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[G.R. No. 207161. September 8, 2015]

Y-I LEISURE PHILIPPINES, INC., YATS INTERNATIONAL LTD. and Y-I CLUBS AND RESORTS, INC., *petitioners, vs.* **JAMES YU,** *respondent*.

SYLLABUS

1. COMMERCIAL LAW; CORPORATION CODE; NELL DOCTRINE; GENERALLY, WHERE ONE CORPORATION TRANSFERS ALL OF ITS ASSETS TO ANOTHER CORPORATION, THE LATTER IS NOT LIABLE FOR THE LIABILITIES OF THE TRANSFEROR; EXCEPTIONS. — In the 1965 case of *Nell v. Pacific Farms, Inc.,* the Court first pronounced the rule regarding the transfer of all the assets of one corporation to another *(hereafter referred to as the **Nell Doctrine**)* as follows: Generally, where one corporation sells or otherwise transfers all of its assets to another corporation, the latter is not liable for the debts and liabilities of the transferor, **except:** 1. Where the purchaser expressly or impliedly agrees to assume such debts; 2. Where the transaction amounts to a consolidation or merger of the corporations; 3. Where the purchasing corporation is merely a continuation of the selling corporation; and 4. Where the transaction is entered into fraudulently in order to escape liability for such debts.

2. ID.; ID.; ID.; ID.; LEGAL BASES OF THE NELL DOCTRINE, ELUCIDATED.— An evaluation of our contract and corporation laws validates that the Nell Doctrine is fully supported by Philippine statutes. The general rule expressed by the doctrine reflects the principle of relativity under **Article 1311** of the Civil Code. Contracts, including the rights and obligations arising therefrom, are valid and binding only between the contracting parties and their successors-in-interest. Thus, despite the sale of all corporate assets, the transferee corporation cannot be prejudiced as it is not in privity with the contracts between the transferor corporation and its creditors. The first exception under the Nell Doctrine, where the transferee corporation expressly or impliedly agrees to assume the transferor's debts, is provided under **Article 2047** of the Civil

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Code. When a person binds himself solidarily with the principal debtor, then a contract of suretyship is produced. Necessarily, the corporation which expressly or impliedly agrees to assume the transferor's debts shall be liable to the same. The second exception under the doctrine, as to the merger and consolidation of corporations, is well-established under **Sections 76 to 80**, **Title X of the Corporation Code.** If the transfer of assets of one corporation to another amounts to a merger or consolidation, then the transferee corporation must take over the liabilities of the transferor. Another exception of the doctrine, where the sale of all corporate assets is entered into fraudulently to escape liability for transferor's debts, can be found under **Article 1388** of the Civil Code. It provides that whoever acquires in bad faith the things alienated in fraud of creditors, shall indemnify the latter for damages suffered. Thus, if there is fraud in the transfer of all the assets of the transferor corporation, its creditors can hold the transferee liable. The legal basis of the last in the four (4) exceptions to the Nell Doctrine, where the purchasing corporation is merely a continuation of the selling corporation, is challenging to determine. In his book, Philippine Corporate Law, Dean Cesar Villanueva explained that this exception contemplates the "business-enterprise transfer." In such transfer, the transferee corporation's interest goes beyond the assets of the transferor's assets and its desires to acquire the latter's business enterprise, including its goodwill.

3. ID.; ID.; ID.; ID.; ID.; BUSINESS ENTERPRISE TRANSFER, AS AN EXCEPTION; WHERE THE TRANSFEREE CORPORATION ACQUIRED NOT ONLY THE ASSETS BUT ALSO THE BUSINESS OF THE TRANSFEROR, THE TRANSFEREE CORPORATION ASSUMES THE DEBTS AND LIABILITIES OF THE TRANSFEROR CORPORATION. — Section 40 of the Corporation Code x x x refers to the sale, lease, exchange or disposition of all or substantially all of the corporation's assets, including its goodwill. The sale under this provision does not contemplate an ordinary sale of all corporate assets; the transfer must be of such degree that the transferor corporation is rendered incapable of continuing its business or its corporate purpose. Section 40 suitably reflects the business-enterprise transfer under the exception of the Nell Doctrine because the purchasing or transferee corporation necessarily continued the business of the selling or transferor corporation. Given that the transferee

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corporation acquired not only the assets but also the business of the transferor corporation, then the liabilities of the latter are inevitably assigned to the former. It must be clarified, however, that not every transfer of the entire corporate assets would qualify under Section 40. It does not apply (1) if the sale of the entire property and assets is necessary in the usual and regular course of business of corporation, or (2) if the proceeds of the sale or other disposition of such property and assets will be appropriated for the conduct of its remaining business. Thus, the litmus test to determine the applicability of Section 40 would be the capacity of the corporation to continue its business after the sale of all or substantially all its assets.

4. **ID.; ID.; ID.; ID.; ID.; ID.; FRAUD AGAINST CREDITORS NOT REQUIRED BECAUSE THE TRANSFEREE CORPORATION IS MERELY A CONTINUATION OF THE TRANSFEROR'S BUSINESS.—** The exception of the Nell doctrine, which finds its legal basis under Section 40, provides that the transferee corporation assumes the debts and liabilities of the transferor corporation because it is merely a continuation of the latter's business. A cursory reading of the exception shows that it does not require the existence of fraud against the creditors before it takes full force and effect. Indeed, under the Nell Doctrine, the transferee corporation may inherit the liabilities of the transferor despite the lack of fraud due to the continuity of the latter's business. The purpose of the business-enterprise transfer is to protect the creditors of the business by allowing them a remedy against the new owner of the assets and business enterprise.

5. **ID.; ID.; ID.; ID.; ID.; ID.; ID.; APPLICABILITY OF CALTEX PHILIPPINES, INC. *VS.* PNOC SHIPPING AND TRANSPORT CORPORATION IN CASE AT BAR.—** Jurisprudence has held that in a business-enterprise transfer, the transferee is liable for the debts and liabilities of his transferor arising from the business enterprise conveyed. x x x [In the case of Caltex, the Court ruled:] While the Corporation Code allows the transfer of all or substantially all the properties and assets of a corporation, the transfer should not prejudice the creditors of the assignor. The only way the transfer can proceed without prejudice to the creditors is to hold the assignee liable for the obligations of the assignor. **The acquisition by the assignee of all or substantially all of the assets of the**

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assignor necessarily includes the assumption of the assignor's liabilities, unless the creditors who did not consent to the transfer choose to rescind the transfer on the ground of fraud. To allow an assignor to transfer all its business, properties and assets without the consent of its creditors and without requiring the assignee to assume the assignor's obligations will defraud the creditors. The assignment will place the assignor's assets beyond the reach of its creditors. x x x Notably, an evaluation of the relevant jurisprudence reveals that fraud is not an essential element for the application of the business-enterprise transfer.

VELASCO, JR., *J., concurring opinion*:

1. COMMERCIAL LAW; CORPORATION LAW; PAR. 2, SEC. 40 OF THE CORPORATION CODE; BUSINESS-ENTERPRISE TRANSFER; SALE OF "ALL OR SUBSTANTIALLY ALL OF THE CORPORATION'S BUSINESS" WITHIN THE CONTEXT THEREOF; MUST RENDER THE TRANSFEROR CORPORATION INCAPABLE OF CONTINUING ITS BUSINESS OPERATIONS AND MUST RESULT IN THE TRANSFEREE'S CONTINUATION OF THE FORMER'S BUSINESS.— In SEC-OGC Opinion No. 13-13, the Securities and Exchange Commission (SEC), Office of the General Counsel, clarifying the meaning of a sale of all or substantially all of the corporation's assets within the context of Paragraph 2 of Sec. 40, explained that: In interpreting paragraph 2 of Section 40, this Commission has been guided **not so much by the number or volume of assets transferred but by the effect of such transfer on the corporation's business**. x x x [I]n determining whether the sale is made in the ordinary course of business, "the test is not the amount involved but the nature of the transaction." Hence, according to the SEC, "if the sale thereof will not render the corporation incapable of continuing its business or if the disposition is necessary in the usual or regular course of business, the requirements under Section 40 will not apply." x x x [I]t is likewise material that, in addition to the transferor's paralysis, said transfer **must result in the continuation by the transferee of the former's business**. The sale or transfer by one corporation of all of its assets to another corporation for value, does not, *by that fact alone*, render Sec. 40 applicable and make the transferee liable for the debts of

the transferor. The business-enterprise transfer doctrine involves an acquisition by the transferee of the transferor's *business enterprise* which effectively results in: (i) the termination of the transferor's entire operations and the prevention of the fulfillment of the transferor's purpose for incorporation; and the continuation by the transferee of said venture. It does not, therefore, contemplate a mere **purchase or sale of assets**. x x x It is well to emphasize that Section 40 contemplates not only of a sale of all of the corporation's assets, but also **substantially all** of said assets. This being the case, it is not necessary for the transferor not to be left with any corporate property. What is only required under Sec. 40 is that, as opined by the SEC, the nature of the transfer prevents the transferor from continuing its business or the purpose for which it was incorporated.

2. **ID.; ID.; ID.; ID.; ID.; TRANSFEREES'S ABSORPTION OF TRANSFEROR'S LIABILITIES UNDER THE BUSINESS ENTERPRISE DOCTRINE AS A CONSEQUENCE OF THE PURCHASE, ELUCIDATED.—** Anent the issue of absorption or non-absorption by the transferee of the transferor's liabilities, the *ponencia* pointed out that **under the business-enterprise transfer doctrine, the transferee inherits the liabilities of the transferor as a consequence of the purchase.** This is so since the transaction is not only limited to the assets of the transferor, as in a sale of assets as previously discussed, but also extends to its goodwill. Additionally, holding the transferee liable for the debts of the transferor is a protection afforded by law to the transferor's creditors. It, therefore, does not require a contractual stipulation to that effect, nor must the transfer itself be in fraud of creditors before liability may attach to the transferee. The mere operation of Section 40 imposes upon the transferee the obligation to answer for the transferor's debts, as correctly observed by the *ponencia*.

3. **ID.; ID.; ID.; ID.; ID.; ID.; FRAUD NOT REQUIRED TO BE LIABLE THEREUNDER.—** The element of fraud is not required in order for the transferee to be liable under Section 40 of the Corporation Code. This is so since the basis for the liability thereon is not that the transfer was done in fraud of creditors but that it included the goodwill of the transferor, as discussed by the *ponencia*, and to protect the creditors of the transferor since the alienation effectively removes the transferor's properties from its creditors' reach.

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LEONEN, *J., concurring opinion*:

COMMERCIAL LAW; CORPORATION LAW; PURCHASING CORPORATION NOT LIABLE FOR THE DEBTS AND LIABILITIES OF THE SELLING CORPORATION; EXCEPTIONS; WHERE THE PURCHASING CORPORATION IS MERELY A CONTINUATION OF THE SELLING CORPORATION.— Jurisprudence reiterates this court's ruling in *Edward J. Nell Company v. Pacific Farms, Inc.* that: Generally where one corporation sells or otherwise transfers all of its assets to another corporation, the latter is not liable for the debts and liabilities of the transferor, except: (1) where the purchaser expressly or impliedly agrees to assume such debts; (2) where the transaction amounts to a consolidation or merger of the corporations; ***(3) where the purchasing corporation is merely a continuation of the selling corporation***; and (4) where the transaction is entered into fraudulently in order to escape liability for such debts. The four exceptions enumerated find basis from the Civil Code and Corporation Code. The third exception grounds on Section 40 of the Corporation Code governing the sale or other disposition of assets. x x x The third exception laid down in *Edward J. Nell Company v. Pacific Farms, Inc.* falls under this framework of providing protection for corporate creditors and consequently encouraging investments in support of economic development.

APPEARANCES OF COUNSEL

Tapales Prodon & Wee-Toe Hio Law Offices for petitioners.

Renato T. Nuguid Teresita de Leon-Nuguid and Oliver C. Ong for respondent.

D E C I S I O N

MENDOZA, *J.*:

The present case attempts to unravel whether the transfer of all or substantially all the assets of a corporation under Section 40 of the Corporation Code carries with it the assumption of corporate liabilities.

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This is a petition for review on *certiorari* under Rule 45 of the Rules of Court assailing the January 30, 2012 Decision[1] and the April 29, 2013 Resolution[2] of the Court of Appeals *(CA),* in CA-G.R. CV No. 96036, which affirmed with modification the August 31, 2010 Decision[3] of the Regional Trial Court, Branch 81, Quezon City*(RTC)*.

The Facts

Mt. Arayat Development Co. Inc. *(MADCI)* was a real estate development corporation, which was registered[4] on February 7, 1996 before the Securities and Exchange Commission *(SEC)*. On the other hand, respondent James Yu *(Yu)* was a businessman, interested in purchasing golf and country club shares.

Sometime in 1997, MADCI offered for sale shares of a golf and country club located in the vicinity of Mt. Arayat in Arayat, Pampanga, for the price of ₱550.00 per share. Relying on the representation of MADCI's brokers and sales agents, Yu bought 500 golf and 150 country club shares for a total price of ₱650,000.00 which he paid by installment with fourteen (14) Far East Bank and Trust Company *(FEBTC)* checks.[5]

Upon full payment of the shares to MADCI, Yu visited the supposed site of the golf and country club and discovered that it was non-existent. In a letter, dated February 5, 2000, Yu demanded from MADCI that his payment be returned to him.[6] MADCI recognized that Yu had an investment of ₱650,000.00, but the latter had not yet received any refund.[7]

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[1] Penned by Associate Justice Remedios A. Salazar-Fernando, with Associate Justices Mario V. Lopez and Amy C. Lazaro-Javier, concurring; *rollo,* pp. 31-57.

[2] *Id*. at 58-60.

[3] Penned by Judge Ma. Theresa L. Dela Torre-Yadao; *id*. at 61-76.

[4] Records, Vol. II, p. 787.

[5] *Id*. at 770-782.

[6] *Id*. at 783-785.

[7] *Id*. at 857.

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On August 14, 2000, Yu filed with the RTC a complaint[8] for collection of sum of money and damages with prayer for preliminary attachment against MADCI and its president Rogelio Sangil *(Sangil)* to recover his payment for the purchase of golf and country club shares. In his transactions with MADCI, Yu alleged that he dealt with Sangil, who used MADCI's corporate personality to defraud him.

In his Answer,[9] Sangil alleged that Yu dealt with MADCI as a juridical person and that he did not benefit from the sale of shares. He added that the return of Yu's money was no longer possible because its approval had been blocked by the new set of officers of MADCI, which controlled the majority of its board of directors.

In its Answer,[10] MADCI claimed that it was Sangil who defrauded Yu. It invoked the Memorandum of Agreement[11] *(MOA),* dated May 29, 1999*,* entered into by MADCI, Sangil and petitioner Yats International Ltd. *(YIL)*. Under the MOA, Sangil undertook to redeem MADCI proprietary shares sold to third persons or settle in full all their claims for refund of payments.[12] Thus, it was MADCI's position that Sangil should be ultimately liable to refund the payment for shares purchased.

After the pre-trial, Yu filed an Amended Complaint,[13] wherein he also impleaded YIL, Y-I Leisure Phils., Inc. *(YILPI)* and Y-I Club & Resorts, Inc. *(YICRI)*. According to Yu, he discovered in the Registry of Deeds of Pampanga that, substantially, all the assets of MADCI, consisting of one hundred twenty (120) hectares of land located in Magalang, Pampanga, were sold to YIL, YILPI and YICRI. The transfer was done in fraud of

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[8] Records, Vol. I, pp. 1-6.

[9] *Id*. at 97-100.

[10] *Id*. at 138-141.

[11] *Id*. at 142-149.

[12] *Id*. at 163.

[13] *Id*. at 239-248.

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MADCI's creditors, and without the required approval of its stockholders and board of directors under Section 40 of the Corporation Code. Yu also alleged that Sangil even filed a case in Pampanga which assailed the said irregular transfers of lands.

In their Answer,[14] YIL, YILPI and YICRI alleged that they only had an interest in MADCI in 1999 when YIL bought some of its corporate shares pursuant to the MOA. This occurred two (2) years *after* Yu bought his golf and country club shares from MADCI. As a mere stockholder of MADCI, YIL could not be held responsible for the liabilities of the corporation. As to the transfer of properties from MADCI to YILPI[15] and subsequently to YICRI,[16] they averred that it was not undertaken to defraud MADCI's creditors and it was done in accordance with the MOA. In fact, it was stipulated in the MOA that Sangil undertook to settle all claims for refund of third parties.

During the trial, the MOA was presented before the RTC. It stated that Sangil controlled 60% of the capital stock of MADCI, while the latter owned 120 hectares of agricultural land in Magalang, Pampanga, the property intended for the development of a golf course; that YIL was to subscribe to the remaining 40% of the capital stock of MADCI for a consideration of ₱31,000,000.00; that YIL also gave ₱500,000.00 to acquire the shares of minority stockholders; that as a condition for YIL's subscription, MADCI and Sangil were obligated to obtain several government permits, such as an environmental compliance certificate and land conversion permit; that should MADCI and Sangil fail in their obligations, they must return the amounts paid by YIL with interests; that if they would still fail to return the same, YIL would be authorized to sell the 120 hectare land to satisfy their obligation; and that, as an additional security, Sangil undertook to redeem all the MADCI proprietary shares sold to third parties or to settle in full all their claims for refund.

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[14] *Id*. at 584-591.

[15] Records, Vol. II, p. 817.

[16] *Id*. at 822.

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Sangil then testified that MADCI failed to develop the golf course because its properties were taken over by YIL after he allegedly violated the MOA.[17] The lands of MADCI were eventually sold to YICRI for a consideration of ₱9.3 million, which was definitely lower than their market price.[18] Unfortunately, the case assailing the transfers was dismissed by a trial court in Pampanga.[19]

The president and chief executive officer of YILPI and YICRI, and managing director of YIL, Denny On Yat Wang *(Wang),* was presented as a witness by YIL. He testified that YIL was an investment company engaged in the development of real estates, projects, leisure, tourism, and related businesses.[20] He explained that YIL subscribed to the shares of MADCI because it was interested in its golf course development project in Pampanga.[21] Thus, he signed the MOA on behalf of YIL and he paid ₱31.5 million to subscribe to MADCI's shares, subject to the fulfilment of Sangil's obligations.[22]

Wang further testified that the MOA stipulated that MADCI would execute a special power of attorney in his favor, empowering him to sell the property of MADCI in case of default in the performance of obligations.[23] Due to Sangil's subsequent default, a deed of absolute sale over the lands of MADCI was eventually executed in favor of YICRI, its designated company.[24] Wang also stated that, aside from its lands, MADCI had other assets in the form of loan advances of its directors.[25]

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[17] TSN, July 13, 2007, p. 10.

[18] *Id*. at 7.

[19] *Id*. at 25.

[20] TSN, November 7, 2008, p. 13.

[21] TSN, September 11, 2009, p. 10.

[22] TSN, November 7, 2008, p. 19.

[23] *Id*. at 25.

[24] *Id*. at 29.

[25] *Id*. at 32.

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The RTC Ruling

In its August 31, 2010 Decision, the RTC ruled that because MADCI did not deny its contractual obligation with Yu, it must be liable for the return of his payments. The trial court also ruled that Sangil should be solidarily liable with MADCI because he used the latter as a mere alter ego or business conduit. The RTC was convinced that Sangil had absolute control over the corporation and he started selling golf and country club shares under the guise of MADCI even without clearance from SEC.

The RTC, however, exonerated YIL, YILPI and YICRI from liability because they were not part of the transactions between MADCI and Sangil, on one hand and Yu, on the other hand. It opined that YIL, YILPI and YICRI even had the foresight of protecting the creditors of MADCI when they made Sangil responsible for settling the claims of refunds of third persons in the proprietary shares. The decretal portion of the decision reads:

> WHEREFORE, premises considered, judgment is hereby rendered as follows:
>
> 1. Ordering defendants Mt. Arayat Development Corporation, Inc. and Rogelio Sangil to pay plaintiff James Yu jointly and severally the amounts of ₱650,000.04 with 6% legal rate of interest from the filing of the amended complaint until full payment and and ₱50,000.00 as attorney's fees.
>
> 2. Dismissing the instant case against defendant Y-I Leisure Philippines, Inc., YATS International Limited and Y-I Clubs and Resorts, Inc.; and
>
> 3. Dismissing the counterclaims of Y-I Leisure Philippines, Inc., YATS International Limited and Y-I Clubs and Resorts, Inc.
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> SO ORDERED.[26]

In two separate appeals, the parties elevated the case to the CA.

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[26] *Rollo,* pp. 75-76.

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The CA Ruling

In its assailed Decision, dated January 30, 2012, the CA *partly granted* the appeals and *modified* the RTC decision by holding YIL and its companies, YILPI and YICRI, jointly and severally, liable for the satisfaction of Yu's claim.

The CA held that the sale of lands between MADCI and YIL must be upheld because Yu failed to prove that it was simulated or that fraud was employed. This did not mean, however, that YIL and its companies were free from any liability for the payment of Yu's claim.

The CA explained that YIL, YILPI and YICRI could not escape liability by simply invoking the provision in the MOA that Sangil undertook the responsibility of paying all the creditors' claims for refund. The provision was, in effect, a novation under Article 1293 of the Civil Code, specifically the substitution of debtors. Considering that Yu, as creditor of MADCI, had no knowledge of the "change of debtors," the MOA could not validly take effect against him. Accordingly, MADCI remained to be a debtor of Yu.

Consequently, as the CA further held, the transfer of the entire assets of MADCI to YICRI should not prejudice the transferor's creditors. Citing the case of *Caltex Philippines, Inc. v. PNOC Shipping and Transport Corporation*[27] *(Caltex),* the CA ruled that the sale by MADCI of all its corporate assets to YIL and its companies *necessarily included the assumption of its liabilities.* Otherwise, the assets were put beyond the reach of the creditors, like Yu. The CA stated that the liability of YIL and its companies was determined not by their participation in the sale of the golf and country club shares, but by the fact that they bought the entire assets of MADCI and its creditors might not have other means of collecting the amounts due to them, except by going after the assets sold.

Anent Sangil's liability, the CA ruled that he could not use the separate corporate personality of MADCI as a tool to evade

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[27] 530 Phil. 149 (2006).

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his existing personal obligations under the MOA. The dispositive portion of the decision reads:

> WHEREFORE, the appeals are PARTLY GRANTED. Accordingly, the assailed Decision dated August 31, 2010 in Civil Case No. Q-00-41579 of the RTC of Quezon City, Branch 81, is hereby AFFIRMED WITH MODIFICATION, in that defendants-appellees YIL, YILPI and YICRI are hereby held jointly and severally liable with defendant-appellee MADCI and defendant-appellant Sangil for the satisfaction of plaintiff-appellant Yu's claim.
>
> In all other respects, the assailed decision stands.
>
> SO ORDERED.[28]

YIL and its companies, YILPI and YICRI, moved for reconsideration, but their motion was denied by the CA in its assailed Resolution, dated April 29, 2013.

Hence, this petition.

ISSUE

WHETHER OR NOT THE COURT OF APPEALS ERRED IN RULING THAT PETITIONERS YATS GROUP SHOULD BE HELD JOINTLY AND SEVERALLY LIABLE TO RESPONDENT YU DESPITE THE ABSENCE OF FRAUD IN THE SALE OF ASSETS AND BAD FAITH ON THE PART OF PETITIONERS YATS GROUP.[29]

Petitioners YIL, YILPI and YICRI contend that the facts of *Caltex* are not on all fours with the case at bench. In *Caltex,* there was an express stipulation of the assumption of all the obligations of the judgment debtor. Here, there was no stipulation whatsoever stating that the petitioners shall assume the payment of MADCI's debts.

The petitioners also argue that fraud must exist to hold third parties liable. The sale in this case was not in any way tainted by any of the "badges of fraud" cited in *Oria v. McMicking*.[30]

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[28] *Rollo*, p. 56.

[29] *Id*. at 17.

[30] 21 Phil. 243 (1912).

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The CA itself stated that the alleged simulation of the sale was not established by respondent Yu. Moreover, Article 1383 of the Civil Code requires that the creditor must prove that he has no other legal remedy to satisfy his claim. Such requirement must be followed whether by an action for rescission or action for sum of money.

On September 20, 2013, respondent Yu filed his Comment.[31] He asserted that the CA correctly applied *Caltex* in the present case as the lands sold to the petitioners were the only assets of MADCI. After the sale, MADCI became incapable of continuing its business, and its corporate existence has just remained to this day in a virtual state of suspended animation. Thus, unless the creditors had agreed to the sale of all the assets of the corporation and had accepted the purchasing corporation as the new debtor, sufficient assets should have been reserved to pay their claims.

On June 19, 2014, the petitioners filed their Reply,[32] reiterating their previous argument that the element of fraud was required in order for a third party buyer to be liable to the seller's creditors.

The Court's Ruling

The petition lacks merit.

To recapitulate, respondent Yu bought several golf and country club shares from MADCI. Regrettably, the latter did not develop the supposed project. Yu then demanded the return of his payment, but MADCI could not return it anymore because all its assets had been transferred. Through the acts of YIL, MADCI sold all its lands to YILPI and, subsequently to YICRI. Thus, Yu now claims that the petitioners inherited the obligations of MADCI. On the other hand, the petitioners counter that they did not assume such liabilities because the transfer of assets was not committed in fraud of the MADCI's creditors.

Hence, the issue at hand presents a complex question of law – whether fraud must exist in the transfer of all the corporate

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[31] *Rollo*, pp. 85-92.

[32] *Id*. at 99-103.

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assets in order for the transferee to assume the liabilities of the transferor. To resolve this issue, a review of the laws and jurisprudence concerning corporate assumption of liabilities must be undertaken.

Background on the corporate assumption of liabilities

In the 1965 case of *Nell v. Pacific Farms, Inc.,*[33] the Court first pronounced the rule regarding the transfer of all the assets of one corporation to another *(hereafter referred to as the* ***Nell Doctrine****)* as follows:

> Generally, where one corporation sells or otherwise transfers all of its assets to another corporation, the latter is not liable for the debts and liabilities of the transferor, **except:**
>
> 1. Where the purchaser expressly or impliedly agrees to assume such debts;
> 2. Where the transaction amounts to a consolidation or merger of the corporations;
> 3. Where the purchasing corporation is merely a continuation of the selling corporation; and
> 4. Where the transaction is entered into fraudulently in order to escape liability for such debts.

The Nell Doctrine states the general rule that the transfer of all the assets of a corporation to another shall not render the latter liable to the liabilities of the transferor. If any of the above-cited exceptions are present, then the transferee corporation shall assume the liabilities of the transferor.

Legal bases of the Nell Doctrine

An evaluation of our contract and corporation laws validates that the Nell Doctrine is fully supported by Philippine statutes. The general rule expressed by the doctrine reflects the principle

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[33] 122 Phil. 825 (1965).

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of relativity under **Article 1311**[34] of the Civil Code. Contracts, including the rights and obligations arising therefrom, are valid and binding only between the contracting parties and their successors-in-interest. Thus, despite the sale of all corporate assets, the transferee corporation cannot be prejudiced as it is not in privity with the contracts between the transferor corporation and its creditors.

The first exception under the Nell Doctrine, where the transferee corporation expressly or impliedly agrees to assume the transferor's debts, is provided under **Article 2047**[35] of the Civil Code. When a person binds himself solidarily with the principal debtor, then a contract of suretyship is produced. Necessarily, the corporation which expressly or impliedly agrees to assume the transferor's debts shall be liable to the same.

The second exception under the doctrine, as to the merger and consolidation of corporations, is well-established under **Sections 76 to 80**, **Title X of the Corporation Code.** If the transfer of assets of one corporation to another amounts to a merger or consolidation, then the transferee corporation must take over the liabilities of the transferor.

Another exception of the doctrine, where the sale of all corporate assets is entered into fraudulently to escape liability for transferor's debts, can be found under **Article 1388** of the Civil Code. It provides that whoever acquires in bad faith the things alienated in fraud of creditors, shall indemnify the latter

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[34] **Art. 1311**. Contracts take effect only between the parties, their assigns and heirs, except in case where the rights and obligations arising from the contract are not transmissible by their nature, or by stipulation or by provision of law. The heir is not liable beyond the value of the property he received from the decedent.

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[35] **Art. 2047**. By guaranty a person, called the guarantor, binds himself to the creditor to fulfill the obligation of the principal debtor in case the latter should fail to do so.

If a person binds himself solidarily with the principal debtor, the provisions of Section 4, Chapter 3, Title I of this Book shall be observed. In such case the contract is called a suretyship.

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for damages suffered. Thus, if there is fraud in the transfer of all the assets of the transferor corporation, its creditors can hold the transferee liable.

The legal basis of the last in the four (4) exceptions to the Nell Doctrine, where the purchasing corporation is merely a continuation of the selling corporation, is challenging to determine. In his book, Philippine Corporate Law,[36] Dean Cesar Villanueva explained that this exception contemplates the "business-enterprise transfer." In such transfer, the transferee corporation's interest goes beyond the assets of the transferor's assets and its desires to acquire the latter's business enterprise, including its goodwill.

In *Villa Rey Transit, Inc. v. Ferrer,*[37] the Court held that when one were to buy the business of another as a going concern, he would usually wish to keep it going; he would wish to get the location, the building, the stock in trade, and the customers. He would wish to step into the seller's shoes and to enjoy the same business relations with other men. He would be willing to pay much more if he could get the "good will" of the business, meaning by this, the good will of the customers, that they may continue to tread the old footpath to his door and maintain with him the business relations enjoyed by the seller.

In other words, in this last exception, the transferee purchases not only the assets of the transferor, but also its business. As a result of the sale, the transferor is merely left with its juridical existence, devoid of its industry and earning capacity. Fittingly, the proper provision of law that is contemplated by this exception would be **Section 40** of the Corporation Code,[38] which provides:

> Sec. 40. Sale or other disposition of assets. – Subject to the provisions of existing laws on illegal combinations and monopolies, a corporation may, by a majority vote of its board of directors or trustees, **sell, lease, exchange, mortgage, pledge or otherwise dispose**

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[36] 2010 ed., p. 682.

[37] 134 Phil. 796 (1968).

[38] See Villanueva, *Philippine Corporate Law*, 2010 ed., p. 684.

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of all or substantially all of its property and assets, including its goodwill, upon such terms and conditions and for such consideration, which may be money, stocks, bonds or other instruments for the payment of money or other property or consideration, as its board of directors or trustees may deem expedient, when authorized by the vote of the stockholders representing at least two-thirds (2/3) of the outstanding capital stock, or in case of non-stock corporation, by the vote of at least two-thirds (2/3) of the members, in a stockholder's or member's meeting duly called for the purpose. Written notice of the proposed action and of the time and place of the meeting shall be addressed to each stockholder or member at his place of residence as shown on the books of the corporation and deposited to the addressee in the post office with postage prepaid, or served personally: Provided, That any dissenting stockholder may exercise his appraisal right under the conditions provided in this Code.

A sale or other disposition shall be deemed to cover substantially all the corporate property and assets if thereby the corporation would be **rendered incapable of continuing the business or accomplishing the purpose for which it was incorporated.**

After such authorization or approval by the stockholders or members, the board of directors or trustees may, nevertheless, in its discretion, abandon such sale, lease, exchange, mortgage, pledge or other disposition of property and assets, subject to the rights of third parties under any contract relating thereto, without further action or approval by the stockholders or members.

Nothing in this section is intended to restrict the power of any corporation, without the authorization by the stockholders or members, to sell, lease, exchange, mortgage, pledge or otherwise dispose of any of its property and assets if the same is necessary in the usual and regular course of business of said corporation or if the proceeds of the sale or other disposition of such property and assets be appropriated for the conduct of its remaining business.

In non-stock corporations where there are no members with voting rights, the vote of at least a majority of the trustees in office will be sufficient authorization for the corporation to enter into any transaction authorized by this section.

[Emphases Supplied]

To reiterate, Section 40 refers to the sale, lease, exchange or disposition of all or substantially all of the corporation's assets,

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including its goodwill.[39] The sale under this provision does not contemplate an ordinary sale of all corporate assets; the transfer must be of such degree that the transferor corporation is rendered incapable of continuing its business or its corporate purpose.[40]

Section 40 suitably reflects the business-enterprise transfer under the exception of the Nell Doctrine because the purchasing or transferee corporation necessarily continued the business of the selling or transferor corporation. Given that the transferee corporation acquired not only the assets but also the business of the transferor corporation, then the liabilities of the latter are inevitably assigned to the former.

It must be clarified, however, that not every transfer of the entire corporate assets would qualify under Section 40. It does not apply (1) if the sale of the entire property and assets is necessary in the usual and regular course of business of corporation, or (2) if the proceeds of the sale or other disposition of such property and assets will be appropriated for the conduct of its remaining business.[41] Thus, the litmus test to determine the applicability of Section 40 would be the capacity of the corporation to continue its business after the sale of all or substantially all its assets.

Jurisprudential recognition of the business-enterprise transfer

Jurisprudence has held that in a business-enterprise transfer, the transferee is liable for the debts and liabilities of his transferor arising from the business enterprise conveyed. Many of the application of the business-enterprise transfer have been related by the Court to the application of the piercing doctrine.[42]

In *A.D. Santos, Inc. v. Vasquez,*[43] a taxi driver filed a suit for workmen's compensation against the petitioner corporation

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[39] *Lopez Realty, Inc. v. Fontecha,* 317 Phil. 216, 229 (1995).

[40] See Paragraph 2, Section 40, Corporation Code.

[41] See Paragraph 3, Section 40, Corporation Code.

[42] Villanueva, *Philippine Corporate Law*, 2010 ed., pp. 686, 687.

[43] 131 Phil. 262 (1968).

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therein. The latter's defense was that the taxi driver's employer was Amador Santos, and not the corporation. Initially, the taxi driver was employed by City Cab, a sole proprietary by Amador Santos. The taxi business was, however, transferred to the petitioner. Applying the piercing doctrine, the Court held that the petitioner must still be held liable due to the transfer of the business and should not be allowed to confuse the legitimate issues.

In *Buan v. Alcantara,*[44] the Spouses Buan were the owners of Philippine Rabbit Bus Lines. They died in a vehicular accident and the administrators of their estates were appointed. The administrators then incorporated the Philippine Rabbit Bus Lines. The issue raised was whether the liabilities of the estates of the spouses were conveyed to the new corporation due to the transfer of the business. Utilizing the alter-ego doctrine, the Court ruled in the affirmative and stated that:

> As between the estate and the corporation, the intention of incorporation was to make the corporation liable for past and pending obligations of the estate as the transportation business itself was being transferred to and placed in the name of the corporation. That liability on the part of the corporation, *vis-a-vis* the estate, should continue to remain with it even after the percentage of the estate's shares of stock in the corporation should be diluted.[45]

The Court, however, applied the business-enterprise transfer doctrine independent of the piercing doctrine in other cases. In *San Teodoro Development Enterprises v. SSS,*[46] the petitioner corporation therein attempted to avoid the compulsory coverage of the Social Security Law by alleging that it was a distinct and separate entity from its limited partnership predecessor, Chua Lam & Company, Ltd. The Court, however, upheld the findings of the SSS that the entire business of the previous partnership was transferred to the corporation ostensibly for a

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[44] 212 Phil. 723 (1984).

[45] *Id*. at 733.

[46] 118 Phil. 103 (1963).

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valuable consideration. Hence, "[t]he juridical person owning and operating the business remain the same even if its legal personality was changed."[47]

Similarly, in *Laguna Trans. Co., Inc. v. SSS,*[48] the Court held that the transferee corporation continued the same transportation business of the unregistered partnership therein, using the same lines and equipment. There was, in effect, only a change in the form of the organization of the entity engaged in the business of transportation of passengers.

Perhaps the most telling jurisprudence which recognized the business-enterprise transfer would be the assailed case of *Caltex.* In that case, under an agreement of assumption of obligations, LUSTEVECO transferred, conveyed and assigned to respondent PSTC all of its business, properties and assets pertaining to its tanker and bulk business together with all the obligations, properties and assets.[49] Meanwhile, petitioner Caltex, Inc. obtained a judgment debt against LUSTEVECO, and it sought to enforce the same against PSTC. The Court ruled that PSTC was bound by its agreement with LUSTEVECO and the former assumed all of the latter's obligations pertaining to such business.

More importantly, the Court held that, *even without the agreement,* PSTC was still liable to Caltex, Inc. based on Section 40, as follows:

> While the Corporation Code allows the transfer of all or substantially all the properties and assets of a corporation, the transfer should not prejudice the creditors of the assignor. The only way the transfer can proceed without prejudice to the creditors is to hold the assignee liable for the obligations of the assignor. **The acquisition by the assignee of all or substantially all of the assets of the assignor necessarily includes the assumption of the assignor's liabilities,** unless the creditors who did not consent to the transfer choose to rescind the transfer on the ground of fraud. To allow an

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[47] *Id*. at 106.

[48] 107 Phil. 833 (1960).

[49] *Supra* note 27 at 158.

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assignor to transfer all its business, properties and assets without the consent of its creditors and without requiring the assignee to assume the assignor's obligations will defraud the creditors. The assignment will place the assignor's assets beyond the reach of its creditors.

Here, Caltex could not enforce the judgment debt against LUSTEVECO. The writ of execution could not be satisfied because LUSTEVECO's remaining properties had been foreclosed by lienholders. In addition, all of LUSTEVECO's business, properties and assets pertaining to its tanker and bulk business had been assigned to PSTC without the knowledge of its creditors. Caltex now has no other means of enforcing the judgment debt except against PSTC.[50]

[Emphasis Supplied]

The *Caltex* case, thus, affirmed that the transfer of all or substantially all the proper from one corporation to another under Section 40 necessarily entails the assumption of the assignor's liabilities, notwithstanding the absence of any agreement on the assumption of obligations. The transfer of all its business, properties and assets without the consent of its creditors must certainly include the liabilities; or else, the assignment will place the assignor's assets beyond the reach of its creditors. In order to protect the creditors against unscrupulous conveyance of the entire corporate assets, *Caltex* justifiably concluded that the transfer of assets of a corporation under Section 40 must likewise carry with it the transfer of its liabilities.

Fraud is not an essential consideration in a business-enterprise transfer

Notably, an evaluation of the relevant jurisprudence reveals that fraud is not an essential element for the application of the business-enterprise transfer.[51] The petitioners in this case, however, assert otherwise. They insist that under the *Caltex*

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[50] *Id*. at 159-160.

[51] *Id*. at 688.

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case, there was an assumption of liabilities because fraud existed on the part of PSTC, as the transferee corporation.

The Court disagrees.

The exception of the Nell doctrine,[52] which finds its legal basis under Section 40, provides that the transferee corporation assumes the debts and liabilities of the transferor corporation because it is merely a continuation of the latter's business. A cursory reading of the exception shows that it does not require the existence of fraud against the creditors before it takes full force and effect. Indeed, under the Nell Doctrine, the transferee corporation may inherit the liabilities of the transferor despite the lack of fraud due to the continuity of the latter's business.

The purpose of the business-enterprise transfer is to protect the creditors of the business by allowing them a remedy against the new owner of the assets and business enterprise. Otherwise, creditors would be left "holding the bag," because they may not be able to recover from the transferor who has "disappeared with the loot," or against the transferee who can claim that he is a purchaser in good faith and for value.[53] Based on the foregoing, as the exception of the Nell doctrine relates to the protection of the creditors of the transferor corporation, and does not depend on any deceit committed by the transferee corporation, then fraud is certainly not an element of the business enterprise doctrine.

The Court also agrees with the CA, in its assailed April 29, 2013 resolution, that there was no finding of fraud in the *Caltex* case; otherwise it should have been clearly and categorically stated.[54] The discussion in *Caltex* relative to fraud seems more hypothetical than factual, thus:

If PSTC refuses to honor its written commitment to assume the obligations of LUSTEVECO, there will be a fraud on the creditors

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[52] 3. Where the purchasing corporation is merely a continuation of the selling corporation.

[53] Villanueva, *Philippine Corporate Law*, 2010 ed., p. 686.

[54] *Rollo,* p. 59.

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of LUSTEVECO. x x x To allow PSTC now to welsh on its commitment is to sanction a fraud on LUSTEVECO's creditors.[55]

Besides, the supposed fraud in *Caltex* referred to PSTC's refusal to pay LUSTEVECO's creditors despite the agreement on assumption of the latter's obligations. Again, the Court emphasizes in the said case, *even without the agreement,* PSTC was still liable to Caltex, Inc. under Section 40, due to the transfer of all or substantially all of the corporate assets. At best, transfers of all or substantially all of the assets to a transferee corporation without the consent of the transferor corporation's creditor gives rise to a presumption of fraud against the said creditors.[56]

Applicability of the business-enterprise transfer in the present case

Bearing in mind that fraud is not required to apply the business-enterprise transfer, the next issue to be resolved is whether the petitioners indeed became a continuation of MADCI's business. Synthesizing Section 40 and the previous rulings of this Court, it is apparent that the business-enterprise transfer rule applies when two requisites concur: (a) the transferor corporation sells all or substantially all of its assets to another entity; and (b) the transferee corporation continues the business of the transferor corporation. Both requisites are present in this case.

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[55] *Caltex v. PNOC, supra* note 27, at 160.

[56] See also Act No. 3952 or the Bulk Sales Law. Section 3 thereof mandates that "[e]very person who shall sell, mortgage, transfer, or assign any stock of goods, wares, merchandise, provisions or materials in bulk, for cash or on credit, before receiving from the vendee, mortgagee, or his, or its agent or representative any part of the purchase price thereof, or any promissory note, memorandum, or other evidence therefor, to deliver to such vendee, mortgagee, or agent x x x a written statement, sworn to substantially x x x of the names and addresses of all creditors to whom said vendor or mortgagor may be indebted."

Section 4 therein provides any person who failed to comply with the submission of the sworn statement of creditors under Section 3 is "[d]eemed to have violated this Act, and any such sale, transfer or mortgage shall be fraudulent and void."

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According to its articles of incorporation, the primary purpose of MADCI was "[t]o acquire by purchase, lease, donation or otherwise, and to own, use, improve, develop, subdivide, sell, mortgage, exchange, lease, develop and hold for investment or otherwise, real estate of all kinds, whether improved, managed or otherwise disposed of buildings, houses, apartment, and other structures of whatever kind, together with their appurtenance."[57] During the trial before the RTC, Sangil testified that MADCI was a development company which acquired properties in Magalang, Pampanga to be developed into a golf course.[58]

The CA found that MADCI had an entire asset consisting of 120 hectares of land, and that its sale to the petitioners rendered it incapable of continuing its intended golf and country club business.[59] The Court holds that such finding is fully substantiated by the records of the case. The MOA itself stated that MADCI had 120 hectares of agricultural land in Magalang, Pampanga, for the development of a golf course.[60] MADCI had the right of ownership over these properties consisting of 97 land titles, except for the 27 titles previously delivered to YIL.[61] The 120-hectare land, however, was then sold to YILPI,[62] and then transferred to YICRI.[63]

Respondent Yu testified that he verified the landholdings of MADCI with the Register of Deeds in Pampanga and discovered that all its lands were transferred to YICRI.[64] Because the properties of MADCI were already conveyed, Yu had no other way of collecting his refund.[65]

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[57] Records, Vol. II, p. 788.

[58] TSN, September 22, 2006, p. 27.

[59] *Rollo,* p. 22.

[60] Records, Vol. I, p. 161.

[61] *Id*. at 162.

[62] Records, Vol. II, p. 817.

[63] *Id*. at 822.

[64] TSN, May 28, 2004, p. 13; TSN, July 2, 2004, p. 7.

[65] TSN, September 24, 2004, p. 11.

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Sangil also testified that MADCI had no more properties left after the sale of the lands to the petitioners:

> Atty. Nuguid: And after the sale, it has no more properties?
> Sangil: That's right, Sir.
>
> Q: And the business of MADCI was to operate and build golf course?
> A: That's right, Sir.
>
> Q: And because of the sale of all these properties, MADCI was not able to build the golf course?
> A: Yes, Sir.
>
> **Q: And did not anymore operate as a corporation?**
> **A: MADCI is still there but as far the development of the golf course, it was taken over by Mr. Wang.**[66]

[Emphasis Supplied]

As a witness for the petitioners, Wang testified that YIL bought the shares of stock of MADCI because it had some interest in the project involving the development of a golf course. The petitioners then found that MADCI had landholdings in Pampanga which it would be able to develop into a golf course.[67] Hence, the petitioners were fully aware of the nature of MADCI's business and its assets, but they continued to acquire its lands through the designated company, YICRI.[68]

Based on these factual findings, the Court is convinced that MADCI indeed had assets consisting of 120 hectares of landholdings in Magalang, Pampanga, to be developed into a golf course, pursuant to its primary purpose. Because of its alleged violation of the MOA, however, MADCI was made to transfer all its assets to the petitioners. No evidence existed that MADCI subsequently acquired other lands for its development projects. Thus, MADCI, as a real estate development corporation, was left without any property to develop eventually

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[66] TSN, July 13, 2007, p. 10.

[67] TSN, September 11, 2009, p. 10.

[68] TSN, November 7, 2008, p. 29.

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rendering it incapable of continuing the business or accomplishing the purpose for which it was incorporated.

Section 40 must apply.

Consequently, the transfer of the assets of MADCI to the petitioners should have complied with the requirements under Section 40. Nonetheless, the present petition is not concerned with the validity of the transfer; but the respondent's claim of refund of his ₱650,000.00 payment for golf and country club shares. Both the CA and the RTC ruled that MADCI and Sangil were liable.

On the question of whether the petitioners must also be held solidarily liable to Yu, the Court answers in the affirmative.

While the Corporation Code allows the transfer of all or substantially all of the assets of a corporation, the transfer should not prejudice the creditors of the assignor corporation.[69] Under the business-enterprise transfer, the petitioners have consequently inherited the liabilities of MADCI because they acquired all the assets of the latter corporation. The continuity of MADCI's land developments is now in the hands of the petitioners, with all its assets and liabilities. There is absolutely no certainty that Yu can still claim its refund from MADCI with the latter losing all its assets. To allow an assignor to transfer all its business, properties and assets without the consent of its creditors will place the assignor's assets beyond the reach of its creditors. Thus, the only way for Yu to recover his money would be to assert his claim against the petitioners as transferees of the assets.

The MOA cannot prejudice respondent

The MOA, which contains a provision that Sangil undertook to redeem MADCI proprietary shares sold to third persons or settle in full all their claims for refund of payments, should not prejudice respondent Yu. The CA correctly ruled that such

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[69] *STRADEC v. Radstock*, 622 Phil. 431, 535 (2009).

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provision constituted novation under **Article 1293**[70] of the Civil Code. When there is a substitution of debtors, the creditor must consent to the same; otherwise, it shall not in any way affect the creditor. In this case, it was established that Yu's consent was not secured in the execution of the MOA. Thus, insofar as the respondent was concerned, the debtor remained to be MADCI. And given that the assets and business of MADCI have been transferred to the petitioners, then the latter shall be liable.

Interestingly, the same issue on novation was tackled in the *Caltex* case and the Court resolved it in this wise:

> The Agreement, under Article 1291 of the Civil Code, is also a novation of LUSTEVECO's obligations by substituting the person of the debtor. Under Article 1293 of the Civil Code, a novation which consists in substituting a new debtor in place of the original debtor cannot be made without the consent of the creditor. **Here, since the Agreement novated the debt without the knowledge and consent of Caltex, the Agreement cannot prejudice Caltex.** Thus, the assets that LUSTEVECO transferred to PSTC in consideration, among others, of the novation, or the value of such assets, remain even in the hands of PSTC subject to execution to satisfy the judgment claim of Caltex.[71]
>
> [Emphasis Supplied]

Free and Harmless Clause

The petitioners, however, are not left without recourse as they can invoke the free and harmless clause under the MOA. In business-enterprise transfer, it is possible that the transferor and the transferee may enter into a contractual stipulation stating that the transferee shall not be liable for any or all debts arising from the business which were contracted prior to the time of

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[70] 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 latter, but not without the consent of the creditor. Payment by the new debtor gives him the rights mentioned in Articles 1236 and 1237. (1205a)

[71] *Caltex v. PNOC, supra* note 27, at 162-163.

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transfer. Such stipulations are valid, but only as to the transferor and the transferee. These stipulations, though, are not binding on the creditors of the business enterprise who can still go after the transferee for the enforcement of the liabilities.[72]

An example of a free and harmless clause can be observed in the case of *PCI Leasing v. UCPB*.[73] In that case, a claim for damages was filed against the petitioner therein as the registered owner of the vehicle, even though it was the latter's lessee that committed an infraction. The Court granted the claim against the petitioner based on the registered-owner rule. Even so, the Court stated therein that:

> x x x the Court believes that petitioner and other companies so situated are not entirely left without recourse. They may resort to third-party complaints against their lessees or whoever are the actual operators of their vehicles. In the case at bar, there is, in fact, a provision in the lease contract between petitioner and SUGECO to the effect that the latter shall indemnify and hold the former free and harmless from any "liabilities, damages, suits, claims or judgments" arising from the latter's use of the motor vehicle. Whether petitioner would act against SUGECO based on this provision is its own option.

In the present case, the MOA stated that Sangil undertook to redeem MADCI proprietary shares sold to third persons or settle in full all their claims for refund of payments. While this free and harmless clause cannot affect respondent as a creditor, the petitioners may resort to this provision to recover damages in a third-party complaint. Whether the petitioners would act against Sangil under this provision is their own option.

WHEREFORE, the petition is **DENIED.** The January 30, 2012 Decision and the April 29, 2013 Resolution of the Court of Appeals in CA- G.R. CV No. 96036 are hereby **AFFIRMED *in toto***.

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[72] Villanueva, *Philippine Corporate Law*, 2010 ed., p. 692.

[73] 579 Phil. 418, 431 (2008).

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SO ORDERED.

Sereno, C.J., Carpio, Leonardo-de Castro, Brion, Peralta, Bersamin, del Castillo, Villarama, Jr., Perez, Perlas-Bernabe, and *Jardeleza, JJ.,* concur.

Velasco, Jr. and *Leonen, JJ.,* see concurring opinion.

Reyes, J., on leave.

CONCURRING OPINION

VELASCO, JR., *J.*:

I concur with the findings and conclusions of the *ponencia* that the purchase by the petitioners of substantially all of Mt. Arayat Development Co., Inc.'s (MADCI) assets which resulted in the cessation of the latter's operations carried with it the assumption of MADCI's liabilities to third persons, including respondent James Yu.

The Court is once again faced with the question of whether the sale by a corporation of all or substantially all of its assets to another entity would carry with it the obligation to settle the transferor's liabilities.

Let us briefly recall the facts. MADCI, a real estate development corporation, ventured in the development of a golf and country club in its 120-hectare property located in Mt. Arayat, Pampanga. Sometime in 1997, pending the commencement of the project, MADCI sold to respondent golf and country club shares totaling 650,000.00, which respondent paid on installment.

Thereafter, or on May 29, 1999, MADCI and its president Rogelio Sangil (Sangil) entered into a Memorandum of Agreement (MOA) with petitioner Yats International Ltd. (YIL), an investment company likewise engaged in the development of real estate, projects, leisure, tourism, and related businesses. Under the MOA, Sangil controlled 60% of MADCI's capital stock and YIL was to subscribe to the remaining 40%, priced at ₱31M, conditioned on the securing by MADCI and Sangil of the necessary government permits. It was also embodied therein

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that MADCI owned said 120-hectare property which is intended for the development of a golf course. Furthermore, Sangil undertook to redeem MADCI proprietary shares sold to third persons or settle in full all their claims for refund of payments. YIL also gave ₱500,000.00 to acquire the shares of minority stockholders. Lastly, per the Agreement, the parties agreed that should MADCI and Sangil fall short in their obligations, YIL can recover the amounts that it paid to the former, plus interest, and that should they fail to deliver said amounts, YIL would be authorized to sell said 120-hectare property to satisfy their obligation.

Thus, pursuant to the Agreement, YIL, together with Y-I Leisure Phils., Inc. (YILPI) and Y-I Club & Resorts, Inc. (YICRI), bought some of MADCI's corporate shares. As it turned out, however, MADCI and Sangil violated the terms of the MOA. The property was eventually sold to YICRI, its designated company, for ₱9.3M.

Then, sometime in 2000, Yu discovered that the project never pushed through. This prompted him to demand from MADCI the return of his payment for the golf and country club shares. While MADCI recognized Yu's investment, it did not heed the latter's demand, reasoning that said payment was no longer possible because MADCI's new set of officers did not give their imprimatur thereto. This prompted Yu to file with the RTC a complaint for sum of money. Yu later filed an Amended Complaint, impleading YIL, YILPI, and YICRI on the basis of the allegedly suspicious transfer of MADCI's property to petitioner which, according to him, was done in fraud of MADCI's creditors.

In their defense, MADCI and petitioners YIL, YILPI, and YICRI insist, among other things, on the observance of the MOA's stipulations, particularly Sangil's categorical undertaking to settle all claims for refund of third parties. For his part, Sangil alleges that Yu dealt with MADCI as a juridical person and that he personally did not benefit from the sale of shares. Too, according to Sangil, MADCI's new set of officers blocked the approval of the refund.

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The RTC, in its August 31, 2010 Decision, ruled in Yu's favor, holding MADCI and Sangil solidarily liable for the refund. Petitioners YIL, YILPI, and YICRI were, however, exonerated since, according to the trial court, they were not part of the transactions between Yu, MADCI, and Sangil. Furthermore, the stipulation in the MOA whereby Sangil obliged himself to settle third party claims for refund was considered by the trial court as foresight on petitioners' part to protect MADCI's creditors.

On appeal, the CA modified the RTC's decision and ruled that petitioners are jointly and severally liable for the satisfaction of Yu's claim. Citing *Caltex (Philippines), Inc. v. PNOC Shipping and Transport Corporation*,[1] the appellate court ruled that the transfer of the entire assets of MADCI to YICRI carried with it the assumption by the transferee of the transferor's liabilities and should not prejudice the transferor's creditors, in this case, respondent Yu. Aggrieved, transferees YIL, YILPI, and YICRI come before this Court insisting on the reversal of the CA's modification and the reinstatement of their exoneration from liability by the trial court.

Simply put, the instant petition seeks to put an end to respondent James Yu's quandary as to who should be liable for his claim, the existence of which was admitted by the transferor.

Petitioners fault the CA for relying heavily on *Caltex*,[2] arguing that the instant case is not on all fours with said case, for in the latter case, there was an express assumption of all obligations of the judgment debtor by the transferee. They likewise insist that fraud, which if present would make the transferee liable for the transferor's obligations to third persons, does not obtain in the instant case. Yu, for his part, contends that the facts of the case properly call for the application of *Caltex* since the transfer resulted in MADCI's paralysis.

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[1] *Caltex (Philippines) Inc. v. PNOC Shipping and Transport Corporation*, G.R. No. 150711, August 10, 2006, 498 SCRA 400.

[2] *Id*.

In affirming the modification by the CA, the *ponencia* applied Section 40 of the Corporation Code which reads:

Section 40. *Sale or other disposition of assets.* – Subject to the provisions of existing laws on illegal combinations and monopolies, **a corporation may**, by a majority vote of its board of directors or trustees, **sell**, lease, exchange, mortgage, pledge or otherwise dispose of **all or substantially all of its property and assets, including its goodwill, upon such terms and conditions and for such consideration, which may be money, stocks, bonds or other instruments for the payment of money or other property or consideration,** as its board of directors or trustees may deem expedient, when authorized by the vote of the stockholders representing at least two-thirds (2/3) of the outstanding capital stock, or in case of non-stock corporation, by the vote of at least two-thirds (2/3) of the members, in a stockholder's or member's meeting duly called for the purpose. x x x.

A sale or other disposition shall be deemed to cover substantially all the corporate property and assets <u>if thereby the corporation would be rendered incapable of continuing the business or accomplishing the purpose for which it was incorporated</u>. (emphasis and underscoring added)

The provision adverted to, as correctly enunciated by the *ponencia*, citing *Lopez Realty, Inc. v. Fontecha*,[3] contemplates a **business-enterprise transfer** whereby one corporation (transferor) sells to another entity (transferee) all or substantially all of its corporate assets, including its goodwill, rendering it incapable of continuing its business or its purpose.

Object of the sale: Meaning of "all or substantially all of the corporation's business"

In SEC-OGC Opinion No. 13-13,[4] the Securities and Exchange Commission (SEC), Office of the General Counsel, clarifying

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[3] 317 Phil. 216, 229 (1995).

[4] Dated December 5, 2013. http://www.sec.gov.ph/investorinfo/opinions/ogc/cy%202013/13-13.pdf, last accessed, August 10, 2015.

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the meaning of a sale of all or substantially all of the corporation's assets within the context of Paragraph 2 of Sec. 40, explained that:

> In interpreting paragraph 2 of Section 40, this Commission has been guided **not so much by the number or volume of assets transferred but by the effect of such transfer on the corporation's business**. Any disposition which does not involve all or substantially all of the corporate assets x x x, made in the ordinary course of business does not require the approval of the stockholders or members.(emphasis added)

The SEC then emphasized that in determining whether the sale is made in the ordinary course of business, "the test is not the amount involved but the nature of the transaction."[5] Hence, according to the SEC, "if the sale thereof will not render the corporation incapable of continuing its business or if the disposition is necessary in the usual or regular course of business, the requirements under Section 40 will not apply."[6]

Continuation by the transferee of the transferor's business

Along with the above explanation from the SEC that the nature of the transaction determines the applicability or non-applicability of Sec. 40, it is likewise material that, in addition to the transferor's paralysis, said transfer **must result in the continuation by the transferee of the former's business**. The sale or transfer by one corporation of all of its assets to another corporation for value, does not, *by that fact alone*, render Sec. 40 applicable and make the transferee liable for the debts of the transferor.[7] The business-enterprise transfer doctrine involves an acquisition by the transferee of the transferor's *business enterprise* which effectively results in:

(1) the termination of the transferor's entire operations and the prevention of the fulfillment of the transferor's purpose for incorporation; and

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[5] See SEC-OGC Opinion No. 13-13, p. 5.

[6] *Id*.

[7] *China Banking Corp. v. Dyne-Sem Electronics Corporation,* G.R. No. 149237, July 11, 2006, 494 SCRA 493.

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(2) the continuation by the transferee of said venture.

It does not, therefore, contemplate a mere **purchase or sale of assets**.

To distinguish a mere sale of assets from a business-enterprise transfer, the Court's ruling in *China Banking Corporation v. Dyne-Sem Electronics Corporation,*[8] on the basic but crucial characteristic of a sale of assets, is instructive.

Briefly, *China Banking Corporation* involved the assertion by the creditor bank that the transferor's unpaid loan with them should be paid by the transferee. There, the creditor bank argued that this should be so since the transferee and the transferor are both engaged in the same line of business and that the transferee acquired some of the transferor's machineries and equipment before the transferor ultimately ceased its operations.[9]

There, the Court ruled in favor of the transferee and held that the "acquisition of some of the machineries and equipment of [the transferor] was not proof that [the transferee] was formed to defraud petitioner. As the [CA] found, no merger took place between [the transferor and the transferee]. What took place was a sale of the assets of the former to the latter. x x x **Thus, where one corporation sells or otherwise transfers all its assets to another corporation for value, the latter is not, by that fact alone, liable for the debts and liabilities of the transferor."** [10] (emphasis and words in brackets added)

It was therein cited that "[i]n a sale of assets, the transferee is only interested in the raw assets of the selling corporation perhaps to be used to establish his own business enterprise or as an addition to his on-going business enterprise.[11] In other words, the object of the disposition in a **sale of assets** is not the very business itself, but simply the properties of the transferor.

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[8] *Id*.

[9] *Id*.

[10] *Id*. at 501.

[11] Footnote No. 21, *id*. at 501.

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The Court further noted that in a sale of assets, the purchasing corporation is not generally liable for the debts and liabilities of the selling corporation, the selling corporation contemplates a liquidation of the enterprise, the transfer of title is by virtue of a contract, and *the selling corporation is not dissolved by the mere transfer of all its property*.[12] Clearly, this kind of alienation of corporate assets is **not** the sale contemplated under Section 40.

These facets and legal effects of a **sale of assets** became pivotal in *Bank of Commerce v. Radio Philippines Network, Inc.*,[13] which involved the issue of whether the purchase by the transferee of the transferor's assets carried with it the liability for the latter's judgment debts.

In resolving the case and ultimately holding that the purchaser is not liable for the transferor's judgment debt subject of the case, the Court clarified that no merger took place between the transferee and the transferor, since **therein transferor was still able to continue its operations despite the sale of its banking venture to the transferee**.[14] There, this Court categorized the sale as one simply of the transferor's assets (its entire banking business) with assumption of liabilities,[15] and not a purchase of all or substantially all of its corporate assets which would ultimately cripple it as a business entity. Therein transferee, therefore, according to this Court, could not be considered as the transferor's successor-in-interest.

Unlike *Bank of Commerce*, in the present petition, the transfer rendered MADCI incapable of continuing its business. This is

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[12] Footnote No. 22, *id*.

[13] G.R. No. 195615, April 21, 2014, 722 SCRA 520. (While the Decision is not yet final, *Bancom* is cited to make clear the dissimilar factual milieu in *Bancom* and the instant Petition).

[14] *Id*. at 545. "The evidence in this case fails to show that Bancommerce was a mere continuation of TRB. TRB retained its separate and distinct identity after the purchase. Although it subsequently changed its name to Traders Royal Holding's, Inc. **such change did not result in its dissolution.** x x x. (emphasis Ours).

[15] *Id*.

so since the only property that MADCI had in order for it to be able to conduct the very reason for its incorporation — that is, "[t]o acquire by purchase, lease, donation, or otherwise, and to own, use, improve, develop, subdivide, sell, mortgage, exchange, lease, develop, and hold for investment or otherwise, real estate of all kinds, whether improved, managed or otherwise disposed of buildings, houses, apartments, and other structures of whatever kind, together with their appurtenance — is the 120-hectare property later sold to YICRI. Petitioners were unable to show that MADCI was still able to continue its operations or to purchase other properties for that purpose. As such, the purchase by YICRI of the said property effectively resulted in the cessation of MADCI's business.

It may be noted that MADCI actually still had other assets comprised of loan advances of its directors. Petitioners, however, failed to show that said remaining assets were sufficient in order for MADCI to be able to continue its operations. It is well to emphasize that Section 40 contemplates not only of a sale of all of the corporation's assets, but also **substantially all** of said assets. This being the case, it is not necessary for the transferor not to be left with any corporate property. What is only required under Sec. 40 is that, as opined by the SEC, the nature of the transfer prevents the transferor from continuing its business or the purpose for which it was incorporated.

Consideration in exchange for transferor's assets

Aside from the nature of the transaction, the consideration to be paid in exchange for the transferor's assets is likewise significant in determining the applicability of Sec. 40. In this respect, the Court distinguishes between a *de facto* merger and a business-enterprise transfer.

For one, this Court has previously clarified that Sec. 40 does not contemplate a *de facto* merger because the provision recognizes the separate existence of the two corporations that transact the sale.[16]

[16] *Id*. at 548.

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Further, and more importantly, even though a business-enterprise transfer and a de facto merger may both involve the acquisition by another entity of all or substantially all of the transferor's assets which would ultimately result in the continuation by the transferee of the transferor's business venture, the distinction hinges on the **consideration in exchange for said assets**.

Citing with approval Dean Cesar Villanueva's explanation on the characteristics of a *de facto* merger, this Court stated that:

"a *de facto* merger can be pursued by one corporation acquiring all or substantially all of the properties of another **corporation in exchange of shares of stock of the acquiring corporation.** The acquiring corporation would end up with the business enterprise of the target corporation; whereas, **the target corporation would end up with basically its only remaining assets being the shares of stock of the acquiring corporation.**"[17] (emphasis Ours)

Thus, unlike in a business-enterprise transfer where the transfer is not in exchange for shares of stock in the transferee and that the transferor does not become a stockholder thereat, in a *de facto* merger, the acquisition of all or substantially all of the transferor's assets is precisely **in exchange of shares of stock of the acquiring corporation**.

Here, suffice it to state that the consideration for the sale was not shares of stocks in any of the petitioners. It was admitted by the parties that the amount of ₱9.3M was paid by petitioner YICRI for and in consideration of the 120-hectare property, which, as argued, was way below the market value of said lot. Thus, the MOA in the instant case could not be said to have resulted into a de facto merger.

Absorption of Liabilities

Anent the issue of absorption or non-absorption by the transferee of the transferor's liabilities, the *ponencia* pointed out that **under the business-enterprise transfer doctrine, the**

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[17] *Id*. at 544.

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transferee inherits the liabilities of the transferor as a consequence of the purchase. This is so since the transaction is not only limited to the assets of the transferor, as in a sale of assets as previously discussed, but also extends to its goodwill. Additionally, holding the transferee liable for the debts of the transferor is a protection afforded by law to the transferor's creditors.[18] It, therefore, does not require a contractual stipulation to that effect, nor must the transfer itself be in fraud of creditors before liability may attach to the transferee. The mere operation of Section 40 imposes upon the transferee the obligation to answer for the transferor's debts, as correctly observed by the *ponencia*.

The factual situation in the instant case can be distinguished from *Bank of Commerce*.[19]

In the instant dispute, **petitioners, as transferees, replaced the transferor, MADCI, in the undertaking of the development of the golf and country club, as a necessary consequence of the sale**. As observed by the *ponencia*, no evidence existed to show that MADCI subsequently acquired other lands for its development projects. It was, thus, rendered incapable of continuing its operations and accomplishing the purpose for which it was incorporated as it was left without any property to develop. As held, after the transfer, MADCI was left **in a state of suspended animation**. But with respect to the golf and country club development project, per Sangil's testimony, this was being undertaken by the managing director of petitioner YIL. In other words, petitioners ventured in the project which MADCI could no longer undertake. To my mind, this, in addition to MADCI's resulting state, calls for the application of Sec. 40.

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[18] While the Corporation Code allows the transfer of all or substantially all the properties and assets of a corporation, the transfer should not prejudice the creditors of the assignor. The only way the transfer can proceed without prejudice to the crditors is to hold the assignee liable for the obligations of the assignor. The acquisition by the assignee of all or substantially all of the assets of the assignor necessarily includes the assumption of the assignor's liabilities. [*Caltex (Philippines) Inc. v. PNOC Shipping and Transport Corporation, supra* note 1 at 411-412].

[19] *Supra* note 13.

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In contrast, in *Bank of Commerce*, the transferee therein was not considered by the Court to be the transferor's successor-in-interest. There, the Court categorized the sale therein as a mere **sale of assets** and not a *de facto* merger. Furthermore, for the sake of discussion, neither can it be considered as a business-enterprise transfer because the transferee remains existent and is able to continue its operations, although not its banking venture — the business, the assets for which were sold to the transferee. In the latter case, the transferee would still be able to, in fact continued to, operate since it has other ventures remaining, unlike in the present case where MADCI only had one business – the development of the 120 hectare property into a golf and country club.

More important is the fact that in *Bank of* Commerce, an escrow fund of ₱50M was set aside for the payment of the transferor's liabilities, in addition to the stipulation as to what liabilities are specifically shouldered by the transferee. The intent is clear - **to limit the liabilities of the transferee to those agreed upon and those covered by the escrow fund**. This, in proper cases, bolsters the fact that the transaction is a mere **sale of assets** and this intention is undoubtedly absent in the present case.

Considering these basic but material distinctions show that the requirement under Sec. 40 that the transfer must render the transferor incapable of continuing its operations is not present in *Bank of Commerce*. That being the case, therein transferee was not held liable for the debts of the transferor which it did not expressly assume under their Agreement. The transferor, therefore, continued to be liable for its excluded liabilities[20] and the only liabilities that the transferee had to absorb and settle were those which it expressly assumed under their Purchase and Assumption Agreement.

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[20] [Bancommerce agreed to assume those liabilities of TRB that are specified in their P & A Agreement. That agreement specifically excluded TRB's contingent liabilities that the latter might have arising from pending litigations in court, including the claims of respondent RPN, *et al.*] *Bank of Commerce v. Radio Philippines Network, Inc., et al.*, G.R. No. 195615, April 21, 2014, 772 SCRA 520, 454.

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In *Caltex (Phils.), Inc. v. PNOC,*[21] the Court also recognized this contractual assumption by the transferee of the transferor's liabilities. There, the transferor - Luzon Stevedoring Corporation – and the transferee – PNOC Shipping and Transport Corporation – entered into an *Agreement of Assumption of Obligations* whereby the former "transferred, conveyed and assigned unto [the latter] all of the [former's] business, properties and assets pertaining to its tanker and bulk all (sic) departments, *together with all the obligations relating to said business, properties and assets*.[22]

At this point it is well to mention that even in a mere *sale of assets,* as opposed to a business-enterprise transfer, liability may still attach to the transferee if the alienation was done in fraud of the transferor's creditors.[23] In *Bank of Commerce*, this non-attachment of liability for excluded obligations was not only supported by the fact that the existence and operations of the transferor continued even after the sale but also, as observed by the Court, the transfer was entered into by the parties *at arm's length*.[24] This bona fide quality of the execution of said Agreement reinforced the transferee's exclusion from the entities upon which the judgment debt may be enforced.

This element of fraud, however, is not required in order for the transferee to be liable under Section 40 of the Corporation Code, as previously mentioned. This is so since the basis for the liability thereon is not that the transfer was done in fraud of creditors but that it included the goodwill of the transferor, as discussed by the *ponencia*, and to protect the creditors of the transferor since the alienation effectively removes the transferor's properties from its creditors' reach.[25]

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[21] *Supra* note 1.

[22] *Id*. at 409.

[23] *Bank of Commerce v. Radio Philippines Network, Inc., et al.*, *supra* note 13 at 574-575.

[24] *Id*. at 547.

[25] *Supra* note 1 at 412.

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With the above disquisition, I concur with the conclusion of the *ponencia* that the sale between MADCI and petitioners of the 120-hectare property was a business-enterprise transfer contemplated under Section 40 of the Corporation Code, which results in the solidary assumption by petitioners of MADCI's admitted obligation.

I vote to **DENY** the present petition.

CONCURRING OPINION

LEONEN, *J.*:

I concur in holding petitioners Yats International Ltd., Y-1 Leisure Philippines, Inc., and Y-1 Clubs and Resorts, Inc. liable to refund respondent James Yu's investment of ₱650,000.00 with legal interest.

The facts, as summarized in the ponencia,[1] involve a creditor's claim against a corporation that sold all or substantially all of its assets to another corporation. Respondent James Yu filed a collection suit against Mt. Arayat Development Co. Inc. (MADCI) and its then President Rogelio Sangil for the ₱650,000.00 respondent James Yu invested in shares of MADCI's golf and country club project in Arayat, Pampanga that turned out to be non-existent.[2] He later amended his Complaint to implead petitioners after he had discovered that MADCI had already sold substantially all of its assets to petitioners.[3] The Regional Trial Court held that MADCI and Rogelio Sangil are solidarily liable to pay respondent James Yu's claim for refund, but dismissed the case against petitioners.[4] The Court of Appeals affirmed the trial court with modification in that petitioners are also liable to satisfy respondent James Yu's claim considering

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[1] *Ponencia*, pp. 2-6.

[2] *Id*. at 2; *Rollo,* pp. 32 and 61.

[3] *Ponencia*, p. 3; *Rollo,* pp. 35 and 64.

[4] *Rollo,* p. 76.

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the transfer of MADCI's entire assets to petitioners.[5] The *ponencia* affirmed the Court of Appeals Decision in toto.[6]

The Regional Trial Court found that MADCI did not deny its contractual obligation with respondent James Yu.[7] The issue before us involves the liability of petitioners as purchasing corporations.

Jurisprudence[8] reiterates this court's ruling in *Edward J. Nell Company v. Pacific Farms, Inc.*[9] that:

> Generally where one corporation sells or otherwise transfers all of its assets to another corporation, the latter is not liable for the debts and liabilities of the transferor, except: (1) where the purchaser expressly or impliedly agrees to assume such debts; (2) where the transaction amounts to a consolidation or merger of the corporations; ***(3) where the purchasing corporation is merely a continuation of the selling corporation***; and (4) where the transaction is entered into fraudulently in order to escape liability for such debts.[10] (Emphasis supplied)

The four exceptions enumerated find basis from the Civil Code and Corporation Code.[11] The third exception grounds on Section 40 of the Corporation Code governing the sale or other disposition of assets.

This provision requires the ratificatory vote of the stockholders representing at least two-thirds of the outstanding capital stock

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[5] *Ponencia,* p. 6; *Rollo,* pp. 53-54 and 56.

[6] *Ponencia*, p. 20.

[7] *Id*. at 5; *Rollo,* p. 72.

[8] See *Philippine National Bank v. Andrada Electric & Engineering Company,* 430 Phil. 882, 893 (2002) [Per *J.* Panganiban, Third Division] and *McLeod v. National Labor Relations Commission,* 541 Phil. 214 (2007) [Per *J.* Carpio, Second Division].

[9] 122 Phil. 825 (1965) [Per *J.* Concepcion, *En Banc*].

[10] *Id*. at 827.

[11] See discussion in *J.* Leonen, Dissenting Opinion in *Bank of Commerce v. Radio Philippines Network, Inc.,* G.R. No. 195615, April 21, 2014, 722 SCRA 520, 607-622 [Per *J.* Abad, Third Division].

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when the transaction amounts to a sale of "all or substantially all of [the corporation's] property and assets."[12] It contemplates a transfer of the entire business enterprise[13] since no such ratificatory vote is required if the sale or other disposition of property and assets "is necessary in the usual and regular course of business"[14] or "if the proceeds of the sale or other disposition of such property and assets be appropriated for the conduct of its remaining business."[15] Thus, the scenario involves a purchaser corporation continuing the business of a seller corporation that no longer conducts such specific business.

Caltex (Phils.), Inc. v. PNOC Shipping & Transport Corp.[16] discussed this third exception in holding that even without the Agreement of Assumption of Obligations, respondent was still

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[12] CORP. CODE, Sec. 40.

[13] *See* Cesar Villanueva, *PHILIPPINE CORPORATE LAW* 679–680, 682, 686, 692–693 (2010), cited in *J.* Leonen, Dissenting Opinion in *Bank of Commerce v. Radio Philippines Network, Inc.,* G.R. No. 195615, April 21, 2014, 722 SCRA 520, 617 [Per *J.* Abad, Third Division], for its discussion on the three levels of Corporate Acquisitions and Transfers, namely: (1) pure assets-only transfer; (2) transfer of the business enterprise; and (3) equity transfer. It discussed that in a pure assets-only transfer, "the purchaser is only interested in the 'raw' assets and properties of the business, perhaps to be used to establish its own business enterprise or to be used for its on-going business enterprise." In a transfer of business enterprise, "[t]he purchaser's primary interest is to obtain the 'earning capability' of the venture." An equity transfer is when "[t]he purchaser takes control and ownership of the business by purchasing the controlling shareholdings of the corporate owner." In this case, "[t]he control of the business enterprise is therefore indirect [as] the corporate owner remains the direct owner of the business, and what the purchaser has actually purchased is the ability to elect the members of the Board of Directors of the corporation which runs the business."

For the first and third type, the transferee shall not be liable for the debts and liabilities of the transferor except where the transferee expressly or impliedly agrees to assume such debts. The second type, the transfer of business enterprise, makes the transferee liable for the transferor's liabilities.

[14] CORP. CODE, Sec. 40.

[15] CORP. CODE, Sec. 40.

[16] 530 Phil. 149 (2006) [Per *J.* Carpio, Third Division].

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liable to petitioner since "[t]he acquisition by the assignee of all or substantially all of the assets of the assignor necessarily includes the assumption of the assignor's liabilities, unless the creditors who did not consent to the transfer choose to rescind the transfer on the ground of fraud."[17]

Corporation law provisions and concepts reflect a concern for protecting corporate creditors. The trust fund doctrine,[18] for example, provides that "subscriptions to the capital of a corporation constitute a fund to which creditors have a right to look for satisfaction of their claims and that the assignee in insolvency can maintain an action upon any unpaid stock subscription in order to realize assets for the payment of its debts."[19]

Section 43 of the Corporation Code provides that the Board of Directors may declare dividends only from unrestricted retained earnings.[20] The term "unrestricted retained earnings" substituted the old Corporation Code's wording of "surplus profits arising from its business."[21]

Section 122 of the Corporation Code on liquidation also provides that "[e]xcept by decrease of capital stock and as otherwise allowed by this Code, no corporation shall distribute any of its assets or property except upon lawful dissolution and after payment of all its debts and liabilities."[22]

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[17] *Id*. at 159-160.

[18] The American case of *Wood v. Dummer* (3 Mason 308, Fed Cas. No. 17, 944) first enunciated this doctrine, which was later adopted in this jurisdiction with *Philippine Trust Co. v. Rivera*, 44 Phil. 469, 470 (1923) [Per *J.* Street, *En Banc*]. This was discussed in *Halley v. Printwell, Inc.,* 664 Phil. 361, 382 (2011) [Per *J.* Bersamin, Third Division].

[19] *Halley v. Printwell, Inc.,* 664 Phil. 361, 382-383 (2011) [Per *J.* Bersamin, Third Division], citing *Velasco v. Poizat,* 37 Phil. 802 (1918) [Per *J.* Street, *En Banc*].

[20] CORP. CODE, Sec. 43.

[21] *Republic Planters Bank v. Hon. Agana, Sr.,* 336 Phil. 1, 10 (1997) [Per *J.* Hermosisima, Jr., First Division].

[22] CORP. CODE, Sec. 122.

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The provisions of law, and as applied and interpreted in jurisprudence, shape and govern the legal fiction of corporations. For one, the law vests in corporations a personality separate and distinct from those that represent them.[23] This separate personality, among other key features, sets the "economic superiority"[24] of a corporate legal structure among other business associations.[25] This attracts investors by allowing small capital contributors to be part of a big business endeavor through the aggregation of their capital funds, and by limiting their liability since corporate assets will answer for corporate debts.[26] However, this legal structure should not be abused.

While a separate corporate personality shields corporate officers acting in good faith and within their scope of authority from personal liability, law and jurisprudence[27] enumerate

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[23] *Solidbank Corporation v. Mindanao Ferroalloy Corporation*, 502 Phil. 651, 664 (2005) [Per *J.* Panganiban, Third Division], citing *Monfort Hermanos Agricultural Development Corporation v. Monfort III*, 478 Phil. 34, 42 (2004) [Per *J.* Ynares-Santiago, First Division], *Spouses Firme v. Bukal Enterprises and Development Corporation*, 460 Phil. 321, 345 (2003) [Per *J.* Carpio, First Division], and *People's Aircargo and Warehousing Co. Inc. v. Court of Appeals*, 357 Phil. 850, 863 (1998) [Per *J.* Panganiban, First Division].

[24] *See* Paddy Ireland, *Limited liability, shareholder rights and the problem of corporate irresponsibility*, Cambridge Journal of Economics 837, 838 (2010) <http://cje.oxfordjournals.org/content/34/5/837.full.pdf+html> (visited July 9, 2015).

[25] See *Pioneer v. Morning Star,* G.R. No. 198436, July 8, 2015 [Per *J.* Leonen, Second Division].

[26] See *Pioneer v. Morning Star,* G.R. No. 198436, July 8, 2015 [Per *J.* Leonen, Second Division].

[27] See *Edsa Shangri-La Hotel and Resort, Inc., et al. v. BF Corporation*, 578 Phil. 588, 607 (2008) [Per *J.* Velasco, Jr., Second Division], *Aratea v. Suico*, 547 Phil. 407, 415-416 (2007) [Per *J.* Garcia, First Division]; *Solidbank Corporation v. Mindanao Ferroalloy Corporation*, 502 Phil. 651, 665 (2005) [Per *J.* Panganiban, Third Division], *MAM Realty Development Corp. v. National Labor Relations Commission*, 314 Phil. 838, 844-845 (1995) [Per *J.* Vitug, Third Division], *citing Tramat Mercantile, Inc. v. Court of Appeals*, G.R. No. 111008, November 7, 1994, 238 SCRA 14, 19 [Per *J.* Vitug, Third Division].

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exceptions[28] to this rule, such as "gross negligence or bad faith [by directors] in directing the affairs of the corporation"[29] when established by clear and convincing evidence.[30] This court has also disregarded the separate personality of corporations by applying the doctrine of piercing the corporate veil in the following instances:

[T]he doctrine of piercing the corporate veil applies only in three (3) basic instances, namely: a) when the separate and distinct corporate personality defeats public convenience, as when the corporate fiction is used as a vehicle for the evasion of an existing obligation; b) in fraud cases, or when the corporate entity is used to justify a wrong, protect a fraud, or defend a crime; or c) is used in alter ego cases, i.e. where a corporation is essentially a farce, since it is a mere alter ego or business conduit or a person, or where the corporation

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[28] *Solidbank Corporation v. Mindanao Ferroalloy Corporation*, 502 Phil. 651, 665 (2005) [Per *J.* Panganiban, Third Division], quoting *Tramat Mercantile, Inc. v. Court of Appeals*, G.R. No. 111008, November 7, 1994, 238 SCRA 14, 19 [Per *J.* Vitug, Third Division]. See also *Aratea v. Suico*, 547 Phil. 407, 415–416 (2007) [Per *J.* Garcia, First Division], quoting *MAM Realty Development Corp. v. National Labor Relations Commission*, 314 Phil. 838, 844–845 (1995) [Per *J.* Vitug, Third Division]:

> Personal liability of a corporate director, trustee or officer along (although not necessarily) with the corporation may so validly attach, as a rule, only when —
>
> '1. He assents (a) to a patently unlawful act of the corporation, or (b) for bad faith or gross negligence in directing its affairs, or (c) for conflict of interest, resulting in damages to the corporation, its stockholders or other persons;
>
> '2. He consents to the issuance of watered stocks or who, having knowledge thereof, does not forthwith file with the corporate secretary his written objection thereto;
>
> '3. He agrees to hold himself personally and solidarily liable with the corporation; or
>
> '4. He is made, by a specific provision of law, to personally answer for his corporate action.'

[29] CORP. CODE, Sec. 31.

[30] *Francisco v. Mallen, Jr.*, 645 Phil. 369, 376 (2010) [Per *J.* Carpio, Second Division], quoting *Carag v. National Labor Relations Commission*, 548 Phil. 581, 602 (2007) [Per *J.* Carpio, *En Banc*], emphasis supplied.

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is so organized and controlled and its affairs so conducted as to make it merely an instrumentality, agency, conduit or adjunct of another corporation.[31] (Emphasis and citations omitted)

The lower courts pierced the veil of corporate fiction against Rogelio Sangil after finding that he had control of MADCI before the execution of the Memorandum of Agreement with petitioners, and he used MADCI as an alter ego to sell golf and country club shares without authority from the Securities and Exchange Commission.[32] He also failed to redeem shares sold to third parties like respondent James Yu as agreed upon in the Memorandum of Agreement, despite his receipt of money for this purpose, and he invoked MADCI's separate personality to evade this existing obligation.[33] These acts, in abuse of the corporate legal fiction, resulted in the injury of investors and creditors such as respondent James Yu.

The third exception laid down in *Edward J. Nell Company v. Pacific Farms, Inc.*[34] falls under this framework of providing protection for corporate creditors and consequently encouraging investments in support of economic development.

The *ponencia* discussed the factual findings supporting the conclusion that seller corporation MADCI can no longer exist as a development company for the golf course, while petitioner purchaser corporation to whom it transferred substantially all of its assets will continue its operations.[35]

The Court of Appeals found that the sale of MADCI's entire asset of 120 hectares of land in Pampanga rendered it incapable of continuing its golf and country club business plan.[36] On the

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[31] *WPM International Trading, Inc. v. Labayen,* G.R. No. 182770, September 17, 2014, 735 SCRA 297, 307–308 [Per *J*. Brion, Second Division].

[32] *Rollo,* pp. 56 and 72.

[33] *Id*. at 54 and 56.

[34] 122 Phil. 825 (1965) [Per *J*. Concepcion, *En Banc*].

[35] *Ponencia*, pp. 16-18.

[36] *Id*. at 17; *Rollo,* p. 52.

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other hand, petitioner purchaser corporation's President and Chief Executive Officer testified that "[petitioner corporation] bought the share[s] of stock of MADCI because it had some interest in the project involving the development of a golf course [and] [t]he petitioners then found that MADCI had landholdings in Pampanga which it would be able to develop into a golf course."[37]

Since the third exception applies, petitioners Yats International Ltd., Y-1 Leisure Philippines, Inc., and Y-1 Clubs and Resorts, Inc. are liable to respondent James Yu.

ACCORDINGLY, I vote to DENY the Petition.

EN BANC

[G.R. No. 213189. September 8, 2015]

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[37] *Ponencia*, pp. 4 and 18.