
OBLIGATIONS AND CONTRACTS

Expanded Course Outline
Professor E. A. Labitag

Karichi Santos | UP Law B2012

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University of the Philippines
College of Law

OBLIGATIONS AND CONTRACTS

Professor Eduardo A. Labitag
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Title I. OBLIGATIONS

Chapter I. General Provision

CONCEPT OF OBLIGATION

Definition Art 1156 Obligation is a juridical necessity to give, to do or not to do.

OBLIGATORY RELATION IN ITS TOTALITY: The juridical relation, created by virtue of certain facts, between two or more persons, whereby the creditor or obligee, may demand of the debtor or obligor, a definite prestation.
on

PASSIVE SIDE: Where there is a right or power to demand, there is a correlative obligation or an imposition upon a person of a definite conduct.

Criticism of definition: It is one sided, reflects only the debtor's side of the agreement – Sanchez Roman

Elements of Obligation

1. Active subject – power to demand the prestation (obligee/creditor)
2. Passive subject – bound to perform the prestation (obligor/debtor) } Personal elements
 - Temporary indefiniteness of a subject e.g. negotiable instrument payable to bearer or a promise of a prize or a reward for anyone performing a certain act
3. Prestation or Object – not a thing but a particular conduct of the debtor, but always a prestation

KINDS OF PRESTATION

- a. **TO GIVE** – consists in the delivery of a movable or an immovable thing, in order to create a real right or for the use of the recipient or for its simple possession or in order to return to its owner
- b. **TO DO** – all kinds of work or services, whether mental or physical
- c. **NOT TO DO** – consists in abstaining from some act, includes "not to give," both being negative obligations

REQUISITES OF PRESTATION

- a. Physically and juridically possible
- b. Determinate or at least determinable according to pre-established elements or criteria
- c. Possible equivalent in money
 - Pecuniary interest need not be for one of the parties, it maybe for the benefit of 3rd person/s distinct from the parties to the contract
 - Prestation need not be of economic character to have pecuniary value, if it does not have value the law attributes to it economic value e.g. moral and nominal damages
4. Efficient cause or juridical tie or vinculum juris – relation between obligor and obligee which is established:
 - By law (e.g. relation of husband and wife giving rise to the obligation to support)
 - By bilateral acts (e.g. contracts giving rise to the obligations stipulated therein)
 - By unilateral acts (e.g. crimes and quasi-delicts)
5. Form in which the obligation is manifested – cannot be considered essential

Distinction between Natural and Civil Obligation

	NATURAL	CIVIL
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As to enforceability	Not by court actions, but by good conscience of debtor	Court action or the coercive power of public authority
As to basis	Equity and natural justice	Positive law

SOURCES OF OBLIGATIONS

A. LAW [Ex-Lege]

Art 1158 Obligations derived from law are NOT PRESUMED. Only those expressly determined in this Code or in special laws are demandable, and shall be regulated by the precepts of the law which establishes them; and as to what has not been foreseen, by the provisions of this book.

- Governed by the law itself
- Agreement of the parties is not necessary e.g. tax collection, Art 448 and Art 488
- Not presumed, only those expressly provided are enforceable

B. CONTRACTS [Ex-Contractu, Culpa Contractual]

Art 1159 Obligations arising from contracts have the force of law between the contracting parties and should be complied with in good faith.

- Expresses principle of autonomy of will, presupposes that contract is valid and enforceable
- PRE-CONTRACTUAL OBLIGATION: Damages can be recovered when contract is not perfected if:
 - o Offers is clear and definite, leading offeree in good faith to incur expenses in expectation of entering into a contract
 - o Withdrawal of the offer must be without any illegitimate cause. If offeror:
 - *Guilty of fault or negligence, liability would be based on Art 2176*
 - *No fault or negligence, withdrawal was in abuse of right, liability would be based on Art 19 e.g. breach of promise to marry*

Art 1305 A contract is a meeting of minds between two persons whereby one binds himself, with respect to the other, to give something or to render some service.

C. QUASI-CONTRACTS or DELICTS [Quasi Ex-Contractu]

Art 1160 Obligations derived from quasi-contracts shall be subject to the provisions of Chapter 1, Title XVII.

Art 2142 Certain lawful, voluntary and unilateral acts give rise to the juridical relation of quasi-contract to the end that no one shall be unjustly enriched or benefited at the expense of another.

- Juridical relation which arises from certain acts that are:
 - *LAWFUL* (against crime),
 - *VOLUNTARY* (against quasi-delict – based on negligence or mere lack of foresight)
 - *UNILATERAL* (against contract in which there are two parties)
- E.g.

Art 2144	Art 2150
Art 2154	Art 2164
Art 2167	Art 2168
Art 2174	Art 2175

Kinds of Quasi-contracts

1. *Negotiorum gestio* (officious management)

Art 2144 Whoever voluntarily takes charge of the agency or management of the business or property of another, without any power from the latter, is obliged to continue the same until the termination of the affair and its incidents, or to require the person concerned to substitute him, if the owner is in a position to do so. This juridical relation *DOES NOT* arise in either of these instances:

- 1) When the property or business is not *neglected* or *abandoned*
- 2) If in fact the manager has been *tacitly* authorized by the owner

2. *Solutio indebiti* (payment not due)

Art 2154 If something is received when there is no right to demand it, and it was unduly delivered through mistake, the *obligation to return* it arises.

3. Other quasi-contracts (support given by strangers and other "Good Samaritans")

- Art 2164 When, without the knowledge of the person obliged to give support, it is given by a stranger, the latter shall have a right to claim the same from the former, UNLESS it appears that he gave it out of piety and without intention of being repaid.
- Art 2165 When funeral expenses are borne by a third person, without the knowledge of those relatives who were obliged to give support to the deceased, said relatives shall reimburse the third person, should the latter claim reimbursement.
- Art 2166 When the person obliged to support an orphan, or an insane or other indigent person unjustly refuses to give support to the latter, any third person may furnish support to the needy individual, with right of reimbursement from the person obliged to give support. The provisions of this article apply when the father or mother of a child under eighteen years of age unjustly refuses to support him.
- Art 2167 When through an accident or other cause a person is injured or becomes seriously ill, and he is treated or helped while he is not in a condition to give consent to a contract, he shall be liable to pay for the services of the physician or other person aiding him, UNLESS the service has been rendered out of pure generosity.
- Art 2168 When during a fire, flood, storm, or other calamity, property is saved from destruction by another person without the knowledge of the owner, the latter is bound to pay the former just compensation.
- Art 2169 When the government, upon the failure of any person to comply with health or safety regulations concerning property, undertakes to do the necessary work, even over his objection, he shall be liable to pay the expenses.
- Art 2170 When by accident or other fortuitous event, movables separately pertaining to two or more persons are commingled or confused, the rules on co-ownership shall be applicable.
- Art 2171 The rights and obligations of the finder of lost personal property shall be governed by Articles 719 and 720.
- Art 2172 The right of every possessor in good faith to reimbursement for necessary and useful expenses is governed by Article 546.
- Art 2173 When a third person, without the knowledge of the debtor, pays the debt, the rights of the former are governed by Articles 1236 (recover what has been beneficial to debtor) and 1237 (cannot compel creditor to subrogate payor in his rights).
- Art 2174 When in a small community a nationality of the inhabitants of age decide upon a measure for protection against lawlessness, fire, flood, storm or other calamity, any one who objects to the plan and refuses to contribute to the expenses but is benefited by the project as executed shall be liable to pay his share of said expenses.
- Art 2175 Any person who is constrained to pay the taxes of another shall be entitled to reimbursement from the latter.

D. ACTS or OMISSIONS PUNISHED BY LAW [Ex-Delictu, Ex-Maleficio, Culpa Criminal]

Art 1161 Civil obligations arising from criminal offense shall be governed by the penal laws, subject to the provisions of Art 2177, and of the pertinent provisions of Chapter 2, Preliminary Title on Human Relations and of Title XVIII of this Book, regulating damages.

Art 100, RPC Every person criminally liable for a felony is also civilly liable.

- GENERAL RULE: Civil liability is a necessary consequence of civil liability
 - Reason: Commission of crime causes not only moral evil but also material damage.
 - Art 12, RPC Exempting circumstances; do not incur liability but are **NOT EXEMPT** from civil liability
 1. Imbecile or insane person, unless acting in a lucid interval
 2. Person under 9 years of age
 3. Person over 9 years of age and under 15, unless acting with discernment
 4. Acting under compulsion of an irresistible force
 5. Acting under impulse of an uncontrollable fear of an equal or greater injury
- EXCEPTION (crimes without civil liability)
 - Criminal contempt
 - Gambling
 - Traffic violations

Subsidiary Liability for Crime

1. Innkeepers, tavern keepers and any other persons or corporations shall be civilly liable for crimes committed in their establishment, in all cases where a violation of municipal ordinances or some general or special police regulation shall have been committed by them or their employees.
2. Also applicable to employers, teachers, persons and corporations engaged in any kind of industry for felonies committed by their servants, pupils, apprentices or employees in discharge of their duties.
 - To hold employers subsidiarily liable for CRIME of an employee: committed in the performance of the functions or duties of the employee.

- But if action is based on CONTRACT, and not upon previous conviction of employee for a crime: employer's liability is PRIMARY and INDEPENDENT, not merely subsidiary.

Civil liability arising from Crime

Art 1161 Civil obligations arising from criminal offenses shall be governed by the penal laws, subject to the provisions of Article 2177, and of the pertinent provisions of Chapter 2, Preliminary Title, on Human Relations, and of Title XVIII of this Book, regulating damages.

Rules on Criminal Procedure Rule 111 When a criminal action is instituted, the civil action for the recovery of civil liability arising from the offense charged shall be deemed instituted with the criminal action UNLESS the offended party waives the civil action, reserves the right to institute it separately or institutes the civil action prior to the criminal action.

Extent of Civil Liability

Art 104, RPC What is included in civil liability

1. Restitution – thing itself is restored (Art 105, RPC)
 2. Reparation of damage caused – court determines amount of damage (Art 106, RPC)
 3. Indemnification for consequential damages – not only caused the 3rd party but also those suffered by his family or by a 3rd person by reason of the crime (Art 107, RPC)
- Civil liability for crimes is extinguished the same causes provided in the CC for the extinguishment of other obligations.

GENERAL RULE: Criminal action bars civil action for the same offense

- Civil action for recovery of civil liability arising from the offense is impliedly instituted with the criminal action

EXCEPTIONS:

- Offended party reserves the *right* to *institute it* separately
- The law provides for an independent civil action (i.e. civil action may proceed to final judgment irrespective of result of the criminal action and filing of the criminal action does not suspend the civil action)
 - obligations arising from the act or omission claimed to be criminal (Art 31)
 - violations of constitutional rights and liberties of individuals (Art 32)
 - defamation, fraud or physical injuries (Art 33)
 - refusal or failure of members of police force to render protection to life or property (Art 34)

E. QUASI-DELICTS [*Quasi Ex-Delicto, Quasi Ex-Maleficio, Culpa Aquilana, Tort (common law)*]

Art 1162 Obligations derived from quasi-delicts shall be governed by the provisions of Chapter 2, Title XVII of this Book and by special laws.

Art 2176 Whoever by act or omission causes damage to another, there being fault or negligence, is obliged to pay for the damage done. Such fault or negligence when there is no pre-existing contractual relation between the parties, is called quasi-delict and is governed by the provisions of this Chapter.

BASIS: Undisputable principle of equity; fault or negligence cannot prejudice anyone else besides its author and in no case should its consequences be borne by him who suffers the harm produced by such fault or negligence.

- Man is responsible not only for his voluntary willful acts, executed consciously and intentionally but also for those acts performed with lack of foresight, care and diligence, which cause material harm to society or to other individuals.

NEW SOURCES OF OBLIGATION – generally recognized by law although not included in the code

1. Unjust enrichment (CC categorized under quasi-contract)
2. Unilateral declaration of will
3. Abuse of rights (CC categorized under quasi-delict)

Test of Negligence: Would a prudent man, in the position of the person to whom negligence is attributed, foresee harm to the person injured as a reasonable consequence of the course about to be pursued?

ELEMENTS OF NEGLIGENCE

- a) duty on the part of the defendant to protect the plaintiff from injury of which the latter complains
- b) failure to perform such duty
- c) an injury to the plaintiff through such failure

KINDS OF NEGLIGENCE

1. *Culpa aquilana* – or *culpa extra-contractual*; negligence as a source of obligation, a quasi-delict
2. *Culpa contractual* – negligence in the performance of a contract
3. *Culpa criminal* – criminal negligence

Distinction between Culpa Aquilana and Culpa Contractual

CULPA AQUILANA (culpa extra-contractual)	CULPA CONTRACTUAL
Governed by Art 2176 to 2194	Governed by Art 1179 et <i>seque/</i>
Negligence as a source of obligation	Negligence in the performance of a contract
Fault or negligence which constitutes an independent source of obligation between parties not previously bound	Fault or negligence of the debtor as an incident in the fulfillment of an existing obligation
Negligence of defendant should be the proximate cause of damage if liability is to attach	

Distinction between Quasi-delicts and Crimes

AS TO...	QUASI-DELICT	CRIMES
<u>Nature of right violated</u> ; - An obligation can arise from both crime and quasi-delict at the same time (e.g. physical injuries) BUT can only recover damage once and not twice	Private rights; wrong against the individual	Public right; wrong against the state
Condition of mind	Criminal intent is not necessary. Possible that there is not criminal charge but only civil liability for damages arising from quasi-delict	Criminal intent is necessary for the existence of liability, without it, there can be no crime
Legal basis of liability	Actionable in any act or omission wherein fault or negligence intervenes	Not as broad as quasi-delict, can be punished only when there is a penal law clearly penalizing it
Liability for damages	Liability for damages to the injured party	Certain crimes do not have civil liability e.g. contempt, gambling, violations of ordinances and traffic regulations when nobody is injured
Forms of redress	Reparation of the injury suffered by the injured party □ compensation, indemnification	Fine (accruing to the public treasury), imprisonment or both □ punishment
Amount of evidence	Preponderance of evidence	Beyond reasonable doubt
Compromise	Can be compromised as any other civil liability	Can never be compromised

Requisites of Liability under Quasi-Delicts

1. There exists a *wrongful act or omission imputable to the defendant by reason of his fault or negligence*
2. There exists a *damage or injury*
3. *Direct causal connection* or relation of cause and effect between the fault or negligence and the damage or injury *OR* that the fault or negligence be the cause of damage or injury
 - DOCTRINE OF PROXIMATE CAUSE: such adequate and efficient cause as, in the natural order of events, and under the particular circumstance surrounding the cause, would necessarily produce the event
 - NATURAL AND PROBABLE CAUSE: either when it acts directly producing the injury, or sets in motion other causes so producing it and forming a continuous chain in natural sequence down to the injury
 - CONCURRENT CAUSE: if two causes operate at the same time to produce a result which might be produced by either independently of the other, each of them is a proximate cause
 - When the plaintiff's own negligence was the immediate and proximate cause of his injury, he cannot recover damages.
 - BUT if negligence is only contributory, the immediate and proximate cause of the injury is defendant's lack of due care, the plaintiff may recover damages, the courts shall mitigate the damages to be awarded (Art 2179)

Liability for fault of others - Obligation arising from quasi-delict is demandable not only for one's own acts or omissions, but also for *those of persons for whom one is responsible*.

Art 2180 The obligation imposed by Article 2176 is demandable not only for one's own acts or omissions, but also for *those of persons for whom one is responsible*.

The father and, in case of *his death or incapacity, the mother*, are responsible for the damages caused by the minor children who live in their company.

Guardians are liable for damages caused by the minors or incapacitated persons who are under their authority and live in their company.

The owners and managers of an establishment or enterprise are likewise responsible for damages caused by their employees in the service of the branches in which the latter are employed or on the occasion of their functions.

Employers shall be liable for the damages caused by their employees and household helpers acting within the scope of their assigned tasks, even though the former are not engaged in any business or industry.

The State is responsible in like manner when it acts through a special agent; but not when the damage has been caused by the official to whom the task done properly pertains, in which case what is provided in Article 2176 shall be applicable.

Lastly, teachers or heads of establishments of arts and trades shall be liable for damages caused by their pupils and students or apprentices, so long as they remain in their custody.

The responsibility treated of in this article shall cease when the persons herein mentioned prove that they observed all the diligence of a good father of a family to prevent damage.

Art 218, FC The school, its administrators and teachers, or the individual, entity or institution engaged in child care shall have special parental authority and responsibility over the minor child while under their supervision, instruction or custody.

Authority and responsibility shall apply to all authorized activities whether inside or outside the premises of the school, entity or institution.

Art 219, FC Those given the authority and responsibility under the preceding Article shall be principally and solidarily liable for damages caused by the acts or omissions of the unemancipated minor. The parents, judicial guardians or the persons exercising substitute parental authority over said minor shall be subsidiarily liable.

The respective liabilities of those referred to in the preceding paragraph shall not apply if it is proved that they exercised the proper diligence required under the particular circumstances.

All other cases not covered by this and the preceding articles shall be governed by the provisions of the Civil Code on quasi-delicts.

Diligence of Employers – An employer may be held civilly liable for the quasi-delict or crime of his employee.

LIABILITY OF EMPLOYERS FOR EMPLOYEES' QUASI-DELICT (Art 2180, CC)	LIABILITY OF EMPLOYERS FOR EMPLOYEES' CRIME (Art 103, RPC)
<u>Primary</u> , can be sued directly by the injured party and after he has paid the damages to such injured party, he can recover from his employee amount paid by him	<u>Subsidiary</u> , employee must have first been convicted and sentenced to pay civil indemnity and it must be shown that he is insolvent in order that employee may be liable
Employer can avoid liability by proving that he exercised the diligence of a good father of a family to prevent damage	Liability is absolute and cannot avail of the defense by proof of such diligence
All employers, whether they are engaged in some enterprise or not, are liable for the acts of their employees including house helpers	Employer is liable only when he is engaged in some kind of business or industry (during performance of duty)

CLASSIFICATIONS OF OBLIGATIONS

A. Primary Classification under the Civil Code

1. WHEN: Pure and Conditional (Art 1179-1192) □ time of enforceability
 - PURE: demandable at once
 - CONDITIONAL: fulfillment or extinguishment depends upon a future and uncertain event
2. WHEN: With a period or term (Art 1193-1198) □ time of demandability
 - PERIOD: its fulfillment or extinguishment depends upon a future and certain event
3. WHAT: Alternative and Facultative (Art 1199-1206) □ multiple objects
 - ALTERNATIVE: multiple prestations but debtor will perform one or some but not all, depending on whose choice it is
 - FACULTATIVE: multiple prestations with a principal obligation and substitute prestations, choice is generally given to the DEBTOR
4. WHO: Joint and Solidary (Art 1207-1222) □ multiple subjects, focuses on the tie that bonds the parties
 - JOINT: each can be made to pay only *his share in the obligation*
 - SOLIDARY: one can be made to *pay for the whole obligation* subject to reimbursement
5. HOW: Divisible and Indivisible (Art 1223-1225) □ performance of the prestation, not to the thing which is object thereof, whether it can be fulfilled in parts or not
6. With a penal clause (Art 1226-1230) □ accessory undertaking to assume greater liability in case of breach

B. Secondary Classification

1. Legal (Art 1158) from law
Conventional (Art 1159) from contracts
Penal (Art 1161) from commission of a crime
2. (As to subject matter) Real (to give) and Personal (to do or not to do)
3. (As to subject matter of obligation) Determinate and Generic
4. Positive (to give, to do) and Negative (not to give, not to do)
5. Unilateral – only one party bound to perform obligation, one debtor and one creditor (e.g. simple and remuneratory donation, to give support)
Bilateral – OR synallagmatic contracts, emptio vendito; two parties are reciprocally bound thus debtor and creditor of each other (e.g. purchase and sale, lease)
6. Individual – only one subject
Collective – several subject
7. Accessory – depends on the principal obligation e.g. pledge, mortgage
Principal – main obligation
8. As to object or prestation
 - a. Simple – only one prestation
 - b. Multiple – two or more prestation
 - i. Conjunctive – all must be performed
 - ii. Distributive – one or some must be performed
 - a. Alternative – more than one prestation but one party may choose which one; several are due but only one must be fulfilled at the election of the debtor
 - b. Facultative – main prestation and a substitute prestation and it is the debtor who chooses; only one thing is due but the debtor has reserved the right to substitute it with another

9. Possible – capable of being performed, either physically or legally
 Impossible – physically or legally incapable of being done

Chapter II. Nature and Effects of Obligations

KINDS OF PRESTATION

A. Obligation TO GIVE

SPECIFIC THING (determinate)	GENERIC THING (indeterminate)
One that is individualized and can be identified or distinguished from others of its kind	Indicated only by its kind, without being designated and distinguished from others of the same kind
	Object due becomes determinable from moment of delivery

Specific thing (determinate)

DUTIES OF THE OBLIGOR (Letters B-D are the accessory/incidental obligations)

- a. to deliver thing itself
Art 1244 Par 1 The debtor of a thing *cannot compel* the creditor to *receive a different* one, although the latter may be of the same value as, or more valuable than which is due.
- Though *upon agreement or consent of the creditor*, the debtor *may deliver a different thing or perform a different prestation in lieu of that stipulated* □ DATION in payment (Art 1245) or OBJECTIVE NOVATION (Art 1291)
 - Defects of the thing may be waived by the creditor IF
 - o Expressly declares
 - o With knowledge thereof, he accepts the thing without protest or disposes or consumes it □ "waiver of defect"
- b. to preserve thing with due care
Art 1163 Every person obliged to give something is also *obliged to take care* of it with the *proper diligence* of a *good father of a family*, *UNLESS* the law or the stipulation of the parties requires another standard of care.
- Why: the obligation to delivery would be illusory.
 - What kind of diligence: DILIGENCE OF GOOD FATHER OF FAMILY; elaborated in Art 1173
 - o Failure to preserve the thing □ Liability for damages
 - o BUT if due to FORTUITOUS EVENTS or FORCE MAJEURE □ Exempted from responsibility
- c. to deliver the accessions and accessories
Art 1166 Obligation to give a determinate thing includes that of *delivering all its accessions and accessories*, even though they may not have been mentioned.
- May be qualified by contrary intentions of the parties, e.g. exclude delivery of accession or accessory of the thing.

ACCESSIONS	ACCESSORIES
Includes everything which is produced by a thing, or which is incorporated or attached thereto, either naturally or artificially. Does not include fruits because Art 1164 mentioned it already <u>Accession continua</u> which includes: <ol style="list-style-type: none"> 1. <i>Accession natural</i> – e.g. <i>alluvion</i> 2. <i>Accession industrial</i> – e.g. <i>building, planting, sowing</i> 	Those <i>things</i> which, <i>destined for embellishment, use or preservation of another thing or more important, have for their object the completion of the latter for which they are indispensable or convenient.</i>

- d. to deliver the fruits
Art 1164 Par 1 The creditor has a right to the fruits of the thing from the *time the obligation to deliver* it arises. However, there is *no real* right until the same has been delivered to him.
- *Non nudis pactis, sed traditione domina rerum trasferentur* □ the ownership of things is transferred not only by mere agreements but by delivery

REAL RIGHT – power belonging to a person over a specific thing, without a passive subject individually determined, against whom such right may be personally exercised

- Gives to a person a direct and immediate power over a thing, which is susceptible of being exercised, not only against a determinate person but against the whole world
- E.g. rights of ownership and possession

PERSONAL RIGHT – power belonging to one person to demand of another, as a definite passive subject, the fulfillment of a prestation to give, to do or not to do

CORRELATIVE RIGHTS OF THE OBLIGEE/CREDITOR (from Sir Labitag's diagrammatical outline)

1. Right to compel delivery
 - a. Fruits (both industrial and natural from the time obligation to deliver arises), accessions and accessories
 - b. No real right until delivery → personal action against debtor, no right against the world
2. Right to rescission or resolution
3. Right to damages
 - a. Failure to deliver
 - Legal excuse for breach of obligation or delay: FORTUITOUS EVENT unless there is
 - Law e.g. possession in bad faith (Art 552)
 - Stipulation to the contrary
 - Nature of obligation requires assumption of risk
 - FE APPLICABLE TO:
 - Nonperformance
 - Delay
 - Loss/deterioration of specific thing
 - Art 1189 Before happening of suspensive condition
 - Art 1190 Before happening of resolutive condition
 - Debtor still liable despite FE:
 - Expressly specified by law
 - Art 1942 Bailee liable for loss (commodatum)
 - Art 2001 Act of a thief
 - Art 2147 Negotiorum gestio
 - Art 1993 Loss of deposit
 - Stipulation e.g. debtor becomes "insurer" of the obligation
 - Assumption of risk
 - Fraud or malice (bad faith)
 - Art 1165 Par 3 Delivers to two or more persons having different interest
 - Debtor in delay already when FE happened (Art 1165 Par 3)
 - Debtor guilty of concurrent negligence → in this case, no long FE
 - Liability arises from criminal act except if debtor tenders thing and creditor unjustifiably refuses to receive (Art 1268)
 - b. Fraud
 - c. Negligence in performance
 - d. Delay or default
 - e. Any manner in contravention of the tenor of obligation

Generic thing (indeterminate)

Art 1246 When the obligation consists in the *delivery of an indeterminate or generic thing*, whose *quality and circumstances have not been stated*, the creditor cannot demand a thing of *superior quality*. Neither can the debtor deliver a thing of *inferior quality*. The *purpose* of the obligation and other circumstances shall be taken into consideration.

- Creditor may ask for compliance by 3rd person at debtor's expense; action for substituted performance (Art 1165)

LIMITED GENERIC THING – generic objects confined to a particular class, the class is considered in itself a determinate object

CORRELATIVE RIGHTS OF THE OBLIGEE/CREDITOR (from Sir Labitag's diagrammatical outline)

1. Right to ask for rescission or damages
2. Right to damages

- a. Failure to deliver
- b. Fraud (malice or bad faith)
- c. Negligence
- d. Delay
- e. Any matter contravene the tenor of obligation

RIGHTS OF A CREDITOR (from BarOps Reviewer 2008)

SPECIFIC	GENERIC
To compel specific performance	To ask for the performance of the obligation
To recover damages, in case of breach of the obligation, exclusive or in addition to specific performance	To ask that the obligation be complied with at the expense of the debtor
Entitlement to fruits, interests from the time obligation to deliver arises	To recover damages in case of breach of obligation

B. Obligation TO DO

Art 1244 Par 2 In obligations to do or not to do, an act or forbearance cannot be substituted by another act or forbearance *against the obligee's will*.

- Exception: FACULTATIVE OBLIGATION wherein the debtor reserves the right to substitute another prestation

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

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

DUTIES OF OBLIGOR (from BarOps Reviewer 2008)

1. To do it (Art 1167)
2. To shoulder the cost if someone else does it (Art 1167)
3. To undo what has been poorly done (Art 1167)
4. To pay damages (Art 1170-1172, 2201-2202)

- No action for compliance because that would be involuntary servitude which is prohibited by the constitution.

C. Obligation NOT TO DO

Art 1244 Par 2 In obligations to do or not to do, an act or forbearance cannot be substituted by another act or forbearance against the obligee's will.

- Performance cannot be by a delegate or an agent
- No legal accessory obligations arise (as compared to obligation to give)

Art 1268 When the obligation consists in not doing, and the obligor does what has been forbidden him, it shall also be undone at his expense.

DUTIES OF OBLIGOR (from BarOps Reviewer 2008)

1. Not to do what should not be done
2. To shoulder the cost to undo what should not have been done (Art 1168)
3. To pay damages (Art 1170, 2201-2202)

BREACH OF OBLIGATION

CONCEPT

VOLUNTARY arises from the *modes* provided in Art 1170

INVOLUNTARY arises because of *fortuitous events*

Distinction between SUBSTANTIAL and CASUAL/ SLIGHT breach

SUBSTANTIAL	CASUAL
Total	Partial
Amounts to non-performance	A part is performed
Basis for rescission and payment of damages	Gives rise to liability for damages

GENERAL RULE: Rescission will not be permitted for a slight or casual breach of the contract, but only for such breaches as are *so substantial and fundamental* as to defeat the object of the parties in making the agreement.

Cases:

- Song Fo v Hawaiian Phils
- Velarde v CA

MODES OF BREACH

Art 1170 Those who *in the performance* of their obligations are guilty of *FRAUD*, *NEGLIGENCE*, or *DELAY* and those who in any manner *CONTRAVENTE THE TENOR* thereof, are liable for damages.

1 FRAUD (Dolo)

Concept Fraud is the *voluntary execution of a wrongful act*, or a willful omission, knowing and intending the effects which naturally and necessarily arise from such act or omission.

- Deliberate and intentional evasion of the normal fulfillment of obligations
- Any voluntary and willful act or omission which prevents the normal realization of the prestation, knowing and intending the effects which naturally and necessarily arise from such act
- Fraud in the *performance* of a *pre-existing obligation*
- Cannot cover mistake and errors of judgment made in good faith, ergo synonymous to bad faith (dishonest purpose or some moral obliquity and conscious doing of wrong)
- The element of INTENT and NOT the harm done is the test

KINDS OF FRAUD

1. Fraud in the performance (Art 1171)
2. Fraud in the execution/ creation/ birth of the contract
 - a. *Dolo causante* (Art 1344)
 - b. *Dolo incidente* (Art 1338)

	FRAUD (Art 1171)	DOLO CAUSANTE (Art 1338)	DOLO INCIDENTE (Art 1344)
WHEN PRESENT	During the performance of a pre-existing obligation	During the perfection of a contract	During the perfection of a contract
PURPOSE	Evade the normal fulfillment of obligation	Secure the consent of another to enter into contract	Secure the consent of another to enter into contract BUT fraud was not the principal inducement in making the contract
RESULTS IN	Breach of the obligation	Vitiation of consent; Voidable contract	Does not result in the vitiation of consent
GIVES RISE TO	Right in favor of creditor to recover damages	Right of the innocent party to annul the contract	Gives rise to a right of the innocent party to claim for damages

Cases:

- Woodhouse v Halili
- Geraldez v CA

Non-waiver of Future Fraud Art 1171 Responsibility arising from fraud is demandable in ALL OBLIGATIONS. Any waiver of action for future fraud is VOID.

- To permit such advance renunciations would practically leave the obligation without effect.
- The law does not prohibit the renunciation of the action for damages on the ground of fraud already committed.

Effects of Fraud - Liability for damages, a crime or a quasi-delict (Art 1170)

2 NEGLIGENCE (*Culpa contractual*)

Art 1172 Responsibility arising from *negligence* in the performance of EVERY KIND OF OBLIGATION is also demandable, but such liability may be REGULATED BY COURTS, according to the circumstances.

Concept – absence of due diligence

Art 1173 Par 1 The fault or *negligence* of the obligor consists in the *omission* of that *diligence* which is required by the nature of obligation and corresponds with the circumstances of the persons, of the time and the place. When *negligence* shows BAD FAITH, the provisions of Art 1171 (responsibility arising from fraud) and Art 2201 Par 2 (responsible for all damages reasonably attributed to *non-performance*) shall apply.

- Art 2201 Par 2 In case of fraud, bad faith, malice or wanton attitude, the obligor shall be *responsible for all damages* which may be REASONABLY ATTRIBUTED to the non-performance of obligation.

Distinction between Culpa and Dolo

CULPA (<i>Negligence</i>)	DOLO (<i>Fraud</i>)
Mere want of care or diligence, not the voluntariness of act or omission	Willfulness or deliberate intent to cause damage or injury to another
Liability may be mitigated by courts	Liability cannot be mitigated by courts
Waiver for future negligence valid if simple void if gross	Waiver for future fraud is void

Distinction between Culpa Aquilana and Culpa Contractual

- Different provisions that apply to the two concepts, hence different legal effects

CULPA AQUILANA (<i>Culpa Extra-contractual</i>)	CULPA CONTRACTUAL
Governed by Art 2176 to 2194	Governed by Art 1179 et <i>sequel</i>
Negligence as a source of obligation	Negligence in the performance of a contract
Fault or negligence which constitutes an independent source of obligation between parties not previously bound	Fault or negligence of the debtor as an incident in the fulfillment of an existing obligation
Negligence of defendant should be the proximate cause of damage if liability is to attach.	

Cases:

- Gutierrez v Gutierrez
- Vasquez v Borja

Standard of care required

Art 1173 Par 2 If law or contract does not state diligence which is to be observed in the performance, that which is expected of a GOOD FATHER OF FAMILY is required.

- Extra-ordinary diligence required in:
 - Art 1733 Common carriers
 - Art 1744 Lesser than extraordinary
 - Art 1998-2002 Inn keepers, hotel keepers

Exemption from Liability for Negligence

1. **INSURANCE:** A party to a contract is relieved from the effects of his fault or negligence by a 3rd person

2. Party to a contract renounces in advance the right to enforce liability arising from the fault or negligence of the other
 - a. VOID if gross negligence □ Stipulations exempting from liability for that amount to a fraud
 - b. VALID if simple negligence only

Cases:

- De Guia v Manila Electric Co
- US v Barias
- Sarmiento v Sps Cabrido
- Crisostomo v CA

Effects of Negligence

1. Damages are demandable, which the courts may regulate according to circumstances
2. Invalidates defense of fortuitous event

3 DELAY (*mora*)

Concept – *non-fulfillment of obligation with respect to time*

Art 1169 Those obliged to DELIVER or to DO something incur in delay from the time the OBLIGEE JUDICIALLY OR EXTRAJUDICIALLY DEMANDS from them the fulfillment of their obligations.

However, the DEMAND by the creditor shall NOT be necessary in order that delay may exist:

1. When the OBLIGATION or LAW expressly so declares
2. When from the nature and the circumstances of the obligation it appears that the DESIGNATION OF THE TIME when the thing to be delivered or the service is to be rendered was a controlling motive for the establishment of the contract
3. When demand would be USELESS, as when the obligor has rendered it beyond his power to perform

In reciprocal obligations, neither party incurs in delay if the other DOES NOT COMPLY or is NOT READY to comply in a proper manner with what is incumbent upon him. From the moment ONE of the parties fulfills his obligation, delay by the other begins.

- There can only be delay in *positive obligations* (to give and to do) and not in negative obligations (not to give and not to do).

Kinds of Mora

- a. Mora solvendi – default on the part of the debtor
 - EX RE referring to obligations to give
 - EX PERSONA referring to obligations to do

REQUISITES OF MORA SOLVENDI

1. PRESTATION is demandable and already liquidated
 - There can be no delay if the obligation is not yet due. There is no mora in natural obligations because performance is optional and voluntary
2. That the debtor delays performance
 - Effects of mora only arise when the delay is due to the causes imputable to the debtor; hence there is legally no delay if this is caused by factors not imputable to the debtor (e.g. fortuitous events)
3. That the creditor requires or demands the performance extrajudicially or judicially
 - Mere reminder is not a demand because it must appear that the benevolence and tolerance of the creditor has ended.

GENERAL RULE: Creditor should make demand before debtor incurs delay

- Default begins from the moment creditor demands the performance of obligation.
 - If extrajudicial: date of demand
 - If uncertain: date of filing of complaint (for purposes of computing payment of interests or damages)

- Demand may be in any form, provided it can be proved. It is also generally necessary even if a period has been fixed in the obligation. Burden of proof of demand on the creditor.
- Demand must refer to the prestation that is due and not another.
- But even if without demand, debtor incurs in delay if he acknowledges his delay. Request for extension of time for payment is not sufficient though, the acknowledgement must be express.

Cases:

- Cetus Devt Corp v CA
- Santos Ventura Hocorma Foundation v Santos
- Vasquez v Ayala Corporation

EXCEPTION: When demand is not required

1. Express stipulation – Insertion of the clause “without further notice”
2. Law so provides - Not enough to merely fix date for performance, but also that default will commence after the period lapses
3. Period is the controlling motive or the principal inducement for the creation of the obligation – in cases where it appears that the obligation would not have been created for a date other than that fixed (Abella v. Francisco)
4. Demand would be useless – performance has become impossible
 - a. Caused by some act or fault of the debtor, e.g. *hiding or disposed of the thing to be delivered*
 - b. *Impossibility caused by fortuitous event but debtor bound himself liable in cases of such events*

Case:

- Abella v Francisco

b. Mora accipiendi – default on the part of the creditor

- Delay in the performance based on the omission by the creditor of the necessary cooperation, especially acceptance on his part.
- Generally, debtor can perform at any time after the obligation has been created, even before the date of maturity.
- It is necessary however that it be lawful for the debtor to perform, and that he can perform (e.g. when the period is established for the benefit of the creditor or both of the parties).

REQUISITES OF MORA ACCIPIENDI

1. Offer of performance by the debtor who has the required capacity
2. Offer must be to comply with the prestation as it should be performed
3. Creditor refuses the performance *without just cause*

See also Art 1268 When the debt of a thing certain and determinate proceeds from a criminal offense, the debtor shall not be exempted from the payment of its price, whatever may be the cause for the loss, *UNLESS* the thing having been offered by him to the person who should receive it, the latter refused without justification to accept it.

Cases:

- Vda de Villaruel v Manila Motor Co
- Tengco v CA

c. Compensatio morae – parties in a bilateral contract can regulate the order in which they shall comply with their reciprocal prestations. Otherwise, the fulfillment must be **SIMULTANEOUS** and **RECIPROCAL**

GENERAL RULE: Fulfillment of parties should be simultaneous

EXCEPTION: Contrary stipulation (e.g. installment plans)

Case:

- Central Bank v CA

Effects of Mora

A. *Mora solvendi*

1. When it has for its object a determinate thing, the delay places the risk of the thing on the debtor
2. Debtor becomes liable for damages of the delay

B. *Mora accipiendi*

1. Responsibility of the debtor for the thing is reduced and limited to fraud and gross negligence
2. Debtor is exempted from the risks of loss of thing, which automatically pass to the creditor
3. All expenses incurred by the debtor for the preservation of the thing after the mora shall be chargeable to the creditor
4. If the obligation bears interest, the debtor does not have to pay it from the moment of the mora
5. The creditor becomes liable for damages
6. The debtor may relieve himself of the obligation by the consignation of the thing

C. Compensation morae

1. *Exceptio non adimpleti contractus* – one is not compelled to perform his prestation when the other contracting party is not yet prepared to perform his prestation; default of one compensates the default of the other

Cessation of effects of mora

1. Renunciation by the creditor
 - a. Express
 - b. Implied: when after delay has been incurred, the creditor grants an extension of time to the debtor or agrees to a novation of the obligation
2. Prescription

4 CONTRAVENTION OF TENOR – any illicit act which impairs the strict and faithful fulfillment of the obligation or every kind of defective performance

- Malicious or negligent *violation of the terms and conditions stipulated in the obligation*
- Must not be due to fortuitous even or force majeure, otherwise there would be no liability
- Immaterial whether or not the actor is in *bad faith* or negligent, what is required is that it is his *fault* or the act *done* contravenes their agreement

Cases:

- Chavez v Gonzales
- Telefast v Castro
- Arrieta v NARIC
- Magat v Medialdea

5 ABSOLUTE NON-PERFORMANCE**REMEDIES OF CREDITOR IN CASE OF BREACH**

Primary Remedies:

1. Action for performance (specific performance or obtain compliance)
2. Action for damages (exclusively OR in addition to either of the first actions)
3. Action for rescission

Subsidiary

1. Accion Subrogatoria
2. Accion Pauliana
3. Other specific Remedies

A. ACTION FOR PERFORMANCE

1. Action for specific performance
(in obligation to give specific thing)

Art 1165 Par 1 When what is to be delivered is a determinate thing, the creditor, in addition to the right granted him by Art 1170 (indemnification for damages), may compel the debtor to make *the delivery*.
ROC 39, Sec 10 Execution, satisfaction and effect of judgment.

- Implies that the basis is a contractual relation between plaintiff and defendants.

2. Action for substituted performance
(in obligation to give generic thing)

Art 1165 Par 2 If the thing is indeterminate or generic, he may ask that the obligation be complied with at the expense of the debtor.

- Delivery of anything belonging to the species stipulated will be sufficient.
- Debtor cannot avoid obligation by paying damages if the creditor insists on the performance.

3. Action for substituted performance or undoing of poor work
(in obligation to do)

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

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

- The court has no discretion to merely award damages to the creditor when the act can be done in spite of the refusal or failure of debtor to do so.
- EXCEPTION: Imposition of personal force or coercion upon the debtor to comply with his obligation □ tantamount to involuntary servitude and imprisonment for debt

Cases:

- Chavez v Gonzales *supra*
- Tanguilig v CA

4. Action for undoing
(in obligation not to do)

Art 1168 When the obligation consists in not doing, and the obligor does what has been forbidden him, it shall also be undone *at his* expense.

- EXCEPTION: When the only feasible remedy is indemnification for the damages caused:
 - If has become impossible to undo the thing physically or legally
 - If the act is definite and will not cease even if undone

B. ACTION FOR DAMAGES

Art 1170 □ Recoverable damages include any and all damages that a human being may suffer. Responsibility for damages is indivisible.

C. ACTION FOR RESCISSION

Art 1191 The power to rescind obligation is *implied in reciprocal ones, in case one of the obligors should not comply* with what is *incumbent upon him*.

The *injured party may choose* between FULFILLMENT *and* the RESCISSION *of the obligation*, with the payment of damages *in either case*. He *may also seek* rescission, *even after he has chosen fulfillment*, if the *latter should become IMPOSSIBLE*.

The *court shall decree the rescission claimed UNLESS* there be a *just cause authorizing the fixing of a period*. This is *understood to be without prejudice* to the rights of *third persons who have acquired the thing, in accordance with Articles 1385 and 1388 and the Mortgage Law*.

Art 1192 *In case both parties have committed breach of obligation, the liability of the first infractor shall be equitably tempered by the courts. If it cannot be determined which of the parties first violated the contract, the same shall be extinguished and each shall bear his own damages.*

- The remedy is *alternative*. Party seeking rescission can only elect one between fulfillment and rescission. There can be no partial performance and partial rescission.
- Only applies to reciprocal obligations, where there is "reciprocity" between the parties i.e. creditor debtor relations arise from the same cause or "identity of cause"
- Reciprocal obligations have a "TACIT RESOLUTORY CONDITION."
- *Power to rescind:*
 - Pertains to the injured party, party who did not perform not entitled to insist upon the performance of the contract by the defendant or recover damages by reason of his own breach

- Rights of injured party subordinated to the rights of a 3rd person to whom bad faith is not imputable
- Not absolute, not permitted in casual/slight breach, may only be claimed in substantial breach (*Song Fo v. Hawaiian Philippines*)
- Rescission requires *judicial approval to produce legal effect*
 - EXCEPTION: object is not yet delivered AND obligation has not yet been performed
 - If the obligation has not yet been performed: extrajudicial declaration of party willing to perform would suffice; can refuse to perform if the other party is not yet ready to comply
 - If the injured party has already performed: cannot extrajudicially rescind IF the other party opposes the rescission (otherwise, rescission produces legal effect). In the case the other party impugns rescission, the court comes in either to:
 - a. Declare the rescission as properly made
 - b. Give a period to the debtor in which to perform

Effects of Rescission

1. Extinguishes obligatory relation as if it had never been created, extinction has a retroactive effect. Equivalent to invalidate the juridical tie, leaving things in their status before the celebration of the contract
 2. Mutual restitution
- **EXPRESS RESOLUTORY CONDITION**: automatic resolution if one of the parties does not comply with his obligation. Often found in insurance contracts. Its nature is a "facultative resolutive condition" (*Taylor v Uy Tieng*)

SUBSIDIARY REMEDIES OF CREDITOR

1 *Accion Subrogatoria* (subrogatory action)

Art 1177 The creditors after having pursued the property in possession of the debtor to satisfy their claims, may exercise all the rights and bring all the actions of the latter for the same purpose, save those which are inherent in his person; they may also impugn the acts which the debtor may have done to defraud them.

Concept Action which the creditor may exercise in place of the negligent debtor in order to preserve or recover for the patrimony of the debtor the product of such action, and then obtain therefrom the satisfaction of his own credit.

- Previous approval of court is not necessary
- EXTENT: Plaintiff entitled only to so much as is needed to satisfy his credit, any balance shall pertain to the debtor
- Patrimony of the debtor (includes both present and future property) is liable for the obligations he may contract by being a legal guaranty in favor of his creditors. Hence, he cannot maliciously reduce such guaranty.
- Double function:
 - Conserving the patrimony of the debtor by bringing into it property abandoned or neglected by him
 - Making execution on such property thereafter

Rights of Creditors

1. Levy by attachment and execution upon all the property of the debtor, except such as exempt by law from execution
2. Exercise all the rights and actions of the debtor, except such as are inherently personal to him
3. To ask for rescission of the contracts made by the debtor in fraud of their rights

REQUISITES OF ACCION SUBROGATORIA

1. Creditor has an interest in the right or action not only because of his credit but because of insolvency of the debtor
2. Malicious or negligent inaction of the debtor in the exercise of his right or action of such seriousness as to endanger the claim of the creditor
3. The credit of the debtor against a third person is certain, demandable and liquidated
 - It is not essential that the creditor's claim be prior to the acquisition of the right by the debtor
4. The debtor's right against 3rd person must be patrimonial, or susceptible of being transformed to patrimonial value for the benefit of the creditor

EXCEPTIONS TO ACCION SUBROGATORIA

1. Inherent rights of debtor
 - a. Right to existence, exempting from the reach of creditors whatever he may be receiving as support
 - b. Rights or relations of a public character

- c. Rights of an honorary character
 - d. Rights consisting of powers which have not been used
 - i. Power to administer e.g. debtor fails to have some property leased the creditor cannot give it in lease for him
 - ii. Power to carry out an agency or deposit because purely personal acts
 - iii. Power to accept an offer for a contract
 - e. Non-patrimonial rights e.g. action to establish the creditor's status as a legitimate or natural child, action for legal separation or annulment of marriage, and other rights arising from family relations
 - f. Patrimonial rights not subject to execution e.g. right to a government gratuity or pension
 - g. Patrimonial rights inherent in the persons of the debtor e.g. right to revoke a donation by reason of ingratitude, right to demand the exclusion of an unworthy heir
2. Art 772 Only those who at the time of the donor's death have a right to the legitime and their heirs and successors in interest may ask for the reduction or inofficious donations. Those referred to in the preceding paragraph cannot renounce their right during the lifetime of the donor, either by express declaration, or by consenting to the donation. The donees, devisees and legatees, who are not entitled to the legitime and the creditors of the deceased can neither ask for the reduction nor avail themselves thereof.
3. Sec 13, Rule 39, Rules of Court

2 Accion Pauliana

Art 1177 "...they may also *impugn* the *acts* which the debtor may have done to *defraud* them"

Art 1381 Par 3 Those *undertaken in fraud* of creditors when the latter cannot in any other manner collect the claims *due* them. (Found under Rescissible Contracts)

Concept Creditors have the right to set aside or revoke acts which the debtor may have done to *defraud* them. All acts of the debtor which *reduce* his patrimony in *fraud* of his creditors, whether by *gratuitous* or *onerous* title, can be revoked by this action.

- Payments of pre-existing obligations already due, whether *natural* or *civil*, cannot be *impugned* by an *accion pauliana*.

REQUISITES OF ACCION PAULIANA

1. Plaintiff asking for rescission (subsidiary action) has a credit prior to the alienation, although demandable later
2. Debtor has made subsequent contract, giving advantage to a 3rd person
3. Creditor has no other remedy but to rescind the debtor's contract to the 3rd person (last resort)
4. Act being impugned is fraudulent
 - Presumption of fraud may be found in Art 1387 (gratuitous transfer without leaving sufficient funds for obligations OR gratuitous transfers by a judgment debtor) More details in page 92
5. 3rd person who received the property is an accomplice in the fraud
 - See Rescissible Contracts for more detailed discussion on the effects of good faith and bad faith of the third party transferee (Page 89)

Cases:

- Khe Hong Cheng v CA
- Siguan v Lim

Distinction between *accion subrogatoria* and *accion pauliana*

ACCION SUBROGATORIA	ACCION PAULIANA
Not essential that credit is prior to the acquisition of debtor's right	Credit must exist before fraudulent act
Intent to defraud creditors is not required	If contracts rescinded is onerous, there must be fraudulent intent
No period of prescription	Action prescribes within 4 years of the discovery of the fraud

3 Other specific remedies (Accion Directa)

Art 1652 Lessor vs. sub-lessee

Art 1729 Laborers vs. owner

Art 1608 Vendee a retro vs. vendee a retro's transferee

Art 1893 Principal vs. substitution appropriated by princip

EXTINGUISHMENT OF LIABILITY IN CASE OF BREACH DUE TO FORTUITOUS EVENT

Art 1174 Except in cases expressly specified by law, or when it is otherwise declared by stipulation, or when the nature of obligation requires the assumption of risk, *no person shall be responsible* for those events which could not be foreseen or which, though foreseen, were inevitable.

Concept of Fortuitous Event [Force Majeure, Fuerza Mayor, Caso Fortuito]

- A. Act of God – by nature e.g. earthquakes, storms, floods, epidemics, fires, etc; all human agencies excluded
 - B. Act of Man – by acts of man, e.g armed invasion, attack by bandits, governmental prohibitions, robbery, etc; for as long as that they have a force of an imposition which the debtor could not have resisted
- Includes unavoidable accidents, even if there has been intervention of human element, provided that the fault or negligence cannot be imputed to the debtor

Requisites of Fortuitous Event

1. Cause of the unforeseen and unexpected occurrence or the failure of the debtor to comply with his obligation must be independent of human will
2. Impossible to foresee the event which constitute the caso fortuito (ordinary) *OR* if it can be foreseen, must be impossible to avoid (extraordinary)
3. Occurrence must be such as to render it impossible for the debtor to *fulfill his obligation in a normal manner*
4. Obligor must be free from any participation in the aggravation of the injury resulting to the creditor (no concurrent negligence)

Effect of CONCURRENT FAULT of the Debtor

- When the negligence of a person concurs with an act of God in producing a loss, such person is not exempt from liability by showing that the *immediate cause* of the damage was the act of God.
- If he *creates a dangerous condition or negligence although the act of God was the immediate cause*, he *cannot escape liability for the natural and probable consequence thereof*.
- There must be *NO fraud, negligence, delay or violation/contravention in any manner of the tenor of the obligation*.
- When the effect is found to be *partly* resulting from the participation of man, whether due to his active intervention or neglect or failure to act, the whole occurrence is then humanized and removed from the rules applicable to the acts of God (*NPC v CA – the case of Welming and the exploding dam*)

Cases:

- Juan Nakpil & Sons v CA
- Republic v Luzon Stevedoring
- Dioquino v Laureano
- Austria v CA
- NPC v CA
- Yobido v CA
- Bacolod-Murcia Milling v CA
- Philcomsat v Globe Telecom

Extinguishment of Liability

GENERAL RULE: No liability if there fortuitous events intervene

SPECIFIC APPLICATION:

Non performance

Delay

Loss and deterioration of a specific thing

Art 1189 Loss without the fault of debtor in suspensive condition

Art 1190 Loss without the fault of debtor in resolutive condition

Art 1194 Loss without the fault of the debtor in suspensive period

Art 1204 Loss of all alternative prestations

Art 1205 In alternative obligations, in case of loss of one alternative, creditor chooses from remainder

EXCEPTIONS:

- a. Cases specified by law

<u>Art 552 Par 2</u> Possessor in bad faith <u>Art 1165</u> Debtor's delay <u>Art 1942</u> Obligation of bailee in commodatum <u>Art 1268</u> Proceeds in a criminal offense <u>Art 1979 & Art 1993</u> Depositary	<u>Art 2001</u> Act of a thief <u>Art 2147</u> Officious management <u>Art 2148</u> Negotiorum gestio <u>Art 2159</u> Accepts undue payment in bad faith <u>Art 1198</u> Loss of benefit to make use period
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- b. Express stipulation by the parties
- c. Assumption of risk
 - The principle is based on social justice, an ethico-economic sensibility of modern society which has noted the injustices which industrial civilization has created
 - Applies to all kinds of public services but limited to risks and events that are typical of the business concerned

USURIOUS TRANSACTIONS

Art 1175 Usurious transactions shall be governed by special laws.

Art 1413 Interest paid in excess of the interest allowed by the usury laws may be recovered by the debtor, with interest thereon from the date of the payment.

Art 1961 Usurious contracts shall be governed by the Usury Law and other special laws, so far as they are not inconsistent with this Code.

INTEREST – the income produced by money in relation to its amount and to the time that it cannot be utilized by its owner. It can either be moratory or compensatory.

- **MORATORY** – paid in contractual obligations to pay a sum of money, either as price for the use of the money *OR* as stipulated advanced determination of the damages due to the delay in the fulfillment of the obligation. *mora = delay
- **COMPENSATORY** – interests on obligations which have an extra-contractual or delictual origin

USURY – contracting for or receiving something in excess of the amount allowed by the law for the loan or forbearance of money, good or chattels. It is also taking more interest for the use of money, goods or chattels or credits than the law allows.

TWO CONCEPTS ON PAYMENT OF INTEREST (from Sir Labitag's handout)

A. Interest for the use or loan or forbearance of money, goods or credit

If <u>no stipulation</u> re: payment of interest:	No <i>interest</i> for use or forbearance * No interest shall be due unless it has been expressly stipulated in writing (<u>Art 1956</u>)
If there is <u>express stipulation</u> (which must be in writing to be valid) for payment of interests, but <u>no rate mentioned</u>	Interest shall be 12% per annum (<u>Sec. 2, Monetary Board Circular 905, 10 Dec 1982</u>)
If there is <u>stipulation</u> in writing and <u>rate of interest is agreed upon</u> (including commissions, premiums, fees and other charges)	Such interest shall <i>not</i> be <i>subject to ceiling</i> prescribed under the Usury Law (<u>Sec. 1, Monetary Board Circular 905, 10 Dec 1982</u>)

B. Interest as damages for breach or default in payment of loan or forbearance of money, goods, credit

<u>No stipulation</u> as to interest for use of money	In case of DEFAULT, loan or forbearance shall earn legal interest, at rate of 12% per annum from <i>date of judicial or extrajudicial demand</i> , subject to <u>Art 1169</u> (delay/mora)
If <u>rate of interest stipulated</u> , e.g. 24% per annum	<u>Loan + stipulated interest</u> , shall earn 12% per annum from <i>date of judicial demand</i> * Interest due shall earn legal interest from the time it is judicially demanded, although the obligation may be silent upon this point (<u>Art 2212</u>)

- C. If obligation NOT consisting of a loan or forbearance of money, goods or credit is breached, e.g. obligation to give, to do, not to do
- Interest may be imposed at the discretion of court at the rate of 6% per annum.
 - No interest adjudged on unliquidated claims or damages, until demand can be established with reasonable certainty.
 - After thus established with reasonable certainty, interest of 6% per annum shall begin to run from the date of judicial or extrajudicial demand.
 - But if obligation cannot be established with reasonable certainty at time of demand, 6% per annum interest shall begin to run only from date of judgment – on amount finally adjudged by court.
- D. When judgment of court awarding money becomes final and executory, money judgment is A, B and C (above) shall earn 12% per annum from finality of judgment until full payment – money judgment shall be considered as forbearance of credit (*Eastern Shipping Lines vs. CA, 1994*)

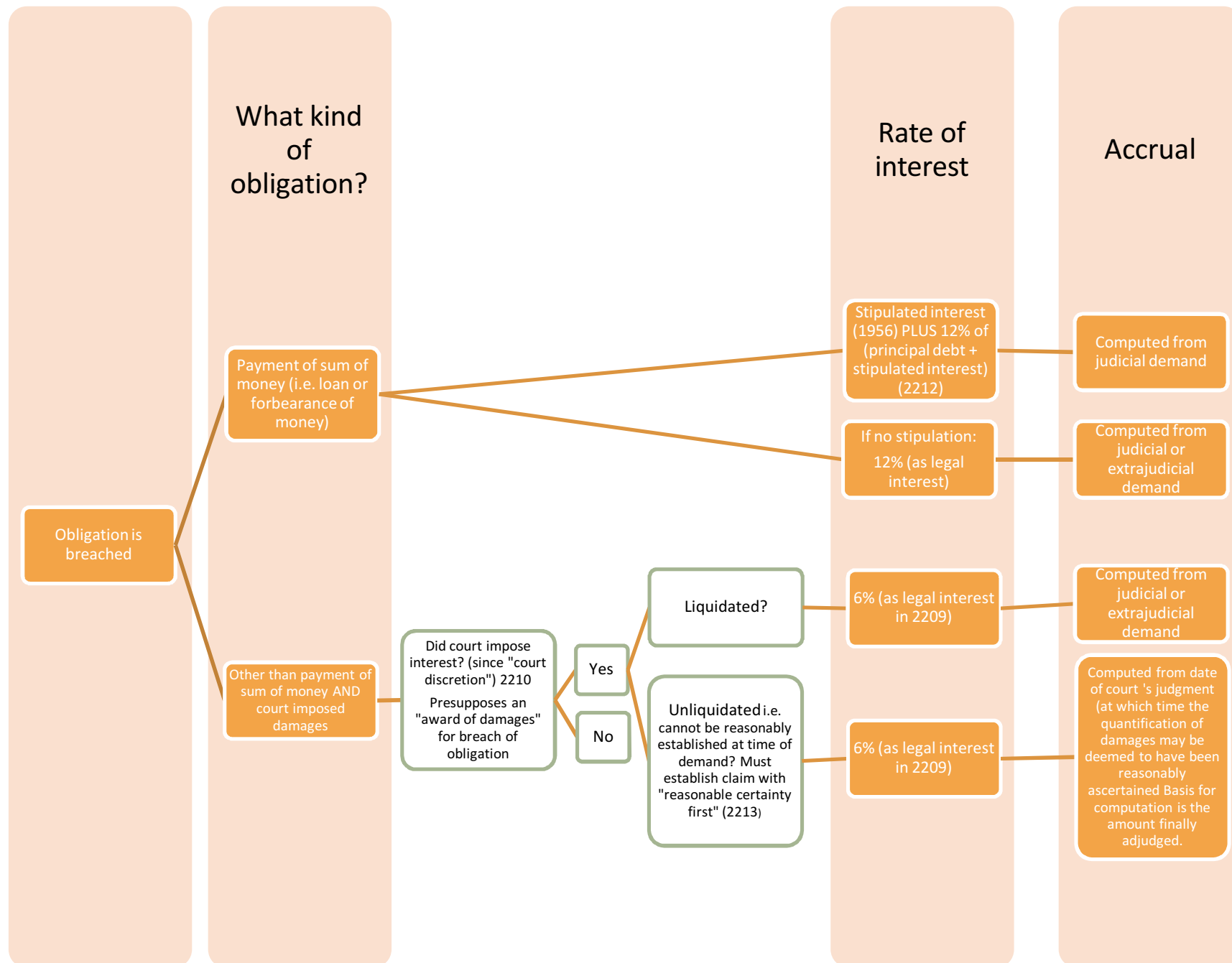
Monetary Board Circular # 905 lifting the interest rate ceiling vs. Art 2209

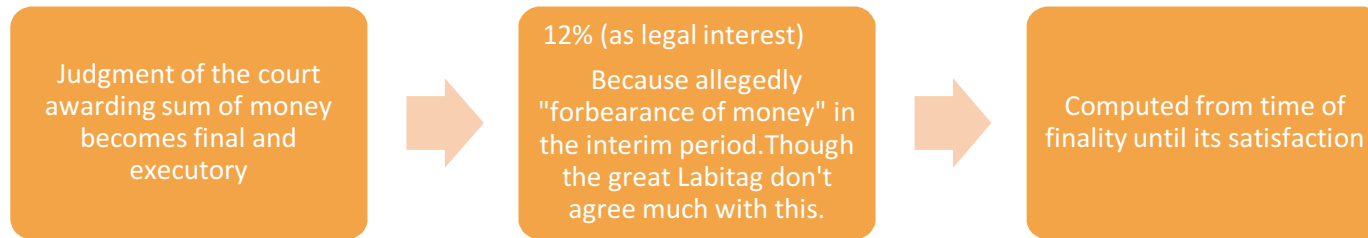
MB 905 Interest can now be charged as lender and borrower may agree upon. It shall not be subject to any ceiling prescribed under or pursuant to the Usury Law as amended.

Art 2209 If the obligation consists in the payment of a sum of money, and the debtor incurs in *DELAY*, the indemnity for damages, there being no stipulation to the contrary, shall be the payment of the interest agreed upon, and in the absence of stipulation, the legal interest, which is six per cent per annum.

Cases:

- Eastern Shipping Lines v CA (see diagram on next page)
- Crismina Garments v CA
- Keng Hua Products v CA
- Security Bank v RTC Makati
- Almeda v CA
- First Metro Investment v Este del Sol





FULFILLMENT OF OBLIGATIONS

See *Chapter 4: Payment*

Presumptions in payment of interests and installments

Art 1176 The receipt of the principal by the creditor, without reservation with respect to the interest, shall give rise to the *presumption* that *interest has been paid*.

The receipt of a later installment of a debt without reservation as to prior installments, shall likewise raise the *presumption* that such *installments have been paid*.

- GENERAL RULE: If the debt produces interests, payment of the principal shall not be deemed to have been made unless the interests have been covered.
- PRESUMPTIONS are rebuttable by evidence

TRANSMISSIBILITY OF RIGHTS

Art 1178 Subject to the laws, all rights acquired in virtue of an obligation are *transmissible*, if there has been no stipulation to the contrary.

EXCEPTIONS:

1. Not transmissible by their very nature e.g. purely personal rights
2. There is a stipulation of the parties that they are not transmissible □ not be easily implied but clearly established or at the very least, clearly inferable
3. Not transmissible by law

Chapter III. Different Kinds of Civil Obligations

I. Pure and Conditional Obligations

A. PURE OBLIGATIONS

Art 1179 Par 1 Every obligation whose performance DOES NOT depend upon a future or uncertain event OR upon a past event unknown to the parties is *demandable at once*.

- Contains no term or condition whatever upon which depends the fulfillment of the obligation contracted by the debtor. Immediately demandable and nothing would exempt that debtor from compliance therewith.

B. CONDITIONAL OBLIGATIONS

Art 1181 In conditional obligations, the acquisition of rights, as well as extinguishment or loss of those already acquired, shall *depend upon the happening* of the event which constitutes the condition.

CONDITION

- every future and uncertain event upon which an obligation or provision is made to depend
- even though uncertain, it should be possible
- must be imposed by the will of a party and NOT a necessary legal requisite of the act e.g. promise to give donation propter nuptias if a person gets married is not conditional (DPN presupposes marriage)
- "past event" cannot be a condition because it is not a future and uncertain event, more properly called as "basis"; although proof of a past event may be a condition
- *TERM* – not uncertain but must necessarily happen e.g. death of a person

CONDITION	PERIOD/ TERM
Determines existence of an obligation	Determines demandability of an obligation

Kinds of Conditions

1. As to effect on obligation

Art 1181 "*Acquisition of rights*" and "*extinguishment or loss of those already acquired*"

	SUSPENSIVE	RESOLUTORY
When condition fulfilled	Obligation arises	Obligation is extinguished
When condition not fulfilled	The juridical or legal tie does not appear	Tie of law is consolidated, becomes absolute
Until it takes place	Obligation is a mere hope	The effect flows, but over it hovers possibility of termination like Sword of Damocles
Effect	Acquisition of rights	Extinguishment or loss of those already acquired
Also known as	Condition precedent/antecedent	Condition subsequent

Case:

- Gonzales v Heirs of Tomas

SUSPENSIVE (condition precedent/antecedent)

- the obligation arises, but if the condition does not happen, obligation does not come into existence

Retroactive effect when "suspensive" condition is fulfilled - The binding tie of conditional obligation is produced from the time of perfection, not happening of condition.

- Can also be seen as "Rights of creditor and debtor after fulfillment of the condition"

Case:

- Coronel v CA

Art 1187 The effects of a conditional obligation to give, once the condition has been fulfilled shall retroact to the day of the constitution of the obligation. Nevertheless, when the obligation imposes *reciprocal prestations* upon the parties, the fruits and interests during the pendency of the condition shall be deemed to have been mutually compensated. If the obligation is *unilateral*, the debtor shall appropriate the fruits and interests received, UNLESS from the nature and circumstances of the obligation it should be inferred that the intention of the person constituting the same was different.

In obligations to *do or not to do*, the courts shall determine, in each case, the retroactive effect of condition that has been complied with.

OBLIGATION TO GIVE	OBLIGATION TO DO or NOT TO DO
<u>Bilateral</u> (reciprocal obligation) - deemed to have been mutually compensated	Courts shall determine the <u>retroactive effect</u> of the condition
<u>Unilateral</u> - debtor shall <u>appropriate fruits and interests received</u> , <u>UNLESS</u> there was a <u>different intention</u>	

- Until the fulfillment of suspensive condition, creditor cannot enforce the obligation as his right then was merely an expectancy. However, upon happening, the debtor can be compelled to perform.
- REASON FOR RETROACTIVITY: Condition is only accidental and not an essential element of the obligation. The obligation is constituted when the essential elements which give rise there to concur.
- Contracts entered into *PENDENTE CONDITIO* (before happening of suspensive condition)
 - CREDITOR transfers his rights prior to happening of condition e.g. mortgage over the property to be delivered to him □ Effect: consolidate or makes effective the act performed.
 - DEBTOR: cannot alienate or dispose the thing, if he does so, all such contracts are abrogated and cease to have any effect upon happening of the suspensive condition. But because delivery transfers real right over the thing:
 - 3rd person in good faith □ retains ownership; debtor becomes liable to creditor for damages.
 - 3rd person is in bad faith □ he may be compelled to deliver the thing to the creditor.
- LIMITATIONS ON RETROACTIVITY (as dictated by justice and required by practicability or convenience):
 - *loss of the thing by fortuitous event*, debtor suffers the *loss* because he is *still* the owner
 - *acts of administration before fulfillment not affected by retroactivity*; however *abuse of rights in guise of administration are not allowed to defeat rights of creditor*
 - *usufructuary rights not within the principle of retroactivity of conditional obligations*

Rights of creditor and debtor before fulfillment of condition

Art 1188 The creditor, may before the fulfillment of the obligation, bring the appropriate action for the preservation of his right.

The debtor may recover what during the same time he has paid by mistake in case of a suspensive condition.

- No preference of credit is granted to the creditor but only allows him to bring proper action for the preservation of his rights.
- PAYMENT BEFORE HAPPENING OF CONDITION: Debtor may only recover what he paid by mistake before happening of suspensive condition, hence if condition has been fulfilled, he can no longer claim because of retroactivity of the condition.
 - If the payment was for a determinate thing: accion reivindicatoria (for inexistent contracts)
 - Otherwise (not a determinate thing): solutio indebiti
 - If the payment was with knowledge of condition: implied waiver of condition and cannot recover
 - If the payment was with knowledge but the condition did not happen: debtor can recover lest the creditor will be unjustly enriched.
 - The law is silent as to whether fruits may be recovered like in Art 1195, but Tolentino says we can apply principle of solutio indebiti, especially if creditor is in bad faith (knew that the debtor is paying before the suspensive condition has happened). Sr Labitag says yes, though. It follows the same rules.

RESOLUTORY (condition subsequent)

- extinguishes rights and obligations already existing

Cases:

- Parks v Province of Tarlac
- Central Philippine University v CA
- Quijada v CA

2. As to cause or origin

Art 1182 When the fulfillment of the condition depends upon the sole will of the debtor the conditional obligation shall be VOID. If it depends upon chance or upon the will of a 3rd person, the obligation shall TAKE EFFECT in conformity with the provisions of this Code.

POTESTATIVE – One which depends upon the will of one of the contracting parties; in the power of one of the parties to realize or prevent

KINDS OF POTESTATIVE CONDITION

1. Simple potestative – presupposes not only a manifestation of will but also the realization of an external act
 - On the part of the debtor: Does not prevent formation of valid obligation because in part depends on contingencies over which he has no control
2. Purely potestative – depends solely and exclusively upon the will
 - Destroys the efficacy of the legal tie
 - Effect if fulfillment of condition depends solely on the will of the debtor □ VOID because it is a direct contravention of Art 1308 on mutuality of contracts and to do so is to sanction illusory conditions
 - If depends exclusively on the will of creditor □ VALID
 - Applicable only to SUSPENSIVE and NOT to RESOLUTORY
 - Hence, resolutive potestative (facultative) conditions are perfectly valid, even if made to depend upon the obligor/debtor, since the obligation is already in force

Debtor's promise to pay when he can is not a conditional obligation

Art 1180 When the debtor binds himself to pay WHEN his means permit him to do so, the obligation shall be deemed to be one with a period subject to the conditions of Art 1197 (period was intended).

- Creditor will have to ask the court to fix a period because an immediate action to enforce the obligation would be premature.

Case:

- Lim v CA

CASUAL – depends exclusively upon chance, will of a third person or other factors, and not upon the will of the contracting parties

Case:

- Naga Telephone Co, Inc v CA

MIXED – depends upon the will of one of the contracting parties and other circumstances, including the will of third persons

Cases:

- Osmena v Rama
- Hermosa v Longora
- Taylor v Uy Tieng Piao
- Smith Bell v Sotelo Matti
- Rustan Pulp and Paper Mills v IAC
- Romero v CA

3. As to possibility

Art 1183 IMPOSSIBLE CONDITIONS, those contrary to good customs or public policy and those prohibited by law shall *annul the obligation* which depends upon them. If the obligation is DIVISIBLE, that part thereof which is not affected by the impossible or unlawful condition shall be *valid*.

The condition *not to do an impossible thing* shall be considered as not having been agreed upon.

IMPOSSIBLE – may either be physical (contrary to the law of nature) or juridical (contrary to law, morals, good customs, and public policy AND restricts certain rights which are necessary for the free development of human activity i.e. political rights, family rights and constitutional rights and liberties e.g. condition not to change domicile, religion or contract marriage)

ILLICIT CHARACTER – determined not by the facts but by the effect upon one of the parties. Thus, the criterion is subjective. Not the act but the intention and its effect that determine the illicit character of the condition.

- Why? Impossibility of fulfillment implies he *does not intend* to be bound, thus the nullity of the promise

Effect of Impossible Conditions

- Annuls only obligations which are POSITIVE and SUSPENSIVE. In the case of a negative *impossible* condition, it's considered as not written and the obligation is converted to a *pure and simple* one.
- Applies only to contracts and not to simple and testamentary donations and to testamentary dispositions
- Impossibility of condition must exist at the time of the creation of the obligation (not existence of a valid obligation subsequently rendered impossible under Art 1266 on "subsequent impossibility")
- DIVISIBLE OBLIGATION: part not affected by the impossible condition shall remain valid

GENERAL RULE: Impossible condition annuls the obligation dependent upon them

EXCEPTIONS:

- | | |
|-------------------------------------|------------------------------|
| ○ Pre-existing obligation | ○ Testamentary disposition |
| ○ Divisible obligation | ○ Negative impossible things |
| ○ Simple or remuneratory obligation | |

Case:

- Roman Catholic Archbishop of Manila v CA

4. As to mode

POSITIVE (suspensive)

Art 1184 The condition that some event happen at a determinate time shall EXTINGUISH the obligation as soon as the time *expires* OR if it has become *indubitable* that the event will not take *place*.

- If there is no period fixed, the rule in Par 2 of Art 1185 is applicable. Intention of the parties is controlling, and the time shall be that which the parties may have probably contemplated, taking into account the nature of the obligation.

NEGATIVE (suspensive)

Art 1185 The conditions that some event will not happen at a determinate time shall render the obligation EFFECTIVE from the moment the time indicated has elapsed OR if it has become evident that the event cannot occur.

If no time has been fixed, the condition shall be deemed fulfilled at such time as may have probably been contemplated, bearing in mind the nature of obligation.

LOSS, *DETERIORATION* or *IMPROVEMENT* pending happening of the condition

Art 1189 When the conditions have been imposed with the intention of *SUSPENDING* the efficacy of an obligation to give, the following rules shall be observed in case of the improvement, loss or deterioration of the thing during the pendency of the condition: If the thing is...

1. Loss without fault of debtor: obligation extinguished
 2. Loss through the fault of debtor: obliged to pay damages. A thing is loss when it:
 - a. Perishes
 - b. Goes out the commerce of man
 - c. Disappears in such a way that its existence is unknown or it cannot be recovered
 3. Deteriorates without fault of the debtor: impairment to be borne by the creditor
 4. Deteriorates through the fault of debtor: creditor may choose between the rescission of the obligation and its fulfillment with indemnity for damages in either case
 5. Improved by its nature, time: inure to the creditor
 6. Improved at the expense of the debtor: no other right than that granted to the usufructuary
- Applicable only to obligations to deliver a determinate or specific thing. NO application to generic objects (genus never perishes).
 - Apply only in case *suspensive condition* is *fulfilled*.

Art 1190 When the conditions have for their purpose the EXTINGUISHMENT of an obligation to give, the parties, upon the fulfillment of the said conditions, shall return to each other what they have received.

In case of the loss, deterioration, or improvement of the thing, the provisions which with respect to the debtor, are laid down in the preceding article shall be applied to the party who is bound to return.

As for obligations to do or not to do, the provisions of 2nd par of Art 1187 (courts shall determine) shall be observed as regards the effect of the extinguishment of obligation.

LOSS	<ol style="list-style-type: none"> 1. Perishes 2. Goes out of the commerce of man 3. Disappears in such a way that its existence is unknown or it cannot be recovered
DETERIORATION	Any reduction or impairment in the substance or value of a thing which does not amount to a loss. The thing still exists at the time the condition is fulfilled, but it is no longer intact, OR is less than what it was when the obligation was constituted.
IMPROVEMENT	Anything added to, incorporated in, or attached to the thing that is due.

Effect of loss or deterioration

	LOSS	DETERIORATION
Without debtor's fault	Extinguished, unless there is a stipulation to the contrary. Mode of extinguishment Art 1262 Par 1	Not liable for damage, creditor must accept the thing in impaired condition
With debtor's fault	Liable to damages upon fulfillment of condition	May demand the thing OR ask for rescission, in either case, creditor may recover damages

Effect of improvement

MODE	
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By nature or time	Inures to the benefit of the creditor by virtue of principle of retroactivity of conditional obligations
At debtor's expense	Only usufructuary rights; Governed by Art 579 (useful improvements or for mere pleasure, remove if possible to remove without damage to property) and Art 580 (set off the improvements he may have made against any damage)

Effect of prevention of the fulfillment of the condition by the obligor

Art 1186 The condition shall be deemed fulfilled when the obligor voluntarily prevents fulfillment.

CONSTRUCTIVE FULFILLMENT – a condition which although not exclusively within the will of the debtor, may in some way be prevented by the debtor from happening.

REQUISITES:

- a. Intent of the obligor to prevent the fulfillment of the condition □ **ESSENTIAL!**
 - b. Actual prevention of the compliance
- Why? Party to a contract may not be excused from performing his promise by the non-occurrence of the event which he himself prevented.
 - Also applicable to *provocation of resolutive conditions*

Cases:

- Taylor v Uy Tieng Piao *supra*
- Herrera v Leviste

C. RECIPROCAL OBLIGATIONS

Art 1191 The power to rescind obligation is implied in reciprocal ones, in case one of the obligors should not comply with what is incumbent upon him.

The injured party may choose between **FULFILLMENT** and the **RESCISSION** of the obligation, with the payment of damages in either case. He may also seek rescission, even after he has chosen fulfillment, if the latter should become IMPOSSIBLE.

The court shall decree the rescission claimed UNLESS there be a just cause authorizing the fixing of a period.

This is understood to be without prejudice to the rights of third persons who have acquired the thing, in accordance with Articles 1385 and 1388 and the Mortgage Law.

Art 1192 In case both parties have committed breach of obligation, the liability of the first infractor shall be equitably tempered by the courts. If it cannot be determined which of the parties first violated the contract, the same shall be extinguished and each shall bear his own damages.

Concept **RECIPROCITY** arises from identity of cause and necessarily, two obligations are created at the same time. Each party is a creditor and debtor of the other and they are to perform simultaneously.

- Recognized "implied or tacit resolutive condition" imposed exclusively by law, even if there is no corresponding agreement between parties □ it's also called **RESOLUTION**
- Power to rescind is given to the injured party

Alternative remedies of injured party in case of breach □ injured party should choose only one, cannot ask for partial rescission and partial fulfillment

a. Action for Fulfillment □ When fulfillment no longer possible, rescission takes place

b. Action for Rescission

- Requisites for rescission
 - a. One of the creditors failed to comply with what is incumbent upon him
 - b. Obligor who performed chose rescission over fulfillment or performance is impossible
 - c. The breach is substantial so as to defeat the object of the parties in making the agreement – it will not be granted in slight or casual breach
- How made – Rescission requires judicial approval to produce legal effect

- EXCEPTION: object is not yet delivered AND obligation has not yet been performed
- If the obligation has not yet been performed: extrajudicial declaration of party willing to perform would suffice; can refuse to perform if the other party is not yet ready to comply
- If the injured party has already performed: cannot extrajudicially rescind IF the other party opposes the rescission (otherwise, rescission produces legal effect). In the case the other party impugns rescission, the court comes in either to:
 - a. Declare the rescission as properly made
 - b. Give a period to the debtor in which to perform
- Effects of Rescission
 1. Extinguishes obligatory relation as if it had never been created □ Equivalent to invalidate the juridical tie, leaving things in their status before the celebration of the contract
 2. Mutual restitution

Rescission Art 1380 Distinguished from Resolution Art 1191

	Art 1191 Resolution	Art 1380 Rescission
Similarities	1. Presuppose contracts validly entered into and existing □ Rescission v. Annulment: the latter there is a defect which vitiates/invalidates the contract 2. Mutual restitution when declared proper	
Who may demand	Only by a party to the contract	Party to the contract suffering lesion Third parties prejudiced by the contract
Grounds	Non-performance (implied tacit condition in reciprocal obligation)	Various reasons of equity provided by the grounds, mainly economic injury or lesions
Scope of judicial control	Court determines sufficiency of reason to justify extension of time to perform obligation (whether slight or casual breach)	Sufficiency of reason does not affect right to ask for rescission (cannot be refused if all the requisites are satisfied)
Kind of obli applicable to	Only to reciprocal	Unilateral, reciprocal Even when contract is fully fulfilled
Character	Principal Remedy	Secondary/Subsidiary

Cases:

- Song Fo v Hawaiian Philippines
- Boysaw v Interphil Promotions
- UP v Delos Angeles
- De Erquiaga v CA
- Angeles v Calasanz
- Ong v CA
- Visayan Saw Mill v CA
- Deiparine v CA
- Iringan v CA
- Vda de Mistica v Sps. Naguiat

See also:

Art 1786 (Partnership) Every partner is a debtor of the partnership for whatever he may have promised to contribute thereto.

He shall also be bound for warranty in case of eviction with regard to specific and determinate things which he may have contributed to the partnership, in the same cases and in the same manner as the vendor is bound with respect to the vendee. He shall also be liable for the fruits thereof from the time they should have been delivered, without the need of any demand.

Art 1788 (Partnership) A partner who has undertaken to contribute a sum of money and fails to do so becomes a debtor for the interest and damages from the time he should have complied with his obligation.

The same rule applies to any amount he may have taken from the partnership coffers, and his liability shall begin from the time he converted the amount to his own use. (1682)

Art 1484 (Sales) In a contract of sale of personal property the price of which is payable in installments, the vendor may exercise any of the following remedies:

- (1) Exact fulfillment of the obligation, should the vendee fail to pay;
- (2) Cancel the sale, should the vendee's failure to pay cover two or more installments;
- (3) Foreclose the chattel mortgage on the thing sold, if one has been constituted, should the vendee's failure to pay cover two or more installments. In this case, he shall have no further action against the purchaser to recover any unpaid balance of the price. Any agreement to the contrary shall be void. (1454-A-a)

Art 1485 (Sales) The preceding article shall be applied to contracts purporting to be leases of personal property with option to buy, when the lessor has deprived the lessee of the possession or enjoyment of the thing. (1454-A-a)

Art 1486 (Sales) In the case referred to in two preceding articles, a stipulation that the installments or rents paid shall not be returned to the vendee or lessee shall be valid insofar as the same may not be unconscionable under the circumstances. (n)

RA 6552 Realty Installment Buyer Protection Act aka "Maceda Law"

II. Obligation with a Period

Art 1193 Obligations whose fulfillment a *day certain* has been fixed, shall be demandable only when that day comes. Obligations with a *resolutive period* take effect at once but terminate upon arrival of the day certain.

A "day certain" is understood to be that which *must necessarily come*, although it may *not be known when*. If the uncertainty consists in *whether the day will come or not*, the obligation is *CONDITIONAL*, and it shall be regulated by the rules of the preceding Section.

Art 1180 When the debtor binds himself to pay *WHEN his means permit* him to do so, the obligation shall be *deemed to be one with a period*, subject to the provisions of Art 1197.

Concept A space of time which, exerting an influence on obligations as a consequence of a juridical act, suspends their demandability or determines their extinguishment.

- *Requisites of Period*
 1. *Future*
 2. *Certain*
 3. *Possible*

Period/ Term vs. Condition

AS TO	TERM/ PERIOD	CONDITION
Fulfillment	Event must necessarily come, whether known before hand OR at a time which cannot be predetermined	Event is uncertain
Influence on the obligation	No effect on the existence, but only on their demandability or performance, HENCE, does not carry with it any retroactive effect	Gives rise to an obligation or extinguishes one already existing
Time	Always to the future	May refer to past event not know to the parties
Will of the debtor	If dependent on will of debtor, merely empowers court to fix such period	If dependent on will of debtor, ANNUL

Kinds of Period/ Term

1. As to effect

SUSPENSIVE (Ex die)

Art 1193 Par 1 Obligations whose *fulfillment* a *day certain* has been *fixed*, shall be *demandable only* when that *day comes*.

- Must lapse before the performance of the obligation can be demanded
- Think: incubating period
- The obligor has the burden of proving any extension of the period by satisfactory evidence

- **SUSPENSION OF PERIOD:** If a fortuitous event supervenes, the obligor is merely relieved of the obligation to fulfill at that time, and does not stop the running of the period because in effect that would be an extension of the term of the contract. Force majeure cannot be deducted from the period stipulated.
- **MORATORIUM LAWS:** postponement of the fulfillment of an obligation, an extension of the period for the performance of the obligation, decreed by the statute. However, to meet constitutional requirements: The suspension should be definite and reasonable.

RESOLUTORY (In diem)

Art 1193 Par 2 Obligations with a resolutive period take effect at once but *terminate* upon arrival of the day certain.

- Period after which the performance must terminate
- Think: expiry date

2. As to expression

EXPRESS – when specifically stated

IMPLIED – when parties “intended a period”

E.g. Art 1197 Par 3 (period has been contemplated by the parties), Art 1180 (promise to pay when able), or when a person undertakes to do some work which can be done only during a particular season

3. As to definiteness

DEFINITE – refers to a fixed known date or time

INDEFINITENESS – event which will necessarily happen but the date of its happening is unknown

- The uncertainty of the date of occurrence in indeterminate period DOES NOT convert it into a condition, so long as there is no uncertainty as whether it will happen or not.
- E.g. death of a person, movable religious holidays (Holy Week), events in civil or political life (age of majority or becoming a qualified voter)
- Debtor promises to “pay when able” or “little by little” or “as soon as possible”
- Two steps in dealing with an indefinite period (from Sir Labitag’s lecture)
 1. Make the indefinite period definite by asking for payment or making an extrajudicial demand
 2. Make judicial demand, then ask the courts to fix the period
- No need to file to actions, just ask for two prayers to avoid multiplicity of suits: (1) fix period and (2) require the debtor to comply on the fixed period (action for specific performance)
- The 2-in-1 action discussed by Sir Labitag is actually contradictory with Tolentino’s commentary.

4. As to source

CONVENTIONAL/ VOLUNTARY – stipulated by the parties

LEGAL – period fixed by law; spread in the CC e.g. Art 1682 lease of rural land and Art 1687 lease of urban land; Franchise agreement in the Constitution (for 25 years)

JUDICIAL – set by the courts in case of implied and indefinite periods (See: *When courts may fix period*)

Rules in case of loss, deterioration or improvement before arrival of period

Art 1194 In case of loss, deterioration or improvement of the thing before the arrival of the day certain, the rules in Art 1189 shall be observed.

- Same as Art 1189

Effect of loss or deterioration

	LOSS	DETERIORATION
Without debtor’s fault	Extinguished, unless there is a stipulation to the contrary. Mode of extinguishment Art 1262 Par 1	Not liable for damage, creditor must accept the thing in impaired condition

With debtor's fault	Liable to damages upon fulfillment of condition	May demand the thing OR ask for rescission, in either case, creditor may recover damages
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Effect of improvement

MODE	
By nature or time	Inures to the benefit of the creditor by virtue of principle of retroactivity of conditional obligations
At debtor's expense	Only usufructuary rights; Governed by Art 579 (useful improvements or for mere pleasure, remove if possible to remove without damage to property) and Art 580 (set off the improvements he may have made against any damage)

Effect of payment in advance

Art 1195 Anything paid or delivered before the arrival period, the obligor being unaware of the period OR believing that the obligation has become due and demandable, may be *RECOVERED*, with the fruits and interests.

- Only applies to obligations to give
- The action only lies before the arrival of the day certain, when the day certain comes cannot recover
- If the creditor refuses, debtor will have to go to the court, but when judgment comes, the day certain has already arrived. Poor him. (Sir Labitag)
- Manresa: good faith/bad faith of the creditor in accepting the premature payment is immaterial
- Tolentino: In accordance with *solutio indebiti*, good faith of creditor makes him liable to restore the fruits and interests insofar as it benefited him.
- The same principle as regards fruits and interest is true for payment before happening of suspensive condition in Art 1188 Par 2
- Fruits and interests not recoverable in these cases:
 - Reciprocal obligation and there has been a premature performance on both sides
 - When the obligation is a loan on which the debtor is bound to pay interest
 - When the period is exclusively for the benefit of the creditor, because the debtor who pays in advance loses nothing
 - If payment was with knowledge of the term, it cannot be recovered because it is considered as tacit waiver of the benefit of the term (not only fruits and interest, but also principal)

Note Art 1197 Par 3 In every case, the court shall *determine such period* as may under the circumstances have been *probably contemplated by the parties*. Once fixed by the courts, the period cannot be changed by them.

Benefit of Period

1. For whose benefit and its effects

Creditor	May demand performance anytime, but not compelled to accept before period expires E.g. payment of interest, wants to keep his money safely invested instead of having it in his hands, protects himself from sudden decline in purchasing power of the currency loaned
Debtor	May oppose a premature demand, but may validly pay any time before period expires E.g. time to raise money
Both	Presumption in absence of stipulation or in case of doubt Creditor must give consent first before debtor may pay in advance especially when creditor receives other benefits by reason of the term

2. Presumption □ for the benefit of BOTH the creditor and debtor

Art 1196 Whenever in an obligation a period is designated, it is *presumed* to have been established for the benefit of *BOTH* creditor and debtor, *UNLESS* from the tenor of the same or other circumstances it should appear that the period has been established in favor of one or the other.

Cases:

- Lachica v Araneta
- Ponce de Leon v Syjuco
- Buce v CA

3. When debtor loses right to make use of period

Art 1198 The debtor shall lose every right to make use of the period:

- 1) When after the obligation has been contracted, he becomes insolvent *UNLESS* he gives a guaranty or security for the debt □ dovetail with *accion pauliana* (prior credit although demandable later)
 - 2) When he does not furnish to the creditor the guaranties or securities which he has promised
 - 3) When by his *own acts* he has impaired said guaranties or securities after their establishment, and when through a fortuitous event they disappear, *UNLESS* he immediately gives new ones equally satisfactory
 - 4) When the debtor violates any undertaking in consideration of which the creditor agreed to the period
 - 5) When the debtor attempts to abscond □ shows bad faith
- Par 1: "insolvency" need not be declared in an insolvency proceeding, enough that he is in a state of financial difficulty that he is unable to pay his debts
 - Par 3: "impaired" need not be total; "disappear through fortuitous event" total, used in the sense of "loss"
 - Obligation becomes immediately due and demandable even if period has not yet expired; converted to a pure obligation
 - Does not apply to extension of period fixed by moratorium statutes

When court may fix period

Art 1197 If the obligation does not fix a period, but from its nature and circumstance it can be inferred that a period was intended, the courts may fix the duration thereof.

Par 2 The courts shall also fix the duration of the period when it depends upon the will of the debtor.

Par 3 The courts shall determine which period as may under the circumstances have been probably contemplated by the parties. Once fixed by the courts, the period cannot be changed by them.

1. Period is implied □ a period was intended; also *INDEFINITE PERIOD*
2. Period depends solely on will of debtor
 - If it were condition: void

Cases:

- Araneta v Phil Sugar Estate Development
- Central Philippine University v CA *supra*

III. **Alternative Obligations** – plurality of objects

Concept

1. Conjunctive – all prestations must be performed to extinguish obligation
 2. Disjunctive – one or some prestations must be performed to extinguish obligation
 - a. Alternative – Debtor must perform one of several alternatives, choice belongs to debtor *UNLESS* expressly given to creditor
 - b. Facultative – One principal prestation but one or more substitutes, choice belongs to *DEBTOR ONLY*
- Absent indication that it is facultative, the presumption is that it is *ALTERNATIVE* because creditor would be at a disadvantage if facultative. Facultative is never presumed.

Art 1199 A person alternatively bound by different prestations shall completely perform one of them.

Par 2 The creditor cannot be compelled to receive part of one and part of the other undertaking.

Right of choice □ debtor unless expressly granted to creditor

Art 1200 The right of choice belongs to the debtor, *UNLESS* it has been expressly granted to the creditor.

Par 2 The debtor shall have no right to choose those prestations which are impossible, unlawful or which could not have been the object of the obligation

- Grant to creditor cannot be implied
- Choice may also be entrusted by the parties to a third person
- LIMITATIONS ON RIGHT OF CHOICE
 - Right to choose is indivisible (cannot choose part of one and part of the other)

- Cannot choose prestations which are impossible, unlawful or could not have been the object of the obligation (Art 1200, Par 2)

Effect of notice of choice

- The effect of notice of choice is to limit the obligation to the object or prestation selected, with all the consequences which the law provides.
- The obligation is converted to a simple obligation to perform the prestation chosen.
- Once the selection has been communicated, it becomes irrevocable.

When notice produces effect

Art 1201 The choice shall produce no effect except from the time it has been *communicated*.

- Notice of selection/choice may be in any form provided it is sufficient to make the other party know that election has been made.
 - Orally
 - In writing
 - Tacitly □ *tacit declaration of the selection may be done:*
 - performance by the debtor who has the right to choose or in the acceptance of a prestation by the creditor when he has the right of selection
 - when the creditor sues for the performance of one of the prestation
 - Any other unequivocal terms
- Law does not require the other party to consent to the choice made by the party entitled to choose. A mere declaration of the choice, communicated to the other party is sufficient □ unilateral declaration of will
- Only possible EXCEPTION: Debtor has chosen a prestation which could not have been the object of the obligation; creditor's consent thereto would bring about a novation of the obligation
- PLURALITY OF SUBJECT
 - Joint: choice must be consented by all, as none of them can extinguish the obligation alone
 - Solidary: choice by one will be binding personally upon him, but not as to other (bakeet?!)
- Right to choose is not lost by the mere fact that the party entitled to choose delays in making his selection.
 - Sir Labitag: Substituted performance □ when the debtor does not want to make a choice, creditor can ask the court for a 3rd party e.g. clerk of court, sheriff, or any other knowledgeable 3rd person to choose

Effect of loss or impossibility of one or all prestations

Art 1202 The debtor shall lose the right of choice, when among the prestations whereby he is alternatively bound, only one is practicable.

- Converted to a *simple and pure obligation*; The *impossibility* of the act *must not be due to creditor's act* where Art 1403 shall apply.
- Creditor cannot claim damages, because it's the debtor's call

Art 1203 If through the *creditor's act*, the *debtor cannot make a choice* according to the terms of the obligation, the latter may *rescind* the contract *with damages*.

- Impossibility due to creditor

Art 1204 The creditor shall have a right to *indemnity* for damages when, through the *fault of the debtor*,

- ALL THE THINGS which are alternatively the object of the obligation have been *LOST* or
- COMPLIANCE of the obligation has become *IMPOSSIBLE*.

Par 2 The *indemnity* shall be *fixed taking as a basis the VALUE of the last thing which disappeared* OR *that of the service which last became impossible*.

Par 3 Damages other than the value of the last thing or service may also be awarded.

- Applies to cases where the debtor has the right to choose
- If only some of the prestations are lost/impossible, not liable for damages because he can still comply by performing the remaining prestations even if there is only one (Art 1202)
- LOSS THROUGH FORTUITOUS EVENTS: obligation is extinguished, debtor not liable for damages

Art 1205 When the choice has been expressly given to the creditor, the obligation shall cease to be alternative from the day when the selection has been *communicated* to the debtor.

Par 2 Until then, the responsibility of the debtor shall be governed by the following rules:

1. If ONE of the thing is LOST through *fortuitous event*, he shall perform the obligation by delivering that which the creditor should choose from the remainder, or that which remains if only one subsists.
2. If the LOSS of ONE of the things occurs through the *fault of the debtor*, the creditor may claim any of those subsisting, or the price of that which, through the fault of the debtor has disappear, with a right to damages.
3. If ALL the things are LOST through the *fault of the debtor*, the choice by the creditor shall fall upon the price of any of them, also with indemnity for damages.

Par 3 the same rules shall be applied to *obligations to do or not to do*, in case ONE, OR SOME OR ALL of the prestations should become IMPOSSIBLE.

FACULTATIVE OBLIGATION

Art 1206 When only one prestation has been agreed upon, but the obligor may render another in substitution, the obligation is called *facultative*.

Par 2 The LOST or DETERIORATION of the thing intended as a substitute through the negligence of the obligor, does not render him liable. BUT once the substitution has been made, the obligor is liable for the loss of the substitute on account of his *delay, negligence or fraud*.

Concept Only one prestation is due, but the obligor reserved the right to render another in substitution

Distinguished from Alternative Obligation

AS TO	ALTERNATIVE	FACULTATIVE
Contents of the obligation	Various prestations all of which constitute parts of the obligation	Only the principal constitutes the obligation, the accessory being only a means to facilitate payment
Nullity of prestation	Nullity of one prestation does not invalidate the obligation which is still in force with respect to those which have no vice Creditor can choose from the remainder	Nullity of the principal prestation (e.g. when the object is unlawful or outside the commerce of man) invalidates the obligation. Creditor cannot demand the substitute even when this is valid.
Choice	Right to choose may be given to the creditor	Only the debtor can choose the substitute prestation
Effect of Loss (fortuitous event)	Only the IMPOSSIBILITY OF ALL the prestations due without fault of the debtor extinguishes the obligation	Impossibility of the principal prestation is sufficient to extinguish the obligation, even if the substitute is possible. Loss of substitute does not make debtor liable, unless substitution has been made
Effect of Loss (through fault)	Debtor not liable if other prestation still available If choice belongs to creditor, loss of one alternative gives rise to liability	Debtor is liable Loss of the substitute before substitution does not render debtor liable

Effects of Substitution

- Before the substitution is effected, the substitute is not the prestation that is due.
- IF the substitute prestation becomes impossible due to the fault or negligence of the debtor → obligation is not affected, and he cannot be held for damages, even if he acts with bad faith in rendering the substitute impossible.
- From the time the debtor communicates to the creditor that he elects to perform the substitute prestation, substitution is effective.

IV. **Joint and Solidary Obligation** – plurality of subjects, the juridical tie that binds them

JOINT OBLIGATIONS

Concept Each of the debtors is liable only for a proportionate part of the debt, and each creditor is entitled only to a proportionate part of the credit. Each creditor can recover only his share of the obligation and each debtor can be made to pay only his part. Sir Labitag describes it as a "thin plastic rope or string" that binds the parties.

- Requisites of Joint Obligations
 1. Plurality of subjects
 2. Determination of the shares in the demandability of the fulfillment of the obligation
- Words used to indicate joint obligations
 - Mancomunada
 - Mancomunada Simple
 - Pro rata
 - "We promise to pay..." used by two or more signers

Presumptions in Joint Obligations

Art 1207 The concurrence of two or more creditors or of two or more debtors in one and the same obligation does not imply that each one of the former has a right to demand, OR that each one of the latter is bound to render entire compliance with the prestations. There is a SOLIDARY LIABILITY only when the obligation expressly so states OR when the law OR the nature of the obligation requires solidarity.

Art 1208 If from the law, or the nature or the wording of the obligations to which the preceding article refers the contrary does not appear, the credit or debit shall be presumed to be *divided* as many equal *shares* as there are creditors or debtors, the credits or debts being considered distinct from one another, subject to the Rules of Court governing the multiplicity of suits.

- Joint character is presumed
- Equal shares

Effects of Joint Obligation

- a. Extent of liability of debtor
 1. Only with respect to his particular share in the debt
 2. Vices of each obligation arising from the personal defect of a particular debtor or creditor does not affect the obligation or rights of the others
 3. The insolvency of a debtor does not increase the responsibility of his co-debtors nor does it authorize a creditor demand anything from his co-creditors
 4. JOINT DIVISIBLE OBLIGATION: defense of res judicata is not extended from one debtor to another
- b. Extent of right of creditor
 1. Demand by one creditor upon one debtor produces the effects of default only with respect to the creditor who demanded and the debtor on whom the demand was made, but not with respect to others
 2. Interruption of prescription by the judicial demand of one creditor upon a debtor does not benefit the other creditors nor interrupt the prescription as to other debtors
- c. In case of:
 - *Novation*: Affects only the share of the joint co-debtor in whom the novation is created
 - *Compensation*: Affects only the share of the joint co-debtor in whom the compensation takes place
 - *Confusion*: Art 1277 Confusion does not extinguish a joint obligation except as regards the share corresponding to the creditor or debtor in whom the two characters concur.
 - *Remission*: Benefits only the joint co-debtor in whom the remission is granted, obligation extinguished

SOLIDARY OBLIGATIONS

Concept Each of the debtors is liable for the entire obligation, and each creditor is entitled to demand the whole obligation. Each creditor may enforce the entire obligation and each debtor may be obliged to pay it in full. Sir Labitag describes it as a "solid steel cable" that binds the parties.

- Solidary obligations exist only by:
 - Stipulation of the parties

- Law
- Nature of obligation
- Charge of condition is imposed upon legatees or heirs
- Imputed by final judgment upon several defendants
- Requisites of Joint Obligations
 1. Plurality of subjects
 2. Determination of the shares in the demandability of the fulfillment of the obligation
- Words used to indicate joint obligations
 - Mancomunada solidaria
 - Joint and several
 - In solidum
 - "I promise to pay..." followed by the signature of two or more persons
 - "Individually and collectively"
- Sir Labitag's magic shortcut formula (applicable only to joint liability on both sides)
 - # of debtors x # of creditors = divisor of the total amount of obligation

KINDS OF SOLIDARY OBLIGATIONS

a. As to source

Art 1208 From law, or the nature or the wording of the obligation...

LEGAL

Art 1915 Two or more principals appointed an agent for common transaction, solidarily liable to agent

Art 1945 Two or more bailees to whom a thing is loaned in the same contracts (commodatum)

Art 2194 Joint tortfeasors

Art 2146 Joint officious management, two or more managers

Art 2157 Joint payees in solutio indebiti (payment is not due)

Art 119, RPC

CONVENTIONAL by stipulation of parties

REAL nature of the obligation requires

b. As to parties bound

ACTIVE – solidarity of creditors; each has right to collect the whole of the prestation from the common debtor

- Mutual representation □ Each creditors represents the other in the act of receiving the payment and in all other acts which tend to secure the credit or make it more advantageous
- Death of solidary creditor does not transmit the solidarity to each of his heirs but all of them taken together
- The credit and its benefit are divided equally among the creditors UNLESS there is an agreement among them to divide differently

PASSIVE – solidarity of debtors; each is liable to pay the whole to the common creditor

- Mutual guaranty

MIXED – simultaneously active and passive

c. As to uniformity

UNIFORM – same terms and condition for all

VARIED/ NON-UNIFORM

Art 1211 Solidarity may exist although the creditors and the debtors may not be bound in the same manner and by the same periods and conditions.

- Effects of non-uniform solidary liability only the portion due at the time of the demand is collectible from any of the debtors or by anyone of the creditors

Cases:

- Inchausti v Yuli
- Lafarge Cement Philippines v Continental Cement

EFFECTS OF SOLIDARY OBLIGATIONS

a. SOLIDARY CREDITOR in relation to:

i. Common debtor

Right to demand

- Debtor may pay to any solidary creditor, but if a judicial demand is made against him, he must pay only to the plaintiff. (Art 1214)
 - Judicial demand revokes the tacit mutual representation of co-creditors, though not perpetually: only until such time the action exists.
 - Payment to creditor who did not sue is a payment to 3rd person.
 - Same effect granted to extrajudicial demand.
 - DEMAND BY SEVERAL CREDITORS: Pay the one who notified him first. If simultaneous, debtor reserves the right to choose.
 - Does not apply to MIXED SOLIDARITY: solidary co-debtor may pay in behalf of the one to whom demand has been made AND to any of the solidary creditors
- The creditor may proceed against ANY ONE of the solidary debtors or SOME or ALL of them *simultaneously*. (*Quiombing v CA*) The demand made against one of them shall not be an obstacle to those which may be *subsequently* be directed against others, so long as the debt has *not been fully collected*. (Art 1216)
- Payment made by one of the solidary debtors extinguishes the obligation. If two or more solidary debtors offer to pay, the creditor may choose which to accept. (Art 1217, Par 1)
- Each creditor may renounce his right even against the will of the debtor, and the latter need not thereafter pay the obligation to the former.

In case of novation, compensation, confusion, remission by a creditor

- Novation, compensation, confusion or remission of the debt, made by any of the solidary creditors OR with any of the solidary debtors, shall *extinguish* the obligation, without prejudice to the provisions of Art 1219 i.e. responsibility of a solidary co-debtor with respect to reimbursement prior to his remission (Art 1215 Par 1)

ii. Solidary co-creditor/s

In case of novation, compensation, confusion, remission

- The creditor who may have executed any of these acts, as well as he who collects the debt, shall be *liable to others for the share* in the obligation corresponding to them (Art 1215 Par 2)
 - Remission done by several but not all of the creditors: those who made it do not have action against each other, but all of them liable for the share of one who does not remit

Prejudicial acts prohibited

- Each one of the solidary creditors may do whatever is useful to the others, but not anything which may be prejudicial to the latter. (Art 1212)
 - E.g. remission, novation, compensation and merger/confusion
 - Take note that the same act is permitted by Art 1215, wherefore Tolentino concludes that the provision is "unhappily inaccurate".
 - To harmonize with Art 1215: The prejudicial acts are valid as to the debtor, but not with respect to the co-creditors whose rights subsists and can be enforced against the creditor who performed prejudicial acts

Assignment of rights not allowed

- Solidary creditor cannot assign his rights without the consent of others (Art 1213)

- Why? As a solidary creditor, he is an agent of others, cannot assign that agency without the consent of his principals. Implies mutual confidence may take into account the personal qualification of each creditor.
- Assignment of rights allowed as to co-creditor

b. SOLIDARY DEBTOR in relation to:

i. Common creditor

Obligation to perform

- Each one of the solidary co-debtor is bound to render entire compliance with the prestations (Art 1207)

In case of novation, compensation, confusion, remission by a creditor

- Extinguishes the obligation without prejudice to the responsibility of a solidary co-debtor with respect to reimbursement prior to his remission (Art 1215 Par 1)

ii. Solidary co-debtor

In case of payment by a co-debtor

- Payment by one of the solidary co-debtors extinguishes the obligation. (Art 1217, Par 1)
- Solidary co-debtor who paid may reimburse from his co-debtors only the share which corresponds to each, with the interest for the payment already made, but if the payment is made before debt is due, no interest for the intervening period may be demanded. (Art 1217, Par 3)
 - Converted into a Joint Obligation as to co-debtors, but no real case of subrogation because the old one is extinguished and the new one is created
 - Partial payment: may recover only insofar as the payment exceeded his share of the obligation
- When one of the solidary debtors is insolvent and cannot reimburse, his share will be borne by all his co-debtors in proportion to the debt of each. (Art 1217, Par 3)
- Payment by co-debtor does not entitle him to reimburse from co-debtors if such payment is made after the obligation has prescribed or become illegal. (Art 1218)
 - Also applies to prior total remission in favor of one debtor
- The remission made by the creditor of the share which affects one of the solidary debtors does not release the latter from his responsibility towards the co-debtors, in case debt had been totally paid by anyone of them before remission was effected. (Art 1219)
 - Applies when one of the debtors has already paid the obligation in full (in such a case, the obligation as to the creditor is already extinguished and nothing more to remit even partially)
 - Relationship of the creditor with the solidary debtor does not extend to the relationship among solidary co-debtors
- The remission of the whole obligation, obtained by one of the solidary debtors, does not entitle him to reimbursement from his co-debtors. (Art 1220)

In case of fortuitous event

- If the thing has been LOST OR if the prestation has become IMPOSSIBLE *without the fault* of the solidary debtors, the obligation shall be extinguished (Art 1221, Par 1)
- If there was fault on the part of any one of them, ALL shall be responsible to the creditor, for the price and payment of damages and interests, without prejudice to their action against the guilty or negligent debtor. (Art 1221, Par 2)
 - Guilty creditor who pays indemnity cannot recover from his co-debtors.
 - Other co-debtors who pay the indemnity can recover the *full amount* from the *guilty* co-debtor.
- If through a *fortuitous event*, the thing is LOST or the performance of the prestation has become IMPOSSIBLE after one of the solidary debtors has incurred in delay through the judicial or extra-judicial demand upon him by creditor, the provisions of the preceding paragraph shall apply. (Art 1221, Par 3)

LOST or IMPOSSIBLE without fault / fortuitous event	Obligation is extinguished
LOST or IMPOSSIBLE with fault of any one	All liable for damages and interest, but co-debtors have right against guilty debtor

LOST or IMPOSSIBLE without fault / fortuitous event but after any one <i>incurred in delay</i>	All liable for damages and interest, but co-debtors have right against guilty debtor
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Cases:

- Jaucian v Querol
- RFC v CA
- Quiombing v CA
- Inciong v CA

DEFENSES AVAILABLE TO A SOLIDARY DEBTOR AGAINST THE CREDITOR

Art 1222 A solidary debtor may, in actions filed by the creditor, avail himself of all defense which are of four types:

1. Those derived from the nature of the obligation
 - Connected with the obligation and derived from its nature
 - Constitutes a total defense
 - E.g. non-existence of the obligation because of illicit cause, object or absolute simulation, nullity due to defect in capacity or consent of all the debtors (minority, fraud or violence), unenforceability because of lack of proper proof under the Statute of Fraud, non-performance of suspensive condition or non-arrival of period affecting the entire obligation, extinguishment of the obligation such as by payment and remission, all other means of defense which may invalidate the original contract
 - Sir Labitag: Look for these things because it will give you a total defense:
 - i. Vices of consent
 - ii. Cause of action has prescribed
 - iii. Entire obligation is void
 - iv. Voidable at the instance of "all of them", BUT if just one, you can use the defense as well
2. Personal defenses
 - Total defense e.g. minority, insanity, fraud, violence, intimidation (sufficient causes to annul consent)
 - Partial defense e.g. special terms or conditions affecting his part of the obligation
3. Defenses pertaining to his share
 - Partial defense
 - E.g. my share is not yet due, so you can only compel me to give the share of the co-debtors
4. Those personally belonging to the other co-debtors □ avail himself thereof only as regards that part of the debt for which the latter are responsible
 - Partial defense only for the debtor-defendant
 - E.g. the co-debtor's share is not yet due, so you can only compel me to give my share

EFFECTS OF THE DEFENSES

1. If derived from the nature: all the solidary co-debtors are benefited
2. If personal one: only him benefited (exclusively)
3. If personally to the co-debtor: partial defense

Cases:

- Inchausti v Yulo *supra*
- Alipio v CA

JOINT INDIVISIBLE OBLIGATIONS

Concept Their tie is joint, but the performance is indivisible. One in which the object of the object or prestation is indivisible, not susceptible of division; while the tie between the parties is joint, that is liable only to a proportionate share. (Art 1209)

- Several creditors or debtors but the prestation is indivisible, obligation is joint unless solidary has been stipulated
- Midway between *joint* (no creditor can do prejudicial acts to others, no debtor can be made to answer for the others) and *solidarity* (fulfillment requires the concurrence of all the debtors, collective action is expressly required for prejudicial acts)

- Sir Labitag's example: obligation to assemble a jeepney between three different specialist: mechanic, welder, upholsterer or car painter.

Indivisibility distinguished from solidarity

Art 1210 The indivisibility of an obligation does not necessarily give rise to solidarity. Nor does solidarity of itself imply indivisibility.

INDIVISIBILITY	SOLIDARITY
Each creditor cannot demand more than his share and each debtor is not liable for more than his share	Each creditor may demand the full prestation and each debtor has the duty to comply with the entire prestation
Indivisibility refers to the prestation that is not capable of partial performance	Solidarity refers to the legal tie or vinculum defining the extent of liability
Only the debtor guilty of breach of obligation is liable for damages, thereby terminating the agency	All of the debtors is liable for the breach of obligation committed by any one of the debtors
Can exist even if there is only one debtor or only one creditor	Can only exist when there is at least creditor or debtors (requires plurality of subjects)
The other debtors are not liable in case of insolvency of one debtor	The other debtors are proportionately liable in case of insolvency of one debtor

Effects of Joint Indivisible Obligation

Art 1209 If the division is impossible, the right of the creditors may be prejudiced only by their collective acts

1. Creditors prejudiced only by their collective acts
2. Co-debtors not liable for the share of the insolvent debtor
3. Creditor must proceed against all the joint debtors, because the compliance of the obligation is possible only if all the joint debtors would act together.
4. If one of the debtors cannot comply, the obligation is converted into monetary consideration (liability for losses and damages). One who is ready and willing to comply will pay his proportionate share plus damages when his financial condition improves.
5. Debtor must deliver to all the creditors. If he delivers to only one, liable for non-performance as to other creditors. Damages are divisible and each creditor can recover separately his proportionate share.

Liability for damages in case of breach

Art 1224 A joint indivisible obligation gives rise to indemnity for damages from the time anyone of the debtors does not comply with his undertaking. The debtors who may have been ready to fulfill their promises shall not contribute to the indemnity beyond the corresponding portion of the price of the thing or of the value of the service which the obligation consists.

1. Gives rise to indemnity for damages, non-compliance with undertaking
2. Debtors ready to fulfill shall not be liable

V. DIVISIBLE AND INDIVISIBLE OBLIGATION – performance of the prestation and not to the thing which is the object thereof

DIVISIBLE OBLIGATIONS

Concept One which is susceptible of partial performance; debtor can legally perform the obligation by parts and the creditor cannot demand a single performance of the entire obligation.

- **DIVISIBILITY OF THINGS** different from **DIVISIBILITY OF OBLIGATIONS**
 - *Divisible Thing*: When each one of the parts into which it is divided forms a *homogenous and analogous* object to the other parts as well as to the thing itself
 - *Indivisible Thing*: When if divided into parts, its value is *diminished disproportionately*
- **Test of Divisibility**
 1. Will or intention of the parties
 2. Objective or purpose of the stipulated prestation
 3. Nature of the thing
 4. Provisions of law affecting the prestation

Effects of Divisible Obligations

1. Art 1223 The divisibility or indivisibility of the things that are the object of obligations in which there is only one debtor and only one creditor does *not alter or modify* the provisions of Chapter 2 of this Title (Nature and Effect of Obligations).
2. Art 1233 A debt shall not be understood to have been paid unless the thing or service in which the obligation consists has been *completely delivered or rendered* as the case may be.

INDIVISIBLE OBLIGATIONS

Concept Whatever may be the nature of the thing which is the object thereof, when it cannot be validly performed in parts.

Distinguished from Solidary Obligations

<i>INDIVISIBILITY</i>	<i>SOLIDARITY</i>
Each creditor cannot demand more than his share and each debtor is not liable for more than his share	Each creditor may demand the full prestation and each debtor has the duty to comply with the entire prestation
Indivisibility refers to the prestation that is not capable of partial performance	Solidarity refers to the legal tie or vinculum defining the extent of liability
Only the debtor guilty of breach of obligation is liable for damages, thereby terminating the agency	All of the debtors is liable for the breach of obligation committed by any one of the debtors
Can exist even if there is only one debtor or only one creditor	Can only exist when there is at least creditor or debtors (requires plurality of subjects)
The other debtors are not liable in case of insolvency of one debtor	The other debtors are proportionately liable in case of insolvency of one debtor

Kinds of Indivisible Obligations**NATURAL**

Art 1225 Par 1 For the purposes of the preceding articles, *obligations to give definite things* and those which are *not susceptible of partial performance* shall be deemed to be indivisible.

1. Obligation to give definite things
2. Not susceptible of partial performance

LEGAL

Art 1225 Par 3 However, even though the object or service may be physically divisible, an obligation is indivisible if *so provided by law* or intended by parties.

CONVENTIONAL

Art 1225 Par 3 However, even though the object or service may be physically divisible, an obligation is indivisible if *so provided by law* or *intended by parties*.

Presumptions in Indivisible Obligations**OF INDIVISIBILITY**

Art 1225 Par 1 For the purposes of the preceding articles, *obligations to give definite things* and those which are *not susceptible of partial performance* shall be deemed to be *indivisible*.

- Presumption of indivisibility also applies in obligations to do

OF DIVISIBILITY

Art 1225 Par 2 When the obligation has for its object the execution of certain number of days of work, the accomplishment of work by metrical units or analogous things which by their nature are susceptible of partial performance, shall be divisible.

Divisibility and indivisibility in obligations not to do

Art 1225 Par 4 In obligations not to do, divisibility or indivisibility shall be determined by the *character of the* prestation in each particular case.

Effects of Indivisible Obligations

1. Art 1223 The divisibility or indivisibility of the things that are the object of obligations in which there is only one debtor and only one creditor does *not alter or modify* the provisions of Chapter 2 of this Title (Nature and Effect of Obligations).
2. Art 1233 A debt shall not be understood to have been paid unless the thing or service in which the obligation consists has been *completely delivered or rendered* as the case may be.
 - a. EXCEPTIONS:
 - a. Obligation has been substantially performed in good faith (Art 1234)
 - b. When the creditor accepts performance, knowing its completeness, and without protest, the obligation is deemed fully performed (Art 1235)
3. Art 1224 A joint indivisible obligation gives rise to indemnity for damages from the time anyone of the debtors does not comply with his undertaking. The debtors who may have been ready to fulfill their promises shall not contribute to the indemnity beyond the corresponding portion of the price of the thing or of the value of the service which the obligation consists.
4. See *Joint Indivisible Obligations*

Cessation of Indivisibility

- a) *Natural Indivisibility*: conversion of the obligation to pay damages
- b) *Conventional/Legal Indivisibility*: novation, death of creditor (division among heirs)

Entire and Severable Contracts – depends upon the consideration to be paid, not upon its object

- Not in the syllabus but Sir mentioned in passing during lecture
- ENTIRE – consideration is entire and single; e.g. Sir Labitag: yearly subscription to Herald Tribune
- SEVERABLE – consideration is expressly or by implication apportioned; e.g. part to be performed by one party consists in several distinct and separate items, and the price is apportioned to each of them

VI. OBLIGATIONS WITH A PENAL CLAUSE

Concept An accessory undertaking to assume greater responsibility in case of breach. Attached to an obligation to insure performance.

- “Ad terrorem clause”
- Generally a sum of money, but can be any other thing stipulated by the parties, including an act or abstention
- Double function: (1) provide for liquidated damages and (2) strengthen the coercive force of the obligation by the treat of greater responsibility in the event of breach
- Mere non-performance of the principal obligation gives rise to damages
- PENAL CLAUSE constitutes an exception to the general rules on the recovery of losses and damages.

PRINCIPAL OBLIGATION	ACCESSORY OBLIGATION
Can stand alone, independent of other obligations	Attached to the principal in order to complete it or take their place in case of breach

OBLIGATIONS WITH A PENAL CLAUSE	CONDITIONAL OBLIGATION
There is already an existing obligation (the principal) from the very beginning	No obligation before the suspensive condition happens, it is the fulfillment of the condition that gives rise to the obligation
Accessory obligation (penalty) is dependent upon non-performance of the principal obligation	Principal obligation itself is dependent upon an uncertain event

OBLIGATIONS WITH A PENAL CLAUSE	ALTERNATIVE OBLIGATION
Only one prestation and it is only when this is not performed that the penal clause is enforceable	Two or more obligations are due, but fulfillment of one of them is sufficient
Impossibility of the principal obligation also extinguishes the penalty	Impossibility of one of the obligations, without the fault of the debtor, still leaves the other subsisting
He cannot choose to pay the penalty to relieve himself of the principal obligation, unless that right is expressly granted to him	The debtor can choose which prestation to fulfill

OBLIGATIONS WITH A PENAL CLAUSE	FACULTATIVE OBLIGATION
Payment of the penalty in lieu of the principal can be made only	Power of the debtor to make substitution is absolute

by express stipulation	
Creditor may demand both prestation as long as such right is granted to him (i.e. complementary penalty)	Creditor can never demand both prestations

OBLIGATIONS WITH A PENAL CLAUSE	GUARANTY
	Contract by virtue of which a person, called the guarantor, binds himself to fulfill the obligation of the principal debtor in case the latter should fail to do so.
SIMILARITIES <ol style="list-style-type: none"> 1. They are both intended to insure the performance of the principal obligation. 2. They are both accessory and subsidiary obligations. 3. Can be both assumed by a third person. 	
To pay the penalty is different from the principal obligation	The object of the obligations of the principal debtor and the guarantor is the same.
Principal obligation and the penalty can be assumed by the same person.	Principal debtor cannot be the guarantor of the same obligation
Penalty is extinguished by the nullity of the principal obligation, except when the penal clause is assumed by a third person	Guaranty subsists even when the principal obligation is voidable or unenforceable or is a natural one. However, if the penal clause is assumed by a third person, the same principle will apply as in the case of a guaranty.

Kinds of Penal Clause

1. As to effect

SUBSIDIARY – only the penalty may be enforced

- Presumed in Art 1227: “Cannot demand the fulfillment of the obligation and the satisfaction of the penalty at the same time”

COMPLEMENTARY – both principal obligation and penalty may be enforced

- Only occurs by express stipulation of the parties

2. As to source

CONVENTIONAL – by express stipulation of the parties

LEGAL – by law

3. As to purpose

PUNITIVE – the right to damages, besides the penalty subsists; the question of indemnity for damage is not resolved, but remains subsisting

- Only occurs by express stipulation of the parties
- Sir Labitag: value of the penal clause is much more than the value of the principal, it's purpose is to bludgeon the debtor into performing the obligation
- The Courts are authorized to reduce the damages if:
 - They find that the breach was not one that is wanton (noodles) or done in callous disregard for the rights of the creditor
 - Treble damages

REPARATORY – substitutes the damages suffered by creditor; the matter of damages is generally resolved, and it represents the estimate of the damages that a party might suffer from non-performance of the obligation, thereby avoiding the difficulties of proving such damages

- Presumption in Art 1226, Par 1: “Shall substitute the indemnity for damages and the payment of interests in case of non-compliance”
- Sir Labitag: pre-agreed measure prior to the breach
- Cases when damages and interest may be recovered in addition to the penalty
 1. There is an express provision to that effect
 2. Debtor refuses to pay the penalty
 3. Debtor is guilty of fraud in the non-fulfillment of the obligation

Demandability of penalty

Art 1226 Par 2 The penalty may be enforced only when it is demandable in accordance with the provisions of Code.

- a. Only when the non-performance is due to the fault or fraud of the debtor
- b. Non-performance gives rise to the presumption of fault □ creditor does not need to prove the fault of the debtor. Burden of proof for the excuse on the debtor. (Art 1228)
- c. When creditor elected fulfillment but the same has become impossible (Art 1227)
 - HOWEVER, penalty not enforceable when the principal obligation becomes IMPOSSIBLE:
 - Due to fortuitous event
 - Because the creditor prevents the debtor from performing the principal obligation

Effects of penal clause

1. Substitute for indemnity for damages and payment of interest (Art 1226)
EXCEPTION: Unless there is a stipulation to the contrary e.g. becomes a facultative obligation

Cases:

- Makati Development Corporation v Empire Insurance
 - Tan v CA
 - Country Bankers Insurance v CA
2. Not exempt debtor from performance – penalty is not a defense for leaving obligation unfulfilled
Art 1227 The debtor cannot exempt himself from the performance of the obligation by paying the penalty
EXCEPTION: Where this right to substitute penalty has been expressly reserved for him
 3. Creditor cannot demand both performance and penalty at the same time
Art 1227 Neither can the creditor demand the fulfillment of the obligation and the satisfaction of the penalty at the same time”
EXCEPTION: Unless this right has been clearly granted him
 4. Creditor cannot collect other damages in addition to penalty
Art 1226 Substitute the indemnity for damages and the payment of interest in case of non-fulfillment *
EXCEPTIONS:
 1. There is an express provision to that effect
 2. Debtor refuses to pay the penalty
 3. Debtor is guilty of fraud in the non-fulfillment of the obligation

When penalty shall be equitably reduced

Art 1229 The judge shall equitably reduce the penalty when the principal obligation has been partly or irregularly complied with by the debtor. Even if there is no performance, the penalty may also be reduced by the courts if it is iniquitous or unconscionable.

- “Partial” – quantity or extent of fulfillment
- “Irregular” – form of fulfillment
- Only applies to penalties prescribed in contracts and not to collection of the surcharge on taxes that are due, which is mandatory on the collector

Effects of Nullity of Principal Obligation or Penal Clause

Art 1230 The nullity of the penal clause does not carry with it that of the principal obligation. The nullity of the principal obligation carries with it that of the penal clause.

GENERAL RULES:

1. Nullity of principal obligation Also nullifies the penal clause
 - EXCEPTIONS: Penal clause may subsist even if the principal obligation cannot be enforced
 - When the penalty is undertaken by a 3rd person precisely for an obligation which is unenforceable, natural or voidable □ assumes a form of guaranty which is valid under Art 2052

- Nullity of principal obligation itself gives rise to liability of debtor for damages e.g. vendor knew that the thing was *inexistent* at the time of the contract, vendor becomes *liable* for the damages although contract itself is void
2. Nullity of penal clause Does not affect the principal obligation
- In the case of non-performance, damages shall be determined by the same rules as if no penalty had been stipulated
 - Penal clause may be void because it is contrary to law, morals, good customs, public order or public policy
 - Rationale: Penalty is merely an accessory to the principal obligation

Chapter IV. Extinguishment of Obligations

I. Modes of Extinguishment

Art 1231 Obligations are extinguished:

- A. Payment or performance – most natural way of extinguishing obligation
- B. Loss of the thing due or Impossibility of performance
- C. Condonation or Remission of the debt
- D. Confusion or Merger of the rights of the creditor and debtor
- E. Compensation
- F. Novation
- G. Other causes of extinguishment of obligations
 - Annulment
 - Rescission
 - Fulfillment of resolutive condition
 - Proscription
- H. Additional miscellaneous causes from Sir Labitag and Tolentino
 - Arrival of resolutive period
 - Compromise
 - Mutual dissent (opposite of mutual agreement)
 - Death – extinguishes obligations which are of a purely personal character, apart from its extinctive effect in some contracts such as partnership and agency
 - Renunciation by the creditor
 - Abandonment e.g. Art 662 (abandonment of interest in a party wall) and abandonment of a vessel under the code of commerce
 - Insolvency – does not extinguish obligation unless judicially declared and a discharge was given him.

II. Payment or Performance

CONCEPT Fulfillment of the prestation due, a fulfillment that extinguishes the obligation by the realization of the purposes for which it was constituted.

- Juridical act which is VOLUNTARY, LICIT, and MADE WITH THE INTENT TO EXTINGUISH THE OBLIGATION
- Requisites of a Valid Payment
 1. Person who pays
 2. Person to whom payment is made
 3. Thing to be paid
 4. Manner, time and place of payment
- Kinds of Payment
 - a. Normal debtor voluntarily performs the prestation stipulated
 - b. Abnormal when debtor is forced by means of judicial proceeding, either to comply with the prestation or pay indemnity
- Why do you pay? Bigger consequences if you don't pay, the creditor will file action for collection then the sheriff will levy upon your other properties
- What are the elements/ characteristics of a valid payment?
 1. *Identity* – what is to be paid, payment should be the very same obligation/prestation promised to be performed/not performed

2. *Integrity* – how payment should be made, it should be complete (not only specific thing but all of its accessions and accessories)

- Can anybody pay? YES, as long as his payment has integrity and identity and the creditor accepts it as a valid tender of payment

1. Who can pay

a. *In general* (creditor cannot refuse valid tender of payment)

1. Debtor
2. Anyone acting on his behalf
 - a. Duly authorized agent or representatives
 - b. Heirs (means that debtor is dead, if alive, they would be third persons interested in obligation)
 - c. Successors in interest and assignees

b. *Third person who is an INTERESTED PARTY* (creditor cannot refuse valid tender of payment)

Meaning of *INTERESTED PARTY* – interested in the extinguishment of the obligations such as

- Co-debtors
- Sureties
- Guarantors
- Owners of mortgaged property or pledge

Art 1302 (3) When even *without* the knowledge of the debtor, a person *interested in the fulfillment* of the obligation pays, *without prejudice* to the effects of confusion as to the latter's share.

Effects of Payment by 3rd Person – Interested

1. Valid payment; obligation extinguished
2. Debtor to reimburse fully 3rd person interested
3. 3rd person subrogated to the rights of the creditor

c. *Third person who is NOT AN INTERESTED PARTY but WITH CONSENT of debtor*

Art 1302 (2) When a third person, not interested in the obligations, pays with the express or tacit approval of the creditor.

Art 1236 Par 1 The creditor is not bound to accept payment or performance by a third person who has no interest in the fulfillment of the obligation, unless there is a stipulation to the contrary.

Effects of Payment by 3rd Person – Not Interested – With Debtor's Consent

1. 3rd person is entitled to full reimbursement
 - Demand from the debtor what he has paid
2. Legal subrogation (novation) – 3rd person is subrogated/steps into the shoes of creditor
 - Payor can exercise all the rights of the creditor arising from the very obligation itself, whether against the debtor or third person
3. Creditor may refuse to accept payment

d. *Third person who is NOT AN INTERESTED PARTY and WITHOUT THE KNOWLEDGE OR AGAINST THE WILL OF THE DEBTOR*

Art 1236 Par 1 The creditor is not bound to accept payment or performance by a third person who has no interest in the fulfillment of the obligation, unless there is a stipulation to the contrary.

Art 1236 Par 2 Whoever pays for another may demand from the debtor what he has paid, except that if he paid without the knowledge or against the will of the debtor, he can recover only insofar as the payment has been beneficial to the debtor.

Art 1237 Whoever pays on behalf of the debtor without the knowledge or against the will of the latter, cannot compel the creditor to subrogate him in his rights, such as those arising from a mortgage, guaranty or penalty.

Effects of Payment by 3rd Person – Not Interested – Without Knowledge or Against the Will

1. 3rd person can only be reimbursed insofar as payment has been beneficial to debtor
 - Burden of proof of payment on the 3rd person
 - Benefit to the creditor need not be proved in the following cases:

- a. If after the payment, the third person acquires the creditor's right
 - b. If the creditor ratifies the payment to the third person
 - c. If by the creditor's conduct, the debtor has been led to believe that the third person had authority to receive the payment
 - d. Assignment of credit without notice to debtor (Art 1626)
2. 3rd person cannot compel creditor to subrogate him in the latter's rights

- e. *Third person who does NOT INTEND TO BE REIMBURSED* □ DEBTOR MUST GIVE CONSENT
Art 1238 Payment by third person who does not intend to be reimbursed by the debtor is *deemed to be a donation*, which requires the debtor's consent. But the payment is in any case *valid as to the creditor* who has accepted it.

Effects of Payment by 3rd person – Interested or not – Does not intend to be reimbursed

- 1. Payment is deemed as a donation/offer of donation
- 2. Donation must be in proper form (i.e. if above P5K it must be in writing)

- f. *In obligation to give*

Art 1239 In obligation to give, payment made by one who does *not* have free *disposal* of the thing due and capacity to alienate it shall *not* be *valid*, without prejudice to the provisions of Art 1427 under Title on Natural Obligations.

Art 1427 When a minor 18-21 entered into a contract without the consent of the parent or guardian, voluntarily pays a sum of money or delivers a fungible thing in fulfillment of an obligation, there shall be *no right to recover* the same from the obligee who has spent or consumed it in good faith.

Effect of Incapacity of the payor

- 1. No free disposal and no capacity to alienate
 - Payment is invalid, but without prejudice to natural obligations
- 2. Minor who entered contract without consent of parent/guardian
 - No right to recover fungible thing delivered to the creditor who spent or consumed it in good faith

- g. *In case of active solidarity*

Art 1214 The debtor may pay any one of the solidary creditors, but if any demand, judicial or extrajudicial has been made by one of them, payment should be made to him.

2. To whom payment can be made

- a. *In general*

Art 1240 Payment shall be made to the person *in whose favor* the obligation has been constituted, or his *successor in interest*, or any person *authorized* to receive it.

- 1. Creditor/person in whose favor obligation was constituted
- 2. His successor in interest
- 3. Any person authorized to receive it

Payment to a wrong third party

GENERAL RULE: Not valid, obligation is not extinguished, even if in good faith of the debtor

EXCEPTION:

- 1. Extinguished if the mistake is imputable to the fault or negligence of the creditor (*PAL v CA*)
- 2. Payment in good faith to person in possession of credit (Art 1242)

Incapacitated person

Art 1241 Par 1 Payment to a third person incapacitated to administer his property shall be valid if he has kept the thing delivered or insofar as the payment has been beneficial to him.

GENERAL RULE: Payment not valid

EXCEPTION - When *payment to an incapacitated person is valid*:

- a) If creditor has kept the thing delivered
- b) Insofar as payment benefited creditor
 - *Benefit to the creditor need not be proved* in the following cases:

- e. If after the payment, the third person acquires the creditor's right
- f. If the creditor ratifies the payment to the third person
- g. If by the creditor's conduct, the debtor has been led to believe that the third person had authority to receive the payment
- h. Assignment of credit without notice to debtor (Art 1626)

b. *Third person*

Art 1241 Par 2 Payment to a third person shall also be valid insofar as it has redounded to the benefit of the creditor.

GENERAL RULE: VALID if third person proves that it redounded to creditor's benefit; otherwise VOID
EXCEPTION; *When proof of benefit not required* □ also applicable to INCAPACITATED PERSONS

Art 1241 Par 3 Such benefit to the creditor need not be proved in the following cases:

1. If after the payment, the third person acquires the creditor's right
2. If the creditor ratifies the payment to the third person
3. If by the creditor's conduct, the debtor has been led to believe that the third person had authority to receive the payment
4. Assignment of credit without notice to debtor (Art 1626)
5. Payment in good faith to any person in *possession of the credit* shall release the debtor (Art 1242) □
EFFECT: Debtor is released

Art 1243 Debtor pays creditor after being judicially ordered to retain debt

EFFECT: Payment not valid if the property is attached or garnished

c. *In case of active solidarity*

Art 1214 The debtor may pay any one of the solidary creditors, but if any demand, judicial or extrajudicial has been made by one of them, payment should be made to him.

- If no demand is made, debtor may pay to any of the solidary creditors
- If any judicial/extrajudicial demand is made by any of the creditors who made the demand

3. *What is to be paid ("identity")*

a. *In general*

- The very prestation (thing or service) due

b. *In obligations to...*

- *GIVE a specific thing*

Art 1244 Par 1 The debtor of a thing cannot compel the creditor to receive a different one, although the latter may be of the same value as, or more valuable than which is due.

1. Give specific things itself
2. Accessions and accessories
3. If with loss, improvements, deterioration □ Apply Art 1189

- *GIVE a generic thing*

Art 1246 When the obligation consists in the delivery of an indeterminate or generic thing, whose quality and circumstances have not been stated, the creditor cannot demand a thing of superior quality. Neither can the debtor deliver a thing of inferior quality. The purpose of obligation and other circumstances shall be taken into consideration.

GENERAL RULE: Creditor cannot demand a superior quality; Debtor cannot deliver a thing of inferior quality

EXCEPTION: Unless quality and circumstances have been stated, purpose and other circumstances of obligation considered.

- *Pay money*

Art 1249 The payment of debts in money shall be made in the currency stipulated, and if it is not possible to deliver such currency, then in the currency which is the legal tender in the Philippines.

The delivery of promissory notes payable to order, or bills of exchange or other mercantile documents shall produce effect of payment only when they have been cashed, or when through the fault of the creditor they have been impaired.

In the meantime, the action derived from the original obligation shall be held in abeyance.

EXCEPTION; RA 4100, RA 8183: Foreign currency if agreed to by parties

Art 1250 In case of an extraordinary inflation or deflation of the currency stipulated should supervene, the value of the currency at *the time of the establishment* of the obligation shall be the basis of the payment, unless there is an agreement to the contrary.

RA 529

RA 4100

- DO or NOT TO DO

Art 1244 Par 2 In obligations to do or not to do, an act or forbearance cannot be substituted by another act or forbearance against the obligee's will.

- Substitution cannot be done against the will of creditor

Cases:

- Arrieta v NARIC *supra*
- Kalalo v Luz
- St. Paul Fire and Marine Insurance v Macondray
- Papa v AV Valencia et al
- PAL v CA

c. *Payment of interest*

Art 1956 No interest shall be due unless it has been expressly stipulated in writing.

Art 1253 Interest must be satisfied first before capital

4. *How is payment to be made ("integrity")*

a. *In general*

Art 1233 A debt shall not be understood to have been paid unless the thing or service in which the obligation consists has been *completely delivered or rendered* as the case may be.

GENERAL RULE: Partial payment is not allowed □ Creditor cannot be compelled to receive partial prestations; Debtor cannot be compelled to give partial payments

EXCEPTIONS:

1. Contrary stipulation

- Art 1248 Par 1 Unless there is an *express stipulation to that effect*, the creditor cannot be compelled partially to receive the prestations, in which the obligation consists. Neither may the debtor be required to make partial payments.

2. Debt is partly liquidated and partly unliquidated

- Art 1248 Par 2 However, when the debt is *in part liquidated and in part unliquidated*, the creditor may demand and the debtor may effect the payment of the former without waiting for the liquidation of the latter.

3. When there are several subjects/parties are bound under different terms and conditions

4. Compensation

b. *Substantial performance in good faith*

Art 1234 If the obligation has been substantially performed in good faith, the obligor *may recover as though there had been a strict and complete fulfillment*, less damages suffered by the obligee.

- *Requisites of Substantial Performance*

1. *Attempt in good faith to perform, without any willful or intentional departure*
2. *Deviation from the obligation must be slight*
3. *Omission or defect is unimportant and technical*
4. *Must not be so material that intention of the parties is not attained*

c. *Estoppel*

Art 1235 When obligee *accepts* the performance, knowing its incompleteness or irregularity, and without expressing any protest or objection, the obligation is deemed *fully complied with*.

- Constitutes a "waiver of defect in performance" □ there must however be an intentional relinquishment of a known right. Waiver will not result from mere failure to assert a claim for defective performance when the thing or work is received

- Applies only when he knows the incompleteness or irregularity of the payment, obligation is deemed extinguished. Estopped from complaining

d. *Presumptions in payment of interests and installments*

INTEREST

Art 1176 The receipt of the principal by the creditor, without reservation with respect to the interest, shall give rise to the presumption that said interest has been paid.

Art 1253 If the debt produces interest, *payment of the principal* shall not be deemed to have been made until the *interests have been covered*.

- If principal amount is received without reservation as to interest
 □ interest is presumed to have been paid

INSTALLMENTS

Art 1176 Par 2 The receipt of a later installment of debt, without reservation as to prior installments shall likewise raise the presumption that such installments have been paid.

- If a latter installment is received without reservation to prior installments
 □ prior installments are presumed to have been paid

5. *When is payment to be made*

- When obligation is due and demandable but debtor may pay before due date if period is for the benefit of debtor. If for the benefit of both the debtor and creditor, debtor may only prior to the due date if creditor consents thereto.

a. *In general*

Art 1169 Debtor incurs in delay from the time creditor *judicially or extrajudicially demands* fulfillment of the obligation

b. *See Chapter 2: Delay*

6. *Where payment is to be made*

a. In the designated place in the obligation (Art 1251 Par 1)

b. If no place is expressly designated

Art 1251 Par 2 There being no express stipulation and if the *undertaking is to deliver a determinate thing* the *payment shall be made wherever the thing might be at the moment the obligation was constituted*.

Art 1251 Par 3 In any other case (not to deliver a determinate thing), the *place of payment* shall be at the *domicile of the debtor*.

Art 1251 Par 4 If the debtor changes his domicile in bad faith, or after he has incurred in delay, the *additional expenses* shall be borne by *him*. (Absent such circumstances, it will be borne by the creditor)

7. *Expenses of making payment*

Art 1247 Unless it is otherwise stipulated, the extra-judicial expenses required by the payment shall be for the account of the *debtor* with regard to the *judicial costs*, the Rules of Court shall govern.

SPECIAL FORMS OF PAYMENT

APPLICATION OF PAYMENTS

Art 1252 He who has *various debts* of the *same kind* in favor of *one and the same creditor*, may declare at the time of making the payment, to which of them the *same* must be applied. **UNLESS** the parties so stipulate, or when the

application of payment is made by the party for whose benefit the term has been constituted, application shall not be made as to debts that are not yet due.

If the debtor accepts from the creditor a receipt in which an application of the payment is made, the former cannot complain of the same, UNLESS there is a cause for invalidating the consent.

Concept Designation of the debt which is being paid by a debtor who has SEVERAL OBLIGATIONS OF THE SAME KIND, in favor of one creditor to whom payment is being made

Cases:

- Reparations Commissions v Universal Deep Sea Fishing
- Paculdo v Regalado

Requisites for Application of Payment

1. Same debtor
2. Same creditor
3. Various debts are of same kind, generally monetary character
 - Cannot apply to prestation to give specific thing
 - Can apply to prestation to give generic thing
4. All obligations must be due
 - EXCEPTIONS:
 - Mutual agreement of parties
 - upon consent of the party in whose favor the term was established
5. Payment is not enough to extinguish all debts
6. Debtor has preferential right to choose the debt which his payment is to be applied
 - Not absolute; LIMITATIONS:
 - Cannot make partial payments
 - Cannot apply to unliquidated debts
 - Cannot choose a debt whose period is for the benefit of the creditor, and period has not yet arrived
 - Right to apply debts must be exercised at the time when debt is paid

Rules in Application of Payment

1. Right to apply must be exercised at the time of the payment (Art 1252)
2. Creditor may undertake application, subject to the debtor's approval. Once the latter accepts receipt of application, he cannot complain UNLESS there is a cause for invalidating the contract. (Art 1252)
3. Apply to interest first. BOTH (1) interest stipulated and (2) interest due because of debtor's delay
Art 1253 If debt produces interest, payment of the principal shall not be deemed to have been made until the interest are covered.

If rules are inapplicable and application cannot be inferred

Art 1254 When payment cannot be applied in accordance with preceding rules, or if application can not be inferred from other circumstances, the debt which is **MOST ONEROUS TO THE DEBTOR** among those due, shall be deemed to have been satisfied.

If the debts are of the same nature and burden, the payment shall be applied to all of them proportionately.

Meaning of "MOST ONEROUS TO DEBTOR"

- Fundamentally a question of fact, which courts must determine on the basis of circumstances of each case eg.
 - Co-debtor (especially if solidary) vs. sole debtor
 - Same amount, younger vs. older
 - Secured vs. unsecured

PAYMENT BY CESSION

Art 1255 The debtor may cede or assign his property to his creditors in payment of his debts. This cession, UNLESS there is stipulation to the contrary, shall only release the debtor from responsibility for the *net proceeds of the thing* assigned. The agreements which on the effect of the cession, are made between the debtor and his creditors shall be governed by law.

Concept Abandonment of the universality of the property of the debtor for the benefit of his creditors, in order that such property may be applied to the payment of his credits.

- Debtor transfers all the properties not subject to execution in favor of creditors that the latter may sell them and thus apply the proceeds to their credits
- Initiative comes from the debtor but must be accepted by the creditors in order to become effective
- Usually done by debtors in state of insolvency

Requisites for Payment by Cession

1. Plurality of debts
2. Plurality of creditors
3. Complete or partial insolvency of the debtor
4. Abandonment of all debtor's property not subject to execution
5. Acceptance or consent on the part of the creditors

Effects of Payment by Cession

1. Creditors do not become the owner; they are merely *assignees* with authority to sell
2. Debtor is released up to the amount of the net proceeds of the sale, unless there is a stipulation to the contrary □ not total extinguishment
3. Creditor will collect credits in the order of preference agreed upon, or in default of agreement, in order ordinarily established by law.

DATION IN PAYMENT (*Dacion en Pago*)

Art 1245 *Dation in payment, whereby property is alienated to the creditor in satisfaction of a debt in money, shall be governed by law of sales.*

Concept *Delivery and transmission of ownership of a thing by the debtor and to the creditor as an accepted equivalent of the performance of the obligation.*

- An onerous contract of alienation because object is given in exchange of credit
- Special form of payment because one element of payment is missing: "identity"

Case:

- DBP v CA

Distinguished from payment by cession

DATION IN PAYMENT	PAYMENT BY CESSION
Transfers the ownership over the thing alienated to the creditor	Only the possession and administration (not the ownership) are transferred to the creditors, with an authorization to convert the property into cash with which the debts shall be paid
May totally extinguish the obligation and release the debtor	Only extinguishes the credits to the extent of the amount realized from the properties assigned, unless otherwise agreed upon
Cession of only some specific thing	Involves ALL the property of the debtor
Transfer is only in favor of one creditor to satisfy a debt	There are various, plurality of creditors
Both are substituted performances of obligations	

Requisites for Dation in Payment

1. Consent of creditor □ sale presupposes the consent of both parties
2. Dacion will not prejudice of other creditors
3. Debtor is not declared judicially insolvent
4. Not a *pactum commissorium* (a stipulation entitling the creditor to appropriate automatically the thing given as security in case debtor fails to pay)

Effects of Dation in Payment

1. Extinguishes payment to the extent of the value at the thing to be delivered, either as agreed upon by the parties, or as may be proved, unless the parties by agreement expressly or impliedly or by their silence, consider the thing as equivalent to the obligation in which case the obligation is totally extinguished.

2. If property delivered to the creditor assumption that it is a PLEDGE, as it involves less transmission of rights unless it is clearly the intention of parties

Case:

- Filinvest Credit Corporation v Philippine Acetylene

TENDER OF PAYMENT AND CONSIGNATION

1. TENDER OF PAYMENT

Concept The act of offering the creditor what is due him together with a demand that the creditor accept the same

- When creditor refuses without just cause to accept payment, he is in mora accipiendi and debtor is released from responsibility if he consigns the thing due
- Manifestation made by debtor to creditor of desire to comply with obligation
- Preparatory act to consignment; does not cause extinguishment of obligation unless completed by consignment
- Required ONLY when the *creditor refuses without just cause to accept payment*
- What are the examples of unjust cause for refusal
 1. There was a previous tender of payment, without which the consignment is ineffective
 2. Tender of payment was of the very thing due, or in case of money obligations, that the legal tender currency was offered
 3. Tender of payment was unconditional
 4. Creditor refused to accept payment without just cause
- What are the examples of just cause for refusal
 1. Debt is not yet due and the period is for the benefit of the creditor
 2. Payment by third persons not interested in the fulfillment of the obligation □ because to begin with, tender presupposes capacity of the payor
 - 3.
- Accrual of interest will be suspended from the date of such tender if immediately deposited with the court

Requisites of a Valid Tender of Payment

1. Made in lawful currency
2. Should include interest due
3. Must be unconditional; but the creditor cannot vary the terms of a tender accepted by him
4. Unaccepted offer in writing to pay is equivalent to actual production and tender of money or property

2. CONSIGNATION

Concept The act of depositing the thing due with the court or judicial authorities whenever the creditor cannot accept or refuses to accept payment.

- Generally requires prior tender of payment
- Made by depositing the things due at the disposal of judicial authority (includes sheriff)

Purpose Avoid performance of an obligation becoming more onerous to the debtor by reasons not imputable to him

- Duty of attending indefinitely to its preservation, without remedy to be relieved from the debt

Requisites of Consignation

1. There is a debt due
2. The consignation of the obligation was made because of some legal cause
 - Previous valid tender was unjustly refused
 - Other circumstances making previous tender exempt
3. Prior notice of consignation had been given to the person interested in the obligation (1st notice)
4. Actual deposit/consignation with proper judicial authority
5. Subsequent notice of consignation (2nd notice)
 - May be complied with by the service of summons upon the defendant creditor together with a copy of the complaint
 - Given to all interested in the performance of obligations: passive (co-debtors, guarantors, sureties) or active (solidary co-creditors, possible litigants)

- a. When tender and refusal not required

Art 1256 Par 2 Consignation alone shall produce the same effect in the following cases:

1. Creditor is absent or unknown or does not appear at place of payment
2. Incapacitated to receive payment at the time it is due □ need not be legally declared
3. Without just case, he refuses to give a receipt
4. Two or more persons claim the same right to collect
5. Title of the obligation has been lost

b. Two notice requirement

FIRST NOTICE: Art 1257 Par 1 In order that the consignation of the thing due may release the obligor, it must *FIRST* be *announced to the persons interested* in the fulfillment of the obligation.

- Why?

SECOND NOTICE: Art 1258 Par 2 The *consignation having been made*, the interested parties shall also be notified thereof.

- Why?

Effects of non-compliance

Art 1257 Par 2 The consignation shall be ineffectual if it is not made strictly in consonance with the provisions which regulate payment. (*Soco v Militante*)

c. Effects of Consignation □ when properly made, charge against the creditor

Art 1260 Par 1 Once the consignation has been duly made, the debtor may ask the judge to order the cancellation of the obligation.

1. The debtor is released in the same manner as if he had performed the obligation at the time of consignation, because this produces the effect of a valid payment.
2. The accrual of interest on the obligation is suspended from the moment of the consignation.
3. The deteriorations or loss of a thing or amount consigned occurring without fault of the debtor must be borne by the creditor, because the risks of the thing are transferred to the creditor from the moment of deposit.
4. Any increment or increase in value of the thing after the consignation inures to the benefit of the creditor.

d. Withdrawal by debtor BEFORE acceptance by creditor OR approval by the Court

- Before the consignation is effected, the debtor is still the owner and he may withdraw it. (*TLG v Flores*)

Art 1260 Par 2 Before the creditor has accepted the consignation, or before a judicial declaration that the consignation has been properly made, the *debtor may withdraw the thing or sum deposited* allowing the *obligation to remain in force*.

Effects of *withdrawal* before *consignation is final*

1. Obligation remains in force
2. Debtor bears all the expenses incurred because of the consignation

e. Withdrawal by debtor AFTER proper consignation

Art 1261 If the consignation having been made, the creditor should authorize the debtor to withdraw the same, he shall *lose every preference* which he may have over the thing. The co-debtors, guarantors, and sureties shall be released.

- With creditor's approval
EFFECTS: revival of the obligation and relationship between creditor and debtor is restored to the condition in which it was before the consignation
- Without creditor's approval
EFFECTS:

f. Expenses of consignation

Art 1259 The expenses of consignment, when properly made, shall be charged against the creditor.

- Consignation is properly made when:
 - After the thing has been deposited in the court, the creditor accepts the consignment without objection and without reservation of his right to contest it because of failure to comply with any of the requisites for consignment
 - When the creditor objects to the consignment but the court, after hearing declares that the consignment has been validly made.

Cases:

- De Guzman v CA
- TLG International Continental Enterprising v Flores
- McLaughlin v CA
- Soco v Militante
- Sotto v Mijares
- Meat Packing Corp v Sandiganbayan
- Pabugais v Sahijwani

III. Loss or Impossibility

LOSS OF THE THING DUE

Concept Not limited to obligations to give but extends to those which are personal, embracing therefore all causes which may render impossible performance of the prestation.

- Generally applies to determinate things
- Must be subsequent to the execution of the contract in order to extinguish the obligation
- If impossibility already existed when the contract was made, the result is not extinguishment but inefficacy of the obligation under Art 1348 (impossible things or services cannot be object of contracts) and Art 1493 (Sales; loss object of contract, contract without any effect).

Art 1189 (2) If the thing is lost through the fault of the debtor, he shall be obliged to pay damages; it is understood that the thing is lost when it:

- a. Perishes
- b. Goes out of the commerce of man
- c. Disappears in such a way that its existence is unknown or it cannot be recovered

Kinds of Loss

- a. As to extent
 - TOTAL
 - PARTIAL

Requisites of Loss of the Thing Due

Art 1262 In order to extinguish obligation:

1. Loss or destroyed without the fault of the debtor
2. Before the debtor incurs in delay
3. After the obligation is constituted

Presumption in Loss of the Thing Due

Art 1265 Whenever the thing is lost in the possession of the debtor, it shall be presumed that the loss was *DUE TO HIS FAULT*, UNLESS there is proof to the contrary, and without prejudice to the provisions of Art 1165.

- Burden of explaining the loss of the thing in the possession of the debtor, rest upon him.

Art 1165 Action for specific performance or substituted performance

- When not applicable □ In case of *earthquake, flood, storm or other natural calamity*.

Effects of Loss of the Thing Due

- a. In obligation to give a specific thing

Art 1262 Loss or destruction of determinate thing without fault of debtor AND before he incurs in delay
EXTINGUISHES OBLIGATION

Art 1268 When the debt of a thing certain and determinate proceeds from a criminal offense, the debtor shall **NOT BE EXEMPTED** from the payment of its price, *whatever may be the cause for the loss*, **UNLESS** the thing having been offered by him to the person who should receive it, the latter refused without justification to accept it.

EXCEPTIONS:

1. Debtor is at fault i.e. in bad faith, negligence, delay
2. Debtor is made liable for fortuitous event by law, contractual stipulation or nature of obligation requires assumption of risk on part of debtor

b. *In obligation to give a generic thing* □ not extinguished

Art 1263 In an obligation to deliver a generic thing, the loss or destruction of anything of the same kind *does not extinguish* the obligation.

- *Genus nunquam perit* or "The genus never perishes"
- Sir Labitag: Fallacy! The genus may be legally loss!

EXCEPTIONS:

1. Delimited generic things: limitation of the generic object to a particular existing mass or a particular group of things; become determinate objects whose loss extinguishes the obligation
2. Generic thing has been segregated
3. Monetary obligation

c. *In case of partial loss*

Art 1264 The courts shall determine whether, under the circumstances, the *partial loss* of the object of the obligation is *so important as to extinguish the obligation*.

- Provided that partial loss is not imputable to the fault or negligence of the debtor but to fortuitous events or circumstances
- Intention of the parties is the controlling factor in the solution of each case of partial loss
- E.g. by Sir: When Tyson bit off Holyfield's ear which did not undermine the latter's boxing prowess hehe

d. *Action against third persons*

Art 1269 The *obligation having been extinguished by the loss of the thing*, the creditor shall have all *rights of action* which the debtor *may have against third person by reason of the loss*.

- Refers not only to the rights and actions which the debtor may have against third persons but also to any indemnity which the debtor may have already received.
- E.g. money paid to the debtor upon expropriation of the property which is the object of obligation; insurance received by owner of company with respect to victims of sunk vessel

IMPOSSIBILITY OF PERFORMANCE

Concept

Art 1266 The debtor in obligations to do shall also be released when the prestation becomes legally or physically impossible without the *fault* of the obligor.

- Refers to "**SUBSEQUENT IMPOSSIBILITY**" □ arises **AFTER** the obligation has been constituted. *If existing BEFORE*, the obligation constituted is under **VOID** contracts

Art 1267 When the service has become so difficult as to be *manifestly beyond the contemplation of the parties*, the *obligor may also be released therefrom, in whole or in part*.

- Doctrine of unforeseen events, "*rebus sic stantibus*" : the parties stipulate in the light of certain prevailing conditions, and once these conditions cease to exist, the contract also ceases to exist.
- **Requisites for application of Art 1267**

1. *Event or change in circumstances could not have been foreseen at the time of the execution of the contract*

2. Makes the performance of the contract extremely difficult but not impossible
3. Event must not be due to the act of any of the parties
4. Contract is for a future prestation

Kinds of Impossibility

1. As to extent

TOTAL

PARTIAL – significant in Art 1264 (extinguishment due to partial loss subject to the court's determination)

2. As to source

LEGAL

- a. Direct – prohibited by law
- b. Indirect – prevented by supervening legal duty such as military service

PHYSICAL – By reason of its nature, cannot be accomplished

Requisites of Impossibility

Art 1266

1. Obligation used to be possible at the constitution of obligation
2. Subsequent impossibility
3. Without the fault of the debtor

Effects of Impossibility

a. In obligations to do

Art 1266 releases debtor from obligation if prestations has become legally or physically impossible

Art 1267 releases debtor if performance has become so difficult to be so manifestly beyond the contemplation of the parties

Art 1262 Par 2 (by analogy) Impossibility due to fortuitous events does *not extinguish* obligation if:

- By law
- By stipulation
- Nature of the obligation requires assumption of risk

- In case of partial performance by the debtor: creditor must pay the part done so long as he benefits from such partial compliance.
- If debtor received anything from creditor prior to loss or impossibility: return anything in excess of what corresponds to the part already performed when the impossibility supervened.

Impossibility vs. Difficulty

- Manifest disequilibrium in the prestations, such that one party would be placed at a disadvantage by the unforeseen event.

Cases:

- Occena v CA
- Naga Telephone Co v CA
- PNCC v CA

b. In case of partial impossibility

Art 1264 The courts shall determine whether, under the circumstances, the partial loss of the object of the obligation is so *important* as to *extinguish the obligation*.

IV. Condonation or Remission

Concept An *act of liberality* by virtue of which, without receiving any equivalent, the creditor renounces the enforcement of obligation, which is *extinguished in its entirety or in that part or aspect of the same to which the remission refers*.

- It is an essential characteristic of remission that it be *gratuitous*, that there is no equivalent received for the benefit given; once such equivalent exists, the nature of the act changes
- Dation in payment – receive a thing different from that stipulated
 - Novation – object or principal conditions of the obligation should be changed
 - Compromise – when the matter renounced is in litigation or dispute and in exchange of some concession which the creditor receives

Kinds of Condonation

1. As to extent

TOTAL

PARTIAL – refer to the *amount* of *indebtedness*, or to *an accessory obligation* (such as *pledge* or *interest*) or to *some other aspect* of the *obligation* (such as *solidarity*)

2. As to form

Art 1270 Par 1 Condonation or remission is essentially gratuitous, and requires the acceptance by the obligor. It may be expressly or impliedly.

EXPRESS – when made formally, accordance with the forms of ordinary donations

IMPLIED – inferred from the acts of parties

Requisites of Condonation

1. Debts must be existing and demandable at the time remission is made
2. The renunciation of the debt must be gratuitous or without any equivalent or consideration
3. Debtor must accept the remission
 - Unilateral renunciation is possible under Art 6 and nothing prevents him from abandoning his rights
 - Parties must be capacitated and must consent; requires acceptance by the obligor, implied in mortis causa (effective upon the death of the creditor) and express inter vivos (effective during the lifetime of the creditor)

Case:

- Yam v CA

When formalities required

Art 1270 Par 2 One and other kind shall be subject to the rules which govern inofficious donation. *EXPRESS* condonation, shall furthermore, comply with the forms of donation.

- Bilateral acts which requires acceptance by the debtor
- Subject to the rules on donations with respect to acceptance, amount and revocation
- Formalities of a donation are required in the case of an express remission
- Revocable – subject to the rule on inofficious donation (excessive, legitime is impaired), ingratitude and condition not followed

Presumptions in Condonation

1. Art 1271 The *DELIVERY* of a private document evidencing a *credit*, made voluntarily by a creditor to the debtor, *IMPLIES* the *renunciation* of the *action* which the former had against the latter.
 - Not applicable to public documents because there is always a copy in the archives which can be used to prove the credit.
 - Surrender of weapon of enforcement of his rights
2. Art 1272 Whenever the private document in which the debt appears is found in the *POSSESSION* of the *debtor*, it shall be *presumed* that the *creditor delivered it voluntarily*, unless the contrary is proved.
 - Only prima facie and may be overcome by contrary evidence to show that notwithstanding the possession by the debtor of the private document of credit, it has not been paid.
3. Art 1274 It is presumed that the *accessory obligations of pledge* has been *REMITTED* when the *thing pledged*, after its delivery to the *creditor*, is found in the *possession* of the *debtor*, or a *third person who owns the thing*.

Effects of Condonation

1. In general □ extinguishes either totally or partially
2. In case of joint or solidary obligations □ affects the share corresponding to the debtor in whose benefit the remission was given

Governing Rules in Condonation

Art 1270 Rules in inofficious donations

Effects of Renunciation of Principal or Accessory Obligation

Art 1273 The renunciation of the principal debt shall extinguish the accessory obligations; but the waiver of the latter shall leave the former in force.

- Why? Accessory merely follows principal

V. Confusion or Merger of Rights

Concept Merger or confusion is the meeting in one person of the qualities of the creditor and the debtor with respect to the same obligation.

- Erases the plurality of subjects of the obligation and extinguishes the obligation because it is absurd that a person should enforce an obligation against himself.
- May be revoked, as a result of which the obligation is recreated in the same condition that it had when merger took place
- CAUSE OF MERGER: Anything that brings about succession to the credit e.g. debtor inherits credit from the creditor. However, cannot be the other way around because under the present law, heirs do not inherit the debts of their predecessors.

Requisites for Confusion

1. Must take place between the creditor and the principal debtor (Art 1276)
2. Very same obligation must be involved, for if the debtor acquires rights from the creditor, but not particular obligation in question, there will be no merger
3. Confusion must be total or as regards the entire obligation

Effects of Confusion

1. In general □ extinguish the obligation
2. In case of
 - *Joint obligations - Art 1277* Confusion does not extinguish a joint obligation *EXCEPT* as regards the share corresponding to the creditor or debtor in whom the two characters concur.
 - *Solidary obligations – Art 1215* "... confusion... made by any of the solidary creditors or with any of the solidary debtors shall extinguish the obligation, without prejudice to the provisions of Art 1219." (*Solidary co-debtor who has been remitted is still liable to co-debtors if one of the had paid the obligation in full prior the remission*)

Confusion in Principal or Accessory Obligation

Art 1276 Merger which takes place in the person of the principal debtor or creditor benefits the guarantors. Confusion which takes place in the person of any of the latter does not extinguish the obligation.

- Merger releases the guarantor because they are merely accessory obligations
- Guarantor acquires the credit, his obligation as guarantor is extinguished, but the principal obligation subsists which he can enforce against the debtor and other co-guarantors.
- When mortgaged property belongs to a third person, mortgagee acquires a part of the property, the same is released from the encumbrance. The obligation merely becomes a partly (if the acquisition is not total) unsecured obligation.

VI. Compensation

Concept It is a mode of extinguishing the obligation to the concurrent amount, the obligations of those persons who in their own right are reciprocally debtors and creditors of each other.

- Abbreviated payment

- Offsetting of two obligations which are reciprocally extinguished if they are of equal value or extinguished to the concurrent amount if of different values.
- Balancing between two obligations, involves a figurative operation of weighing two obligations simultaneously in order to extinguish them to the extent in which the amount of one is covered by the other.
- Payment is simplified and assured between persons who are indebted to each other.
- Although it takes place by operation of law, it must be alleged and proved by the debtor who claims its benefits. Once proved, its effect retroacts to the moment when the requisites provided by law concur.
- Distinguished from payments

PAYMENT	COMPENSATION
Capacity to dispose of the thing paid and capacity to receive are required for debtor and creditor	Such capacity is not necessary, because it takes place by operation of law and not by the acts of parties
Performance must be complete	There may be partial extinguishment of an obligation

Advantage of Compensation over Payment

1. Simple, taking effect without action by either party to extinguish their respective obligations
2. More guaranty in making the credit effective, because there is less risk of loss by the creditor due to insolvency or fraud of the creditor

Art 1278 Compensation shall take place when two persons, in their own right are creditors and debtors of each other.

Distinguished from Confusion

CONFUSION	COMPENSATION
Involves only one obligation	There must always be two obligations
There is only one person in whom the characters of creditor and debtor meet	Two persons who are mutually debtors and creditors of each other in two separate obligations, each arising from a different cause

Kinds of Compensation

1. As to extent

TOTAL – when two obligations are of the same amount

PARTIAL – when the amounts are not equal

2. As to origin

LEGAL – takes place by operation of law because all the requisites are present

VOLUNTARY/ CONVENTIONAL – when the parties agree to compensate their mutual obligations even if some requisite is lacking, such as that provided in Art 1282

Art 1279 Requisites of legal compensation is inapplicable

Art 1282 The parties may agree upon the compensation of debts which are not yet due.

- Requisites of Voluntary Compensation

1. Each of the parties can dispose of the credit he seeks to compensate
2. They agree to the mutual extinguishment of their credits

JUDICIAL – when decreed by the court in a case where there is a counterclaim e.g. defendant is the creditor of the plaintiff for an unliquidated amount, sets up his credit as a counterclaim against the plaintiff and his credit is liquidated by judgment, thereby compensating it with the credit of the plaintiff. Legal compensation is not possible because the claim is unliquidated

Art 1283 If one of the parties to a suit over an obligation has a claim for damages against the other, the former may set it off by proving his right to said damages and the amount thereof.

FACULTATIVE – when it can be claimed by one of the parties who, however, has the right to object to it, such as when one of the obligations has a period for the benefit of one party alone and who renounces that period so as to make the obligation due

- When legal compensation cannot take place for want of some legal requisites

- As compared with conventional: facultative is unilateral, while conventional depends upon agreement of both parties

LEGAL COMPENSATION

Requisites for Legal Compensation

Art 1279 In order that compensation may be proper it is necessary that:

1. Each one of the obligors be bound principally and that at the same time a principal creditor of the other
 - "Principals" not applicable if only a guarantor
 - Solidary debtor cannot set up the obligation of the creditor in favor of a co-debtor, except as regards the share of the latter
2. That both debts consists in a sum of money, or if the things due are consumable, they be of the same kind and also of the same quality if the latter has been stated
3. That the two debts are due
4. That they be liquidated and demandable
 - "Liquidated debts" – when its existence and amount are determined
 - "Demandable" - enforceable in court
 - What are not subject to compensation
 - Period which has not yet arrived
 - Suspensive condition has not yet happened
 - Obligation cannot be sued upon e.g. natural obligation
5. That over neither of them there be any retention or controversy, commenced by third persons and communicated in due time to the debtor
 - Not applicable to facultative obligations, but applicable to those with penal clause

Art 1280 Notwithstanding the provisions of the preceding article, the *guarantor* may *set up compensation as regards what the creditor may owe the principal debtor*.

- Liability of the guarantor is only subsidiary; it is accessory to the principal obligation of the debtor
- If debtor's obligation is compensated, it would mean the extinguishment of the guaranteed debt and benefits the guarantor

Cases:

- Gan Tion v CA
- Silahis Marketing Corp v IAC
- BPI v Reyes
- PNB v Sapphire Shipping
- BPI v CA
- Mirasol v CA

Effects of Legal Compensation

1. Both debts are extinguished to the concurrent amount (Art 1290)
2. Interests stop accruing on the extinguished obligations or the part extinguished
3. Period of prescription stops with respect to the obligation or part extinguished
4. All accessory obligations of the principal which has been extinguished are also extinguished
5. If a person should have against him several debts which are susceptible of compensation, the rules on application of payments shall apply to the *order of the compensation*. (Art 1289)

When compensation is not allowed

1. Depositum (Art 1287)
2. Commodatum (Art 1287)
3. Support due gratuitous title (Art 1287)
4. Civil liability arising from a penal offense (Art 1288)

Art 1287 Compensation shall not be proper when one of the debts arises from a *depositum* or from the obligations of a depositary or of a bailee in a *commodatum*.

Neither can compensation be set up against a creditor who has a claim for *support due by gratuitous title*, without prejudice to the provisions of Art 301 (support in arrears can be compensated).

- Why? A deposit is made or a *commodatum* is given on the basis of confidence of the owner. It is therefore, just that the depositary or borrower should in fact perform his obligation; otherwise the trust of the depositor or lender would be violated.

Art 1288 Neither shall there be compensation if one of the debts consists in civil liability arising from a *penal offense*.

- Why? Satisfaction of such obligation is imperative

No compensation may occur even when all the requisites concur:

1. When there is renunciation of the effects of compensation by a party □ rests upon a potestative right and unilateral declaration of renunciation is sufficient
2. When the law prohibits compensation
 - a. Art 1287 one of the debts arises from a depositum or from the obligations of a depositary or a bailee in *commodatum*
Claim for support due by gratuitous title, without prejudice to the provisions of 2nd Par, Art 3012
 - b. Art 1288 civil liability arising from a penal offense

Compensation of debts payable in different places

Art 1286 Compensation takes place by operation of law, even though the debts may be payable at different places, but there shall be an indemnity for expenses of exchange or transportation to the place of payment.

- Applies to legal compensation but not to voluntary compensation

Effects of Nullity of debts to be compensated

Art 1284 When one or both debts are rescissible or voidable, they may be compensated against each other *BEFORE* they are judicially rescinded or avoided.

Effects of Assignment of Credit

- A. Made *AFTER* compensation took place: no effect; compensation already perfected, nothing to assign at all
- Assignee is left with an action for eviction or for damages for fraud against assignor

B. Made *BEFORE* compensation took place

1. With consent of debtor □ cannot set up against assignee *UNLESS* debtor reserved his right to compensation when he gave his consent

Art 1285 Par 1 The debtor who has *consented* to the assignment of rights made by a creditor in favor of a third person, cannot set up against the assignee the compensation which would pertain to him against the assignor, *UNLESS* the assignor was notified by the debtor at the time he gave his consent, that he reserved his right to the compensation.

2. With knowledge but without consent of debtor □ only debts *prior to assignment*, not subsequent

Art 1285 Par 2 If the creditor communicated the cession to him but the debtor *did not consent* thereto, the latter may set up the compensation of debts previous to the cession, but not of subsequent ones.

3. Without the knowledge of debtor □ all debts maturing *prior to his knowledge*

Art 1285 Par 3 If the assignment is made *without the knowledge* of the debtor, he may set up the compensation of all credits prior to the same and also later ones until he had knowledge of the assignment.

Rationale: As far as the debtor is concerned, the assignment does not take effect except from the time he is notified thereof.

VII. Novation

Concept The extinguishment of an obligation by the substitution or change of the obligation by a subsequent one which extinguishes or modifies the first either by:

1. Changing the object or principal conditions
2. Substituting the person of the debtor
3. Subrogating a third person in the rights of the creditor

- Unlike other acts of extinguishing obligation, novation is a juridical act of dual function in that at the time it extinguishes an obligation, it creates a new one in lieu of the old.
- Does not operate as absolute but only as a relative extinction.

Art 1291 Obligations may be modified by:

1. Changing the object or principal conditions
2. Substituting the person of the debtor
3. Subrogating a third person in the rights of the creditor

Kinds of Novation

1. As to form

EXPRESS – parties declare that the old obligation is extinguished and substituted by the new obligation

IMPLIED – incompatibility between the old and the new obligations that they cannot stand together

2. As to origin

CONVENTIONAL – by express stipulation of the parties

LEGAL – by operation of law

3. As to object

OBJECTIVE/ REAL – change in the cause, object or principal

SUBJECTIVE/ PERSONAL – modification of obligation by the change of the subject

- passive - substitution of debtor
- active - subrogation of a third person in the rights of the creditor

MIXED – both objective and subjective novation

4. As to effect

PARTIAL – only a modification or change in some principal conditions of the obligation

TOTAL – obligation is completely extinguished

Art 1292 In order that obligation may be extinguished by another which substitutes the same, it is imperative that

1. It be so declared in unequivocal terms (express)
 2. Old and the new obligations be on every point incompatible with each other (implied)
- Novation is not presumed
 - Express novation: expressly disclose that their object in making the new contract is to extinguish the old contract
 - Implied novation: no specific form is required, all that is needed is incompatibility between original and subsequent contracts
 - Test of incompatibility: If the two contracts can stand together and each one having independent existence
 - The change must refer to the object, the cause or the principal conditions of the obligations. Accidental changes do not produce novation.

Requisites of Novation

1. Previous valid obligation
2. The agreement of all parties to the new contract
3. Extinguishment of the old contract
4. Validity of the new one
5. Animus novandi or intent to novate (especially for implied novation and substitution of debtors)

Cases:

- Millar v CA
- Dormitorio v Fernandez
- Magdalena Estate v Rodriguez
- Reyes v Secretary of Justice
- Congchingyan v RB Surety and Insurance
- Broadway Centrum Condominium Corp v Tropical Hut

- California Bus Line v State Investment

Effects of Novation

1. In general □ extinguishment of the original obligation and creation of a new one
2. When accessory obligation may subsist □ only insofar as they may benefit third person who did not give the consent to the novation
 - Why? Mortgage, pledge, guaranty was given to any for a particular obligation or for the insolvency of a particular debtor; any change in either of this destroys the basis of the consent of the mortgagor, pledgor, surety or guaranty

Effect of the Status of the Original or the New Obligation

1. Nullity of the original obligation □ new obligation is VOID
 - One of the requisites of novation is a *previous valid obligation*
 - Also applies to voidable that are already annulled/extinguished

Voidability of the original obligation

- new obligation is VALID if *ratified* before novation
- new obligation is VALID even if not *ratified*, but *voidable* at the instance of the debtor
 - Consent of debtor constitutes implied waiver of the action for nullity
 - Defect is not completely cured in expromission wherein debtor has not intervened or consented

Art 1298 The novation is void if the original obligation was void, except when annulment may be claimed only by the debtor, or when ratification validates acts which are voidable.

2. Nullity of the new obligation □ original SUBSISTS, *UNLESS* intends extinguishment of former in any event

Voidability of the new obligation □ new obligation is VALID

- BUT if new obligation is annulled and set aside, original SUBSISTS

Art 1297 If the new obligation is void, the original one shall subsist, unless the parties intended that the former one shall be extinguished in any event.

3. Suspensive or resolutive condition of original obligation □ New is pure
 - If intention is merely to suppress the condition, *no novation*
 - If intention is to extinguish the original obligation itself by the creation of a new obligation, the *novation does not arise* except from fulfillment of the condition from original obligation.
 - Where the original obligation is conditional, novation itself must be held to be conditional also and its efficacy depends upon whether the condition which affects the former is complied with or not
 - Suspensive condition of the original not performed, obligation does not come into existence, cause for the new obligation is wanting
 - Resolutive condition, same category as void obligation or one which has been extinguished

Original obligation is pure □ New obligation is conditional

- If the intention is merely to attach the condition to the original obligation, there is *no novation*.
- If the new conditional obligation is intended to substitute the original and pure obligation, novation (and consequent extinguishment of the original) is subject to the condition.
- Pending the happening of the condition, the old obligation is enforceable

Art 1299 If the original obligation was subject to a suspensive or resolutive condition, the new obligation shall be under the same condition, unless it is otherwise stipulated.

OBJECTIVE NOVATION – change in the object of prestations

Meaning of "PRINCIPAL CONDITIONS" - principal conditions or terms (e.g. making the debt absolute instead of conditional and vice-versa)

- Sir Labitag lecture notes
 - *Dacion en pago* is an objective novation

- Increase in amount and you can prove that the intention to novate, then it will be an implied novation, but usually, it's not a novation if you change the amount.
- Extension of time does not imply novation. But if the time situation is reversed (shortening of the period), that is a novation. E.g. *Ynchausti v Yulo*
- Conversion of an obligation to some other obligation e.g. obligation for contract of deposit for one of loan, or a contract of deposit to one of commodatum.

SUBJECTIVE NOVATION

- In all kinds of subjective novation, the consent of the creditor is required.

1. By change of debtor

- CONSENT OF THE THIRD PARTY ALWAYS REQUIRED. Why? Because he assumes the obligation
- CONSENT OF THE CREDITOR IS LIKEWISE INDISPENSABLE. Why? Substitution of one debtor for another may delay or prevent the fulfillment of the obligation by reason of the inability or insolvency of the new debtor
 - Consent may be implied or express as long as it is given.
 - However, it cannot be presumed from his acceptance of payments by a 3rd party for the benefit of the debtor without further acts; no novation because no consent to the transfer of the debt itself
- It is not enough to extend the juridical relation to a 3rd person, it is necessary that the old debtor be released from the obligation and the 3rd person or new debtor takes his place.
- Without the release, there is no novation, the person who assumed the obligation of the debtor merely becomes a co-debtor or a surety
- No agreement to solidarity, the first and the new debtor are considered obligated jointly.

a. EXPROMISION

- May be done at the instance of the creditor or the third party himself

Requisites of Expromision

1. Consent of two parties (new debtor and creditor)
2. Knowledge or consent of the debtor is not required

Art 1293 Novation which consists in *substituting a new debtor* in the place of the original one, may be made even *without* the knowledge or against the will of the original debtor, *but not without the consent of the creditor*. Payment by the new debtor gives him the rights mentioned in Art 1236 and Art 1237.

Art 1236 Par 2 Whoever pays for another *may demand from the debtor what he has paid*, except that if he paid *without* the knowledge or against the will of the debtor, he can recover only insofar as the payment has been beneficial to the debtor.

Art 1237 Whoever pays on behalf of the debtor *without* the knowledge or against the will of the latter, *cannot compel the creditor to subrogate him in his rights*, such as those arising from a mortgage, guaranty, or penalty.

Effects of Expromision

1. The debtor is released from obligation
2. Creditor generally cannot recourse from the old debtor if the new debtor is insolvent
3. If substitution is without his knowledge or consent
 - a. Old debtor is not liable for the insolvency or non-fulfillment of the new debtor (Art 1294)
 - b. The new debtor can only compel old debtor to reimburse inasmuch as the payment has been beneficial to him □ No subrogation takes place (Art 1237)
4. If substitution is with knowledge and consent
 - a. New debtor is entitled to full reimbursement of the amount paid and subrogation

Art 1294 If the substitution is without the knowledge or against the will of the debtor, the new debtor's insolvency or non-fulfillment of the obligation shall *NOT* give rise to any liability on the part of the debtor.

b. DELEGACION

- Debtor offers and the creditor accepts a third person who consents to the substitution so that the *consent of the three* is necessary
- *Delegante* (old debtor), *delegatario* (creditor) and *delegado* (third person new debtor)

Requisites of Delegacion (vs. Art 1293)

1. Initiative for substitution must emanate from the old debtor
2. Consent of the new debtor
3. Acceptance by the creditor

Effects of Delegacion

1. Original debtor is released from the obligation
2. The new debtor is subrogated in the rights of the creditor. He may demand from the old debtor the entire amount of what he has paid for the obligation. (Art 1302 Par 2)
3. GENERAL RULE: Old debtor is not liable for the insolvency or non-fulfillment of the new debtor (Art 1295)
EXCEPTION:
 - i. He is aware of the insolvency at the time he delegated his debt (Art 1295)
 - ii. At the time of the delegation, the new debtor's insolvency is already existing and of public knowledge (Art 1295)

Art 1295 The insolvency of the new debtor *who has been proposed by the original debtor and accepted by the creditor shall NOT REVIVE the action of the latter against the original obligor, EXCEPT when said insolvency was already existing and of public knowledge OR known to the debtor when he delegated his debt.*

Cases:

- Garcia v Llamas
- Quinto v People

2. By change of creditor: subrogation of a third person in the rights of the creditor

Art 1300 Subrogation of a third person in the rights of a creditor is either legal or conventional. The former is not presumed, except in cases expressly mentioned in this Code; the latter must be clearly established in order that it may take effect.

- The transfer of all the rights of the creditor to a third person who substitutes him in all his rights.

a. CONVENTIONAL SUBROGATION

- Takes place by agreement of the parties

Requisites of Conventional Subrogation (Art 1301)

1. Consent of the old creditor □ because his right is extinguished
2. Consent of the debtor □ old is extinguished and he becomes liable to a new obligation
3. Consent of the third person new creditor □ becomes a party to the new relation

Distinguished from Assignment of Credits

CONVENTIONAL SUBROGATION	ASSIGNMENT OF CREDITS
Debtor's consent is necessary	Debtor's consent not required
Extinguishes the old obligation and gives rise to a new one	Refers to the same right which passes from one person to another
The nullity of an old obligation may be cured by subrogation such that the new obligation will be perfectly valid	Nullity of an obligation is not remedied by the assignment of the creditor's right to another

Effects of Conventional Subrogation

1. Art 1303 Subrogation *transfers to the person subrogated the credit with all the rights* thereto appertaining, either against the creditor or against third persons, be they guarantors or possessors of mortgages, subject to stipulation in a conventional subrogation.
 - If suspensive condition is attached, that condition must be fulfilled first in order the new creditor may exercise his rights.
2. Art 1304 A creditor, to whom *partial payment* has been made, may exercise his *right for the remainder* and he shall be *preferred to the person who has been subrogated* in his place in virtue of the partial payment of the same credit.

Case:

- Licaros v Gatmaitan

b. LEGAL SUBROGATION

- Takes place without agreement but by operation of law because of certain acts
- GENERAL RULE: Not presumed, EXCEPTION: Art 1302
- The third person is called "legal subrogee"

Requisites of Legal Subrogation

When is Legal Subrogation presumed

Art 1302 It is presumed that there is legal subrogation:

1. When a creditor pays another creditor who is preferred, even without the debtor's knowledge
 - o Refers to hierarchy of credits which will be taught next sem hehe
 - o Debtor can still use any defenses he may have against the original creditor such as compensation
2. When a 3rd person, not interested in the obligation, pays with the express/ tacit approval of the debtor
3. When, even without the knowledge of the debtor, a person interested in the fulfillment of the obligation pays, without prejudice to the effects of *confusion* as to the latter's share
 - o Solidary co-debtor may reimburse to the extent of the debtor's share
 - o Guarantors, mortgagors and sureties

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Case:

- Astro Electronics Corp v Philippine Export and Foreign Loan Guarantee Corporation

Title II. CONTRACTS

Chapter I. General Provisions

A. DEFINITION

Art 1305 A contract is a meeting of minds between two persons whereby one binds himself, with respect to the other, to give something or to render some service.

- Sanchez Roman: "a juridical convention manifested in legal form, by virtue of which one or more persons bind themselves in favor of another or others, or reciprocally, to the fulfillment of a prestation to give, to do or not to do."
- Limited to that which produces patrimonial liabilities
- Binding effect of contract based on the following principles
 - o Obligations arising from the contract have the force of law between the contracting parties
 - o There must be mutuality between the parties based on their essential equality, to which is repugnant to have one party bound by the contract leaving the other free therefrom

B. ELEMENTS OF A CONTRACT

1. *Essential elements* (Chapter II, *infra*) – without which there can be no contract
 - a. Consent
 - b. Object
 - c. Cause
2. *Natural elements* – exist as part of the contract even if the parties do not provide for them, because the law, as supplementary to the contract, creates them. E.g. warranty against hidden defects or eviction in the contract of purchase and sale
3. *Accidental elements* – agreed upon by the parties and which cannot exist without being stipulated e.g. mortgage, guaranty, bond

Case:

- GSIS v CA

C. CHARACTERISTICS OF A CONTRACT

1. *Obligatory force* – constitutes the law as between the parties
Art 1308 The contracts must *bind both contracting parties*; its validity or compliance cannot be left to the will of one of them.
2. *Mutuality* – validity and performance cannot be left to the will of only one of the parties
 - Purpose is to render void a contract containing a condition which makes fulfillment dependent exclusively upon the uncontrolled will of the one of the contracting parties.

Art 1308 The contracts must bind both contracting parties; its *validity or compliance cannot* be left to the will of one of them.

Art 1309 The determination of the performance may be left to a third person, whose decision shall not be binding until it has been made known to both contracting parties.

Art 1310 The determination shall not be obligatory if it is evidently inequitable. In such case, the courts shall decide what is equitable under the circumstances.

Art 1473 The fixing of the price can never be left to the discretion of one of the contracting parties. However, if the price fixed by one of the parties is accepted by the other, the sale is perfected.

CONTRACT OF ADHESION: A contract in which one party has already prepared a form of a contract containing stipulations desired by him and he simply asks the other party to agree to them if he wants to enter into the contract.

3. *Relativity* – binding only upon the parties and their successors
 - a. Contracts take effect only between the parties, their assignments and heirs

Art 1311 Par 1 Contracts take effect only between the parties, assigns and heirs EXCEPT in case where the rights and obligations arising from the contract are no transmissible by their nature or by stipulation or by provision of law. The heir is not liable beyond the value of property he received from the decedent.

INTRANSMISSIBLE CONTRACTS:

- a. Purely personal e.g. partnership and agency
- b. Very nature of obligation that requires special personal qualifications of the obligor
- c. Payment of money debts not transmitted to the heirs but to the estate

Cases:

- Manila Railroad Co v La Compana Transatlantica
- DKC Holdings Corp v CA
- b. No one may contract in the name of another
Art 1317 No one may contract in the name of another without being authorized by the latter or unless he has by law a right to represent him.
 - Unenforceable unless ratified expressly or impliedly (Unenforceable Contracts, Art 1302 Par 1)

Case:

- Gutierrez Hermanos v Orense

Two more general principles of contracts that were not included in your book/syllabus

- 4. *Consensuality*
- 5. *Freedom* – entering into contracts is a guaranteed right of the citizens. They are free to do so as long as it's not contrary to law, good morals, customs, public order and public policy.

D. PARTIES IN A CONTRACT

1. *Auto-contracts*

- Necessary for the existence of a contract that two distinct persons enter into it
- No general prohibitions, only special prohibitions such as Art 1491 (Persons who cannot acquire by purchase, even at a public or judicial auction)
- Auto-contracts are generally VALID □ Existence of a contract is not determined by the number of *persons* who intervene in it, but by the number of *parties*. Not by the number of individual wills but by the number of declarations of will.
- As long as there are two distinct patrimonies, even if they are represented by the same person.

2. *Freedom to contract*

Art 1306 The contracting parties may establish such stipulations, clauses, terms and conditions as they may deem convenient, provided they are not contrary to law, morals, good customs, public order and public policy.

Cases:

- Gabriel v Monte de Piedad
- Pakistan International Airlines v Ople

Special disqualifications:

- Art 87, FC *inter vivos* donation between spouses
- Art 1490 husband and wife generally cannot sell property to each other, subject to exceptions
- Art 1491 special prohibition as to who cannot acquire by purchase
- Art 1782 persons prohibited from giving each other any donation or advantage, cannot enter into universal partnership

3. *What they may not stipulate*

Art 1306 "... contrary to law, morals, good customs, public order and public policy"

- A contract is to be judged by its character, courts will look into the substance and not to the mere form of the transaction
- a. Contrary to law

Laws a contract must not intervene:

1. Expressly declare their obligatory character
 2. Prohibitive
 3. Express fundamental principles of justice which cannot be overlooked by the contracting parties
 4. Impose essential requisites without which the contract cannot exist
- i. Pactum commissorium – automatic foreclosure
Art 2088 The creditor cannot appropriate the things given by way of pledge or mortgage, or dispose of them. Any stipulation to the contrary is null and void.
 - ii. Pactum leonina – one party bears the lion's share of the risk
Art 1799 A stipulation including one or more parties from any share in the profits or losses is void
 - iii. Pactum de non alienado – not to alienate
Art 2130 A stipulation forbidding the owner from alienating the immovable mortgaged shall be void
- b. Contrary to morals
 - Man's innate sense or notion of what is right and wrong. More or less universal.
 - c. Contrary to good customs
 - Custom pertains to certain precepts that cannot be universally recognized as moral, sometimes they only apply to certain communities or localities
 - E.g. *Liguez v CA*
 - d. Contrary to public order
 - Consideration of the public good, will or weal (welfare), peace and safety of the public and health of the community
 - e. Contrary to public policy
 - Court must find that the contract contravenes some established interest of the society
 - E.g. *Ferrazzini v Gsel* - stipulation not to engage in competitive enterprise after leaving the employment. Those stipulation must be limited to time, place and extent

Cases:

- Cui v Arellano
- Arroyo v Berwin
- Filipinas Compania de Seguros v Mandanas
- Bustamante v Rosel

E. CLASSIFICATION OF CONTRACTS

1. According to subject matter

- a. Things
- b. Services

2. According to name

- a. NOMINATE – have their own individuality (names) and are regulated by special provisions of law,
- b. INNOMINATE – without particular names
Art 1307 Innominate contract shall be regulated by the stipulations of the parties, by the provisions of Titles I and II of this Book, by the rules governing the *most analogous nominate* contracts and by *customs of the place*.

Cases:

- Dizon v Gaborro
 - i. *Do ut des* I give, you give
 - ii. *Do ut facias* I give, you do
 - iii. *Facio ut facias* I do, you do

iv. *Facio ut des* I do, you give

3. According to perfection

- a. By MERE CONSENT (consensual) – e.g. purchase and sale
Art 1315 Contracts are *perfected by mere consent*, and from that moment, the parties are bound not only to 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.
- b. By DELIVERY OF THE OBJECT (real) – *commodatum*
Art 1316 Real contracts such as *deposit, pledge and commodatum*, are not perfected until the delivery of the object of obligation.

4. According to its relation to other contracts, degree of dependence

- a. Preparatory – e.g. agency
- b. Principal – e.g. lease or sale
- c. Accessory – e.g. pledge, mortgage or suretyship

5. According to form

- a. Common or informal – e.g. loan
- b. Special or formal – e.g. donations and mortgages of immovable property

6. According to purpose

- a. Transfer of ownership – e.g. sale or barter
- b. Conveyance of use – e.g. *commodatum*
- c. Rendition of services – e.g. agency

7. According to the nature of the vinculum produced, nature of obligation produced

- a. Unilateral - e.g. *commodatum* or gratuitous deposit
- b. Bilateral or *sinalagmatico* – e.g. purchase and sale
- c. Reciprocal

8. According to cause

- a. Onerous
- b. Gratuitous or lucrative

9. According to risk

- a. Commutative
- b. Aleatory

F. STAGES OF CONTRACTS

- a. *Preparation* – period of negotiation and bargaining, ending at the moment of agreement of the parties
- b. *Perfection* – moment when the parties come to agree on the terms of the contract
- c. *Consummation* or death – fulfillment or the performance of the terms agreed upon in the contract

G. AS DISTINGUISHED FROM A PERFECTED PROMISE AND AN IMPERFECT PROMISE (*policitation*)

CONTRACT	PERFECTED PROMISE	IMPERFECT PROMISE
Establishes and determines the obligation arising therefrom	Tends only to assure and pave the way for the celebration of a contract in the future; until the contract is actually made, the rights and obligations are not yet determined	Mere unaccepted offer

H. WITH RESPECT TO THIRD PERSONS

1. *Stipulations in favor of third persons* (stipulation pour autrui) □ may demand its fulfillment provided the acceptance is made prior to revocation

Art 1311 Par 2 If a contract should contain some stipulation in favor of a third person, he may *demand its fulfillment* provided he communicated his acceptance to the obligor before its revocation. A mere incidental

interest or benefit of a person is not sufficient. The contracting parties must have *clearly and deliberately conferred favor* upon third person.

- Test of beneficial stipulation - A mere incidental interest of a 3rd person is not within the doctrine; it must be the purpose and intent of the stipulating parties to benefit the third person
 - *Requisites of stipulation pour autrui*
 - a. *Stipulation in favor of third person is a part, not the whole of the contract*
 - b. *Favorable stipulation not conditioned or compensated by any kind of obligation whatever*
 - c. *Neither of the contracting parties bear the legal representation or authorization of the third party*
 - d. *Benefit to the 3rd person was clearly and deliberately conferred to by parties*
 - e. *Third person communicated his acceptance to the obligor before the latter revokes the same*
2. *Possession of the object of contract by third persons* □ only for real rights
Art 1312 In contracts creating *real rights*, third persons who come into possession of the object of the contract are bound thereby, subject to the provisions of the Mortgage Law and the Land Registration laws.
3. *Creditors of the contracting parties*
Art 1313 Creditors are protected in cases of contracts *intended to defraud* them.
- Art 1387 - in rescissible contracts, presumption of fraudulent alienation when debtor does leave sufficient property to cover his obligations
 - Creditor may ask for rescission – Art 1177 (accion subrogatoria) and Art 1381 (accion pauliana)
4. *Interference by third persons*
Art 1314 Any third person who *induces another to violate* his contract shall be *liable for damages* to the other contracting party.
- Liability for damages: third person's liability cannot be more than the party he induced (*Daywalt v Recoletos*)
 - Requisites of Interference With Contractual Relation by Third Person
 - a. Existence of a valid contract
 - b. Knowledge by a third person of the existence of a contract
 - c. Interference by the third person in the contractual relation without legal justification

Cases:

- Daywalt v La Corporacion de los Padres Agustinos Recoletos
- So Ping Bun v CA

Chapter II. Essential Requisites of Contracts

CONSENT

Art 1319 Consent is manifested by the *MEETING* of the offer and the acceptance upon the thing and the cause which are to constitute the contract. The offer must be certain and the acceptance absolute. A qualified acceptance constitutes a counter-offer.

Acceptance made by letter or telegram does not bind the offerer *except from the time it came to his knowledge*. The contract, in such a case, is PRESUMED to have been entered into in the place where the offer was made.

REQUISITES OF CONSENT

1. Plurality of subjects
2. Capacity
3. Intelligent and free will
4. Express or tacit manifestation of will
5. Conformity of the internal will and its manifestation

1. Must be MANIFESTED by the concurrence of the offer and acceptance □ with respect to object and cause

Cases:

- Rosenstock v Burke
- Malbarosa v CA

OFFER – unilateral proposition which one party makes to the other for the celebration of the contract. It must be:

- a. Must be certain (Art 1319)
 - *DEFINITE* – so that upon acceptance an agreement can be reached on the whole contract; not definite if object is not determinate
 - *COMPLETE* – indicating with sufficient clearness the kind of contract intended and definitely stating the essential conditions of the proposed contract, as well as the non-essential ones desired by the offeror
 - *INTENTIONAL* – should be serious and not made for fun or in jest
- b. What may be fixed by the offeror □ time, place and manner of acceptance
 Art 1321 The person making the offer may fix the *time, place and manner* of acceptance, all of which must be complied with.
 - Acceptance not made in the manner provided by the offeror is ineffective.
- c. When made through the agent □ accepted from the time acceptance communicated to the agent
 Art 1322 An offer made through an agent is accepted from the time acceptance is communicated to him.
- d. Circumstances when offer becomes defective □ death, civil interdiction, insanity or insolvency
 Art 1323 An offer becomes ineffective upon the *death, civil interdiction, insanity or insolvency* of either party *before acceptance* is conveyed.
- e. Business advertisements of things for sale □ not definite offers
 Art 1325 Unless it appears otherwise, business advertisements of things for sale are *not definite offers*, but *mere invitation to make an offer*.
- f. Advertisement for bidders
 Art 1326 Advertisements for bidders are *simply invitations to make proposals*, and the advertiser is *not bound to accept* the highest of lowest bidder, *UNLESS* the contrary appears.
 - Not applicable to judicial sale wherein the highest bid must necessarily be accepted

Case:

- Jardine Davies v CA

ACCEPTANCE – an unaccepted offer does not give rise to consent

- Contract is perfect when the offeror or counter-offeror learns about the acceptance!

- a. Must be absolute (Art 1319)
- b. Kinds of acceptance
 - EXPRESS* (Art 1320)
 - IMPLIED* (Art 1320) arise from acts or facts which reveal the intent to accept such as the consumption of things sent to the offeree, or the fact of immediately carrying out the contract offered
 - QUALIFIED* (Art 1319) not an acceptance but constitutes a counter-offer
- c. If made by letter or telegram
 Art 1319 Par 2 Acceptance made by letter or telegram does not bind the offeror except *from the time it came to his knowledge*.

Four theories on *when the contract is perfected*

1. Manifestation theory – counterofferee manifest his acceptance
2. Expedition Theory – sending of the letter, mailing if by letter
3. Reception Theory – receipt of the message of acceptance
4. Cognition Theory – knowledge of offeror of the acceptance
 Art 1319 Par 2 "... except from the time of his knowledge"

- d. Period of acceptance
 Art 1324 "When the offeror has allowed the offeree a certain period to accept..."
 - Offeree may accept any time until such period expires.

- Acceptance beyond the time fixed is not legally an acceptance but constitutes a new offer.
- Acceptance not made in the manner provided by the offeror is ineffective.
- If offeror has not fixed the period, the offeree must accept immediately within a reasonable tacit period.
- Offer implies an obligation on the part of the offeror to maintain it for such a length of time as to permit the offeree to decide whether to accept it or not.
- Extinguishment or annulment of offer
 - Withdrawal by the offeror
 - Lapse of the time for option period
 - Legally incapacitated to act
 - Offeree makes counter-offer
 - Contract becomes illegal

Case:

- Sanchez v Rigos

e. Contract of option

Art 1324 "... the offer *may* be *withdrawn* at any time before acceptance by communicating such withdrawal, *EXCEPT* when the option is *founded upon* a consideration, as something paid or promised."

- Preparatory contract in which one party grants to the other, for a fixed period and under specified conditions, the power to decide whether or not to enter into a principal contract
- Must be supported by an independent consideration and the grant must be exclusive
- If the option is not supported by an independent consideration, offeror can withdraw the privilege at any time by communicating the withdrawal to the other party, even if the "option" had already been accepted.

Case:

- Adelfa Properties v CA

2. Necessary LEGAL CAPACITIES of the parties

Who cannot give consent

Art 1327 The following cannot give consent to a contract:

1. Unemancipated minors
2. Insane or demented persons
3. Deaf-mutes who do not know how to write

When offer and/or acceptance is made

- During a lucid interval □ VALID
- In a state of drunkenness □ VOIDABLE utter want of understanding
- During a hypnotic spell □ VOIDABLE utter want of understanding

3. The consent must be INTELLIGENT, FREE, SPONTANEOUS and REAL

Art 1330 A contract where consent is given through mistake, violence, intimidation, undue influence, or fraud is VOIDABLE.

- Mistake and violence – spontaneous and intelligence

Effect of Defects of Will: Contract is VOIDABLE (Art 1330)

VICES OF CONSENT

- a. Mistake or Error – a wrong or false notion about such matter, a belief in the existence of some circumstance, fact or event which in reality does not exist.

Art 1331 In order that MISTAKE may invalidate consent, it should refer to the *substance of the thing* which is the *object* of the contract, or to those *conditions* which have *principally moved* one or both parties to enter into the contract.

Mistake as to the identity or qualifications of one of the parties will vitiate consent only when such identity or qualifications have been the *principal cause of the contract*.

A simple mistake of account shall give rise to its *correction*.

KINDS OF MISTAKE

1. Mistake of fact - generally not a ground for annulment of contracts
 - Ground of mistake based on error is *limited* to cases in which it may reasonably be said that without such error the consent would not have been given
 - Effect of mistake is determined by whether the parties would still have entered into the contract despite knowledge of true fact □ "influence upon party"

a. As to substance of object	Invalidates consent if refers to the substance of the thing □ But if mistake in lot number for instance, remedy is only reformation of the contract
b. As to principal conditions (essential or substantial in character)	Invalidates consent
c. As to identity or qualifications of one of the parties	For identity/error as to person - generally not, except when the qualification is the principal cause of the contract especially in gratuitous contracts For qualifications – Invalidates consent Solvency of the party – not a cause of nullity
d. As to quantity, as distinguished from simple mistake of account	Error of account is a mistake in computation □ make proper correction Error as to quantity – may vitiate a contract if the primary consideration is the quantity e.g. parcel of land was actually only 10 ha and not 30 ha

Mistakes that do not affect the validity of the contract

- a. Error with respect to accidental qualities of the object of the contract
- b. Error in the value of thing
- c. Error which refers not to conditions of the thing, but to accessory matters in the contract, foreign to the determination of the objects

Cases:

- Asiain v Jalandoni
- Theis v CA
- Heirs of William Sevilla v Leopoldo Sevilla

2. Error of law – mistake as to the existence of a legal provision or as to its interpretation or application

GENERAL RULE: *Ignorantia legis neminem excusat*

Art 3 Ignorance of the law excuses no one from compliance therewith.

EXCEPTION: *Mutual error of law*

Art 1334 Mutual error as to the legal effect of an agreement when the real purpose of the parties is frustrated, may vitiate consent.

- *Requisites for mutual error of law*
 - a. Error must be as to the legal effect of an agreement □ includes rights and obligations of the parties, not as stipulated in the contract but as provided by law
 - b. Must be mutual
 - c. Real purpose of the parties is frustrated

When one of the parties is unable to read and fraud is alleged □ burden of proof on party enforcing the contract

Art 1332 When one of the parties is unable to read, or if the contract is in a language not understood by him, and mistake or fraud is alleged, the person enforcing the contract must show that the terms thereof have been fully explained to the former.

Cases:

- Dumasug v Modelo
- Hemedes v CA
- Katipunan v Katipunan

Inexcusable mistake □ knew the doubt, contingency or risk

Art 1333 There is no mistake if the party alleging it *knew the doubt, contingency or risk* affecting the object of the contract.

- Party cannot alleged error which refers to a fact known to him or which he should have known by ordinary diligent examination of the facts
- Courts consider not only the objective aspect of the case but also the subjective e.g. intellectual capacity of the person who made the mistake
- E.g. Caused by manifest negligence

b. Violence and Intimidation

Art 1335 There is VIOLENCE when in order to wrest consent, *serious or irresistible force* is employed.

There is INTIMIDATION when one of the contracting parties is *compelled by a reasonable and well-grounded fear of an imminent and grave evil* upon his person or property, or upon the person or property of his spouse, descendants or ascendants, to give his consent.

To determine the degree of intimidation, the *age, sex and condition* of the person shall be borne in mind.

A threat to enforce one's claim through competent authority, if the claim is just or legal, does NOT vitiate consent.

- DURESS: degree of constraint or danger either actually inflicted (violence) or threatened and impending (intimidation) sufficient to overcome the mind and will of a person of ordinary firmness
- Seriousness of the evil or wrong measured both *objectively* (degree of harm that the evil in itself is likely to produce) and *subjectively* (determining the effect of the threat upon the mind of the victim in view of his personal circumstances and his relation to the author of the intimidation)

VIOLENCE

- Physical force or compulsion
- External and generally serve to prevent an act from being done
- *Requisites of Violence*
 1. *Physical force employed must be irresistible or of such a degree that the victim has no other course, under the circumstances, but to submit*
 2. *That such force is the determining cause in giving the consent to the contract*

INTIMIDATION

- Moral force or compulsion
- Internal operating upon the will and induces the performance of an act
- Influences the mind to choose between two evils, between the contract and the imminent injury
- *Requisites of Intimidation*
 1. *Intimidation must be the determining cause of the contract, or must have caused the consent to be given*
 2. *That the threatened act be unjust or unlawful*
 3. *That the threat be real and serious, there being an evident disproportion between the evil and the resistance which all men can offer, leading to the choice of the contract as the lesser evil*
 4. *That it produces a reasonable and well-grounded fear from the fact that the person from whom it come has the necessary means or ability to inflict the threatened injury*

"Person" not limited to life and physical integrity but also includes liberty ad honor, covers all injuries which are not patrimonial in nature

"Reasonable fear" fear occasioned by the threat must be reasonable and well-grounded; it must be commensurate with the threat

Effect of Violence and Intimidation

Art 1336 Violence or intimidation shall *ANNUL* the obligation, although it may have been employed by a *third person* who did not take part in the contract.

Case:

- Martinez v HSBC

- c. **Undue Influence** – any means employed upon a party which, under the circumstances, he could not well resist, and which controlled his volition and induced him to give his consent to the contract which otherwise he would not have entered into.

Art 1337 There is **UNDUE INFLUENCE** when a person *takes improper advantage of his power* over the will of another, depriving the latter of a reasonable freedom of choice. The following circumstances shall be considered: the *confidential, family, spiritual and other relations* between the parties, or the fact that the person alleged to have been unduly influenced was *suffering from mental weakness, or was ignorant or in financial distress*.

- In some measure destroy the free agency of a party and interfere with the exercise of that independent discretion which is necessary for determining the advantages and disadvantages of a contract.
- Distinguished from intimidation

UNDUE INFLUENCE	INTIMIDATION
There need not be an unjust or unlawful act	Unlawful or unjust act which is threatened and which causes consent to be given
Moral coercion	

- By analogy, undue influence by a third person may also vitiate consent (Art 1336)

- d. **Fraud or Dolo** – every kind of deception whether in the form of insidious machination, manipulations concealments, misrepresentation, for the purpose of leading a party into error and thus execute a particular act.
- Must have a determining influence on the consent of the victim
 - Compared with error

ERROR	FRAUD
Vitiate the consent only when it refers to the matters mentioned in Art 1331	Mistake induced by fraud will always vitiate consent when fraud has a decisive influence on such consent

- *Requisites of Fraud*
 1. Must have been employed by one contracting party upon the other (Art 1342 and Art 1344)
 - If both party, they cannot have action against each other, fraud is compensated
 2. Induced the other party to enter into a contract (Art 1338)
 3. Must have been serious (Art 1344)
 4. Must have resulted in damage or injury to the party seeking annulment

Art 1338 There is **FRAUD** when, through *insidious words or machinations of one of the contracting parties*, the other is induced to enter into a contract which, without them, he *would not have agreed to*.

"*Insidious words and machinations*" constituting *deceit* includes false promises, exaggeration of hopes or benefits, abuse of confidence, fictitious names, qualifications or authority, all the thousand and one forms of *deception* which may influence the consent of a contracting party, without necessarily constituting *estafa* or some offense under the penal laws.

Cases:

- Hill v Veloso
- Woodhouse v Halili *supra*
- Geraldez v CA *supra*

Kinds of Fraud

1. *Dolo causante* – determines or is the essential cause of the consent; ground for annulment of contract Art 1338 "...without them, he *would not have agreed to*."
2. *Dolo incidente* – does not have such a decisive influence and by itself cannot cause the giving of consent, but only refers to some particular or accident of the obligation; only gives rise to action for damages Art 1344 Par 2 *Incidental fraud only obliges the person employing it to pay damages*.

Failure to disclose facts; duty to reveal them □ **FRAUD**

Art 1339 Failure to disclose facts, when there is a *duty to reveal them*, as when the parties are bound by confidential relations, constitutes FRAUD.

- GENERAL RULE: Silence or concealment does not constitute a fraud
- EXCEPTIONS:
 1. There is a special duty to disclose certain facts
 2. According to good faith and usages of commerce the communication should have been made

Cases:

- Tuason v Marquez
- Rural Bank of Sta. Maria v CA

Usual exaggeration in trade; opportunity to know the facts □ NOT FRAUD

Art 1340 The usual exaggerations in trade, when the other party had an *opportunity to know the facts*, are NOT in themselves fraudulent

- Aka "tolerated fraud" or lawful misrepresentation (*dolus bonus*) as long as they do not go to the extent of malice or bad faith such as changing the appearance of the thing by false devices and of preventing all verification or discovery of truth by the other party
- Caveat emptor! Do not give rise action for damages because of their insignificance OR because the stupidity of the victim is the real cause of his loss. □ import of "opportunity to know facts"

Cases:

- Azarraga v Gay
- Trinidad v IAC

Mere expression of an opinion □ NOT FRAUD, unless made by an expert and relied upon by the plaintiff

Art 1341 A mere expression of an opinion DOES NOT signify fraud, unless made by an expert and the other party has relied on the former's special knowledge.

Effects of Fraud

1. Nullity of the contract
2. Indemnification for damages

Art 1344 In order that fraud may make a contract voidable, it should be *serious* and should not have been employed by *BOTH* contracting parties. *Incidental fraud* only obliges the person employing it to *pay damages*.

Case:

- Songco v Sellner

e. Misrepresentation

1. By a third person

Art 1342 Misrepresentation by a third person does NOT vitiate consent, *unless* such misrepresentation has created substantial mistake and the same is mutual.

GENERAL RULE: Fraud by third person does not vitiate the contract

EXCEPTIONS:

- a. If 3rd person is in collusion with one of the parties, he is considered an accomplice to the fraud and contract becomes VOIDABLE
- b. If 3rd person not in connivance with any of the parties but leads them both into error (mutual error), the consent is vitiated, contract is VOIDABLE.

VIOLENCE AND INTIMIDATION BY 3RD PERSON: annuls the contract

FRAUD BY 3RD PERSON: does not annul unless it produces substantial mistake on the part of both parties

JUSTIFICATION FOR THE DIFFERENCE:

- Party has nothing to do with fraud by a third person and cannot be blamed for it
- Intimidation can be more easily resisted than fraud

2. Made in good faith □ not fraudulent but may constitute error

Art 1343 Misrepresentation made in good faith is not fraudulent but may constitute error.

3. Active/passive
- Applicable to legal capacity especially age

Cases:

- Mercado v Mercado
- Braganza v Villa Abille

- f. Simulation of Contracts – declaration of a fictitious will, deliberately made by agreement of the parties in order to produce, for the purposes of deception the appearance of a juridical act which does not exist or is different from that which was really executed.

Kinds of Simulated Contracts

Art 1345 Simulation of a contract may be ABSOLUTE or RELATIVE. The former takes place when the parties do not intend to be bound at all; the latter, when the parties conceal their true agreement.

Effects of simulation of contracts

Art 1346 An absolutely simulated or fictitious contract is void. A relative simulation, when it does not prejudice a third person and is not intended for any purpose contrary to law, morals, good customs, public order or public policy binds the parties to their real agreement.

ABSOLUTE (simulados)	RELATIVE (disimulados)
Color of contract, without any substance thereof, the parties not having intention to be bound	Parties have an agreement which they conceal under the guise of another contract
VOID - Does not legally exist. Illusory, mere phantom, injuring 3 rd persons, generally fraudulent	VALID except when it prejudices 3 rd persons or has an illicit purpose <ol style="list-style-type: none"> 1. Ostensible acts – apparent or fictitious; contract that the parties pretend to have executed 2. Hidden act – real; true agreement between the parties

Recovery under simulated contract in absolute simulation

1. If does not have illicit purpose – prove simulation to recover what may have been given
2. If simulated has illegal object – IN PARI DELICTO rules apply

Cases:

- Rodriguez v Rodriguez
- Suntay v CA
- Blanco v Quasha

OBJECT OF CONTRACTS

- Thing, right or service which is the subject-matter of the obligation arising from the contract
- Object of the contract and object of the obligation created thereby are identical

What may be the Object of Contracts

Art 1347 All things which are not *outside* the commerce of men, including future things, may be the object of a contract. All rights which are not *intransmissible* may also be the object of contracts.

No contract may be entered into upon *future inheritance* except in cases expressly authorized by law.

All services which are not contrary to law, morals, good customs, public order or public policy may likewise be the object of a contract.

1. All things not outside the commerce of man
 - Including “future things” do not belong to the obligor at the time the contract is made; they may be made, raised or acquired by the obligor after the perfection of the contract
 - Conditional – subject to the coming into existence of the thing
 - Aleatory – one of the parties bears the risk of the thing never coming into existence

- “Outside the commerce of man” – all kinds of things and interests whose alienation or free exchange is restricted by law or stipulation, which parties cannot modify at will
 - Services which imply an absolute submission by those who render them, sacrificing their liberty, independence or own beliefs or disregarding in any manner the equality and dignity of persons e.g. perpetual servitude or slavery
 - Personal rights e.g. patria postestas, marital authority, status, capacity of persons, honorary titles
 - Public offices, inherent attributes of the public authority, political rights of individuals e.g. right of suffrage
 - Property while they pertain to the public dominion
 - Sacred things e.g. air and sea
- 2. All rights not intransmissible
- 3. All services not contrary to law, morals, good customs, public order or public policy

Requisite of Object of Contracts

1. Within the commerce of man (Art 1347)
2. Licit, not contrary to law, morals, good customs, public policy or public order (Art 1347)
3. Possible (Art 1348)
4. Determinate as to its kind

Art 1349 The object of every contract must be *determinate as to its kind*. The fact that the quantity is not determinate shall not be an obstacle to the existence of the contract, provided it is possible to determine the same, without the need of a new contract between the parties.

What may NOT be the Objects of Contracts

1. Contrary to law, morals, good customs, public policy or public order
2. Indeterminable as to their kind
3. Outside the commerce of man
4. Intransmissible rights
5. Future inheritance, except when authorized by law

Art 1347 Par 2 No contract may be entered into upon future inheritance except in cases expressly authorized by law.

- The succession must not have been opened at the time of the contract
- Exception to “future things”

Cases:

- Blas v Santos
- Tanedo v CA

6. Impossible things or services

Art 1348 Impossible things or services cannot be the object of contracts.

- E.g. of impossible things:
 - Not susceptible of existing
 - Outside the commerce of man
 - Beyond the ordinary strength of power of man
- Liability for damages
 - Debtor knew of impossibility – liable for damages
 - Debtor is ignorant of impossibility and ignorance is justifiable – no liability for damages
 - Both parties have knowledge of impossibility – no liability for damages
- Impossibility must be actual and contemporaneous with the making of the contract and not subsequent
 - ABSOLUTE or objective: nobody can perform it
 - RELATIVE or subjective: due to the special conditions or qualification of the debtor it cannot be performed
 - TEMPORARY – does not nullify the contract
 - PERMANENT – nullifies the contract

CAUSE OF CONTRACTS

Meaning of “CAUSE”

- Why of a contract; the immediate and most proximate purpose of the contract, the essential reason which impels the contracting parties to enter into it and which explains and justifies the creation of the obligation through such contract
- Essential reason that moves the parties to enter into a contract
- Requisites of Cause
 1. Exist
 2. True

3. Licit

- As distinguished from object
 - Object is the starting point of agreement, without which the negotiations or bargaining between the parties would never have begun
 - Object may be the same for both of the parties
 - Cause is different with respect to each party
- As distinguished from consideration CONSIDERATION < CAUSE

CONSIDERATION	CAUSE
Reason or motive or inducement by which a man is moved into bind himself by agreement	Why of contracts; essential reason that compels contracting parties to celebrate the contract
Requires a legal detriment to the promisee more than a moral duty	Never rejects any cause as insufficient; need not be material at all and may consist in moral satisfaction for the promissory

Art 1350 In onerous contracts the cause is understood to be, for each contracting party, the prestation or promise of a thing or service by the other; in remuneratory ones, the service or benefit which is remunerated; and in contracts of pure beneficence, the mere liberality of the benefactor.

- a. Onerous Contracts
 - Prestation or promise of a thing or service by the other
 - Need not be adequate or an exact equivalent in point of actual value especially in dealing with objects which have rapidly fluctuating price
- b. Remuneratory Contracts
 - One where a party gives something to another because of some service or benefit given or rendered by the latter to the former where such service or benefit was not due as a legal obligation
 - E.g. bonuses
- c. Contracts of pure beneficence (Gratuitous)
 - Essentially agreements to give donations

As distinguished from motive

Art 1351 The particular motives of the parties in entering into a contract are different from the cause thereof.

CAUSE	MOTIVE
Objective, intrinsic and juridical reason for the existence of the contract itself	Psychological, individual or personal purpose of a party to the contract
Essential reason for the contract	Particular reason for a contracting party, which does not affect the other and which does not impede the existence of a true distinct cause
Objective of a party in entering into the contract	Person's reason for wanting to get such objective
Always the same for both parties	Differs with each person

GENERAL RULE: Motive does not affect the validity of the contract.

EXCEPTIONS:

1. When the motive of a debtor in alienating property is to defraud his creditors, alienation is rescissible
2. When the motive of a person in giving his consent is to avoid a threatened injury, in case of intimidation the contract is voidable.
3. When the motive of a person induced him to act on the basis of fraud or misrepresentation by the other party, the contract is likewise voidable.

Defective causes and their effects

- a. Absence of cause and unlawful cause □ produces no effect whatever

Art 1352 Contracts without cause, or with unlawful cause, *produce no effect whatever*. The cause is *unlawful* if it is contrary to law, morals, good customs, public order or public policy.

- E.g. simulated contracts

Case:

- Liguez v CA
- b. Statement of a false cause in the contract □ VOID if there is no other true and lawful cause
Art 1353 The statement of a *false cause* in contracts shall render them VOID, if it should not be proved that they were founded upon another cause which is true and lawful.
- c. Lesion or inadequacy of cause □ VALID unless fraud, mistake or undue influence is present
Art 1355 Except in cases specified by law, lesion or inadequacy of cause shall *not invalidate a contract*, *UNLESS* there has been *fraud, mistake or undue influence*.
 - Gross inadequacy suggest fraud and is evidence thereof

Cases:

- Carantes v CA
- Sps Buenaventura v CA

Presumption of the existence and lawfulness of a cause, though it is not stated in the contract

Art 1354 Although the cause is not stated in the contract, it is presumed that it exists and is lawful, unless the debtor proves the contrary.

Chapter III. Form of Contracts

- A. GENERAL RULE: Contracts shall be obligatory, in *whatever form they may have been entered into*, provided all essential requisites *for their validity are present*.
("Spiritual system" of the Spanish Code)

Art 1356 Contracts shall be obligatory, in *whatever form they may have been entered into*, provided all the essential requisites for their validity are present.

- B. EXCEPTION: When the law requires that a contract be in some form in order that it may be VALID or ENFORCEABLE
(Anglo-American principle in Statutes of Fraud) □ indispensable and absolute; parties

Art 1356 However, when the law requires that a contract be in some form in order that it may be valid or enforceable, or that a contract be proved in a certain way, that requirement is absolute and indispensable. In such cases, the right of the parties stated in the following article cannot be exercised.

Cases:

- Hernaez v De los Angeles

C. KINDS OF FORMALITIES REQUIRED BY LAW

1. *Ad esentia, ad solemnitatem* □ Those required for the validity of contracts, such as those referred to in
(Sir refers to these as *formal* contracts)

<u>Art 748</u>	Donation of <i>movable</i>
<u>Art 749</u>	Donation of <i>immovable</i>
<u>Art 1874</u>	Sale of piece of <i>land</i> through an agent
<u>Art 2134</u>	Contract of <i>antichresis</i> ; <i>amount</i> of <i>principal</i> and of the <i>interest</i>
<u>Art 1771</u>	Partnership; <i>immovable</i> property or <i>real</i> rights are contributed
<u>Art 1773</u>	Partnership; inventory of <i>immovable</i> property contributed
<u>Art 1956</u>	Interest for using <i>someone else's money</i>
<u>Art 2140</u>	<i>Chattel mortgage</i>

2. Those required, not for the validity, but to make the contract effective as against third persons, such as those covered by Art 1357 (if law requires a special form, parties may compel each other to observe that form upon perfection of the contract) and Art 1358 (documents which must appear in a public document; it also constitutes constructive delivery)

(1) Acts and contracts which have for their object the creation, transmission, modification or extinguishment of real rights over immovable property; sales of real property or of an interest therein a governed by Articles 1403, No. 2, and 1405;

- (2) The cession, repudiation or renunciation of hereditary rights or of those of the conjugal partnership of gains;
- (3) The power to administer property, or any other power which has for its object an act appearing or which should appear in a public document, or should prejudice a third person;
- (4) The cession of actions or rights proceeding from an act appearing in a public document.

All other contracts where the amount involved exceeds five hundred pesos must appear in writing, even a private one. But sales of goods, chattels or things in action are governed by Articles, 1403, No. 2 and 1405.

- 3. *Ad probationem* □ Those required for the purpose of proving the existence of the contract, such as those under the Statute of Frauds in Art 1403

Chapter IV. Reformation of Instruments

Art 1359 When, there having been a meeting of the minds of the parties to a contract, their true intention is not expressed in the instrument purporting to embody the agreement, by reason of mistake, fraud, inequitable conduct or accident, one of the parties may ask for the reformation of the instrument to the end that such true intention may be expressed.

If mistake, fraud, inequitable conduct, or accident has prevented a meeting of the minds of the parties, the proper remedy is not reformation of the instrument but annulment of the contract.

Reason for Reformation of Instruments

- Equity dictates the reformation of instrument in order that the true intention of the contracting parties may be expressed. Unjust and inequitable to allow the enforcement of a written instrument which does not reflect or disclose the real meeting of the minds of the parties
- Court do not attempt to make a new contract for the parties, but only to make the instrument express their real agreement
- Statute of Frauds is no impediment to the reformation of an instrument
- Distinguished from Annulment

REFORMATION	ANNULMENT
Action presupposes a valid existing contract between the parties and only the document or instrument which was drawn up and signed by them does not correctly express the terms of agreement	No meeting of the minds or the consent of either one was vitiated by mistake or fraud
Gives life to the contract upon certain corrections	Involves a complete nullification of contracts

Requisites for Reformation of Instruments

1. Meeting of the minds upon the contract
2. The true intention of the parties is not expressed in the instrument
3. The failure of the instrument to express the true agreement is due to mistake, fraud, inequitable conduct or accident

Cases:

- Garcia v Bisaya
- Bentir v Leande

Causes for Reformation

1. Mutual – instrument includes something which should not be there or omit what should be there
 - a. Mutual
 - b. Mistake of fact
 - c. Clear and convincing proof
 - d. Causes failure of instrument to express true intention
2. Unilateral
 - a. One party was mistaken
 - b. Other either acted fraudulently or inequitably or knew but concealed
 - c. Party in good faith may ask for reformation
3. Mistake by 3rd persons – due to ignorance, lack of skill, negligence, bad faith of drafter, clerk or typist
4. Others specified by law – to avoid frustration of true intent

Example of cases where reformation is allowed

1. Art 1361 When a mutual mistake of the parties causes the failure of the instrument to disclose their real agreement, said instrument may be reformed.
2. Art 1363 When one party was mistaken and the other knew or believed that the instrument did not state their real agreement, but *concealed* that fact from the former, the instrument may be reformed.
3. Art 1364 When through the ignorance, lack of skill, negligence or bad faith on the part of the person drafting the instrument or of the clerk or typist, the instrument does not express the true intention of the parties, the courts may order that the instrument be reformed.

Cases where no reformation is allowed

1. Oral contracts – there's nothing to reform at all!
2. Art 1366 There shall be no reformation in the following cases:
 - (1) Simple donations inter vivos wherein no condition is imposed;
 - (2) Wills;
 - (3) When the real agreement is void.

Implied ratification

Art 1367 When one of the parties has brought an action to enforce the instrument, he cannot subsequently ask for its reformation.

- There has been election between two inconsistent remedies, one in affirmance, the other in disaffirmance

Who may ask for reformation

- **MUTUAL MISTAKE:** either party or successor in interest
- **MISTAKE BY ONE:** injured party, heirs or assigns

1. Art 1368 Reformation may be ordered at the instance of either party or his successors in interest, if the mistake was *mutual*; otherwise, upon petition of the injured party, or *his heirs and assigns*.
2. Art 1362 If one party was mistaken and the other acted fraudulently or inequitably in such a way that the instrument does not show their true intention, the former may ask for the reformation of the instrument.

Procedure of reformation

Art 1369 The procedure for the reformation of instrument shall be governed by ROC to be promulgated by the Supreme Court.

Cases:

- Atilano v Atilano
- Carantes v CA *supra*
- Sarming v Dy

Chapter V. Interpretation of Contracts

(Compare with Rules on Statutory Construction)

Primacy of intention

- "*Verba intentione non e contradebent inservare*" - words ought to be subservient to the *intent*, not the *intent to the word*
- Look for the contractual intent

Art 1370 If the terms of a contract are clear and leave no doubt upon the intention of the contracting parties, the *literal meaning* of its stipulations shall control.

Art 1372 However *general* the terms of a contract may be, they shall not be understood to comprehend things that are *distinct* and cases that are *different* from those upon which the parties *intended to agree*.

- "*Generalia verba sunt generaliter intelligencia*" □ *general things are to understood in a general sense*

Cases:

- Borromea v CA
- Kasilag v Rodriguez

How to determine intention

Art 1371 In order to judge the intention of the contracting parties, their *contemporaneous and subsequent acts* shall be principally considered.

- Also take note of the usage and customs of the place

How to interpret a contract

1. When it contains stipulations that admit of several meanings

Art 1373 If some stipulation of any contract should admit of several meanings, it shall be understood as bearing that import which is most adequate to *render it effectual*.

2. When it contains various stipulations, some of which are doubtful

Art 1374 The various stipulations of a contract shall be interpreted together, attributing to the doubtful ones that sense which may *result from all of them taken jointly*.

3. When it contains words that have different significations

Art 1375 Words which may have different significations shall be understood in that which is *most in keeping with the nature and object of the contract*.

4. When it contains ambiguities and omission of stipulations

Art 1376 The *usage or custom of the place* shall be borne in mind in the interpretation of the ambiguities of a contract, and shall fill the omission of stipulations which are ordinarily established.

5. With respect to the party who caused the obscurity

Art 1377 The interpretation of obscure words or stipulations in a contract *shall not favor the party who caused the obscurity*.

- Contracts of adhesion – resolved against the party who prepared the contract and in favor of the one who merely adhered to it

6. When it is absolutely impossible to settle doubts by the rules above

Art 1378 Par 1 When it is absolutely impossible to settle doubts by the rules established in the preceding articles, and the doubts refer to incidental circumstances of a gratuitous contract, the least transmission of rights and interests shall prevail. If the contract is onerous, the doubt shall be settled in favor of the greatest reciprocity of interests.

- a. In gratuitous contracts, incidental circumstances □ least transmission of rights and interests
- b. In onerous contracts □ greatest reciprocity of interests

7. When the doubts are cast upon the principal objects so that the intention cannot be known

Art 1378 Par 2 If the doubts are cast upon the principal object of the contract in such a way that it cannot be known what may have been the intention or will of the parties, the contract shall be *null and void*.

Applicability of Rule 12, Rules of Court (now Secs. 10-19, Rule 130)

Art 1379 The principles of interpretation stated in Rule 123 of the Rules of Court shall likewise be observed in the construction of contracts.

- Law in evidence; interpretation of documents)

In between VALID and DEFECTIVE contracts is RELATIVELY INEFFECTIVE – ineffectively only with respect to certain parties, but are effective as to other persons.

- Against voidable contract: ineffectiveness is produced ipso jure
- Void or inexistent contract: can be made completely effective by the consent of the person as to whom it is effective or by the cessation of the impediment which prevents its complete ineffectiveness

- (1) assignment of the lease by the lessee without the consent of the lessor is ineffective only as regards the lessor,
- (2) transfer of a debt by the debtor to another, without the consent of the creditor is ineffective as to the creditor,
- (3) the payment by a debtor to his creditor after the credit has been garnished or attached by a third person is ineffective to the latter

DEFECTIVE CONTRACTS

1. RESCISSIBLE – contract that has caused a particular damage to one of the parties or to a third person and which for EQUITABLE REASONS may be set aside even if valid
2. VOIDABLE OR ANNULLABLE (*contrato nulo*) – contract in which CONSENT of one of the parties is defective, either because of WANT OF CAPACITY or because it is VITIATED, but which contract is VALID until JUDICIALLY set aside
3. UNENFORCEABLE – contract that for some reason CANNOT BE ENFORCED, UNLESS RATIFIED in the manner PROVIDED BY LAW
4. VOID AND NON-EXISTENT (*contrato inexistente*) – contract which is an ABSOLUTE NULLITY and produces NO EFFECT, as if it had never been executed or entered into

Chapter VI. Rescissible Contracts

Kinds of Rescissible Contracts

Art 1381 The following are rescissible contracts:

1. Entered into by *guardians* whenever the wards suffer lesion by more than $\frac{1}{4}$ of value of things object
 - Guardian: authorized only to “manage” ward’s property, no power to dispose without prior approval of court. Only includes those which are “ordinary course” of management of estate of the ward, because if sale, mortgage and other encumbrance AND not approved by court, it becomes unenforceable.
 - Sir Labitag: “thin band of contracts”
2. Agreed upon in representation of *absentee*, suffer lesion by more than $\frac{1}{4}$ of the value of things object
 - Same principle in relation to contracts by guardians
3. In *fraud of creditors* who cannot collect claims due them
 - *Requisites of Accion Pauliana*
 1. Plaintiff asking for rescission (*subsidiary action*) has a credit prior to the alienation
 2. Debtor has made subsequent contract, giving advantage to a 3rd person
 3. Creditor has no other remedy but to rescind the debtor’s contract to the 3rd person (*last resort*)
 4. Act being impugned is fraudulent
 5. 3rd person who received the property is an accomplice in the fraud
 - Credit must be existing at the time of the fraudulent alienation, although not yet due. But at the time of *accion pauliana*, the credit must already be due because it *presupposes a judgment and unsatisfied execution* which cannot exist when the debt is not yet demandable at the time the rescissory action is brought.
 - GENERAL RULE: Credit is prior to the alienation
 - EXCEPTION: Credit is after alienation but entitled to *accion pauliana* because of some prior right
 1. Claims were acknowledged by the debtor after alienation, but origin of which antedated the alienation
 2. Those who become subrogated, after the alienation, in the rights of a creditor whose credits were prior to the alienation
 - Even secured creditors are entitled to AP
 - Conveyance was intentionally fraudulent which may be established by the presumption in Art 1387
 - TEST OF FRAUD: Whether the conveyance was a bona fide transaction or a trick and contrivance to defeat creditors or whether it conserves to the debtor a special right; founded on good consideration or is made with bona fide intent. □ Does it prejudice the right of creditors??
 - Good consideration: creditor is not prejudiced because the property was merely replaced or substituted
 - Badges of fraud applicable
4. Things *under litigation*, without knowledge and approval of litigant or of competent judicial authority
 - To secure the possible effectivity of a claim
 - Transferee of property in good faith who acquires property for valuable consideration, without knowledge of the litigation or claim of the plaintiff, cannot be deprived of property.
5. *Specially declared by law* to be subject of rescission

Characteristics of Rescissible Contracts

1. Their defect consist in *injury or damage* either to one of the contracting parties or to third persons
LESION: injury which one of the parties suffers by virtue of contract that is disadvantageous to him; must be known or could have been known at the birth of contract and not due to subsequent thereto or unknown to the parties
E.g.
Art 1098 Partition, judicial and extra-judicial may be rescinded on account of lesion
Art 1539 Sale of real estate of inferior thing
Art 1542 Sale of real estate made for a lump sum
2. They are *valid before rescission*
3. They *can be attacked directly only, not collaterally*
4. They *can be attacked only either by a contracting party, or by a third person who is injured or defrauded*
5. They *can be convalidated only by prescription and not by ratification*

RESCISSION

Art 1380 Contracts validly agreed upon may be rescinded in the cases established by law.

Definition Remedy granted by law to the contracting parties and even to third persons, to secure the reparation of damages caused to them by a contract, even if this should be valid, by means of the restoration of things to their condition at the moment prior to the celebration of said contract.

- Relief for the protection of one of the contracting parties AND third persons from all injury and damages the contract may cause OR protect some incompatible and preferent right created by the contract
- Implies a contract which, even if initially valid, produces a lesion or pecuniary damage to someone
- Set asides the act or contract for justifiable reasons of equity
- Grounds for rescission can only be for legal cause
- Voidable contracts may also be rescinded
- Sir Labitag: Rescissible contracts are in between valid and void

Rescission Art 1380 Distinguished from Resolution Art 1191

	Art 1191 Resolution	Art 1380 Rescission
Similarities	1. Presuppose contracts validly entered into and existing □ Rescission v. Annulment: the latter there is a defect which vitiates/invalidates the contract 2. Mutual restitution when declared proper	
Who may demand	Only by a party to the contract	Party to the contract suffering lesion Third parties prejudiced by the contract
Grounds	Non-performance (implied tacit condition in reciprocal obligation)	Various reasons of equity provided by the grounds, mainly economic injury or lesions
Scope of judicial control	Court determines sufficiency of reason to justify extension of time to perform obligation (whether slight or casual breach)	Sufficiency of reason does not affect right to ask for rescission (cannot be refused if all the requisites are satisfied)
Kind of obli applicable to	Only to reciprocal	Unilateral, reciprocal Even when contract is fully fulfilled
Character	Principal Remedy	Secondary/Subsidiary

Case:

- Universal Food Corporation v CA

MUTUAL DISSENT not the same with rescission, because mutual dissent is tantamount to a simple creation of new contract for the dissolution of the previous one. In order for rescission to take place, the requisites must first be satisfied:

Requisites for Rescission

1. The contract is rescissible
Art 1381 Kinds of rescissible contracts
Art 1382 Payments *made in a state of insolvency* for obligations to whose fulfillment the debtor could not be compelled at the time (has not yet matured) they were effected, are also rescissible.
2. The party asking for rescission has no other legal means to obtain reparation

Art 1383 The action for rescission is *subsidiary*; it cannot be instituted except when the party suffering damage has no other legal means to obtain reparation for the same.

3. He is able to return whatever he may be *obliged to restore* if *rescission is granted*

Art 1385 "Rescission creates the obligation to return the things which were the object of the contract, together with their fruits, and the price with its interest..."

4. The object of the contract has not passed legally to the possession of a third person acting in good faith
Art 1385 "...consequently, it can be carried out only when he who demands rescission *can return* whatever he may be obliged to restore."

Art 1385 Par 3 Neither shall rescission take place when the things which are the object of the contract are *legally in the possession of third persons who did not act in bad faith*.

5. The action for rescission is brought within the prescriptive period of four years

Art 1389 The action to claim rescission must be commenced *within four years*.

For persons under guardianship and for absentees, the period of four years shall not begin until the termination of the former's incapacity or until the domicile of the latter is known.

- Period commences on the termination of the ward's incapacity or absentee's domicile is known

Effect of Rescission

- If in fraud of the creditors: Property alienated reverts to the patrimony of the debtor and becomes liable to creditor who sought rescission, under its original liability as a guaranty of the debtor's obligation
- Art 1385 Rescission creates the obligation to *return the things which were the object of the contract*, together with their fruits, and the price with its interest; consequently, it can be carried out only when he who demands rescission can return whatever he may be obliged to restore.

With respect to third persons who acquired the thing in good faith

- Transferee of property in good faith who acquires property for valuable consideration, without knowledge of the litigation or claim of the plaintiff, cannot be deprived of property.
- Art 1385 Par 2 Neither shall rescission take place when the things which are the object of the contract are *legally in the possession of third persons who did not act in bad faith*.
- Art 1385 Par 3 In this case, indemnity for damages may be demanded from the person causing the loss.
- Right of transferee to retain alienation:
 - Nature of transfer
 - ONEROUS
 - Good faith – no rescission
 - Bad faith – rescissible because of his complicity in the fraud □ not entitled for reimbursement because in *pari delicto*; if not possible to return, indemnify the plaintiff;
 - GRATUITOUS
 - Good faith – does not protect him because he gave nothing; rescissible, though not required to restore the fruits
 - Bad faith – rescissible because of his complicity in the fraud; if not possible to return, indemnify the plaintiff

Who may bring action for rescission

1. Creditor injured
2. Heirs of creditor injured
3. Creditors of creditor injured (by virtue of accion subrogatoria)

Extent of Rescission

Art 1384 Rescission shall be on/y to the extent necessary to cover the damages caused.

- As to the excess, alienation is maintained even if transferee is in bad faith
- Benefits only the plaintiff creditor, not everyone
- BUT if transferee is willing to pay, no rescission

Presumptions of Fraud

Art 1387 All contracts by virtue of which the debtor alienates property by gratuitous title are presumed to have been entered into in fraud of creditors, when the donor did not reserve sufficient property to pay all debts contracted before the donation.

Alienations by onerous title are also *presumed fraudulent* when made by persons against whom *some judgment* has been issued. The decision or attachment need not refer to the property alienated, and need not have been obtained by the party seeking the rescission.

In addition to these presumptions, the design to defraud creditors may be proved in *any other manner* recognized by the *law of evidence*.

- Rebuttal by evidence that conveyance was made:
 - In good faith
 - For a sufficient cause
- Effect of Fraud: Does not necessarily make the alienation rescissible. It is only one of the requisites for accion pauliana. Can be overruled by a transferee in good faith and for valuable consideration

Badges of Fraud (indicia of fraud) – rules by which fraudulent character of transaction may be determined

1. Fictitious/insufficient consideration
2. Conveyance is after suit is filed and while it is pending
3. Sale on credit by insolvent debtor
4. Evidence of insolvency or large indebtedness
5. Transfer of All or nearly all of debtor's property
6. Transfer is between father and son when some of above is present
7. Failure of vendee to take exclusive possession of the property

Cases:

- Oria v McMicking
- Siguan v Lim
- Suntay v CA *supra*

Liability for acquiring in bad faith the things alienated in fraud of creditors

Art 1388 Whoever acquires in bad faith the things alienated in fraud of creditors, shall indemnify the latter for damages suffered by them on account of the alienation, whenever, due to any cause, it should be *impossible* for him to return them.

If there are two or more alienations, the first acquirer shall be liable first, and so on successively.

Chapter VII. Voidable or Annullable Contracts

Kinds of Voidable/ Annullable Contracts

Art 1390 Although no damage to contracting parties:

1. Want of capacity
2. Vitiated consent

Characteristics of Voidable/ Annullable Contracts

1. Their defect consists in the *vitiation* of consent of one of the contracting parties
2. They are binding until they are annulled by a competent court
3. They are susceptible of convalidation by ratification or by prescription

ANNULMENT

Annulment distinguished from Rescission

NULLITY (Voidable)	RESCISSION (Rescissible)
Declares inefficiency which contract already carries in itself (intrinsic defect)	Merely produces inefficiency, which did not exist essentially in the contract (external defect i.e. pecuniary damages or prejudice to one of the contracting parties or 3 rd persons)
Requires act of ratification to be cured	Needs no ratification to be effective
Based on a vice of the contract which invalidates it	Compatible with the perfect validity of the contract
Annulment is a sanction based on law	Rescission is a remedy based on equity
Demanded only by the parties to the contract	Demanded even by third parties affected by it
Public interest predominates	Private interest predominates

Grounds for Annulment Art 1390

1. Incapacity to consent

- Not a requisite *sine qua non* of the contract; *want* is *only* a ground for *annulment*
- 2. Vices of *consent*: *violence, intimidation, undue influence, mistake or fraud*

Who may and may not institute an Action for Annulment Art 1397

A. *MAY*: All who are obliged principally or subsidiarily

Art 1395: action does not require conformity of the other party who has no right to bring action for annulment

Requisites:

- a. Interest in the contract – there must be legal capacity by being bound to the contract either principally or subsidiarily
- b. Victim and not the party responsible for the defect – he who comes to the court must come with clean hands (so not applicable to the successor in interest of one who has contracted with a minor)

B. *MAY NOT*:

1. Capable parties cannot allege the incapacity of those with whom they contracted
2. Parties who exerted intimidation, violence or undue influence or employed fraud or caused mistake
3. Third person who is a stranger to the contract. *UNLESS* he can prove that the contract prejudiced his rights with respect to one of the contracting parties, he may ask for annulment e.g. guarantors and sureties (*Singsong v. Isabela Sawmill*)

Case:

- *Singsong v Isabela Sawmill*

Prescription of Action for Annulment – after prescription, contract can no longer be set aside

Art 1391 - Within 4 years

Period shall begin:

1. Intimidation, violence or undue influence: from the time consensual defect ceases
2. Mistake or fraud: from the time of discovery of the same
3. Incapacity: from the time guardianship ceases

* Extinctive prescription applies not only to action for annulment, but also to the defense of nullity

* Applies to the parties of to the contract, but NOT to third persons

Effects of Annulment– cleanses the contract from all its defect from the moment it was constituted (retroactive effect), but does not prejudice rights of 3rd persons acquire before the ratification Art 1396

a. *MUTUAL RESTITUTION* Art 1398 Restore to each other things which have been the subject matter of the contract, together with fruits and the price with interest,

- *EXCEPT* in cases provided by law (principle of unjust enrichment): compensation, services rendered in contracts of service
- *ELIMINATES AWARD FOR DAMAGES*. But when there is loss or suffered damages, injured party may be entitled to recover indemnity for damages.

b. Art 1402 as long as one does not restore what he is bound to return, the other cannot be compelled to return

- LOSS THROUGH PLAINTIFF'S (party entitled to bring action) FAULT or FRAUD: Action is extinguished, even if at the time of the loss the plaintiff is still a minor or insane (Art 1401)
- LOSS THROUGH FORTUITOUS EVENT, BUT PLAINTIFF WILLING TO PAY: Apply Art 1400, defendant should return but not including the interest because loss not due to his fault.
- LOSS OF FRUITS AND ACCESSIONS: Apply Art 1400, pay value if cannot return (both plaintiff and defendant)

1. When one of the parties is incapacitated

Art 1399 not obliged to make any restitution EXCEPT insofar as he has been benefited by the price/thing received

- Benefit not necessarily a material and permanent increase in fortune
- Proof of benefit incumbent upon the defendant, in the absence of such proof, the presumption is there is no benefit/profit to the incapacitated person
- If still in the patrimony at the time incapacity ceases, deemed to have been benefited. If he asks for annulment, he must return it to the other party. If he squanders, it is ratification.

2. When the thing is lost through the fault of the party obliged to return the same (i.e. defendant)

Art 1400 return the fruits received AND the value of thing at the time of loss, with interest from same date
LOSS THROUGH FORTUITOUS EVENT: pay the value of the thing lost but not fruits and interests

Cases:

- Cadwallader & Co v Smith, Bell & Co
- Velarde v CA *supra*

Extinguishment of the Action

a. Art 1392 By *ratification*

Confirmation/ratification: cures a defect of nullity

Acknowledgment: remedies deficiency of proof

b. Art 1401 When the *thing* is lost through the *fault* of the person who has the right to file the *action*

- LOSS NOT THROUGH THE FAULT, e.g. fortuitous event: not extinguished because extinguishment limited only to the loss by fault of plaintiff. Unjust enrichment if the loss is returned for the defendant to bear. Hence, the defendant cannot be obliged to make restitution to the plaintiff because of Art 1402 (cannot compelled to return if the other party does not return)
- Cannot extinguish action for annulment by any event not imputable to the fault or fraud of the plaintiff

RATIFICATION

Requisites of Ratification

- Contract is *voidable/annullable* (i.e. consent of one party is *defective*)
- Ratification is made *with the knowledge* of the cause for nullity
- At the time of the ratification, the cause of nullity has already ceased to exist

Forms of Ratification

a. Art 1393 Express or tacit: execute an act which necessarily implies an intention to waive his rights

E.g. of *EXPRESS*: any oral or written manifestation of the person entitled to ask for annulment that he agrees to be bound by the contract or that he will not seek its annulment

E.g. of *IMPLIED*:

- silence or acquiescence
- acts showing approval or adoption of the contract
- acceptance and retention of benefits flowing therefrom

b. Art 1394 By the parties themselves or by the guardian in behalf of an incapacitated party

- During the existence of incapacity
- Right to ratify is transmitted to the heirs of the party entitled to such right.

Effects of Ratification

- Art 1392 Action to annul is extinguished
- Art 1396 The contract is cleansed retroactively from all its defects from the time it was constituted
EXCEPTION: Right of 3rd persons prior to ratification

Case:

- Uy Soo Lim v Tan Unchuan

Chapter VIII. Unenforceable Contracts

Characteristics of Unenforceable Contracts

1. They *cannot* be enforced by a proper action in court
2. They are susceptible of *ratification*
3. They *cannot* be assailed by third persons Art 1408

Unenforceable distinguished from Rescissible and Annullable

UNENFORCEABLE	RESCISSIBLE AND ANNULLABLE
Produces NO legal effect unless ratified by competent court	Produce legal effects unless set aside by competent court

Kinds of Unenforceable Contracts

1. Entered into in the name of another person by one who has no authority or no legal representation OR acted beyond his powers
2. Do not comply with Statute of Frauds, which are agreements unenforceable unless in written memorandum and subscribed by the party charged

- a. Not to be performed within 1 year from the making □ If no time is fixed and nothing to show that it cannot be performed within a year, then not within SoF; Partial performance also takes it out of SOF
 - b. Special promise to answer for the debt, default or miscarriage of another □ *Default or Miscarriage include liability for tort and are not to be restricted to defaults and miscarriages arising out of contracts; Must be collateral only and not primarily liable for the debt*
 - c. Agreement made in consideration of marriage other than "mutual" promise to marry □ not limited to marrying parties but also to promises by a third person to one of the parties contemplating the marriage
 - d. Sale of goods, chattels or things in action, priced > P500 unless buyer accept and receive part of such goods and chattels or the evidences or some of them or pay at the time some part of the purchase money.
EXCEPTION: sale is by auction and entry is made by auctioneer in his sales book (because it constitutes sufficient memorandum)
 - e. Leasing for period longer than one year OR sale of real property or of an interest therein
 - f. Representation to the credit of a 3rd person
3. Both parties are incapable of giving consent to contract

Art 1403 Par 1: Unauthorized contracts

Governing rules in Unauthorized Contracts: Art 1404 Governed by Art 1317 (no one may contract in the name of the other without being authorized or unless he has by law a right to represent him; representation without authority or legal representation makes the contract unenforceable) and principles of Agency in Title X of this Book

- Does not having binding effect on the principal, UNLESS principal ratifies it which cures the unauthorized contract.
- Agent who binds his principal without authority to do so is liable to 3rd persons.

Art 1403 Par 2: Contracts covered by the Statute of Frauds

Statute of Frauds: descriptive of statutes which requires certain classes of contracts to be in writing. Merely regulates the formalities of the contract necessary to render it enforceable.

- NOT APPLICABLE TO: (1) Action for specific performance, (2) Violation of the contract
- APPLICABLE TO: *Executory and not to complete or executed contracts* □ intention of the parties become apparent by their execution. However, partial performance must also be proven.
- Exclusive list of agreements/contracts enumerated; Rule of exclusion
- A personal defense (hence cannot be raised by 3rd persons) and the same may be waived
- Does not determine credibility or weight of the evidence, merely concerned with the *admissibility* thereof

Purpose of Statute: Prevent (and not to encourage it) fraud and perjury in the enforcement of obligations depending for their evidence upon the unassisted memory of witnesses, by requiring certain enumerated contracts and transactions to be evidenced by a writing signed by the party to be charged.

- Provides for the manner which contracts under it shall be proved
- Does not attempt to make contracts invalid if not executed in writing, only makes ineffective the action for specific performance
- Principal aims: (1) prevent commission of injustice due to faulty memory, (2) discouraging intentional misrepresentations

WRITTEN MEMORANDUM OR NOTE evidence of the agreement and is used to show the intention of the parties

Minimum requirement for written memorandum:

1. Names of the parties
2. Terms and conditions of the agreement
3. Description of the subject matter sufficient to render it capable of identification
4. Date and place of the making of the agreement
5. Signature of the party assuming the obligation

Cases:

- PNB v Philippine Vegetable Oil Co
- Limketkai Sons Milling Inc v CA
- Swedish Match v CA

How to ratify contracts under Statute of Frauds? Art 1405

1. Failure to object to the presentation of oral/parole evidence to prove the same
2. Acceptance of benefits under them □ SoF cannot be invoked when the contract has been partly executed

Case:

- Carbonell v Poncio

Right of the parties when a contract is ENFORCEABLE *BUT* a public document is NECESSARY for its registration
Art 1406 □ may avail of their rights under Art 1357 (parties may compel each other to observe the necessary form once the contract has been perfected)

Art 1403 Par 3: Contracts executed by parties who are both incapable of giving consent to a contract
Art 1407

- a. Effect of ratification by the parent or guardian of one of the parties: (express or implied)
 - Converts the contract into a voidable contract, at the option of the party who has not ratified.
 - The non-ratifying party may: enforce the contract OR ask for the annulment
- b. Effect of ratification by the parents or guardians of both parties: validated from the inception

Chapter IX. Void or Inexistent Contracts

Characteristics of Void/ Inexistent Contracts

1. Void *from the beginning*
2. Produces *no effect whatsoever* □ nullity exist ipso jure, judgment of nullity is merely declaratory
3. Cannot be confirmed or validated (by prescription OR ratification), neither can the right to set up the defense of illegality be waived Art 1409

ACCION REIVINDICATORIA – any person may invoke the inexistence of the contract whenever juridical effects founded thereon are asserted against him

Action to Declare Nullity

- necessary because nobody can take the law into his own hands
- if the void contract is still *executory*, no party need to bring an action; but if one party brings action to *enforce* it, nullity can be set up as defense

Void/inexistent contracts distinguished from other defective contracts

VOID	RESCISSIBLE
Defect is inherent <u>in the contract itself</u>	Defect is in their <u>effects</u> , either to one of the parties or to a 3 rd party
Matter of law and public interest	Based on equity and more a matter of private interest
No legal effects even if no action is taken to set it aside	No action, remains valid and produces all its effects
Action to declare nullity of void contracts never prescribes	Action to rescind prescribes in 4 years
VOID	UNENFORCEABLE
Cannot be the basis of actions to enforce compliance	
Can never be ratified and become enforceable	Can be ratified and thereafter enforced
There is no contract at all	There is a contract which, however, cannot be enforced unless properly ratified
VOID	VOIDABLE
One of those essential requisites is wanting, either in fact or in law or is declared void by statute	Essential requisites for validity is present, BUT consent is vitiated
No contract, but only appearance of one, produces no effect even if not set aside by direct action (collateral attack allowed)	Valid until set aside, validity may only be assailed directly, never by a 3 rd person
Not susceptible of ratification	May be rendered perfectly valid by ratification
Action to declare nullity does not prescribe, permanent, even if the cause of nullity ceased to exist	Action for annulment prescribes in 4 years

Kinds of Void/ Inexistent Contracts Art 1409

Contracts that are VOID

- Art 1409 Par 1 1. Those whose cause, object or purpose is contrary to law, morals, good customs, public order, or public policy

- a. Art 1411 When the act constitutes a criminal offense (illegality of cause or object)

IN PARI DELICTO RULE

1. BOTH are *in pari delicto*
 - No action against each other
 - BOTH will be prosecuted
 - RPC provision relative to the disposal of effects/instruments of a crime shall apply
2. ONLY ONE is guilty
 - INNOCENT PARTY may claim what he has given
 - INNOCENT PARTY not bound to comply with his promise

Case:

- Urada v Mapalad

- b. Art 1412 When the act is unlawful but does not criminal offense

IN PARI DELICTO RULE

1. BOTH parties at fault
 - Neither party may recover what he has given by virtue of the contract
 - Neither party may demand the performance of the other's undertaking
2. ONLY ONE is guilty
 - INNOCENT PARTY may demand the return of what he has given without obligation to comply with his promise
 - PARTY AT FAULT cannot recover what he has given by reason of the contract
 - PARTY AT FAULT cannot ask for the fulfillment of what has been promised to him

- Not applicable to fictitious contracts because they refer to contracts with an illegal cause or subject-matter (criminal offense OR only illegal), OR to contracts that are null and void ab initio. Fictitious or simulated contracts don't have cause.

Case:

- Modina v CA

EXCEPTIONS TO THE IN PARI DELICTO RULE

General Statement of the Exception (Art 1416): Agreement is not illegal per se, but merely prohibited

- Prohibition is designed for the protection of the plaintiff
- Plaintiff may recover what he paid or delivered if public policy is enhanced
- *ILLEGAL PER SE* – one that by universally recognized standards is inherently or by its very nature bad, improper, immoral or contrary to good conscience.

Cases:

- PBC v Lui She
- Frenzel v Catito

OTHER SPECIFIC EXCEPTIONS

- c. Art 1414 When the *PURPOSE* is illegal and money is paid or property delivered therefore □ maybe repudiated by one of the parties before the purpose has been accomplished OR before any damage has been caused to a 3rd person. Courts may allow the party repudiating the contract to recover the money or property, if the public interest will thus be subserved.
- d. Art 1415 When the *CONTRACT* is *illegal* and one of the parties is *INCAPABLE* of *giving* consent □ courts may allow recovery of money/property delivered by the incapacitated person, if interest of justice so demands

Case:

- Liguez v CA
- Relloza v Gaw Cheen Hun

- e. Art 1417 When the amount paid exceeds the maximum fixed by law → any person paying in excess of the maximum price may recover such excess
- f. Art 1418 When by virtue of contract a laborer undertakes to work longer than the *maximum* number of hours of work fixed by law → worked may demand additional compensation for service rendered beyond the limit
- g. Art 1419 When a laborer agrees to accept a lower wage than that set by law → entitled to recover deficiency
- h. Art 1420 When the contract is *divisible* → if illegal terms can be separated from legal ones, enforce latter
 - In case of doubt, contract is considered as divisible or separable.
 - EXCEPTIONS:
 1. Nature of contract requires indivisibility e.g. contract of compromise
 2. Intention of the parties is that the contract be entire e.g. if what is void be the essential part, void the entire contract. Divisibility will only be followed when the nullity affects only the secondary or accessory obligations.
- i. Art 1422 When the contract is the DIRECT RESULT of a previous illegal contract → also void and inexistent

Art 1409 2. Those whose object is outside the commerce of man

Par 4

Art 1409 3. Those which contemplate an impossible service

Par 5

Art 1409 4. Those where the intention of the parties relative to the principal object of the contract cannot be ascertained

Par 6

Art 1409 5. Those expressly prohibited are declared void by law

Par 7

Contracts that are INEXISTENT

Art 1409 1. Those which are absolutely simulated or fictitious

Par 2

Art 1345 Simulation of contracts may be ABSOLUTE (parties do not intend to be bound at all) or RELATIVE (parties conceal their true agreement)

Art 1346 Absolute or Fictitious: void

Art 1409 2. Those whose cause or object did not exist at the time of the transaction

Par 3

Right to set up defense of illegality cannot be waived Art 1409

The action or defense for the declaration of the inexistence of a contract

1. Art 1410 Does not prescribe, defect is permanent and incurable
2. Art 1421 Is *NOT* available to 3^d persons whose interest is not directly affected

* Ratification may take the form of a new contract, in which case its validity shall be determined only by the circumstances at the time of the execution of the new contract. However, the same does not retroact to the constitution of the first contract.

See Table of Defective Contracts in the next page.

DEFECTIVE CONTRACTS

Professor E. A. Labitag

DEFECTIVE CONTRACTS	AS TO NATURE OF DEFECT	EFFECT ON CONTRACT	ASSAILABLE? HOW?	WHO CAN ASSAIL?	WHEN TO ASSAIL?	CURABLE? HOW?	WHO C
RESCISSIBLE (Arts 1381 – 1389) Economic prejudice or damage to: - owner - 3 rd person - litigant Can generally be ASSAILED and CURED by: Injured Party EFFECTS: Mutual restitution	Contracts of guardians (acts of administration) when wards they represent suffer lesion of more than 25% of the value of thing	VALID until rescinded	YES but only through DIRECT action for rescission <u>No rescission if:</u> a. plaintiff has other legal means to obtain reparation (subsidiary) b. plaintiff cannot return what must be restored	By ward Or by guardian ad litem of ward during incapacity of ward in action against original guardian	Within 4 years from gaining (minor) or regaining (insane) capacity	YES By ratification (Confirmation by the ward)	By ward
	Contracts in representation of absentees when latter suffers lesion of more than 25% of value of thing	VALID until rescinded	c. object in the hands of 3 rd persons in good faith d. Contract approved by court (Art 1386)	By absentee	Within 4 years from knowledge of domicile of absentee	YES By prescription	By absen
	Contracts entered into by debtor who is a state of insolvency, i.e. contracts entered into in fraud of creditors (Accion Pauliana)	VALID until rescinded	YES but only through DIRECT action for rescission <u>No rescission if:</u> a. plaintiff has other legal means to obtain reparation (subsidiary)	By plaintiff-creditor By heirs of creditor BY creditors of creditors injured (accion subrogatoria) By other third parties prejudiced by the contract	Within 4 years from knowledge of fraudulent contract	YES By prescription	By credito
	Contracts which refer to things in litigation without the knowledge and approval of litigants or competent judicial authority	VALID until rescinded	b. plaintiff cannot return what must be restored c. object in the hands of 3 rd persons in good faith	By party litigant	Within 4 years from knowledge of fraudulent contract	YES By prescription	By party
	All other contracts declared by law to be subject of rescission E.g. Art 1098 Partition	VALID until rescinded					

DEFECTIVE CONTRACTS	AS TO NATURE OF DEFECT	EFFECT ON CONTRACT	ASSAILABLE? HOW?	WHO CAN ASSAIL?	WHEN TO ASSAIL?	CURABLE? HOW?	WHO C
VOIDABLE (Arts 1390 – 1402) Vitiated consent EFFECT: Cleanses defect of contract Does not prejudice right of 3P prior to ratification Mutual restitution	Want of capacity - age - insanity	VALID until annulled by court action	YES. Both through direct and collateral attacks. Action for annulment	All who are obliged principally or subsidiarily (i.e. guarantors and sureties) Incapacitated party; not the party with capacity Victim; not the party who cause the defect	Within 4 years from cessation of (re)gaining capacity	YES By ratification By prescription	By partie By guard of an inca party dur of incapa
	Consent is vitiated by: - mistake or error - violence and intimidation (duress) - undue influence - fraud, misrepresentation				Within 4 years from: - cessation of intimidation, violence, undue influence (consensual defect) - discovery of mistake or fraud	YES 1 By ratification - Express - Implied (silence or acquiescence, acts showing approval or adoption of contract, acceptance and retention of benefits) 2 By prescription	
UNENFORCEABLE (Arts 1403 – 1408)	Contract entered into name of another without authority or in excess of authority	VALID but cannot be ENFORCED by a proper action in court	YES. Not by direct action but by DEFENSE of unenforceability of contract through motion to dismiss complaint on the ground that contract is unenforceable	By owner of property	At any time one party attempts to enforce contract against the other through a court action	By ratification	Person in the contr entered i
	Contracts covered by Statute of Frauds and not complying with requirement of a written memo	VALID but cannot be ENFORCED by a proper action in court	YES. Not by direct action but by DEFENSE of unenforceability of contract either through: 1. motion to dismiss complaint on the ground that contract is unenforceable 2. objection to presentation of oral evidence to prove contract	By other party By his privies (heirs, representatives and assigns)	At any time one party attempts to enforce contract against the other through a court action	By acknowledgement By performance of oral contract By failure to object seasonably to presentation of oral evidence By acceptance of benefits under the contract	By party the contr enforced

	Both parties are legally incapacitated to act	VALID but cannot be ENFORCED by a proper action in court	YES. Not by direct action but by DEFENSE of unenforceability of contract through motion to dismiss complaint on the ground that contract is unenforceable	By other party By his privies (heirs, representatives and assigns) By guardian	At any time one party attempts to enforce contract against the other through a court action	By confirmation	By parents/guardians/parties Both parties (re)gain act
VOID or INEXISTENT (Arts 1409 – 1422)	Cause, object or purpose of contract contrary to law, good customs, morals, public order or public policy (Art 1401, Par 1)	DOES NOT CREATE RIGHTS AND CANNOT IMPOSE OBLIGATION	YES. By an action for declaration for nullity By defense of nullity	By innocent party By 3 rd persons whose interest are directly affected (If in pari delicto, neither has an action against each other)	Imprescriptible	Cannot be cured	
	One or some of essential requisites of valid contract lacking in fact or in law a. Absolutely simulated b. Those whose cause or object did not exist c. Object outside the commerce of man d. Contemplate an impossible service e. Where intention of parties re: principal object of contract cannot be ascertained (Art 1402 Pars 2 to 6)	DOES NOT CREATE RIGHTS AND CANNOT IMPOSE OBLIGATION	YES. By an action for declaration for nullity By defense of nullity	By any of the contracting parties By 3 rd persons whose interests are directly affected	Imprescriptible	Cannot be cured	
	Contracts expressly prohibited by law (Art 1409 Par 7)	DOES NOT CREATE RIGHTS AND CANNOT IMPOSE OBLIGATION	YES. By an action for declaration for nullity By defense of nullity	By party whose protection the prohibition of the law is designed By 3 rd party whose interests are directly affected	Imprescriptible	Cannot be cured	

Title III. NATURAL OBLIGATIONS

Four types of obligations in juridical science □ reduced to two by jurisprudence

1. Moral obligations – duties of conscience completely outside the field of law
2. Natural obligations – duties not sanctioned by any action but have a relative judicial effect
3. Civil obligations – juridical obligations that are in conformity with positive law but are contrary to juridical principles and susceptible of being annulled; enforceable by action
4. Mixed obligations – full juridical effect; falls under civil obligations

Definition Art 1423 Not being based on positive law but on equity and natural law, do not grant a right of action to enforce their performance, but after voluntary fulfillment by the obligor, they authorize the retention of what has been delivered or rendered by reason thereof.

- Midway between civil and the purely moral obligation. "Obligation without a sanction," susceptible of voluntary performance, but not through compulsion by legal means.
- Real obligation which law denies action, but which the debtor may perform voluntarily.
- Patrimonial and presupposes a prestation.

Requisites of Natural Obligation

1. Juridical tie between two persons.
2. Tie is not given effect by law but instead by the conscience of *man* □ distinguishes it from civil obligations.

As distinguished from Civil Obligations

	NATURAL	CIVIL
As to enforceability	Not by court actions, but by good conscience of debtor	Court action or the coercive power of public authority
As to basis	Equity and natural justice	Positive law

As distinguished from Moral Obligations

NATURAL	PURELY MORAL
There is a juridical tie	There is no juridical tie
Performance by the debtor is a legal fulfillment of the obligation	Act is purely liberality
A true obligation with a legal tie between debtor and creditor	Matter is entirely within the domain of morals

Cases:

- Villaroel Estrada
- Fisher v Robb

Conversion to Civil Obligation

GENERAL RULE: Partial payment of a natural obligation does not make it civil; the part paid cannot be recovered but the payment of the balance cannot be enforced. □ applicable only to natural obligation because of prescription or lack of formalities (nullity due to form e.g. Art 1430) and *NOT* to natural obligation subject to ratification or confirmation.

- Payment by mistake is not voluntary and may be recovered. Payment is voluntary when the debtor knew that the obligation is a natural one. One who pays a natural obligation, believing it to be civil, does not thereby recognize the natural obligation; and there being no civil obligation either, he can recover what he has paid. The debtor however has the burden of proving the mistake.
1. By novation
 2. By confirmation or ratification

Examples

Art 1424 When the right to sue upon a civil obligation has lapsed by extinctive prescription, the obligor who voluntarily

performs the contract cannot recover what he has delivered or the value of the service he has rendered.

- Art 1425 When without the knowledge OR against the will of the debtor, a 3rd person pays a debt which the obligor is not legally bound to pay because the action thereon has prescribed, but the debtor later voluntarily reimburses the third person the obligor cannot recover what he has paid.
- Art 1426 When a minor 18-21 entered into a contract without the consent of the parent or guardian, after the annulment of the contract, voluntarily returns the whole thing or price received, notwithstanding that he has not been benefited thereby, there is no right to demand the thing or price thus returned.
- Art 1427 When a minor 18-21 entered into a contract without the consent of the parent or guardian, voluntarily pays a sum of money or delivers a fungible thing in fulfillment of an obligation, there shall be no right to recover the same from the obligee who has spent or consumed it in good faith.
- Not the voluntary payment that prevents recovery, but the consumption or spending of the thing or money in good faith.
 - This article creates an exception to the rule of mutual restitution. Minor would have been required to return whatever he received upon annulment of contract.
 - Good faith: belief that debtor has capacity to deliver the object of contract
 - Fungible thing: consumable
 - Non-consumable: debtor cannot recover if no longer in the possession of the creditor, because the right to recover presupposes existence of thing.
- Art 1428 When after an action to enforce a civil obligation has failed, the defendant voluntarily performs the obligation, he cannot demand the return of what he has delivered or the payment of the value of the service he has rendered.
- Art 1429 When a testate or intestate heir voluntarily pays a debt of a decedent exceeding the value of the property which he received by will or by the law of testacy from the estate of the deceased, the payment is valid and cannot be rescinded by the payer.
- Art 1430 When a will is declared void because it has not been executed in accordance with the formalities required by law, but one of the intestate heirs, after the settlement of the debts of the deceased, pays a legacy in compliance with a clause in the defective will, the payment is effective and irrevocable.

Title IV. ESTOPPEL

Definition Art 1431 Admission or representation is rendered conclusive upon the person making it, and cannot be denied or disproved as against the person relying thereon.

- Bar which precludes a person from denying or asserting anything to the contrary of that which in has, in contemplation of law, been established as the truth, either by the acts of judicial or legislative officers or by his own deed or representation, either express or implied.
- Concludes the truth in order to prevent falsehood and fraud, and imposes silence on the party only when in conscience and honesty he should not be allowed to speak.
- Origin is in equity and is therefore based on moral right and natural justice
- Cannot be predicated on an illegal act

EQUITABLE ESTOPPEL	WAIVER
May arise even when there is no intention on the part of the person estopped to relinquish any existing right	Voluntary and intentional abandonment or relinquishment of a known right
Frequently carries implication of fraud	No implication of fraud
Involves the conduct of both parties	Involves the act or conduct of only one of the parties

ESTOPPEL	RATIFICATION
Bound notwithstanding the fact that there was no such intention, because the other party will be prejudiced and defrauded by his conduct unless the law treats him as legally bound	Bound because he intended to be

Case:

- Kalalo v Luz

Kinds of Estoppel – **Art 1433**: Estoppel may be in pais or by deed

A. TECHNICAL ESTOPPEL

1. By record – preclusion to deny the truth of matters set forth in a record, whether judicial or legislative, and also to deny the facts adjudicated by a court of competent jurisdiction
 - i. E.g. conclusiveness of judgment (estoppel by judgment) on the parties to a case, which according to Sir is broader than *res judicata*
2. By deed – bar which precludes on party to a deed and his privies from asserting as against the other party and his privies any right or title in derogation of the deed, or from denying the truth of any material facts asserted in it □ usually written documents

B. EQUITABLE ESTOPPEL (estoppel *in pais*) – because of something which he *has done* or omitted to do, *a party is denied the right to plead or prove an otherwise important act*

- Essential elements of estoppel in pais in relation to the party sought to be estopped:
 1. Conduct amounting to false representation or concealment of material facts, or at least calculated to convey the impression that the facts are otherwise than and inconsistent with, those which the party subsequently attempts to assert
 2. Intent, or at least expectation that this conduct shall be acted upon by or at least influence, the other party
 3. Knowledge, actual or constructive, of the real facts
- Essential elements of estoppel in pais in relation to the party claiming the estoppel:
 1. Lack of knowledge or of the means of knowledge of the truth as to the facts in question
 2. Reliance, in good faith, upon the conduct or statements of the party to be estopped
 3. Action or inaction based thereon of such character as to change the position or status of the party claiming the estoppel, to his injury, detriment or prejudice

POSITIVE ESTOPPEL IN PAIS

1. Estoppel by *representation or misrepresentation* (Art 1437 or estoppel against owners) □ When a contract between 3rd persons concerning immovable property, one of them is misled by a person with respect to the ownership or real right over real estate, the latter is precluded from asserting his legal title or interest therein, provided all these requisites are present:
 1. Fraudulent representation or wrongful concealment of facts known to the party estopped
 2. Party precluded must intent that the other should act upon the facts as misrepresented
 3. Party misled must have been unaware of the true facts
 4. Party defrauded must have acted in accordance with the misrepresentation
2. Estoppel by *acceptance of benefits* (Art 1438 or estoppel from benefits) □ One who has allowed another to assume apparent ownership of personal property for the purpose of making any transfer of it, cannot, if he received the sum for which a pledge has been constituted, set up his own title to defeat the pledge of the property, made by the other to a pledgee who received the same in good faith and for value.
3. *Promissory estoppel* □ An estoppel may arise from making of a promise, even though without consideration, if it was intended that the promise should be relied upon and in fact it was relied upon, and if a refusal to enforce it would be virtually to sanction the perpetuation of fraud or would result in other injustice.
 - b. A promise cannot be the basis of an estoppel if any other essential element is lacking.
 - c. *Justifiable reliance* or *irreparable detriment* to the promise are requisite factors.
 - d. Came from Anglo-American Law, by virtue of Art 1432 which adopts principle of estoppel

NEGATIVE ESTOPPEL IN PAIS

1. *Estoppel by laches* – failure or neglect, for an unreasonable and unexplained length of time, to do that which, by exercising due diligence, could or should have been done earlier.
 - Public policy requires for the peace of society, discouragement of stale claims and laches, unlike statute of limitations, is not a mere question of time but principally a question of inequity or unfairness of permitting a right or claim to be enforced or asserted.
 - Discretionary on the part of the court.
 - Requisites of laches:
 - a. Conduct on part of the defendant, or one under whom he claims, giving rise to the situation complained of
 - b. Delay in asserting complainant's right after he had knowledge of the defendant's conduct and after he has had an opportunity to sue
 - c. Lack of knowledge or notice on the part of the defendant that the complainant would assert the right on which he bases his suit
 - d. Injury or prejudice to the defendant in the event relief is accorded to the complainant
 - Distinguished from prescription

LACHES	PRESCRIPTION
Concerned with <i>effect of delay</i>	Concerned with <i>fact of delay</i>
Principally question of <i>inequity of permitting a claim</i>	Matter of <i>time</i>
Not based on statute but on equity	Statutory
Not based on <i>fixed time</i>	Fixed time

2. *Estoppel by silence* - "One who is silent when he ought to speak will not be heard to speak when he ought to be silent." Mere innocent silence will not work an estoppel, there must also be some element of turpitude or negligence connected with the silence by which another is misled to his injury. Closely connected to ESTOPPEL BY ACQUIESCENCE: a person is prevented from maintaining a position inconsistent with one in which he has acquiesced.

Persons bound Art 1439 Effective only as between the parties thereto or their successors in interest (privies in blood like heirs, and in estate like grantees).

- Why? Mutuality is an essential element of an estoppel, an estoppel must bind both parties or neither is bound.
- No estoppel against government. It is not estopped by *mistake or error on the part of its officials or agents*, the *erroneous application and enforcement of the law by public officers does not prevent a subsequent correct application of the statute*.

Case:

- Manila Lodge No. 761 Benevolent and Protective Order of the Elks v CA

Cases where estoppels applies

<u>Art 1434</u> Subsequent acquisition of title	When a person who is not the owner of a thing sells or alienates and delivers it, and later the seller or grantor acquires title thereto, such title passes by operation of law to the buyer or grantee.
<u>Art 1435</u>	If a person in representation of another sells or alienates a thing, the former cannot subsequently set up his own title as against the buyer or grantee.
<u>Art 1436</u> Tenant	A lessee or a bailee is estopped from asserting title to the thing leased or received, as against the lessor or bailor.
<u>Art 1437</u> Estoppel against owner	When a contract between 3 rd persons concerning immovable property, one of them is misled by a person with respect to the ownership or real right over real estate, the latter is precluded from asserting his legal title or interest therein, provided all these requisites are present: <ol style="list-style-type: none"> 1. Fraudulent representation or wrongful concealment of facts known to the party estopped 2. Party precluded must intent that the other should act upon the facts as misrepresented 3. Party misled must have been unaware of the true facts 4. Party defrauded must have acted in accordance with the misrepresentation
<u>Art 1438</u> Estoppel from benefits	One who has allowed another to assume apparent ownership of personal property for the purpose of making any transfer of it, cannot, if he received the sum for which a pledge has been constituted, set up his own title to defeat the pledge of the property, made by the other to a pledge who received the same in good faith and for value.

Case:

- Miguel v Catalino
- Read the annotation on 32 SCRA 542

Title V. TRUSTS

Definition Trust is the legal relationship between one person having an EQUITABLE OWNERSHIP in property and another person OWNING THE LEGAL TITLE to such property, the equitable ownership of the former entitling him to the performance of certain duties and the exercise of certain powers by the latter.

Characteristic of Trust

1. It is a relationship
2. A relationship of fiduciary character
3. A relationship with respect to property, not one involving merely personal duties
4. It involves the existence of equitable duties imposed upon the holder of the title to the property to deal with it for the benefit of another
5. It arises as a result of a manifestation of intention to create the relationship

Governing rules in Trust

Art 1442 Principles of the general law of trusts are transplanted to the Philippine soil

Parties in a Trust

Art 1440 A person who establishes a trust is called the trustor; one in whom confidence is reposed as regards property for the benefit of another person is known as the trustee; and the person for whose benefit the trust has been created is referred to as the beneficiary.

TRUSTOR – Establishes a trust

TRUSTEE – One in whom confidence is reposed as regards property for the benefit of another person

BENEFICIARY or cestui que trust – Person for whose benefit the trust has been created

- Liability of trustee who violates trust is personal. The action (nature of a general demand for damages) can be maintained by cestui que trust or persons claiming under him or by creator of the trust only against the trustee.
- Cestui que trust: Not always necessary that should be named, or even be in existence at the time the trust is created in his favor.

Kinds of Trust

Art 1441 Trusts are either express or implied. EXPRESS trusts are created by the *intention* of the trustor or of the parties. IMPLIED trusts come *into being* by operation of law.

Case:

- Salao v Salao

1. EXPRESS TRUSTS can come into existence ONLY by the manifestation of an intention (manifested by conduct or by words) to create it by the one having legal and equitable dominion over the property made subject to it.
 - Disables the trustee from acquiring for his own benefit the property committed to his management or custody, at least while he does not openly repudiate the trust and make such repudiation known to the beneficiary.

Proof required for Express Trust

Art 1443 No express trust concerning an immovable or any interest therein may be *proved by parol evidence*.

- Writing necessary to *prove* it; not for the validity but for the purposes of proof □ it is in the nature of a Statute of Fraud
- EXCEPTION: If property subject to trust is not real estate or an interest therein, it may be proved by any competent evidence including parol evidence
- Requisites of Express Trust
 1. Competent trustor
 2. Competent trustee
 3. Ascertainable trust res
 4. Sufficiently certain beneficiaries

Form of an Express Trust

Art 1444 No particular words are required for the creation of an express trust, it being sufficient that a trust *is clearly intended*.

Want of Trustee

Art 1445 No trust shall fail because the trustee appointed declines the designation, UNLESS the contrary should appear in the instrument constituting the trust.

- Where a trustee dies, resigns, suffers any legal incapacity, the trust does not fail but a new trustee will be appointed, which will be made by the proper court UNLESS by the terms of the trust, other provision is made for the appointment of successor trustee.
- Why? To permit it to fail for this reason would be contrary to the intention of the trustor in creating a trust who is primarily interested in the disposition of the beneficial interest in the property, and the matter of its administration is a subsidiary consideration.

Acceptance by beneficiary

Art 1446 Acceptance by the beneficiary is necessary. Nevertheless, if the trust imposes no onerous condition upon the beneficiary, his acceptance shall be PRESUMED, if there is no proof to the contrary.

2. IMPLIED TRUSTS come into existence either through implication of an intention to create a trust as a matter of law or through the imposition of the trust irrespective of and even contrary to any, such intention.

How to establish Implied Trusts

Art 1441 Trusts are either express or implied. Express trusts are created by the intention of the trustor or of the parties. Implied trusts come into being by operation of law.

- a. RESULTING – arises where a person makes or causes to be made a disposition of property under circumstances which raise an inference that he does not intend that the person taking or holding the property should have beneficial interest in the property
 - Sir Labitag: effect of failure to create an express trust, did not comply with the proper formality
- b. CONSTRUCTIVE – imposed where a person holding title to property is subject to an equitable duty to convey it to another on the ground that he would be unjustly enriched if he were permitted to retain it. The duty to convey the property arises because it was acquired through fraud, duress, undue influence, or mistake or through breach of fiduciary duty or through the wrongful disposition of another's party.
 - Sir Labitag: The trustee never intended to be a trustee, perhaps he intended to be the owner. The law imposed on him the obligation of the trustee because the real owner will be prejudiced (or will suffer irreparable damage) if no implied trust is created by law

How to prove implied trust

Art 1457 An implied trust may be proved by oral evidence.

Examples of implied trust

Art 1448
Trust from payment
Resulting There is an implied trust when property is sold, and the legal estate is granted to one party but the price is paid by another for the purpose of having the beneficial interest of the property. The former is a trustee, while the latter is the beneficiary. However if the person to whom the title is conveyed is a child, legitimate or illegitimate, of the one paying the price of the sale, no trust is implied by law, it being disputably presumed that there is a gift in favor of the child.

EXCEPTIONS:

1. Last part of the article (in loco parentis)
2. Actual contrary intention is proved e.g. fraudulent transfers

Art 1449
Resulting There is also an implied trust when a donation is made to a person but it appears that although the legal estate is transmitted to the donee, he nevertheless is either to have no beneficial interest or only a part thereof.
E.g. Somebody else is the true beneficiary like an infant son

Art 1450
Resulting If the price of a sale of property is loaned or paid by one person for the benefit of another and the conveyance is made to lender or payor to secure the payment of the debt, a trust arises by operation of law in favor of the person

to who the money is loaned or for whom it is paid. The latter may redeem the property and compel a conveyance thereof to him.

E.g. Nakpil vs. Valdez in LegProf

Art 1451

When land passes by succession to any person and he causes the legal title to be put in the name of another, a trust is established by implication of law for the benefit of the true owner.

Art 1452

Title in one
co-owner

If two or more persons agree to purchase property and by common consent the legal title is taken in the name of one of them for the benefit of all, a trust is created by force of law in favor of the others in proportion to the interest of each.

Resulting

Art 1453

Resulting

When property is conveyed to a person in reliance upon his declared intention to hold it for, or transfer it to another or the grantor, there is an implied trust in favor of the person whose benefit is contemplated.

Art 1454

If an absolute conveyance of property is made in order to secure the performance of an obligation of the grantor toward the grantee, a trust by virtue of law is established. If the fulfillment of the obligation is offered by the grantor when it becomes due, he may demand reconveyance of the property to him.

Art 1455

*Constructive
in favor of
the owner*

When any trustee, guardian or other person holding a fiduciary relationship uses trust funds for the purchase of property and causes the conveyance to be made for him or to a third person, a trust is established by operation of law in favor of the person to whom the funds belong.

Art 1456

If property is acquired through mistake or fraud, the person obtaining it is, by force of law, considered a trustee of an implied trust for the benefit of the person from whom the property comes.

Cases:

- Fabian v Fabian
- Bueno v Reyes
- Tamayo v Callejo