was found in the Spanish Civil Code of 1889, and in the Code of Commerce of 1888.

Under these laws, partnerships were divided into two general kinds: civil and commercial. In civil partnerships, general partners were not solidarily liable to contractual creditors of the partnerships. In commercial partnerships, general partners were solidarily liable, with all their property, to contractual creditors of the partnership.

The new Civil Code of the Philippines has repealed these provisions. Now there is only one law on partnerships, the distinction between civil and commercial partnerships has been eliminated. Nevertheless, the decisions of the Supreme Court under these former laws may still be of binding force on some points, where the new law is merely a restatement of the old, and of persuasive effect on other points, in view of the fact that there are as yet no decided cases on the new Civil Code provisions on partnerships.

American cases and authorities have not been included in this study, although some of the provisions of the new Civil Code of the Philippines on partnerships were taken from the U. S. Uniform Partnership Act, because of two reasons: First, under American Law a partnership has no juridical personality distinct and separate from that of its members, while under the Civil Code of the Philippines a partnership is a juridical person. Second, the liability of general partners to contractual creditors under American Law is solidary, and sometimes even primary, while under the Civil Code of the Philippines it is merely "pro rata."

THE SPIRIT OF THE LAW

The new Civil Code of the Philippines was enacted at a time when the Philippines was exerting strong efforts toward industrialization, nationalization of the retail trade, and other measures aimed at giving Filipinos a larger participation in the commerce and industry of their own country. There was an acute need for capital, usually in amounts beyond the capacity of the average individual.

Capital needed to be pooled in order to be usable, but the potential investor was met on the one hand by the frightening prospect of personal solidary liability with all his property if he joined a commercial partnership, risking his savings of a lifetime on a venture of which he had no sole control, and on the other hand there was the discouraging alternative of corporate organization, far too complicated, technical, and legalistic for the average man. While the corporation offered freedom from personal liability, there was the very unwelcome feature of a corporate flat rate income tax, from which the registered general partnership was exempt.

It would seem, therefore, that the Congress of the Philippines, in providing that partnerships under the new Civil Code would subject general partners only to pro rata liability to creditors, intended to solve this dilemma and provide the potential investor with a simpler form of commercial organization with limited liability. The encouragement of the formation of partnerships appears to be the underlying spirit of the new Civil Code and it is this spirit that has been kept uppermost in this study.

At the same time, one should not lose sight of the fact that the rights of the creditors of the partnership must also be protected, over and above the interests of the partners.

LIABILITY OF GENERAL PARTNERS

TO CONTRACTUAL CREDITORS OF THE PARTNERSHIP

Art. 1797 C.C.Phil.—The losses and profits shall be distributed in conformity with the agreement. If only the share of each partner in the profits has been agreed upon, the share of each in the losses shall be in the same proportion.

In the absence of stipulation, the share of each partner in the profits and losses shall be in proportion to what he may have contributed, but the industrial partner shall not be liable for the losses. As for the profits, the industrial partner shall receive such share as may be just and equitable under the circumstances. If besides his services he has contributed capital, he shall also receive a share in profits in proportion to his capital.

Art. 1816 C.C.Phil.—All partners, including industrial

ones, shall be liable *pro rata* with all their property and after all the partnership assets have been exhausted, for the contracts which may be entered into in the name and for the account of the partnership, under its signature and by a person authorized to act for the partnership. However, any partner may enter into a separate obligation to perform a partnership contract.

Art. 1817 C.C.Phil.—Any stipulation against the liability laid down in the preceding article shall be void, except as among the partners.

These articles were taken from the following articles of the Code of Commerce and the old Civil Code:

Art. 127 Com.C.—All the members of the general copartnership, be they or be they not managing partners of the same, are personally and severally liable with all their property for the results of the transactions made in the name and for the account of the partnership, under the signature of the latter, and by a person authorized to make use thereof.

Art. 140 Com.C.—The part corresponding to each partner in the profits not having been determined in the contract of partnership, these shall be divided in proportion to the interest which each one may have in the company, the industrial partners, if there be any, participating in the distribution in the class of the capitalist partners with the smallest interest.

Art. 141 Com.C.—The losses shall be charged in the same proportion among the capitalist partners, without including the industrial partners, unless by express agreement the latter have been made participants therein.

Art. 237 Com.C.—The private property of the general partners which has not been included in the assets of the partnership when it was formed cannot be seized for the payment of the obligations contracted by the partnership until after the assets of the partnership shall have been exhausted.

Art. 1689 C.C.—The losses and profits shall be distributed in accordance with the terms of the agreements. If an agreement exists only with regard to the share of each partner in the profits, his share in the losses shall be in the same proportion.

In the absence of an agreement, the share of each partner in the profits and losses shall be in proportion to what he may have contributed. The partner who contributes his services only, shall receive a share equal to the one who has contributed the least. If besides his services he has contributed capital, he shall receive the proportional share which may correspond to him for this capital.

Art. 1698 C.C.—The partners shall not be solidarily bound with regard to the debts of the partnership; and none of them

may bind the others by a personal act, if they have not granted him a power therefor.

The last sentence of Art. 1816 C.C.Phil. appears to be a restatement of the ruling of the Supreme Court in the case of Bachrach *vs.* La Protectora, 37 Phil. 441, where it was held that when a partner signs a note worded "I promise to pay," in the partnership name, and in his own name, said partner is solidarily liable with the partnership for the full amount of said note.

A perusal of these provisions leads to three important questions:

(1) Is the liability of partners to partnership creditors in the nature of guarantee, or is it by surrogation?

(2) What is the meaning of the words "pro rata" as used in Art. 1816 C.C.Phil.

(3) What are the partnership assets referred to in Art. 1816 C.C.Phil?

The three questions are so intimately related and intertwined that they will be discussed together.

If the liability of partners to partnership creditors is by guarantee, then the liability is to be considered entirely independent of the profit and loss sharing ratio (the method of dividing profits agreed upon, or imposed by law).

If it is by surrogation, then the liability of the partners to the creditors will only be the same amounts as they are required to contribute to the losses of the partnership; in other words, the creditors will step into the shoes of the partnership, and collect from the partners only the amounts that the partnership itself can collect.

The stand taken by the Philippine Supreme Court on this question, under the old law, may be deduced from the analysis of a related question that has been discussed and decided, to wit: Is an industrial partner who is exempted from the partnership losses liable to partnership creditors for partnership contracts with his own private property? If the liability of partners to creditors is in the nature of guarantee, then the industrial partner is liable to the creditors. But if the liability of partners to creditors is by surrogation, then the industrial partner, not being liable to the partnership for any losses, has no liability to the partnership creditors.

The question of liability of industrial partners was discussed in the leading case of Cia Maritima *vs.* Muñoz (9 Phil. 326). In that case, the Supreme Court admitted that the question of personal liability of industrial partners under Art. 141 Com.C. was susceptible of two interpretations. The majority opinion, penned by Justice Willard, and concurred in by Justices Torres, Johnson and Tracey, held that an industrial partner, although exempted from losses, is nevertheless a general partner, and therefore solidarily liable to partnership creditors. The minority, in a vigorous dissenting opinion by Chief Justice Arellano, insisted that an industrial partner who was exempted from losses was necessarily also exempted from personal liability to partnership creditors.

> The majority: "Our construction of the article (Art. 141 Com.C.) is that it relates conclusively to the settlement of the partnership affairs among the partners themselves and has nothing to do with the liability of the partners to third person; that each one of the industrial partners is liable to third persons for the debts of the firm; that if he has paid such debts out of his private property during the life of the partnership, when its affairs are settled he is entitled to credit for the amount so paid, and if it results that there is not enough property in the partnership to pay him, then the capitalist partners must pay him." (Cia Maritima *vs.* Muñoz, 9 Phil. 326, 333-334)
>
> The minority: "There need be no distinction made between obligations and losses. . . . The case at bar could only thus be set forth: Should an industrial partner be responsible for such losses, for such obligations in favor of third persons? Article 141 (Com.C.) expressly states that he shall not." (Cia Maritima *vs.* Muñoz, 9 Phil. 326, 342-343)
>
> "In a copartnership, and as the result of the obligations thereunder, an industrial partner cannot lose except what he has actually contributed thereto for a limited or an unlimited purpose, subject ultimately to company or personal obligations; this is all that law and logic may demand of him; anything also would not come under the law. . . ." (Ibid., p. 346)
>
> "Manuel Duran y Bas, a former professor of the University of Barcelona, in his addition to the work of Marti de Exiala, which is so generally and specially consulted in that eminently commercial and industrial city, has offered no remarks to the original text of said work which establish as an elemental doctrine that 'When the copartnership is purely a collective one, each one of its members is jointly obligated for the result of the transactions which should be charged to the copartnership * * *. From the general rule which we have just set up the industrial partners who contract no obligation to secure the liabilities of the company should be excepted, unless there be an express covenant to the contrary.' (Art. 319 of the code of 1829, identical with Art. 141 of the Code now in force."
>
> "During almost half a century no objection has been raised by the professors of law, the press, or the bar, to this doctrine regarding the exemption, not merely with respect to losses but to company obligations of the industrial partner, on the supposition, which I do not admit, as already shown, that it may be possible to discriminate between losses and obligations in connection with an industrial partner, for whom there are none but the final losses, such as absorb the assets of the company, which cannot be otherwise then outstanding obligations in favor of third parties inasmuch as, so long as there are company assets, no recourse can be had to the private property of any partner." (Ibid., pp. 346-348)

The ruling in the Cia Maritima *vs.* Muñoz case was reiterated by the Supreme Court in the case of Pacific Commercial Co. *vs.* Aboitiz and Martinez (48 Phil. 841), in which the court stated:

> "There is a marked distinction between a liability and a loss, and the inability of a partnership to pay a debt to a third party at a particular time does not necessarily mean that the partnership business, as a whole, has been operated at a loss. The partnership may have outstanding credits which eventually may be realized upon and yield profits more than sufficient to cover all losses. Bearing this in mind it will be found that there in reality is no conflict between the two articles quoted; one speaks of liabilities (Art. 127 Com.C.) and the other of losses" (Art. 141 Com.C.) Pacific Commercial Company *vs.* Aboitiz and Martinez (48 Phil. 841, 843-844).

The ruling in these two cases just cited clearly shows that the Supreme Court, under the old Code of Commerce considered the personal liability of partners to creditors, as in the nature of guarantee, independent of any agreements among the partners as to the division of losses. This is why even the industrial partners who are exempted from losses (by stipulation) were nevertheless held liable to the creditors.

It seems however, that in these two cases, the majority opinion which claims that there is no relation between losses and liability of the partners to partnership creditors, and the minority opinion which insists that there is no

distinction between the two, both fail to present the correct relationship between losses and liability to creditors. We shall present a simple example to illustrate this relationship:

A and B form a partnership and contribute ₱30,000 each, agreeing to divide profits and losses equally. The total assets of the partnership are ₱60,000, consisting of the cash contributed. The partnership then purchases merchandise on credit from X, worth ₱100,000. Upon receipt of this merchandise, the total partnership assets will total ₱160,000; while there are ₱100,000 of liabilities. The situation may be summarized as follows:

Assets	Liability to X	A's Capital	B's Capital
160,000	100,000	30,000	30,000

(a) Assume that the partnership suffers a loss of ₱40,000, either from operations, from extraneous causes like fire, or any other cause. The loss will cause a decrease in the assets by ₱40,000, and said loss should be divided between A and B equally, as follows:

	Assets	Liability to X	A's Capital	B's Capital
	160,000	100,000	30,000	30,000
Loss	—40,000		—20,000	—20,000
Left	120,000	100,000	10,000	10,000

Although a loss occurred, the remaining assets are more than enough to pay the liability, and the partners have no personal liability to X.

(b) Starting with same basis facts, assume that the partnership suffers losses of ₱90,000. The loss causes the assets to decrease, and is divided equally between A and B.

	Assets	Liability to X	A's Capital	B's Capital
	160,000	100,000	30,000	30,000
Loss	—90,000		—45,000	—45,000
Left	70,000	100,000	—15,000	—15,000

The creditor X is entitled to proceed against all the assets worth ₱70,000, and against A and B personally for a total of ₱30,000, in order to collect what is due him.

The loss causes the assets to decrease to an amount less than the liabilities. Thereupon the partners become personally liable to the creditor for the amount unpaid.

Conclusion: Losses cause a decrease in the assets. Decrease in the assets to a point when the remainder are insufficient to meet the liabilities gives rise to personal liability of partners to the creditors. Losses, therefore, give rise to personal liability. This is the relation between losses and liability.

Therefore it is not correct to say that there is no distinction between liability and losses, because it is possible to have losses without personal liability, when the remaining partnership assets are insufficient to meet the liabilities. It is similarly incorrect to say that there is no relation between liability and losses: liability is caused by losses, when the latter reduce the assets to an amount insufficient to pay the liabilities. Since liabilities arise from losses, then the method of dividing losses among the partners should have a bearing on the method of dividing the liability among them, where said liabilities are only "pro rata."

The ruling in these two cases (Cia Maritima *vs.* Muñoz, and Pacific Commercial Co. *vs.* Aboitiz and Martinez) was formulated with an important idea in mind: the protection of the creditor. Under the old commercial partnerships, the liability of general partners for partnership liabilities was expressly stated to be solidary. This was advantageous to the creditor, for it was to his benefit to have more partners solidarily liable to him, including the industrial partner. The creditor had nothing to lose thereby.

Under the new Civil Code of the Philippines, the situation is drastically different. Here the liability to creditors is only "pro rata," which has always been interpreted to mean joint. Is it also to the creditors' benefit to have the industrial partner jointly liable for the partnership debts? Usually the industrial partner does not have the same ample resources as the capitalist partners. Often the industrial partner is an old employee who has been rewarded with the status of a partner and a share in the profits; sometimes he is a person with the skill and experience but not the resources. When the liability is joint, any portion of the liability assessed against an industrial partner without resources, is thereby lost to the creditors who are deprived of the right to collect it from the capitalist partners, usually the ones who can afford it. To hold the industrial partner liable to the creditors, when he is exempted from losses, works to the detriment of the creditors.

From the creditors' point of view, therefore, under the new partnership law, it is more advantageous to hold

that the personal liability of general partners for partnership liabilities is in the nature of surrogation, rather than of guarantee. In such a case, the right of the creditors against the partners would be in the same amounts as the partnership itself could collect from the partners to cover the losses; the capitalist partners would bear the liability, the industrial partner who is exempted from losses also being exempted from liability.

Incidentally, it may also be in point to state that the Republic has adopted a policy of protecting the worker. It is in this spirit that the Minimum Wage Law, and Woman and Child Labor Law, and other similar laws and regulations, were promulgated. The view advocated above also operate to protect the industrial partner, who as mentioned is often an old employee or a skilled man without capital.

It now becomes necessary to determine the meaning of the word "assets" as used in Art. 1816 C.C.Phil.

> In the case of Vda. de Chan Dioco *vs.* Peng (53 Phil. 906) the court ruled that where the partnership has no visible assets, the partners may be proceeded against personally.

Reading together the cases of Vda de Chan Dioco *vs.* Peng and Pacific Commercial Co. *vs.* Aboitiz and Martinez (see page 9), it seems that the court considers as partnership assets only those which are visible. Debts of third persons to the partnership do not seem to have been included in the term "assets." In Pacific Commercial Co. *vs.* Aboitiz and Martinez (see citation on page 9), the court implied that the creditors could collect from the partners, even though the partnership had some uncollected claims against third persons.

It would seem that the Court has narrowed down the meaning of the term "assets" to a point much more limited than that contemplated in the law.

> Webster's New International Dictionary, Second Edition, defines the legal meaning of assets as: "The entire property, of all sorts, of an insolvent or bankrupt, or of a person, association, corporation, or estate, applicable or subject to the payment of his or its debts."
>
> The same authority defines the meaning of assets in accounting as "any item of value owned."

In a debt of a third person to the partnership an "asset" of the partnership? Here is what the law itself states:

> Art. 417 C.C.Phil.—The following are also considered as personal property:
>
> (1) Obligations and actions which have for their object movables or demandable sums;
>
> Art. 1177 C.C.Phil.—The creditors, after having pursued the property in possession of the debtor to satisfy their claims, may exercise all the rights and bring all the actions of the latter for the same purpose, save those which are inherent in his person; they may also impugn the acts which the debtor may have done to defraud them.

The law itself considers a debt as property, i.e. as asset. Under Rule 59, Sec. 7, Rules of Court, the following are considered properties, and may be attached: (a) (b) Real property, growing crops, (c) Personal property capable of manual delivery, (d) Stock or shares, (e) Debts and credits and other personal property not capable of manual delivery, (f) Interest in the estate of a decedent. The attachment of debts and credits under (e) is known as "garnishment."

Other personal property not capable of delivery under Rule 59 Sec. 7 (e) includes goodwill, copyrights, patents, trademarks and tradenames, franchises. These are far from visible, but no one can deny that they are quite capable of appropriation, and of bringing a price when sold on the market. These are also assets.

The new partnership law in the Civil Code of the Philippines is even more broad on this point:

> Art. 1786 C.C.Phil.—Every partner is a debtor of the partnership for whatever he may have promised to contribute thereto.
>
> Arts. 1767, 1787, 1788, 1790 refer to contributions to the capital of the partnership.
>
> Art. 1791 C.C.Phil.—If there is no agreement to the contrary, in case of an imminent loss of the business of the partnership, any partner who refuses to contribute an additional share to the capital, except an industrial partner, to save the venture, shall be obliged to sell his interest to the other partner.
>
> Art. 1839 C.C.Phil.—In settling accounts between the partners after dissolution, the following rules shall be observed, subject to any agreement to the contrary:

(1) The assets of the partnership are:
(a) The partnership property,
(b) The contributions of the partners necessary for the payment of all the liabilities specified in No. 2.

(2) The liabilities of the partnership shall rank in order of payment, as follows:
(a) Those owing to creditors other than partners,
(b) Those owing to partners other than for capital and profits,
(c) Those owing to partners in respect of capital,
(d) Those owing to partners in respect of profits.

(3) The assets shall be applied in the order of their declaration in No. 1 of this article to the satisfaction of the liabilities.

(4) The partners shall contribute, as provided by Article 1797, the amount necessary to satisfy the liabilities.
(for Art. 1797 see page 4)

(5) An assignee for the benefit of creditors, or any person appointed by the court shall have the right to enforce the contributions specified in the preceding number.

(6) Any partner or his legal representative shall have the right to enforce the contributions specified in No. 4, to the extent of the amount which he has paid in excess of his share of the liability.

Art. 417 C.C.Phil. clearly considers money or property obligations, from the point of view of the creditor, as assets. Art. 1177 lays down the general principle of surrogation. Rule 59 specifies the remedy and procedure in levying against these obligations, known as "garnishment." Art. 1786 states that the partner is a debtor of the partnership for any amount he promises to contribute thereto. Art. 1839 (4) states that one of the contributions of a partner is the amount necessary to satisfy the liabilities, in case the partnership properties have been exhausted. Finally, Art. 1839 (1) expressly states that the contributions of the partners necessary for the payment of all the liabilities are assets of the partnership.

The term "assets" as used in Art. 1816 C.C.Phil. (see page 4) therefore includes not only the visible assets of the partnership, but also debts of third persons to the partnership, other intangible assets, and even the contributions that the partners should make to the partnership to cover all the liabilities. As we stated before, these contributions become necessary when the partnership properties are reduced by losses to an amount insufficient to meet the liabilities.

An incidental point regarding debts of third persons: If these debts are collectible, the amount thereof is an asset of the partnership, and may be garnished by the creditors. If any debt is uncollectible, the amount thereof becomes a loss to the partnership, and must be borne by the partners in the profit and loss sharing ratio, as stipulated.

As this stage, an objection may be interposed: Art. 1839 C.C.Phil. states that it applies "in settling accounts between the partners after dissolution . . . subject to any agreement to the contrary."

We submit that despite these words, not all points discussed in Art. 1839 C.C.Phil. are subject to stipulations to the contrary: Could the partners stipulate to eliminate the contributions specified in par. (1) (b)?—obviously they cannot. If the partners, during liquidation, agree on a different ratio of contributions, contrary to par. (4), will the creditors who did not consent thereto be bound by this new agreement?—obviously not. Par (5) gives the court the power to enforce the partners' contributions —most certainly the partners cannot stipulate against this!

Despite the wording of its first paragraph, Art. 1839 C. C. Phil. is not only "between the partners,"—it intimately involves the creditors, and if there are agreements contrary thereto, these agreements are not binding on the creditor who did not consent thereto. We submit that Art. 1839 C.C.Phil., despite its first paragraph, is of a compulsory nature, as between the creditors and the partners. "Agreement to the contrary" in this article means an agreement to which the creditors consent.

HOW THE LAW OPERATES:

Art. 1839 (5) gives the court the power to enforce the partners' contributions specified in par. (4). Par. (4) in turn provides that the contributions shall be in accordance with Art. 1797 (see page 4). Art. 1797 provides for the method of dividing the profits and losses: first, in accordance with the agreement, in which case the industrial

partner may be exempted from sharing losses, but the capitalist partners may not; second, in the absence of agreement, in proportion to the capital contributed, with the industrial partner definitely exempted from losses.

The agreement mentioned in Art. 1797 is the partnership contract, known as the "Articles of Co-Partnership". When the partnership capital is Three Thousand Pesos or more, this partnership agreement must be in a public instrument and registered in the Securities and Exchange Commission (Art. 1772 C.C.Phil.) The execution of the public instrument and registration operates as constructive notice to creditors; the profit and loss sharing ratio appearing in this instrument is therefore the basis of computation in applying Art. 1839 (4).

Any subsequent amendment in the original agreement will not be binding on the creditors, who can enforce contributions in accordance with the original registered agreement, unless the amendment is also in a public instrument and registered, thereby operating as another constructive notice to creditors.

Should there be no registered agreement, the creditors cannot be charged with notice of the profit and loss sharing ratio, which may have been verbally made between the partners. In such a case, in the absence of clear evidence to the contrary, the creditors may presume that the capital contributions are in equal shares, in accordance with Art. 1790 C.C.Phil. This in turn leads to a presumption that the profit and loss sharing ratio is also equal, reading Arts. 1797 and 1790 together.

The losses having been distributed in accordance with the foregoing rules, the liability of the partners to the partnership can now be computed. Those whose investment exceeds or equals their share of the losses are not liable, for it is they who may instead have a claim against the partnership. Those whose share in the losses exceed their investment are liable to the partnership for the difference. This liability of the partners to the partnership is considered an additional asset of the partnership, in accordance with Art. 1839 (1) (b).

The partnership properties are now attached or garnished and the proceeds paid to the creditors. If there are further losses in the execution sale, these losses should also

be assessed against the partners in the profit and loss sharing ratio, further increasing their liabilities to the partnership, or in some cases reducing their claims against it, as the case may be.

The partnership properties having been exhausted, the creditors may now proceed against the partners. In accordance with Art. 1839 (5), the creditors, through the court, merely step into the shoes of the partnership, and enforce the contributions which the partnership itself could collect from the partners.

A partner may not be made to pay more than he is required to contribute to cover his share of the partnership losses, in accordance with Art. 1816, which states that the liability is only "pro rata" or joint.

Art. 1816 C.C.Phil. uses the word "pro rata" in describing the partners' liability to creditors. The Supreme Court, applying Art. 1698 of the old Civil Code (see page 5), has ruled that the liability of partners in civil partnerships was "pro rata" or joint, as distinguished from solidary liability in commercial partnerships.

In the case of Co Pitco vs. Yulo (8 *Phil.* 544), an action based on contract, the two members of the civil partnership were ordered each to pay one-half of the plaintiff's claim. The partnership had been previously dissolved and liquidated, and had no remaining assets. The court apparently presumed the partners' liability to be equal.

In the case of Dietrich vs. Freeman et al. (18 Phil. 341), an action for breach of contract, the court ordered each of the two partners of the Manila Steam Laundry, a civil partnership, to pay one-half of the plaintiff's claim.

In the case of Cang Yui vs. Gardner and Tan Sinco (34 Phil. 376), an action to recover a balance on open account, the defendants were held to be partners in a civil partnership, and therefore jointly liable to the plaintiff, who was a creditor of the partnership. The two partners were ordered each to pay one-half of the debt. Here, too, the partnership had been previously dissolved, and had no remaining assets.

In the case of Bachrach vs. La Protectora et al. (37 Phil. 441), an action on promissory notes of the partnership, the court ruled that the notes be satisfied first out of partnership property. Should the property be insufficient to satisfy the liability, the court ordered the five partners to each pay one-fifth of the unpaid balance. This decision seems to be a fairly accurate application of the old civil code provisions on partnerships.

In the case of Manila Railroad Co. vs. Salmon (48 Phil. 132), the court held that the Philippine By-Products Co. was a civil partnership, and ordered the partners Frisbie and Allen each to pay one-half of the debt of the partnership. The question of whether there were partnership properties available was not touched in the decision.

Invariably, the Supreme Court, when faced with a case involving a civil partnership where there were no remaining partnership assets, resolved the case by dividing the unpaid debt equally among the partners. This is an easy way out, as far as computations are concerned. We submit, however, that under the new Civil Code provisions, the rulings in the above mentioned cases are no longer applicable. The "pro rata" liability of the partners should be computed as previously discussed. A few examples will illustrate how the law operates:

Illustration A—NO INDUSTRIAL PARTNER

Assets Liabilities

	Assets	Liabilities
(a) Original situation	200,000	120,000
(b) Operating loss	80,000	......
(c) Remainder	120,000	120,000
(d) Loss on exec. sale	30,000	......
(e) Remainder	90,000	120,000
(f) Payment to creditors	—90,000	—90,000
(g) Remainder	......	30,000

Partners' Capital

Partners' Capital

A	B	C
30,000	30,000	20,000
40,000	20,000	20,000
—10,000	10,000	......
—15,000	—7,500	—7,500
—25,000	2,500	—7,500
......	......	......
—25,000	2,500	—7,500

Assume that the partnership of A, B and C has assets of ₱200,000, liabilities of ₱120,000, and capital of ₱80,000 divided as follows: A—₱30,000, B—₱30,000, C—₱20,000. Profits and losses as agreed upon are divided as follows: A—½, B—¼, C—¼. tion is shown on line (a) of the illustration above.

The partnership suffers a big loss of ₱80,000. Naturally the assets will decrease by this amount. The loss is borne by the three partners in the stipulated profit and loss sharing

ratio. The loss and its apportionment are shown on line (b).

The remaining assets will be ₱120,000. Partner A owes the partnership the amount of ₱10,000 in order to cover his share of the loss, inasmuch as his share of the loss (₱40,000) is bigger than the capital he had (₱30,000). B still has ₱10,000 capital in the business. C has no capital left, but he does not owe the partnership anything, because his share in the loss was just sufficient to wipe out his capital. This is shown on line (c).

The partnership being unable to pay the liabilities as they fall due, the creditors attach the assets of the partnership (including garnishment of its receivables). Experience show that the face value of the assets can not be recovered in an execution sale. Assume that the assets brought only ₱90,000 in the execution sale, resulting in a loss of ₱30,000. This being a loss, it should be divided among the partners in the profit and loss ratio. This is shown on line (d).

The remaining assets (cash obtained from the execution sale) are now only ₱90,000 while the liabilities are ₱120,000. Partner A owes the partnership ₱25,000 as his contribution to cover the losses, and Partner C owes the partnership ₱7,500 for the same reason. Partner B still has ₱2,500 capital in the partnership, which he can not collect until the creditors are fully paid. Under Art. 1839 (6) C. C. Phil. B may recover this amount from his fellow partners. This is shown on line (r).

The creditors get the ₱90,000 cash. This is shown on line (f).

Partner A and C owe the partnership ₱32,500. These are assets of the partnership according to Art. 1839 (1) C. C. Phil. Out of this amount, the creditors are entitled to collect ₱30,000, after which B can collect ₱2,500. However, A's liability can not exceed ₱25,000, while C's liability can not exceed ₱7,500. This is shown on line (g).

Illustration B—INDUSTRIAL PARTNER

	Assets	Liabilities
(a) Original situation	200,000	120,000
(b) Profits 1st year	40,000	......
(c) Total	240,000	120,000
(d) Loss 2nd year	—102,000	......
(e) Remainder	138,000	120,000
(f) Loss on exec. sale	18,000	......
(g) Remainder	120,000	120,000
(h) Payment to creditors	—120,000	—120,000
(i) Remainder	......	......

CAPITAL		
X	Y	Z
50,000	30,000	none
20,000	10,000	10,000
70,000	40,000	10,000
—68,000	—34,000	......
2,000	6,000	10,000
—12,000	—6,000	......
—10,000	......	10,000
......	......	......
—10,000	......	10,000

Assume that X, Y, and Z are partners. X invested ₱50,000, and Y ₱30,000 into the capital of the partnership. Z is an industrial partner. The partnership agreement states that profits are to be divided as follows: X—½, Y—¼, Z—¼. It is likewise stipulated that Z does not share in the losses, which are therefore divided between X and Y in the ratio of 2 to 1, which is the same as their profit sharing ratio. Thus, X bears ⅔ of losses, while Y bears ⅓.

In addition, merchandise worth ₱120,000 is purchased on account. The total assets of the partnership now total ₱200,000. This is shown on line (a).

During the first year, profits amounted to ₱40,000, which were divided among the partners in the stipulated profit sharing ratio. This is shown on line (b).

The total assets, including the increase due to profits, are now ₱240,000. Assume that the liabilities have not changed, and the partners withdraw nothing. The situation is shown on line (c).

During the second year, operations were very poor, and partnership suffered a big loss of ₱102,000. This is divided between X and Y in the stipulated loss ratio of ⅔ and ⅓ respectively. As stipulated, Z does not share the loss. This is shown on line (d).

The remaining assets are now ₱138,000, and the liabilities are still ₱120,000. X's capital, after deducting his share of the loss, has dwindled to ₱2,000, and Y's to ₱6,000. Z still has ₱10,000 in the partnership, representing the profits of the first year that he has not withdrawn. As he does not share in the losses, this full amount represents a claim he has against the partnership. This is shown on line (e).

The creditors press the partnership for payment. The partnership being unable to produce cash, the creditors attach the partnership assets and sell them at execution. The assets bring only ₱120,000, a loss of ₱18,000 being suffered in the execution sale. This being a loss, it is divided between X and Y in the stipulated ratio of ⅔ and ⅓ respectively. This is shown on line (f).

The situation after the sale is shown on line (g). The creditors are paid in full out of the partnership assets, as shown on line (h).

Z still has a claim against the partnership for ₱10,000, which he can collect from X, who owes the partnership ₱10,000. Y neither owes nor collects. This is shown on line (i).

Illustration C—INSOLVENT PARTNER

		Assets	Liabilities
(a)	Original situation	100,000	60,000
(b)	Profits 1st year	12,000	......
(c)	Total	112,000	60,000
(d)	Loss 2nd year	54,000	......
(e)	Remainder	58,000	60,000
(f)	Loss on exec. sale	18,000	......
(g)	Remainder	40,000	60,000
(h)	Payment to creditors	—40,000	—40,000
(i)	Remainder	......	20,000
(j)	D pays creditors	......	—12,000
(k)	Remainder, uncollectible	......	8,000

Partners' Capital		
D	E	F
20,000	20,000	none
4,000	4,000	4,000
24,000	24,000	4,000
—27,000	—27,000	......
—3,000	—3,000	4,000
—9,000	—9,000	......
—12,000	—12,000	4,000
......	......	......
—12,000	—12,000	4,000
12,000	......	......
......	—12,000	4,000

Assume that D, E, and F are partners sharing profits and losses equally, but F is exempted from losses, being an industrial partner. D and E invested ₱20,000 each, and ₱60,000 of merchandise was obtained on credit. The situation is shown on line (a).

Profits of first year are divided equally among the three partners, as shown on line (b).

The situation at the end of the first year is shown on line (c).

The second year results in a big loss. Partners D and E share the loss, as shown on line (d).

The situation at the end of the second year is shown on line (e).

The creditors now force payment, and levy on the available partnership properties. Execution sale brings only ₱40,000, resulting in a loss of ₱18,000. The loss is divided equally between D and E, as stipulated, shown on line (f).

The remaining assets of the partnership are insufficient to pay the liabilities, but partners D and E are liable for ₱12,000 each. F still has his unpaid claim against the partnership, for profits during the first year which he did not withdraw from the business. The situation is shown on line (g).

The ₱40,000 cash is paid to the creditors, as shown on line (h).

The unpaid liabilities are still ₱20,000 to the creditors, and ₱4,000 to partner F, while D and E are to contribute ₱12,000 each to satisfy the liabilities. This is shown on line (i).

D pays ₱12,000 to the creditors. E is insolvent. Line (j).

The creditors are left with an unpaid balance of ₱8,000, which will be a loss to them. They can not collect any additional amount from D who has paid his "pro rata" share already, nor from F who is exempt. Partner F can not collect his claim of ₱4,000 from insolvent partner E. Line (k). (As to the right of F to collect from D, see page 36.)

After the foregoing discussion, which we have tried to prevent from becoming more complicated than it already is, we arrive at the answers to the three original questions:

(1) Under the new Civil Code of the Philippines, the liability of partners to partnership creditors is one of surrogation. In other words, the creditors can collect from the partners only the amounts that the partnership itself can collect. The creditors merely step into the shoes of the partnership and enforce its claims against the partners.

(2) The creditors can collect from the partners "pro rata," which means: in the amounts that the partners must contribute to the partnership to cover the losses. The profit and loss sharing ratio (as stipulated, or in the absence of stipulation, as provided by law) is applied in apportioning the losses among the partners. Any excess of losses over the capital investment represents a liability of the partner to the partnership, and—by surrogation—to the creditor.

(3) The assets mentioned in Art. 1816 include not only visible assets, but also receivables and other intangibles, and—as the law itself clearly provides—the contributions

assessable against the partners to cover the losses mentioned in the next preceding paragraph.

We shall now try to refute some objections which may be presented.

OBJECTION: The idea of surrogation is inapplicable in the case of a partnership without capitalist partners. Under Arts. 1780-1783 C. C. Phil., a partnership may be formed entirely of industrial partners. This objection was discussed in the case of Cia Maritima vs. Munoz (9 *Phil* 326, 334-335) as follows:

"If industrial partners in commercial partnerships are not responsible to third persons for the debts of the firm, then industrial partners in civil partnerships are not. Waiving aside the question as to whether there can be a commercial partnership composed entirely of industrial partners, it seems clear that there can be such a civil partnership, for Art. 1678 of the Civil Code (now Art. 1783 C. C. Phil.) provides as follows:

" 'A particular partnership has for its object specified things only, their use or profits, or a specified undertaking, or the exercise of a profession or art.'

"It might very easily happen, therefore, that a civil partnership could be composed entirely of industrial partners. If it were, according to the claim of the appellees, there would be no personal responsibility whatever for the debts of the partnership. Creditors could rely only upon the property which the partnership had, which in the case of a partnership organized for the practice of any art or profession would be practically nothing. In the case of Agustin vs. Inocencio (9 *Phil* 134), just decided by this court, it was alleged in the complaint, and admitted by the answer—

" 'That this partnership has been formed without articles of association or capital other than the personal work of each one of the partners, whose profits are to be equally divided among themselves.'

"Article 1675 of the Civil Code (now Art. 1780 C. C. Phil.) is as follows:

" 'General partnerships of profits include all that the partners may acquire by their industry or work during the continuation of the partnership.

" 'Personal or real property which each of the partners may possess at the time of the celebration of the agreement shall continuè to be their private property, the usufruct only passing to the partnership.'

"It might very well happen in partnerships of this kind that no one of the partners would have any private property

and that if they did the usufruct thereof would be inconsiderable.

"Having in mind these different cases which may arise in the practice, that construction of the law should be avoided which would enable two persons, each with a large amount of private property, to form and carry on a partnership and, upon the bankruptcy of the latter, to say to its creditors that they contributed no capital to the company but only their services, and that their private property is not, therefore, liable for its debts."

This seems a formidable argument, but it can be refuted.

First: Let us take the case of limited partnerships. A limited partner has no personal liability to third persons. Yet limited partners are allowed by the law-on one condition, that there be at least one general partner. Why? For the protection of creditors, there must be at least one partner answerable for the liabilities of the partnership with his private property. So the law can not allow a partner-composed entirely of limited partners.

So what? The law authorizes partnerships composed entirely of industrial partners.

The spirit of the law is this: that a partnership can not be tolerated in which no member thereof is liable to the partnership creditors. This is true of limited partnership; it is also true in the case of a partnership of industrial partners. If a partnership of only limited were formed, the ners. If a partnership of only limited partners were formed, the members thereof would be subjected to the liability of general partners: not one, but all. The reasoning would be along this line:

> A limited partnership, to be validly constituted as such, must have at least one general partner in addition to the limited partners. This partnership has no general partner. For want of an essential requisite, it can not be considered as a limited partnership. By necessity, therefore, it must be considered as a general partnership. It follows that all the partners are liable as general partners.

In a partnership of industrial partners, the same solution may be applied—all of them can be considered as not exempt from the losses, for want of a capitalist partner to bear the same.

The idea of exemption from liability of industrial partners is not impossible of application merely because in some cases it may not be applicable. The exception does not destroy the rule. Just as an example: While the law of partnerships provides for "pro rata" liability, in the case of torts and crimes it makes an exception and specifies solidary liability (Arts. 1822-1824 C. C. Phil.)

Second: Exemption of a person from losses carries with it a necessary corollary—the existence of another person to bear said losses. In the absence of the latter, the former must necessarily bear his own losses, all stipulations to the contrary notwithstanding. In a partnership of industrial partners, stipulations that no one of the members shall bear losses are nugatory and impossible of application. When the losses do occur, they will necessarily be borne, whether the partners like it or not.

Third: Art. 1797 par. 2 C. C. Phil. contemplates a division of profits or losses in a partnership where there are both capitalist and industrial partners. It should be considered inapplicable when there are no capitalist partners. Such a narrowing down of terms by interpretation, in order to uphold the spirit of the law, is not unknown in our jurisprudence. Just as an example: Art. 1180 C. C. Phil. provides that a condition is deemed fulfilled when the debtor voluntarily prevents its fulfilment. The Supreme Court has held that the condition referred to in this article is a suspensive one, that resolutory conditions are not included. (*Taylor vs. Uy Tieng,* 43 *Phil* 873)

Following the foregoing reasoning, if a limited partnership is formed wherein the only general partner happens to be an industrial partner, there are two possible remedies. It is possible to hold that in such a case, the industrial partner can not be exempted from personal liability. On the other hand, it is also possible to hold that the general partner referred to here means a capitalist partner. As mentioned before, the law can be narrowed down by interpretation.

To sum up: In a partnership composed entirely of industrial partners, any stipulation exempting all from sharing the losses is, even as among the partners, null and void and impossible of application. This being so, said

partners can not evade personal liability to partnership creditors either.

OBJECTION: Liability of partners by guarantee gives the creditors better protection than liability by surrogation. After all, it is the intention of the law to protect them. In addition, it is unfair to the capitalist partners.

Under the old commercial partnerships, where liability was solidary, liability by guarantee was naturally more favorable to the creditors. The more persons solidarily liable to him, the better are his chances to collect. As a matter of fact, guarantee is the only possibility in such a case; liability by surrogation is entirely impossible when the liability is solidary. Where each and every partner is solidarily liable to the creditors, there naturally is no relation or connection whatsoever between liability and losses.

Under the new Civil Code of the Philippines, where liability is only "pro rata," liability by surrogation is more favorable to the creditors. The weight of liability falls on the shoulders of the partners with the larger share in the profits and losses. These are usually the richer partners, who have the means to pay. Where the industrial partner is a man of limited means, as he often is, any portion of the liability assessed "pro rata" against him is thereby lost to the creditor, who loses his right to collect said portion from the partners who can afford it.

Liability by surrogation is also more favorable to the industrial partner. This is too apparent to need further explanation.

As to the capitalist partners, it may seem paradoxical to state that surrogation is also more favorable to them, but that is the fact. In liability by guarantee, when the industrial partner has paid to the creditors, he can in turn collect from the capitalist partners, with whom he has a binding agreement that he is exempt from the losses. For all practical purposes, the capitalist partners insure the industrial partner against losses. In the final analysis, the capitalist partners have to bear the losses anyway. In surrogation, payment is direct from the capitalist partners to the creditors; it shortens the process, and leads to the same results.

In liability by guarantee, a partner who has already shouldered his share of the losses by paying to the partnership, may nevertheless be compelled to pay the creditors in addition. This imposes a double burden on those partners who are up to date and dutiful in their obligations to the partnership, and rewards those who are not so dutiful. This is manifestly unjust. In surrogation, the partner who has already contributed his share of the losses is freed from further liability to the creditors.

Surrogation kills two birds with one stone: the creditors are paid, and the inter-partner affairs are settled. If the creditors were to collect from the partners in amounts different from the latter's liability to the partnership, the result would be a further increase in the number of mutual claims and counterclaims, and multiplicity of suits.

Liability by surrogation, therefore, is more favorable and just to the creditors, to the industrial partner, and to the capitalist partner.

LIABILITIES AND CLAIMS OF GENERAL PARTNERS AGAINST THE PARTNERSHIP IN LIQUIDATION

We now come to that stage of liquidation where all the creditors have been paid. The situation where the partnership assests are completely exhausted has already been discussed and illustrated under the previous general topic. (See pages 18-26.)

Here we shall study the situation where there are partnership assests left after all the creditors have been paid. The Civil Code of the Philippines provides:

> Art. 1839 (2) C.C.Phil.—The liabilities of the partnership shall rank in order of payment, as follows:
> (a) Those owing to creditors other than partners,
> (d) Those owing to partners other than for capital and profits, (e.g. advances, loans)
> (c) Those owing to partners in respect of capital,
> (d) Those owing to partners in respect of profits.

There is no question as to the priority of creditors over the partners. Assuming all liabilities to creditors to

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have been paid, we now confine our attention to the claims of the partners themselves against their own partnership.

The law states that these are to be settled in the following order: (1) advances and losses, (2) capital, (3) profits. These are the claims of the partner against the partnership.

On the other hand, the partnership may also have claims against the partner, such as loans to the partner, claims for damages arising from his fraud or negligence, and the share of the partner in the losses that have not yet been distributed.

At first it would seem that the partners' claims against the partnership should be settled in the precise order given. We submit, however, that it is not so.

We submit that no partner can collect any amount from the partnership unless his claims against the partnership, regardless of their nature, are greater in amount than the partnership's claims against him, regardless of their nature.

The reason is found in the law of compensation:

> Art 1279 C.C.Phil.—In order that compensation may be proper, it is necessary:
>
> (1) That each one of the obligors be bound principally, and that he be at the same time a principal creditor of the other;
>
> (2) That both debts consist in a sum of money, or if the things due are consumable, they be of the same kind, and also of the same quality if the latter has been stated;
>
> (3) That the two debts be due;
>
> (4) That they be liquidated and demandable;
>
> (5) That over neither of them there be any retention or controversy, commenced by third persons and communicated in due time to the debtor.
>
> Art. 1290 C.C.Phil.—When all the requisites mentioned in Article 1279 are present, compensation takes effect by operation of law, and extinguishes both debts to the concurrent amount, even though the creditors and debtors are not aware of the compensation.

Let us analyze these requisites and apply them to the question:

(1) Are the partnership and the partners principal debtors and creditors of each other? The partnership, a juridical person, is most certainly a principal debtor of the

partners as regards the partners' claims. Similarly, the partners are principal debtors of the partnership for any loans, claims, or share of losses pertaining to them—there is no one else liable for these except them.

(2) Both debts consist in a sum of money. Of course, if either the partners or the partnership have an obligation to deliver to the other some specific property, such an obligation can not be compensated.

(3) The partnership being in liquidation, the mutual claims of partnership and partners are due.

(4) The claims are liquidated as soon as the accounts are prepared and the amounts of the mutual claims ascertained, i.e. liquidated. The partnership being in liquidation, the claims are demandable.

(5) All the creditors having been paid, there is usually no retention or controversy unsettled, as between the partners and the partnership. Should there be any, there won't be compensation as to the claims affected.

It is apparent that the five requisites of compensation are all present, and therefore it will take place by operation of law. It is possible that one partner who has a claim for profits only may receive the amount of his claim in preference to another who claims; loans, capital, and profits. An illustration will clarify this:

	Assets	A	B	C	D(ind)
(a) Investment	70,000	50,000	10,000	10,000	—
(b) Loan	5,000		5,000		
(c) Profits	20,000	5,000	5,000	5,000	5,000
(d) Total	95,000	55,000	20,000	15,000	5,000
(e) Losses	60,000	20,000	20,000	20,000	
(f) Distribution	35,000	35,000	—	—5,000	5,000

A, B, C, and D formed a partnership, contributing the amounts shown in the illustration. D was an industrial partner, and by stipulation he was exempt from sharing in the losses. Profits and losses are divided equally, by stipulation. The original situation is shown on line (a).

Partner B loaned the partnership ₱5,000 in addition to his investment. This is shown on line (b).

Profits during the first years were ₱20,000, divided equally as stipulated, shown on line (c). Totals after the profits were distributed are shown on line (d), assuming the partners kept all earnings in the business.

Losses were incurred in subsequent years, and the total,

including losses in the process of liquidation, were ₱60,000. These were apportioned as stipulated, shown on line (e).

The remaining assests are to be distributed as shown on line (f). A is entitled to recover ₱35,000 from the partnership. This is a part of his original investment.

B receives nothing, despite the fact that he gave a loan to the partnership. If the loan were to be paid first, he would owe the partnership an equal amount, which he must pay in order to properly bear his share of the losses. The loan is compensated against his share of the losses.

C receives nothing because his share in the losses is greater than his total claim against the partnership. Instead, it is he who owes the partnership ₱5,000, which he must pay in order to properly bear his share of the losses as stipulated.

D's claim is for profits only. As he does not share losses, he is entitled to his claim in full.

C must pay ₱5,000 to the partnership funds of ₱35,000, in order to make a grand total of ₱40,000. Of this amount, A is entitled to ₱35,000, while D gets ₱5,000.

If C is insolvent, the ₱5,000 he fails to pay will be a loss to the remaining partners, who must divide it equally in accordance with the stipulated profit and loss sharing ratio. Since D is exempt, A and B will have to pay ₱2,500 each to D. ("...if it results that there is not enough property in the partnership to pay him, then the capitalist partners must pay him." Cia Maritima vs. Muñoz, 9 Phil. 326, 334)

B's claim for his loan is supposed to rank first in the order of payment. Nevertheless he gets nothing, while A's claim for capital and D's claim for profits are entitled to payment.

We submit that this is the correct way to distribute the partnership assests, at the same time giving full effect to the stipulated profit and loss sharing ratio. To follow literally the order given in Art. 1839 (2, b,c,d) C.C.Phil. would violate the profit and loss sharing ratio, delay liquidation, cause multiplicity of claims, and work injustice on some of the partners.

*(Speech delivered by Justice Cesar Bengzon * of the Supreme Court on November 8, 1952 at the Manila Hotel in the occasion of the Seventh-Anniversary Celebration of the Bulacan Bar Association)*

"Whether constitutional dictatorship is feasible in this jurisdiction..." "President Osmeña, President Roxas and even President Quirino ruled the Philippines by executive order. What of the future? May we again be subjected to Executive legislation or Presidential law-making?

ON this, the seventh anniversary of the Bulacan Bar Association it is my pleasant privilege to greet its members and wish them well in their endeavors to improve their record of public and private service. To a lawyer's mind Bulacan province recalls the Malolos Republic and the Malolos Constitution, the saving courage and the native wisdom of our fathers whose examples remain a source of inspiration from which Filipinos should drink deep and long. To me Bulacan is all that, plus Marcelo del Pilar, Gregorio del Pilar, Balagtas and others of national fame, to whom I desire to pay at this moment modest and respectful tribute.

When the Committee of this Association visited me to extend its invitation, they were accompanied by their adviser the honorable Judge Bonifacio Ysip, my friend Pacio. Meeting my esteemed contemporary brought to my

* A.B., Ateneo de Manila, '15.