

Utilizing an Integrative Analytical Framework to Extract Negotiable Instruments Law Principles

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I. INTRODUCTION

Laws are social tools necessary for order in a world where a single individual's interests are as diverse as the other's. To achieve this purpose, laws regulate human interaction and relations. Stripped to its bare essentials, law forces a compromise or understanding between individuals. While appearing as seemingly lifeless words on paper, the law is not oblivious to these diverse human interests. Having been authored by individuals who were aware of, if not thinking from, the perspective of the different spheres of human interest, the law relates to the world from a multi-person point of view.

Take for example a case in Property Law. The drafters of the chapter in the Civil Code¹ that dealt with the protection of an individual's property authored the law to state that "the owner... has a right to exclude any

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1. An Act to Ordain and Institute the Civil Code of the Philippines [CIVIL CODE].

person from the enjoyment [of the thing]... for this purpose, he may use such force as may be reasonably necessary to repel or prevent an actual or threatened unlawful physical invasion or usurpation of his property."² On the other hand, the authors of the same chapter contemplated a situation wherein "the owner of the thing [may not] prohibit the interference with the [said property] if the interference is necessary to avert an imminent danger and threatened damage arising to the owner from the interference."³

This shows that the law was crafted in such a way to lay down, acknowledge, regulate and protect diverse interests at different temporal conditions. Take for example the scenario given above. The law, as a general rule, protects the interests of the owner, but in extraordinary circumstances favors the usurper over the owner. If this distinction was blurred, then one may harbor the conviction that usurping the possession of another's land is permissible to avoid any kind of inconvenience such as his or her being homeless. A careful study of the law, however, will show that this opinion is wrong.

Looking back as to how the law was wrongly interpreted, it can be seen that two steps were taken. First, the law mandated that owners of property must be respected in their possession and that non-owners may usurp this possession only in extreme cases. Second, the law was interpreted in a manner that apparently empowered a non-owner to usurp another's property at anytime, even in the absence of extraordinary circumstances. The effect of this second step creates a situation flagrantly inconsistent to what the law previously mandated.

The Civil Code, from which the above example was taken, does not however provide many avenues for the faulty interpretations of its provisions since the Code is written in fairly simple language. But not all laws share this characteristic of simplicity. Some laws are written in convoluted language. The Negotiable Instruments Law⁴ is one example. To make matters worse, jurisprudence on the subject matter tends to make the subject matter more confusing.

It can be seen that one of the difficulties in the examination of the Negotiable Instruments Law arises from the law's inconsistency in defining terminologies. An example is the term "holder in due course." Section 57 of the Negotiable Instruments Law identifies a holder in due course by naming his or her rights. Speaking in the active voice, the law says "rights of a holder in due course." Yet Section 28 reveals that a holder in due course is a person who, in addition to possessing rights under Section 57, also possesses rights

2. CIVIL CODE, art. 429.

3. *Id.* art. 432.

4. The Negotiable Instruments Law, Act No. 2031 (1991).

under Sec. 28 rights. However, this qualification is stated in the passive voice. It says "absence or failure of consideration is a matter of defense against a person not a holder in due course." Thus, there is an implied expansion of the rights already stated in Section 57. This method of definition is probably due to the law's linear presentation of a multi-level subject matter.

To illustrate, as per Section 57, a holder in due course is one who has the following rights: (1) to hold the instrument free from any defect of title of prior parties (2) to be free from defenses available to prior parties among themselves, and (3) to enforce payment of the instrument for the full amount thereof against all parties liable thereon. But this is not exhaustive since Section 28 further provides that a holder in due course is also free from the defense of absence or failure of consideration. Such right, nonetheless, is stated in the negative, to wit: "Absence or failure of consideration is a matter of defense as against any person not a holder in due course."⁵ A closer analysis of the law reveals that Section 28 falls under Chapter II entitled "Consideration" while Section 57 falls under Chapter IV, entitled "Rights of a Holder." It can be said, therefore, that a holder in due course is a person guaranteed with rights that are viewed from the perspective of the validity of the instrument and from the perspective of a holder as technically defined by the law.

To make matters more difficult, the law is sometimes used in improper circumstances, thus adding another hurdle to its appreciation. The recent cases of *Traders Royal Bank v. Radio Philippines Network*⁶ and *Westmont Bank v. Eugene Ong*⁷ attest to this thesis. In these cases, the Negotiable Instruments Law was used to regulate relationships which, when carefully examined, should not have fallen within the ambit of its regulatory provisions. The net effect of which is the muddling of the concept of a "Holder" under the Negotiable Instruments Law because jurisprudence granted a right that originally and rightfully belonged to a holder to a non-holder. In these cases, the Supreme Court was not able to address the following questions: Who may sue on a negotiable instrument? If this person cannot sue on a negotiable instrument, can an action be instituted using another law?

This essay will, after reporting the aforementioned cases, delve into the philosophy behind the existence of actionable rights; thereafter reexamine the rights of holders in terms of enforcing their rights to be paid on the basis of a negotiable instrument; finally, it will attempt to restate the proper perspective on how the Negotiable Instruments Law *vis-à-vis* the pertinent provisions of the Civil Code should be viewed.

5. *Id.* § 28.

6. G.R. No. 138510, Oct. 10, 2002.

7. 375 SCRA 212 (2002).

II. CASE REPORTS

A. *Traders Royal Bank v. Radio Philippines Network*

1. The Facts of the Case

On 15 April 1985, the Bureau of Internal Revenue (BIR) assessed Radio Philippines Network (RPN), Intercontinental Broadcasting Corporation (IBC), and Banahaw Broadcasting Corporation (BBC) (hereinafter RPN) of their tax obligations for the years 1978-1983.

To settle their obligations, RPN purchased three manager's checks from Traders Royal Bank (TRB) on 26 June 1986 to pay their tax liabilities. Aside from the purchase, RPN instructed TRB to designate BIR as payee of the manager's checks and to deliver the said checks to the BIR. TRB, however, was not able to deliver the checks to BIR. Thus in 1988, the BIR reassessed RPN of their 1978-1983 tax liabilities.

Subsequently, it was then discovered by RPN that the TRB manager's checks which they purchased were never delivered by the bank to the BIR. Instead, the checks were presented for payment to Security Bank and Trust Company (SBTC) by unknown persons who altered the name of the payee, BIR, and substituted it for theirs.

RPN, thereafter, purchased a second set of manager's checks to pay the BIR. This time, the second set of checks were received by BIR. RPN then instituted an action against TRB as drawee bank and against SBTC as collecting bank for reimbursement, since the first set of TRB manager's checks they purchased were paid to persons whom they did not designate as payee.

The trial court ruled that TRB should reimburse RPN for the cost of the purchased manager's checks plus interest and that SBTC as collecting bank who paid on a forged note should reimburse TRB for the cost of the reimbursement. Having disagreed with the pronouncement, TRB and SBTC then interposed separate appeals and reiterated their position that they should not be ordered to pay.

On appeal, the Court of Appeals (CA) reversed the Regional Trial Court's finding. It ruled that SBTC did not indorse the said manager's checks — thus, it was not liable as collecting bank. In effect, the CA ruled that only TRB was liable to RPN. Confident that the CA ruling was wrong, TRB elevated its case to the Supreme Court.

2. The Ruling of the Supreme Court

Ruling on the Petition for Review of the CA decision, the Supreme Court identified and phrased the issue as: whether or not TRB should be held

solely liable when it paid the amount of the checks in question to a person other than the payee indicated on the face of the check, the Bureau of Internal Revenue.

The Supreme Court upheld the appellate court's finding that TRB should be held solely liable since SBTC cannot be considered a collecting bank. This is because SBTC neither received nor indorsed the manager's checks. To support this position, the Supreme Court highlighted the fact that the subject checks' dorsal portion did not bear an "endorsement and guarantee attestation clause" and a stamped "non-negotiable notice" by SBTC.⁸

Accordingly to the Court, since SBTC stamps were not made on the checks' dorsal portion, SBTC was not a collecting bank. Moreover, the Court discovered that the Philippine Clearing House Report did not show that SBTC received the contested check. This reasoning was but logical. However, the Supreme Court, and even the CA, discovered "what appears to be a guarantee stamped at the back of the check is that of the Philippine National Bank, Buendia branch, thereby indicating that it was the latter Bank which received the same."⁹

This, albeit impliedly, meant that there could have been another collecting bank — the PNB Buendia Branch. But both courts did not inquire further. In sustaining the CA, Supreme Court ruled:

Since TRB did not pay the rightful holder or other person or entity entitled to receive payment, it has no right to reimbursement. Petitioner TRB was remiss in its duty and obligation, and must therefore suffer the consequences of its own negligence and disregard of established banking rules and procedures.

By way of an aside, Section 130 of the Negotiable Instruments Law provides: "Where in a bill the drawer and drawee are the same person... the

8. The "endorsement and guarantee attestation clause" is a clearing house requirement that mandates banks to stamp a guarantee on the dorsal portion of checks which they receive. As provided by Sec 17 of the Philippine Clearing House Corporation Rules:

Sec 17. — BANK GUARANTEE. All checks cleared through the PCHC shall bear the guarantee affixed thereto by the Presenting Bank/Branch which shall read as follows: Cleared through the Philippine Clearing House Corporation. All prior endorsements and/or lack of endorsement guaranteed. NAME OF BANK/BRANCH BRSTN (Date of clearing)

On the other hand, the "non-negotiable notice" is the SBTC requirement that mandates its tellers to stamp such a notice on the dorsal portion of checks which they receive for deposit or encashment.

9. *Traders Royal Bank*, G.R. No. 138510 at 9.

holder may treat the instrument at his option either as a bill of exchange or as a promissory note." In this case, the Supreme Court impliedly stated that the holder treated the manager's checks as a bill of exchange because it entertained the theory that there could have been a collecting bank — PNB. More on this will be discussed later.

At first impression, the case could simply have been one discussing the liabilities of holders and indorsers of a negotiable instrument. It is disturbing however, that the Court allowed RPN to sue under the Negotiable Instruments Law despite the fact that it was not a holder of the check. Why did the Court permit it to invoke the protective shroud of the Negotiable Instruments Law?

An advocate of the correctness of this Supreme Court ruling would say that the status of RPN's being a holder was not in issue but was already assumed. However, the soundness of this assumption may be questioned since a month before the *Traders* case was decided, the case of *Westmont Bank v. Eugene Ong* demonstrated that in resolving controversies arising from the Negotiable Instruments Law, the RTC, CA and even the Supreme Court, paid little attention to the fundamental question of who can sue on a negotiable instrument.

The examination proceeds.

B. *Westmont Bank v. Eugene Ong*

1. Facts of the Case

Eugene Ong maintained a current account with Associated Banking Corporation, now known as Westmont Bank. He sold some of his shares of stock in various corporations through Island Securities Corporation — a sort of consignee, to a person or entity not mentioned in the case.

Island Securities then had to pay Ong, leading the company to purchase two Pacific Banking Corporation manager's checks with Eugene Ong, as payee.

Even before Ong got hold of the checks, his friend Paciano Tanlimco illegally acquired the said manager's checks. He then falsified Ong's signature making it appear that Ong indorsed the checks to him (Tanlimco). The manager's checks were then deposited and encashed in the same Westmont Bank where Ong was maintaining a current account.

Ong sued Westmont Bank to recover the value of the check that he allegedly lost because of the bank's negligence. Ong claimed that had Westmont Bank been diligent enough in looking at the record of his specimen signatures, they would have discovered that the indorsement of Ong appearing on the back of the check was a forgery. Further, Ong cited

*Associated Bank v. Court of Appeals*¹⁰ to bolster his position that since Westmont was a collecting bank who had the opportunity to check his (Ong's) signature, he, being a client, then the Bank should bear the loss for failing to comply with its duty to ascertain the genuineness of all prior indorsements.

Westmont Bank raised the defense that Ong had no cause of action against it since the check was neither delivered to him nor his agents, nor did he take possession of the checks. Ong, according to the bank, never became a holder — an individual empowered by the Negotiable Instruments Law to sue in his own name. Moreover, Westmont Bank argued that a manager's check was not legal tender, therefore Ong was but an unpaid seller who should institute a civil action against Island Securities.

The trial and the appellate courts ruled in favor of Ong by denoting that his suit "against the petitioner bank is a desirable shortcut to reach the party who ought in any event to be ultimately liable."¹¹

2. Ruling of the Supreme Court

Sustaining the RTC and CA rulings that Ong had a cause of action because as he was alleging his right as payee of the manager's check to receive the amount involved, the Supreme Court ruled:

[Westmont Bank's] claim that since there was no delivery yet and respondent has never acquired possession of the checks, respondent's remedy is with the drawer [Pacific Banking Corporation] and not with petitioner bank. Petitioner relies on the view to the effect that where there is no delivery to the payee and no title vests in him, he ought not to be allowed to recover on the ground that he lost nothing because he never became the owner of the check and still retained his claim of debt against the drawer.¹² However, another view in certain cases holds that even if the absence of delivery is considered, such consideration is not material. The rationale for this view is that in said cases the plaintiff uses one action to reach, by a desirable short cut, the person who ought in any event to be ultimately liable as among the innocent persons involved in the transaction. In other words, the payee ought to be allowed to recover directly from the collecting bank, regardless of whether the check was delivered to the payee or not.¹³

10. 256 SCRA 620 (1996).

11. *Westmont Bank*, 375 SCRA 212 at 218.

12. *Citing* I AGUEDO F. AGBAYANI, *COMMERCIAL LAWS OF THE PHILIPPINES* 206 (1987) which cites 31 Mich. L. Rev. 819.

13. *Citing* I AGUEDO F. AGBAYANI, *COMMERCIAL LAWS OF THE PHILIPPINES* 206-207 (1987) which cites 31 A.L.R. 1021-22; Brannan, 7d ed., 453.

This argument thwarted the "no-cause of action defense" of Westmont Bank.

The Court further ruled that Westmont Bank had a correlative duty as collecting bank to ensure that the amount is received by the rightful payee or to be disposed of according to his order; and that Westmont Bank breached this duty because of a blatant act of negligence in encashing a forged check, thereby violating Ong's rights.¹⁴ Westmont Bank should, therefore, bear the loss because it failed to comply with its duty of ascertaining the genuineness of the signature before encashing the check. This is because:

The theory of the rule is that the possession of the check on the forged or unauthorized indorsement is wrongful, and when the money had been collected on the check, the bank or other person or corporation can be held as for monyes (sic) had and received, and the proceeds are held for the rightful owners who may recover them. The position of the bank taking the check on the forged or unauthorized indorsement is the same as if it had taken the check and collected the money without indorsement at all and the act of the bank amounts to conversion of the check.¹⁵

The question whether or not Ong could sue Westmont Bank in this case is more conspicuous than in the case of *Traders*. Nonetheless, it seems that the Court did not take time to thoroughly consider the matter.

Taken in isolation, these rulings are hallmarks of legal erudition with respect to standing concepts such as the repercussions of wrong encashment and duties of a collecting bank. The question, however, is whether such protracted discussions were necessary given that legal concepts should be applied to detailed situations after a broader perspective of the issue had been analyzed. It seems that the Supreme Court quickly pounced into an analysis of the Negotiable Instruments Law the moment the suit arose because of a check — a species of a negotiable instrument — without however determining whether the suit was proper. Much discussion could have been avoided had the question "*Is there a right of action or a cause of action that exists in favor of the RPN and Eugene Ong under the Negotiable Instruments Law?*" been primarily addressed. Also, addressing this question could have been the start of a whole new field of literature clarifying the Negotiable Instruments Law.

14. *Id.* at 220.

15. *Id.* at 221 (citing 31 A.L.R. 1070; *U.S. Portland Co. v. U.S. Nat. Bank*; L.R.A. 1917-A, 21 A.L.R. 1072; 31 A.L.R. 1071).

III. LAYING THE RESOLVING CONCEPTS

A. Cause of Action

To answer the question whether a right of action or cause of action existed in favor of RPN and Ong, substantive issues have to be pitted against procedural considerations since law is not just a menu of privileges, but a regulatory device that balances the privileges of at least two individuals. Thus, when confusion as to substantive rights arise, procedural laws which are in the nature of the application of laws between individuals, enforce the more paramount right over the lesser one.

An example of this stance may be found in the Law of Succession. Despite the clear provisions of section 774 and 777 of the Civil Code saying that transmissible rights and obligations are transmitted through the death of the decedent, Section 1, Rule 90 of the Rules of Court states that transmissible money obligations such as the payment of debts are to be paid first by the estate of the decedent before the estate is distributed to the heirs. In weighing two existing rights in such a particular relation, the law seems to say that both heirs and debtors of the decedent have rights under the law; but with respect to the payment of debts, the debtor's right to be paid is paramount.

No doubt, RPN and Eugene Ong suffered damages and deserved the proper indemnification. However, in regulating the relationship of the plaintiffs and defendants, the Court did not distinguish between the substantive rights that the plaintiffs may have as persons under the Negotiable Instruments Law or as persons under the Civil Code. The Supreme Court did not consciously determine which substantive right the plaintiffs could invoke. Had the Court done these, the proper law could have been utilized and further enriched.

This part of the essay engages in such an exercise.

A *cause of action* is a formal statement of the operative facts that gives rise to a *right of action* — a remedial right belonging to a person.¹⁶ The operative fact constituting the cause of action is the act or omission by which a party violates a right of another.¹⁷ The former concept (cause of action) is regulated by laws of procedure, the latter (right of action), by substantive law.¹⁸

16. See 1 JOSE FERIA & MARIA CONCEPCION NOCHE, CIVIL PROCEDURE ANNOTATED 212-13 (2001 ed.); RUBEN E. AGPALO, HANDBOOK ON CIVIL PROCEDURE, 29 (2000 ed.).

17. 1987 RULES OF COURT, Rule 2, § 1.

18. See 1 JOSE FERIA & MARIA CONCEPCION NOCHE, CIVIL PROCEDURE ANNOTATED 212-13 (2001 ed.).

The essential elements of a cause of action are: the legal right of the plaintiff; a correlative obligation of the defendant; and the act or omission of a defendant in violation of the plaintiff's legal right.¹⁹ Knowing the bases and bounds of one's rights cannot be over emphasized. The Rules of Court recognizes this importance as it provides that a suit for the enforcement or protection of a right or for the prevention or redress of a wrong must be based on a cause of action.²⁰

Reference to the definition of "cause of action" to two persons, the plaintiff and defendant, shows that it is regulating a relationship. Author Crisolito Pascual²¹ considers this an important element in the legal order. Calling it 'legal relation,' he defines a legal relationship as a situation established by law concerning certain legal facts in connection with a particular thing.²² Thus:

Every situation, condition, status, connection, or problem involves some kind of a legal relation. As stated in Section 25 [of the old Civil Code], a person is either in the exercise of a "right" or in the performance of a "ligation" in his relationship with others. Therefore, the analysis of a legal situation, condition, status, connection, or problem will involve the determination of the legal relationship in the light of the legal facts involved.

Legal relations stem from these two basic concepts, namely, "right" and its correlative "ligation." These, in turn, are two of the three essential elements of a cause of action under the law, the third being the act or omission violating the "right" which gives rise to the correlative "ligation."²³

Despite the importance of the term "right," it is surprising to find that there is no express definition of the term in Philippine Law, yet the laws are replete with reference to it. On the other hand, the term "obligation" is expressly defined by Article 1156 of the Civil Code as a juridical necessity to do or not to do.

Pascual defines the term "right" as the standard of permitted or forbidden action within a certain sphere,²⁴ while "ligation"²⁵ as a prestatation²⁶

19. *Id.*; see RUBEN E. AGPALO, HANDBOOK ON CIVIL PROCEDURE, 28 (2000 ed.).

20. ¶ a, § 3, Rule 1 of the Rules of Court provides: "A civil action is one by which a party sues another for the enforcement or protection of a right or the prevention or redress of a wrong."

§ 1, Rule 2 provides: "Every civil action must be based on a cause of action."

21. CRISOLITO PASCUAL, LEGAL METHOD (1989).

22. *Id.* at 170 (citing Arthur L. Corbin, *Legal Analysis and Terminology*, 29 YALE L. J. 163, 164 (1919)).

23. *Id.* at 171.

24. *Id.*

or undertaking. He defines right as an advantage that is protected by law,²⁷ while "ligation" as the necessity to comply with a prestation or undertaking to give, to do, or to forbear something that is protected by positive law.²⁸ Thus, it can be said that the law makes mention of rights and obligations only to emphasize that it is regulating a relationship, the term "right" being an explanation or "the why" one should act towards another (or perform an obligation) in some prescribed way.

The starting point where one should determine and understand his or her obligation, or what one should do or not do towards another, surprisingly lies in Book IV of the Civil Code²⁹ and not in the beginning books. Yet in the first few chapters, the Civil Code already mandated certain rules of conduct such as the obligation of parents to support their children. Article 1157 states, "Obligations arise from law; contract; quasi-contracts; acts or omissions punished by law and quasi-delicts." Article 1158 explains further, "Only those expressly determined in this Code or in special laws are demandable, and shall be regulated by the precepts of law which establishes them; and as to what has not been foreseen by the provisions of this book."

Having these concepts in mind, can it be concluded that the mere existence of a check automatically summons the use of the Negotiable Instruments Law to resolve controversies arising from the said check? Despite a negative answer, the above cited cases show that the courts hold otherwise.

The reasons for this position are hereafter submitted.

25. It should be noted that Pascual warns that: the term "ligation" should be distinguished from the common acceptance of the term "obligation." The former is derived from the Latin word "lagatio" which means the state of being bound to comply with an undertaking or prestation to do or forbear. The latter is derived from the Latin word "obligatio" and is a compound of the Latin verb "ligo" which means to tie or bind and the Latin preposition "ob" which is prefixed to increase the intensity and significance of the verb. *Id.*

26. PASCUAL, *supra* note 21, at 180.

27. *Id.* at 172.

28. *Id.* at 180-81.

See Article 1158 of the Civil Code. It provides: "Only those expressly determined in this Code or in special laws are demandable, and shall be regulated by the precepts of law which establishes them; and as to what has not been foreseen by the provisions of this book."

29. Specifically Obligations and Contracts Title I, Chapter I, General Provisions.

B. The Negotiable Instruments Law

I. Objects Brought into Existence by the Negotiable Instruments Law

The Negotiable Instruments Law gives rise to the existence of objects called promissory notes, bills of exchange, and the species of a bill of exchange called checks. The law provides:

Sec. 184. *Promissory note, defined.* - A negotiable promissory note within the meaning of this Act is an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay on demand, or at a fixed or determinable future time, a sum certain in money to order or to bearer....

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

Sec. 185. *Check, defined.* - A check is a bill of exchange drawn on a bank payable on demand. Except as herein otherwise provided, the provisions of this Act applicable to a bill of exchange payable on demand apply to a check.

A manager's check meanwhile, does not draw its existence from the Negotiable Instruments Law; rather, it exists as a species of a check. Thus, a manager's check "is one drawn by the manager of the bank of which he is the manager against the same bank payable to the order of a third person."³⁰ "A cashier's or manager's check is one which is drawn by a bank on itself, and its issuance has the effect of acceptance. Since the drawer and the drawee are the same persons, a holder may treat it either as a bill of exchange or as a promissory note."³¹

30. VIRGINIA M. DIAZ, *HAND BOOK ON NEGOTIABLE INSTRUMENTS* 5 (3d ed. 1995).

31. JOSE C. CAMPOS & MARIA CLARA LOPEZ-CAMPOS, *NOTES AND SELECTED CASES ON NEGOTIABLE INSTRUMENTS LAW* 429 (1990).

By way of an aside, Campos cites Sec. 130 of the Negotiable Instruments Law, thus:

Sec. 130. *When bill may be treated as promissory note.* - Where in a bill the drawer and drawee are the same person or where the drawee is a fictitious person or a person not having capacity to contract, the holder may treat the instrument at his option either as a bill of exchange or as a promissory note.

to support the opinion that: "Since the drawer and the drawee are the same persons, a holder may treat it either as a bill of exchange or as a promissory note." This, to the author, is however questionable, since a bill of exchange must be presented for payment and thereafter accepted by the drawee bank. But

2. Parties to a Negotiable Instrument, their Rights and Obligations

The existence of the abovementioned objects thus by necessity gives rise to the existence of characters or persons whose conduct, in relation to the aforementioned objects, are regulated by the Negotiable Instruments Law.

a. The Maker

In a promissory note, the person making an unconditional promise in writing to another, engaging to pay on demand, or at a fixed or determinable future time, a sum certain in money to order or to bearer is the maker. Thus:

Sec. 184. *Promissory note, defined.* - A negotiable promissory note within the meaning of this Act is an unconditional promise in writing made by one person to another, signed by the maker....

Generally,³² the maker's obligations, called "liabilities" by Section 160, are to: (1) pay [the promissory note] according to its tenor; and (2) admit the existence of the payee and his then capacity to indorse. Thus:

Sec. 60. *Liability of maker.* - The maker of a negotiable instrument, by making it, engages that he will pay it according to its tenor, and admits the existence of the payee and his then capacity to indorse.

b. The Drawer

In a bill of exchange, the person addressing and instructing another (the addressee) to pay a third party is impliedly defined by Section 132 as the drawer. Thus:

Sec. 132. *Acceptance; how made, by and so forth.* - The acceptance of a bill is the signification by the drawee of his assent to the order of the drawer;

and the addressee or the person to whom the drawer gives his instruction is impliedly defined by Section 128 as the drawee. Thus:

Sec. 128. *Bill addressed to more than one drawee.* - A bill may be addressed to two or more drawees jointly....

Although entitled "Liabilities of Drawer," Section 61 enumerates the obligations³³ of the drawer. It says that by drawing the instrument, the

how can this be when the issuance by the bank of its manager's check has the effect of acceptance?

32. Because the law provides for instances when he may dispense with the performance of his obligations such as when his signature is forged or that the holder only stole the instrument from another. The topic of defenses is best addressed in another paper.

drawer: (1) admits the existence of the payee and his then capacity to indorse (2) that on due presentment, the instrument will be accepted or paid, or both, according to its tenor, (3) that if the bill of exchange be dishonored and the necessary proceedings on dishonor be duly taken, he will pay the amount thereof to the holder or to any subsequent indorser who may be compelled to pay it.

Unlike the drawer who can be considered a primarily active character — since his mere creation or drawing of an instrument gives rise to certain obligations — the drawee is but a passive character until he accepts the instrument. As Section 127 provides:

Sec. 127. *Bill not an assignment of funds in hands of drawee.* - A bill of itself does not operate as an assignment of the funds in the hands of the drawee available for the payment thereof, and the drawee is not liable on the bill unless and until he accepts the same.

Acceptance, as provided by Section 132, is the signification by the drawee of his assent to the order of the drawer. Once the drawee accepts the instruments, he is called an acceptor.

Although entitled "Liability of Acceptor," Section 62 mandates the obligations of the drawee who accepts the instrument to (1) pay [the bill of exchange] according to the tenor of his acceptance, and (2) admit: (2a) The existence of the drawer, the genuineness of his signature, and his capacity and authority to draw the instrument; and (2b) the existence of the payee and his then capacity to indorse.

c. Collecting Bank

As a parenthetical note, there is also another character called a "Collecting Bank." Although not named as such by the Negotiable Instruments Law, it is but an indorsee, at the same time a drawee who becomes an acceptor. It is also an indorser, that is when it forwards the check to the drawer and in effect says, "I have complied with your instruction, I have paid the payee, now reimburse me." However, unlike any other indorser, it is subject to a more stringent degree of responsibility in paying payees since it is a bank entrusted with the duty of protecting the public interest by making sure forgeries made on checks are not rewarded.

33. The provision also empowers the drawer with a right to: "insert in the instrument an express stipulation negating or limiting his own liability to the holder."

d. The Holder

In the case of a bill of exchange and promissory note, the person with a right to be paid is called the holder. Section 51 reveals that the right can be exercised by providing: The holder of a negotiable instrument may sue thereon in his own name; and payment to him in due course discharges the instrument. Section 191, meanwhile, defines a holder as: the payee or indorsee of a bill or note who is in possession of it, or the bearer thereof.

Such person becomes a holder either after issuance or after the process of negotiation. Section 191 defines: "Issue" as the first delivery of the instrument, complete in form, to a person who takes it as a holder, while Section 30 provides:

An instrument is negotiated when it is transferred from one person to another in such manner as to constitute the transferee the holder thereof. If payable to bearer, it is negotiated by delivery; if payable to order, it is negotiated by the indorsement of the holder [to the indorsee] and completed by delivery.

From this provision, it can be observed that the concept of negotiation — a process wherein a payee or holder exercises the power to make a stranger a party to a contract existing in the realm of the Negotiable Instruments Law and evidenced by a negotiable instrument — requires that there must be a transfer of the instrument in a manner to constitute the transferee as a holder.

What should be highlighted in these provisions is that the potency of the Negotiable Instruments Law to uphold a person's right to maintain an action is grounded on his being a holder. That is, a person may only sue on the basis of a negotiable instrument when the instrument was either issued or negotiated to him/her.

IV. APPLICATION OF THE RESOLVING CONCEPTS TO THE CASES

In the case of *Traders Royal Bank*, RPN entered into a contract with TRB that created a reciprocal obligation — they will pay TRB a sum of money and TRB will produce the manager's check payable to and to be delivered to BIR. RPN performed their obligation, they paid TRB and such payment was reflected by a monetary reduction in their TRB bank account. But TRB did not reciprocate. TRB did not deliver the manager's check to BIR.

This should have been the cause of action of the suit since obligations arising from contracts have the force of law between the contracting parties and should be complied with in good faith.³⁴ There was no need to introduce the Negotiable Instruments Law to justify that TRB had a legally demandable obligation to perform in favor of the plaintiff corporations. The Civil Code could also amply be the source of remedies such as compelling

TRB to pay BIR and compelling TRB to compensate the plaintiff corporations for damages.³⁵

Since TRB did not issue or negotiate the manager's check to RPN, there was no "holder" armed with the right to sue on the negotiable instrument. This flaw became more apparent in the Court's failure to approach the problem from the Civil Code perspective. Furthermore, the question of whether a non-holder can sue on an instrument was left unanswered.

Engaging in a discussion of the issue under the Negotiable Instruments Law in the case of *Traders* created more questions than answers. Although the Supreme Court said that SBTC was not a collecting bank, the Court discovered that the manager's checks were presented to PNB and nevertheless ruled that TRB was solely liable to RPN. Why did it not discuss the Civil Procedure concepts of necessary and indispensable parties and rule that PNB was but a necessary party that need not be implicated for the suit to prosper? Could this have been a necessary implication of resolving a Civil Code obligation using a Negotiable Instruments Law regulation?

The Court did not even declare, whether as per Section 130,³⁶ that the manager's checks were to be treated as bills of exchange or promissory notes. If the checks were treated as bills of exchange, then PNB's liability as an acceptor should have been clarified since the Supreme Court found that the checks passed through PNB as evinced by the guarantee stamps at the back of the instrument. On the other hand, if the manager's checks were treated as promissory notes, then the obligation of SBTC as collecting bank should have been set aside, since it was TRB that made the promise to pay.

In sum, matters just became more confusing.

What is more surprising is the ruling in *Westmont Bank*. In this case, Westmont Bank was exacting enough to know that Eugene Ong did not become a holder of the manager's checks. The Bank even argued that the circumstances should fall within the ambit of the Law on Sales because what transpired was a sale between Island Securities and Ong — an unpaid seller.³⁷

35. Art 1165 of the Civil Code provides: "When what is to be delivered is a determinate thing [in this case the sum of money] may compel the debtor [TRB] to make the delivery."

Art 1170 of the Civil Code provides: "Those who in the performance of their obligations [TRB] are guilty of . . . negligence [by not exercising due diligence in ensuring that BIR, the rightful payee receives the check] . . . delay [by not paying BIR on time] and those who in any manner contravene the tenor thereof, are liable for damages."

36. Sec. 130. *When bill may be treated as promissory note.* - Where in a bill the drawer and drawee are the same person... the holder may treat the instrument at his option either as a bill of exchange or as a promissory note.

34. CIVIL CODE, art. 1159.

The Supreme Court, however, closed its ears to these facts and ruled that: "The plaintiff (Ong in this case) uses one action to reach, by a desirable shortcut, the person who ought in any event to be ultimately liable (Westmont Bank in this case) as among the innocent persons involved in the transaction."³⁷ The particular argument was cited by the Supreme Court from the treatise of Agbayani, who in turn cited foreign jurisprudence. Such could have been a milestone in Philippine jurisprudence on the Negotiable Instruments Law. Sadly, however, the factual circumstances, particularly the law in force in the jurisdiction where the case law was cited, was not discussed. As of this writing, there is even reason to believe that Agbayani's citation of this foreign jurisprudence is not accurate.

In effect, this case expanded the rights of a payee-holder from suing in his own name as provided by Section 51, to enforcing on an expectant right to become a payee. Notably, the facts of this case reveal that the check was not delivered to Ong. He merely expected that the check should be delivered to him, yet his suit was recognized by the Courts to have arisen from the perspective of the Negotiable Instruments Law. One cannot help but conclude that this ruling should not become a precedent.

V. PROPER PERSPECTIVE

This essay does not purport to prove that the Philippine Supreme Court is incapable of breaking down issues regarding multi-level rights arising from a single subject matter. Jurisprudence will show that the Supreme Court has in fact built foundations of depth that a legal scholar should adopt in order to fathom the wisdom and intricacies of the law. The reported cases, however, seem to have shelved these tools of analyses. It is befitting to highlight these tools in this part of the essay.

In the case of *Castillo v. Court of Appeals*,³⁸ the debtors, spouses Castillo, loaned Php33,000 from Development Bank of the Philippines (the Bank). In consideration of the loan, real properties owned by the spouses were mortgaged to the Bank. Because of such loan, the spouses made and issued a promissory note payable to the payee-Bank.

The Bank, however, was only able to lend Php31,000 to the spouses and so the Bank altered the instrument by erasing and changing items in the aforesaid promissory note. Due to this, the spouses went to court to demand that they should be adjudged as no longer liable to pay the Bank on the loan since the negotiable instrument that evinced such loan and the loan agreement itself became void due to material alteration as provided in Sections 124 and 125 of the Negotiable Instruments Law. The spouses

claimed that the properties mortgaged to the Bank should be returned to them.

The Supreme Court approached the issue from the Civil Code perspective. It quoted with approval the ratiocination of the appellate court:

As between the parties, the lender and the borrower, the obligation arising from the contract of loan exists. And the lender may choose to sue on the loan, even if the note is null and void. The nullity of the promissory note as a negotiable instrument does not extinguish the obligation to pay the loan. In the present case, the DBP chose to enforce the loan obligation by an extrajudicial foreclosure of the mortgage. It chose not to enforce the promissory note. Sections 124³⁹ and 125 of the Negotiable Instruments Law therefore are not applicable to set aside the extrajudicial foreclosure of the mortgage. It appearing that the plaintiff admits that he contracted the loan and has not paid the same, the motion to dismiss is well taken.⁴⁰

Had the Court resolved the issue from the Negotiable Instruments Law perspective, then, knowing that human reason dictated that the spouses had to pay their loan, the Court could have enforced the right of the Bank to receive payment by ruling that the spouses constituted the Bank to be their agent when they signed the promissory note prepared by the Bank. In that case, even if the Bank materially altered the promissory note, it would have been as if the spouses altered the note making the exception in section 124 apply, and the spouses would still be liable to pay the loan. Fortunately, this was not done.

Resolving the controversy from the Civil Code perspective clarified and preserved the *purpose* of the Negotiable Instruments Law to prescribe rules and regulations regarding payments or performance of monetary obligations using money substitute media. Thus, contracted obligations that had been merely incorporated into writing in the form of a negotiable instrument acting as deed should be regulated by the Civil Code. This is consistent with the tenor of Section 1 of the Negotiable Instruments Law which states that a negotiable instrument must contain an unconditional promise or order to pay a sum certain in money, with Section 24 presuming that every negotiable instrument is deemed *prima facie* to have been issued for valuable consideration, and with Section 28 prescribing that absence of consideration cannot be used as a defense against holders in due course.

39. Sec. 124. *Alteration of instrument; effect of.* - Where a negotiable instrument is materially altered without the assent of all parties liable thereon, it is avoided, except as against a party who has himself made, authorized, or assented to the alteration and subsequent indorsers. But when an instrument has been materially altered and is in the hands of a holder in due course not a party to the alteration, he may enforce payment thereof according to its original tenor. (emphasis supplied)

40. *Castillo*, 159 SCRA at 224.

37. *Westmont Bank*, 375 SCRA at 221.

38. *Castillo v. Court of Appeals*, 159 SCRA 220 (1988).

Surprisingly however, in *Traders* and *Westmont*, the Supreme Court enforced the obligations arising from and regulated by the Civil Code by using Negotiable Instrument Law provisions, thereby altering the situations to which the Negotiable Instruments Law were originally meant to apply.

Since this philosophy had not been applied to the abovementioned cases, a staunch position can be taken that a non-holder can sue on a negotiable instrument as a holder and that a mere expectant right to become a holder is enough basis to sue.

This position, however, is inconsistent with the following theories:

1. That obligations arising from special laws are regulated by the precepts of law which establishes them.⁴¹ Therefore, when the Negotiable Instruments Law says that a holder may thereon sue in his own name,⁴² a non-holder or one to whom an instrument is not delivered or indorsed or who does not possess the instrument⁴³ cannot sue on the instrument.
2. That since a right is an advantage or a standard of permitted action protected by positive law, then the so-called "right of an expectant payee" which cannot be found in positive law — lest judicial legislation be a pervasive practice, can be breached without giving rise to a remedial right in favor of another.

In the earlier part of this essay, an example was presented as to the misinterpretation of property laws. At first, such example seemed absurd, to say the least. Yet it seems that such an example was just a magnified step-by-step process of what the *Traders* and *Westmont* cases had done to the Negotiable Instruments Law, pertinent provisions of the Civil Code, and the concept of cause of action.

VI. CONCLUSION

Article 1157 states, "Obligations arise from law; contract; quasi-contracts; acts or omissions punished by law and quasi-delicts." Article 1158 explains further, "Only those expressly determined in this Code or in special laws are demandable, and shall be regulated by the precepts of law which establishes them; and as to what has not been foreseen by the provisions of this book [the Civil Code]." These Civil Code provisions are in harmony with the Rules of Court which says that, "A suit for the enforcement or protection of a right or for the prevention or redress of a wrong must be based on a cause of action;" the essential elements of a cause of action being: the legal right of

41. CIVIL CODE, art. 1158.

42. *Id.* art. 51.

43. Act No. 2031, § 191.

the plaintiff, a correlative obligation of the defendant, and the act or omission of a defendant in violation of the plaintiff's legal right. Thus, enforceable rights are those that the law recognizes.

Misinterpreting the significance of, and the relation between, substantive law and procedural law disrupts the balance that ensures the co-existence of such concepts. When such misinterpretation is applied to factual circumstances, relationships that the laws had initially regulated are changed. Unfortunately, however, this exercise leaves a constant reminder to undo the error that had been committed.

The cases reviewed occurred within a sphere where both the Negotiable Instruments Law — which provides that only holders can sue on an instrument, and the Civil Code — which provides that those who have an obligation to pay must faithfully discharge that obligation, existed. However, the Court was not able to determine what precept of law should resolve the controversy.

In both *Traders* and *Westmont*, the obligation of the Bank to pay arose from the Civil Code and not from the Negotiable Instruments Law. Since the obligation arose because of the Civil Code, then enforcement of such obligation should have been regulated by the Civil Code — the precept of law which established it. The Court, however, enforced the obligation to pay using the Negotiable Instruments Law.

In doing so, the Court missed the opportunity to clarify some ambiguous concepts in the Negotiable Instruments Law such as Section 130.⁴⁴ It had expanded the right of a holder of a negotiable instrument to include the right to sue as an expectant payee. The Court even rendered the concept of "cause of action" vague. But more conspicuous is that the Court was not able to rule as to what perspective of human conduct was regulated by the Negotiable Instruments Law.

It is then posited that *Traders* and *Westmont* should have been resolved by applying Civil Code concepts of faithfully discharging obligations and not the Negotiable Instrument Law facility of discharging monetary obligation using money substitute media since in these cases, the negotiable instrument was but evidence that the defendant had an obligation to the plaintiff which was to perform an act by delivering checks to the proper parties and *not* to pay a sum certain in money. Had the courts, including the Supreme Court, resolved such controversies in this fashion, they could have avoided blurring other important co-existing principles of law.

44. Sec. 130. *When bill may be treated as promissory note.* — Where in a bill the drawer and drawee are the same person or where the drawee is a fictitious person or a person not having capacity to contract, the holder may treat the instrument at his option either as a bill of exchange or as a promissory note.