of the police power of the State and is thus, constitutional. (Lee vs. Rodel, *supra;* Lozano vs. Martinez, 146 SCRA 329 [1986]; People vs. Nitafan, *supra.)*

or sections to other persons or circumstances shall not be affected thereby.

Sec. 16. ***Repealing clause.*** **—All Acts inconsistent with this Decree are hereby repealed.**

Sec. 17. ***This Decree shall take effect immediately.***

ISSUED, JANUARY 29,1973.

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