their lives. GRP and the Christian Filipinos, on one hand, and majority of the seven million Muslim People, on the other, have yet to come to peace with each other in spite of the Tripoli Agreement and the 1996 Final Peace Agreement. The GRP and the Christian Filipinos, therefore, must re-examine their often tenuous and strained relationship with the Muslim People and the peace agreements that they have concluded. They have had the upper hand in the bargaining table, offering only what they can give. They have dictated the terms of the peace and its implementation. They must, therefore, bear the blame for its failure. Meanwhile a people suffers. They suffer and fight.

The GRP and the majority of the Christian Filipinos must realize the injustice of forcing the effectivity of the constitutional provisions that negatively affect the very essence of seven million other Filipinos. Likewise, the Muslim People must realize that Islam is a call for peace. It is, however, a peace that must be "just, comprehensive and durable." For the Muslim People, that means living the Islamic way of life. The GRP must start with that as a premise. Only then can there be a conclusion of peace. This proponent calls upon the GRP, the Christian Filipinos, and the Muslim People to work and sacrifice together to achieve the elusive peace – ***salam***.

Revisiting the Philippine "Laws" On Corporate Rehabilitation[1]

Cesar L. Villanueva[*]

The current financial turmoil in Asia has not spared the Philippines from its debilitating effects and has spawned the filing of several cases for suspension of payments with prayers for rehabilitation with the Securities and Exchange Commission (SEC), pursuant to its jurisdiction and powers under Presidential Decree No. 902-A (PD 902-A).

The primary purpose of rehabilitation proceedings is to give a petitioning corporation[2] a breathing period for the deferment of the payments of its obligations, to come up with a rehabilitation plan that will provide it the opportunity to recover from financial distress, to achieve profitable operations to eventually be able to service its obligations, and perhaps even to once again accumulate retained earnings to be in a position to distribute dividends to its equity holders.

The terms of some rehabilitation plans have been discussed or made public in newspaper reports. Often the difficulties faced arise from conflicting interests among various creditors — some of whom have fully secured claims while others are not adequately secured or are entirely without collateral security, and even with the stockholders of the company.

While PD 902-A undoubtedly recognizes the proper jurisdiction of, and grant of certain powers to the SEC for suspensions of payments proceedings which seek the rehabilitation of a petitioning corporation, the legal basis upon which to enforce and implement a rehabilitation plan among the various stakeholders in the distressed company does not clearly appear in the text of the Decree. For example, in the rehabilitation proceedings involving the Philippine Airlines, Chairman Perfecto Yasay of the SEC has been

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1. This Paper has been written and submitted as the required output for the professorial chair award of the JUSTICE CARMELO ALVENDIA CHAIR IN COMMERCIAL LAW for School Year 1998-1999.

2. The term "petitioning corporation" is used in its most generic meaning and is intended to include the situation where the corporation is subjected to management or rehabilitation proceedings without or against the wishes of the board of directors or its management.

quoted in declaring that it is the SEC and not the PAL creditors who will have a final say on whether the airline's plan will be approved: "whether or not the creditors will agree to the habilitation plan is beside the point. If SEC feels it is viable, we will enforce it. [3] "He reportedly held that once PAL's rehabilitation plan is finalized, a permanent receivership committee will be created to implement it, and that "[t]he committee will not include the creditors [to avoid] an inherent conflict of interest."[4]

The nature and extent of the power of the SEC to approve and enforce a rehabilitation plan is certainly an important issue. Often, a rehabilitation plan would require the diminution, if not destruction, of contractual and property rights of some, if not most of the various stakeholders in the petitioning corporation. In the absence of clear coercive legal provisions, the courts of justice and much less the SEC would have no power to amend or destroy the property and contractual rights of private parties, much less relieve a petitioning corporation from its contractual commitments.

The purpose of this Paper is to examine the provisions of PD 902-A, and other relevant statutory provisions, as well as relevant decisions of the Supreme Court, relating to the power of the SEC to adopt and enforce rehabilitation plans for financially distressed corporations that may have the legal effect of amending, nullifying or abrogating the property and contractual rights of the various stakeholders in the petitioning corporation. The tasks set become very difficult because the primary enabling law relating to corporation rehabilitation proceedings, PD 902-A, is at best a poorly crafted piece of legislation that seems not to have been thoroughly thought-out, leaving vagueness in its trail and in the case of rehabilitation proceedings, large gaps which reason, logic, and sometimes even equity, are not able to bridge.

With the magnitude of Asia's financial turmoil, bankruptcy codes all over the region are being scrutinized not only by international agencies such as the IMF, but also by international creditors and investors. In fact, other countries like Thailand and Indonesia have recently overhauled their bankruptcy laws to restore investors' confidence.[5] Reportedly, that the main objective of bankruptcy reforms underway in Asia is to make company rehabilitation a viable alternative to liquidation, encouraging editors "to take a pro-active and constructive role in salvaging debtors' businesses."[6]

3. Business World, June 1998.
4. *Id.*
5. *See* Dan Murphy, *Loopholes in the Law*, Far Eastern Economic Review, 22 October 1998.
6. Teresa Wyszomiersk, Asian Wall Street Journal, 5 October 1998.

In the Philippine scene, it was estimated that for the first eight months of 1998 alone, corporate dissolution had gone up by 32.4% compared to the year before, with about 98 companies shutting down their operations from 74 companies all of last 1997.[7] Since the Asian crisis is projected to last for another three to five years, it would mean that potential investors to the Philippines, whether foreign or local, and both in equity and debts instruments, would be scrutinizing our bankruptcy laws, and the adequacy under which they provide for reasonable protection to investors and creditors to local ventures.

What both foreign and local investors may find in the Philippines is an insolvency law of early American colonial vintage, old and antediluvian, and smithereens on corporate rehabilitation under PD 902-A.

I. THE UNDERLYING CORPORATE BUSINESS PRINCIPLES

The power of the SEC to adopt and enforce a rehabilitation plan binding on the corporation and the various stakeholders must be gauged against such doctrines and underlying philosophical background pervasive in the Philippine legal system.

1. Economic and Social Values of Philippine Society

The economic and constitutional history of the Philippines would show that when it comes to business and property rights, our society has always sought to strike a balance between the free enterprise system and the paternalistic or socialistic system. This ambivalent stance is manifested in the various provisions of the Philippine Constitution itself. Although the Constitution protects property and life under the due process clause,[8] and declares that "[t]he State recognizes the indispensable role of the private sector, encourages private enterprise, and provides incentives to needed investments,"[9] it provides nevertheless for the "social function" of private property and enterprise ownership, Thus,

>]T]he use of property bears a social function, and all economic agents shall contribute to the common good, individuals and private groups, including corporations, cooperatives, and similar collective organizations, shall have the right to own, establish, and operate economic enterprises, subject to the duty of the State to promote distributive justice and to intervene when the common good so demands.[10]

7. The Philippine Star, p.21, 19 October 1998.
8. PHIL. CONST. art. III, § 1.
9. PHIL. CONST. art. II, § 20.
10. PHIL. CONST. art. XII, § 6.

2. The Sanctity of Contracts and Contractual Commitments

Since the 1935 Constitution, our society has constitutionally sanctified the binding effects of contracts between the parties and prohibits the passage of any law, rule or regulation impairing the obligation of contracts, now embodied in Section 10, Article III of the 1987 Constitution. The purpose of the non-impairment clause is to safeguard the integrity of valid contractual agreements against unwarranted interference by the State. As a rule, they should be respected by the legislature and not tampered with by subsequent laws that will change the intention of the parties or modify their rights and obligations. The will of the obligator and the obligee must be observed; the obligation of their contract must not be impaired."[11]

The sanctity of contractual commitments is likewise emblazoned in basic provisions of the Civil Code, which requires that contracts shall "bind both contracting parties, and its validity or compliance cannot be left to the will of one of them"[12] and from the moment of their perfection "the parties are bound not only to the fulfillment of what has been expressly stipulated but also to all the consequences which, according to their nature, may be in keeping with good faith, usage and law."[13] Contracts "shall be obligatory, in whatever forms they may have been entered into, provided all the essential requisites for their validity are present."[14]

3. Philippine Corporate Set-Up and the Business Judgment Rule

On the other hand, the "business judgment rule" has always been a tenet in Philippine Corporate Law, which recognizes corporate power and competence to be within the board of directors. Under this doctrine, courts and administrative bodies exercising quasi-judicial powers are enjoined from supplanting the discretion of the board on administrative matters as to which they have legitimate power of action; and contracts which are *intra vires* entered into by the board are binding upon the corporation and will not be interfered with unless such contracts are so unconscionable and oppressive as to amount to a wanton destruction of rights of the minority.[15]

Courts and other administrative bodies having jurisdiction over corporations generally would not interfere in the judgment or business decisions of the board, nor will they substitute their wisdom for that of the board. Under Sec. 23 of the Corporation Code,[16] the contract of the State

11. ISAGANI CRUZ, CONSTITUTIONAL LAW 192 (1980).
12. Civil Code of the Philippines, Art. 1308.
13. *Id.* Art. 1308.
14. *Id.* Art. 1315.
15. Gamboa v. Victoriano, 90 SCRA 40 (1979).
16. Batas Pambansa Blg. 68.

with corporations, their investors, and the public at large who must deal with the corporation, is that the "corporate powers" are vested in the board, and generally no courts or other tribunal would overturn or interfere with the judgment and decisions of the board, and the management appointed by the board. Courts and other tribunals are wont to override the business judgment of the board mainly because courts are not in the business of running businesses, and the laissez faire rule or the free enterprise system prevailing in our social and economic set-up dictate that it is better for the State and its agencies to leave business to the businessmen. This is specially so since courts and administrative bodies are ill-equipped to make business decisions. More importantly, the prevailing social contract in the corporate setting on the power to decide the course of corporate business enterprise is been vested in the board and not with the courts or other quasi-judicial bodies.

4. The Hierarchical System on Claims Against the Business Enterprise

In the hierarchical test of priority, creditors have by express statutory provision, and common law application always been preferred to the business assets on which they have extended credit, as against the equity holders, whether they be sole proprietors, partners[17] or shareholders.[18]

One who makes an equity placement in the corporation expects that his returns shall be tied-up with the success or loss of the operations of the corporation. Therefore, he places his investment ready and willing to take a risk with the management's style of operating the affairs of the corporation. The return of the equity investor is intricately woven into the business affairs of the corporation. Reciprocally, he is given a voice or a say in management in the sense that he would be entitled to participate in the election of the board of directors, and also to cast votes on certain corporate structural matters in those instances enumerated by law when stockholders have a ratificatory vote on management action.

To a corporation, the advantage of equity investment is the absence of "carrying cost," since the corporate enterprise is not bound to pay any return on the investment unless there is profit. And even then, the board of directors is generally granted large business discretion to determine when to declare such return in the form of dividends. The corporate enterprise has the flexibility of declaring dividends in the form of stock dividend which

17. Article 1839(2) of the Civil Code provides priority payment from partnership assets to those owing to creditors other than partners before any payment may be made to the partners.
18. Section 122 of the Corporation Code embodies the "trust fund doctrine" and provides that" no corporation shall distribute any of its assets or property except upon lawful dissolution and after payment of all its debts and liabilities."

does not drain the finances of the enterprise, and yet allows the stockholders to "cash-in" on the stock dividends by selling them in the open market.

An equity investment in a corporate enterprise is generally non-withdrawable for so long as the corporation has not been dissolved. This assures the corporate enterprise and its managers that they will have such resources at their disposal so long as the corporate enterprise remains a going concern.

On the other hand, a creditor of the corporation only looks at the financial condition and operation of the corporation as a means of gauging the ability of the corporation to pay-back the loan and accumulated interests at the specified period. But a creditor puts no stake on the operations of the corporation and therefore the contractual obligation of the corporate enterprise to pay the stipulated return (interest) remains binding even when the operations are incurring losses. Since the relationship is essentially contractual in a loan placement with a corporation, the creditors has every right to demand the payment of the placement upon its maturity.

Consequently, the expected return between the two types of "investments" would be different. In a loan placement in a corporation, since the investor places no stake in the results of the operations, he can only demand the stipulated fixed return of his investment even if by the use of the borrowed funds, the enterprise is able to reap huge profits. In the case of an equity investors, since he has placed his stake in the results of operations, he generally participates in all income earned by the venture.

This difference in legal motivation and risks-assumption factors between a debt investors and an equity investors, also dictates the legal preference in payment from corporate properties of the first as compared to the latter. Since a debt investor places no stake in the corporate operations and his rights are based on contract then the corporate venture must, in case of insolvency, devote and prefer all corporate assets towards the payment of its creditors. On the other hand, since the equity investors clearly undertook to place their investment to the risk of the venture, they can only receive a return of their investment only from the remaining assets of the venture, if any, after the payment of all liabilities to creditors.

II. The Nature and Purpose of Rehabilitation

1. Meaning of "Rehabilitation"

Corporate rehabilitation has been defined as a process "to try to conserve and administer [the corporation's] assets in the hope that it may eventually be able to return from financial stress to solvency. It contemplates the continuation of corporate life and activities so it may be able to return to its former condition of successful operations and financial stability."[19]

In a recent case,[20] the Supreme Court defined "rehabilitation" as contemplating a continuance of corporate life and activities in an effort to restore and reinstate the corporation to its former position of successful operation and solvency.

2. Comparison with Liquidation Proceedings

In "rehabilitation," the creditors are promised to be paid from the future earnings of the debtor not from the current properties of the debtors existing at the time the petition for rehabilitation is filed. On the other hand, "liquidation" essentially involves the appointment of a trustee or assignee who collects the non-exempt properties of the insolvent debtor, converts the property to cash, and distributes the proceeds to the creditors in accordance with prevailing preference rights existing under the law, with also the end in view of obtaining a discharge for the debtor. Both liquidation and rehabilitation proceedings are embodied into the generic nomenclature of "bankruptcy," and the main thrust of both proceedings is to afford an equitable distribution of the properties of the debtor to allow the maximum means by which to cover the claims of the creditors.

Bankruptcy proceedings therefore, although they may provide for certain relief or advantages to the debtor (i.e., discharge in the case of liquidation, and return to profitable operations, when it comes to rehabilitation), are nevertheless primarily undertaken to provide maximum protection on the claims of the creditors. The requirements and procedures of the enabling law always provides for the optimum and equitable means by which to provide for the payment of such claims. There is no legal, equitable or even moral ground, by which a bankruptcy proceeding shall be undertaken to undermine the contractual and proprietary rights of creditors, or to put their claims in consideration below those of the stockholders of the corporation.

3. The Philippine Scheme of Legislation on Bankruptcy

Under the current Philippine setting, we do not have a Bankruptcy Code as known in America setting, which covers both the liquidation and the rehabilitation of debtors. What we have is The Insolvency Law[21] which

19. Balgos, Corporate Rehabilitation: Should Secured Creditors Queue?, 8 PHIL. L. GAZ. 1 (Nos. 6-7), citing BLACK'S LAW DICTIONARY, p.1451.

20. Ruby Industrial Corp. v. Court of Appeals, G.R. No. 124185-87, 20 January 1998.

21. Act No.1956, enacted during the early American regime on 20 May 1909. Section 1 of the Law specifically provides that it be referred to as "the Insolvency Law."

provides for the temporary and limited suspension of payments for a debtor who has enough assets to cover his liabilities but is experiencing temporary illiquidity, and for the voluntary and involuntary liquidation of the estate of the insolvent debtor.

When PD 902-A was first promulgated in 1976, it provided for the reorganization of the SEC and granted it specific powers not previously given under the Securities Act. In 1981, when P.D. No. 1758 was promulgated to amend PD 902-A, it was still primarily meant to further strengthen the SEC,[22] and in the enumeration of the jurisdiction and powers thereof, it included the concept of rehabilitation of corporations and other juridical entities.

Instead of providing for detailed statutory language for the procedures and effects of rehabilitation, PD 1758 embodied merely cursory provisions governing the forum and certain powers on rehabilitation. Therefore, PD 902-A, as amended, currently presents a mere "preliminary attempt" to express in statutory form the laws relating to rehabilitation of corporations and other juridical entities.

Since the demands of commerce, especially in the realm of enforcement of creditors' claims against a financially distressed or insolvent debtor, cannot await the time when Legislature decides to finally enact a comprehensive Bankruptcy Code, judges, lawyers, businessmen and the public in general, must struggle with what is in the statute books and in jurisprudence to see the extent by which the concept of rehabilitation may be pursued or even properly opposed.

III. The American Parallel: Chapter 11 Proceedings

To provide the proper frame of reference in the substantive discussion in this paper, it would be worthwhile to take an overview of the Chapter 11 proceedings on reorganization or rehabilitation of the United States, from whence our original insolvency law patterned.

22. The Whereas Clauses of PD No. 902-A Provides:"[i]n order to attain this national objective, it is incumbent upon government to provide a favorable climate for investments to be vigorously mobilized to insure a wider and more meaningful equitable distribution of wealth; ... being the principal agency of the government charged with the establishment of the needed atmosphere in all phases of the country's economic and industrial development, the Securities and Exchange Commission must be provided with the appropriate organizational structure, financial support and manpower capabilities commensurate with the scope of its task; and ... for these programs to succeed, there is now a pressing need to restructure the Securities and Exchange Commission not only to make it a more potent, responsive and effective arm of the government but to enable it to play a more effective role in the socio-economic development of the country.

A. Bankruptcy Code of the United States

The Bankruptcy Code[23] of the United States expressly provides for "Liquidation" under Chapter Seven, and for "Reorganization" under Chapter 11.

Under Chapter Seven, the filling of a petition is intended to bring the debtor's estate into the bankruptcy court for the collection and liquidation of its properties with the proceeds to be distributed to the creditors in accordance with their preference rights under the law and for a determination of whether the debtor is to be discharged from further liabilities to the creditors.[24] That would be similar to our insolvency proceedings under our Insolvency Law.

Chapter 11 involves the rehabilitation, rather than the liquidation, of the debtor's business. The petition is filed to place the debtor into bankruptcy, but the business continues to be operated; in the meantime there is a formulation of a plan for rehabilitation, which is submitted to the creditors for acceptance, and to the court for confirmation; there will be a discharge of the debtor as a result of confirmation; and eventually there will be payments to the creditors under the terms of the plan.[25] Reorganization or rehabilitation under the Bankruptcy Code has no counterpart in our Insolvency Law.

B. Chapter 11 Reorganization or Rehabilitation

It has been written that the filing of a petition under Chapter 11 "always alters and sometimes tears asunder the web of contractual and state law relationships among the various parties with an interest in the corporation."[26] To understand better the concept of a Chapter 11 reorganization under the Bankruptcy Code, and provide a better comparison with the state of privation in our own jurisdiction, we shall proceed to discuss in outline format the proceedings and consequence of a reorganization or rehabilitation proceedings.

1. Who Is Subject to Chapter 11?

A debtor, other than a sole proprietorship, a railroad company, a stock broker and a commodity broker, is qualified to file a petition under Chapter 11.[27]

23. Bankruptcy Reform Act of 1978.

24. *See* EPSTEIN, NICKELS, & WHITE, BANKRUPTCY (1993).

25. *Id.*

26. *Id.* at 737.

27. Bankruptcy Code, § 109 (d).

A debtor is also subject to creditor-initiated (involuntary) bankruptcy under Chapter 11,[28] except for one who is a farmer or non-profit corporation.[29]

2. When the Proceedings Officially Begin

The filing of the petition, whether the proceedings be voluntary or involuntary, commences the bankruptcy case, and determines the date in applying the important provisions of the Bankruptcy Code, such as on automatic stay,[30] what constitute the property of the estate of the debtor,[31]preferences,[32] and fraudulent conveyances.[33]

3. Consequences of Filing of the Petition

The filing of the petition has legal consequences against both the debtor and the creditors: it triggers the automatic stay that bars creditors from collecting their claims;[34] the person who will operate the corporation after the petition is filed is called the "debtor in possession," and only matters relating to the corporation's ordinary business transactions will be allowed to be pursued,[35] allowing the use, sale or lease of property,[36] and obtaining of the credit for working funds;[37] it provides time for the debtor to determine how best to reorganize, and ultimately to submit a rehabilitation plan.[38]

4. Who Handles the Business in the Meantime?

When a Chapter 11 petition is filed, the person who will operate the business is called the "debtor in possession," which basically means the

28. *Id.* § 303 (a).

29. A creditor shall have legal standing to file an involuntary petition only when he holds a claim that is "not contingent as to liability or subject o a bona fide dispute." Generally, three or more creditors with unsecured claims totaling at least $5,000.00 must join the petition, which shall not include employees, insiders and transferees under voidable transfers; however, if the debtor has less than 12 unsecured creditors, a single creditor with an unsecured claim of at least $5,000.00 is sufficient. Section 303(b), Bankruptcy Code.

30. *Id.* § 362.

31. *Id.* § 541.

32. *Id.* § 547.

33. *Id.* § 548.

34. *Id.* § 362.

35. *Id.* § 1108.

36 *Id.* § 363.

37. *Id.* § 364.

38. EPSTEIN, NICKLES AND WHITE, *supra* note 24, at 756.

management who is in charge at the time of the filing of the petition, but this time the management prerogatives are subject to the control and supervision of the court. "[I]t is quite unusual [in rehabilitation proceedings] to have a trustee or even an examiner selected by the court,"[39] and "the requesting party must establish the grounds for appointment by clear and convincing evidence,"[40] and the grounds relied upon basically would be "fraud, dishonesty, incompetence, or gross mismanagement of the debtor by the current management."[41]

5. Who Can Propose a Plan?

Under the Bankruptcy Code, the debtor has an exclusive period of 120 days in which to file a plan.[42] If the debtor files within that period, no other party is permitted to file a plan for an additional 60 days.[43] As a matter of routine, the courts grant extensions to the exclusivity periods.[44]

C. The Rehabilitation Plan

1. Contents and Requisites of the Rehabilitation Plan

Under the requirements of the Bankruptcy Code, the reorganization plan must:

Designate classes of claims and interests;[45]

Specify which classes of claims and interests remain unimpaired;

Explain the proposed treatment of any class of impaired claims and must give equal treatment to all claims and interests within a particular class, unless an individual claimholder agrees to accept less;[46]

Comply with the "feasibility requirement," that the plan once confirmed will not likely be followed by liquidation or the need for further financial reorganization;[47]

Comply with the "best interests" test on the treatment of non-consenting individual claimants; and

39. *Id.* at 738.

40. *Id.* at 745.

41. *Id.* at 746.

42. Bankruptcy Code, § 1121.

43. *Id.*

44. Epstein, Nickles & White, *supra* note 24, at 736.

45. Bankruptcy Code, S 1122 (a).

46. *Id.* § 1123 (a) (4).

47 *Id.* § 1129 (a) (11).

Comply with the "fair and equitable" standards for cramdown.[48]

2. Classification of Claims and Interests under the Plan

In the submitted plan, the debtor can classify claims or interests together "only if" they are "substantially similar to the other claims or interests of such class."[49] The objective of the section is to limit the "debtor's power to gerrymander the class in a way that might enable the debtor either to prefer one set of creditors over another or to nullify the vote of one set of creditors or shareholders."[50] It prevents the debtor from diluting voting rights of a creditor who holds greater rights than other creditor's by including the creditor's claim in a much larger class of dissimilar claims.[51]

3. Disclosure, Solicitation and Modification of Proposed Plan

Section 1125 provides for disclosure after the plan has been submitted and the manner of solicitation of votes. The Code allows and provides for the manner of modification of a previously proposed plan.[52]

4. Acceptance of the Plan

A class of creditors is deemed to have accepted the plan only if two-thirds (2/3) in amount and more than one-half (1/2) in number of those creditors in the class vote to accept the plan. A single creditor holding a claim composing more than one-third of the sum of the claims in the class can cause the class to reject a plan by a single negative vote.[53]

D. Standards for Confirmation

The Code sets out the factors that a court is to consider in approving a plan, which are:[54]

(a) Feasibility Requirement — The requirement that "confirmation is not likely to be followed by the liquidation,"[55] for it would be inutile to proceed with rehabilitation that from the onset had no chance of success;

48. *Id.* § 1129 (b).
49. Bankruptcy Code, § 1122 (a).
50. EPSTEIN, NICKELS & WHITE, *supra* note 24, at p. 736.
51. *Id.* at 771.
52. Bankruptcy Code, § 1127.
53. EPSTEIN, NICKLES & WHITE, *supra* note 24, at 736.
54. Bankruptcy Code, § 1129.
55. *Id.* § 1129 (a) (11).

(b) Best Interests of Creditors Test — The requirement that each non-assenting creditor must receive "not less than the amount that such holder would receive or retain if the debtor were liquidated under Chapter 7;[56]

(c) Absolute Priority Rule — The requirement that provides for the fair and equitable treatment of creditors in a class;[57] and

(d) Cramdown — The requirement that allows confirmation in spite of opposition to the plan.[58]

The feasibility requirement and best interests of creditors test are always applicable for the confirmation of a plan; even if every class of claims and interests accepts a plan, a court still must apply those two requirements. However, while feasibility requirement is always applicable, the best interests of creditors test is applicable only if the plan: (1) was accepted by at least one class of claims impaired under the plant but (2) not accepted by all classes of claims or interests impaired by the plan.

The Code provides for a confirmation hearing to be set and held and that parties can oppose the confirmation.[59]

E. Impairment

The plan must propose treatment for every class of "impaired" claims or interests.[60] Only impaired creditors may vote on the plan because the Code establishes a conclusive presumption that classes of unimpaired claims accept the plan. A claim is "impaired" unless it fits within one of three narrow exceptions:

(a) The plan does not alter the legal, equitable or contractual rights of the holder;[61]

(b) To cure a default and reinstate the maturity date under the original agreement; or

56. *Id.* § 1129 (a) (7).
57. *Id.* § 1129 (b) (2)(B) (ii).
58. *Id.* § 1129 (b).
59. *Id.* § 1128.
60. *Id.* § 1123 (a) (3).
61. Examples of alteration of the rights of creditors are the changing of the amount of principal, interest rates, altering maturity, and changing the form or the amount of collateral. Even an alteration that enhances the values of the creditor's claim impairs it. EPSTEIN, NICKLES & WHITE, *supra* note 24, at 770.

(c) Cash payment of the amount of the claim on the effective date of the plan.

An interest (e.g. holder of preferred or common stock may be rendered "unimpaired" by a cash payment only if the security provides for a fixed liquidation, preference or redemption price.

F. Cramdown under Section 1129(b)

On motion of the proponent, the Code allows confirmation of the reorganization plan, despite the rejection of one or more classes, "if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan."[62]

1. Unfair Discrimination

Unfair discrimination is not defined in the Code legislative history in the United States suggests that the criterion is to protect creditors from unfair discrimination between classes of claims with equal priority.[63]

2. Fair and Equitable

a. Even when the secured claims object to the plan, cramdown is allowed in the following instances mainly because there is no "impairment" of their claims:

(a) If the members of the secured class retain their lien on the secured property; receives cash payments, with face amounts of at least the allowance amount of the secured claim; and a present value equal to the value of their collateral.

(b) If the plan provides that each member of the class will realize the "indubitable equivalent" of its allowed secured claims.[64]

(c) If the plan provides for the sale of the property free and clear with the creditor's lien attaching to proceeds of the sales. Payment of the claim secured by those liens must then follow either under the present value standard or the indubitable equivalent standard for cramdown.[65]

62. Bankruptcy Code, § 1129 (b) (1).

63. Epstein, Nickles & White, *supra* note 24, at 767.

64. Bankruptcy Code, § 1129 (b) (2) (A) (iii).

65. *Id.* § 1129 (b) (2) (A) (ii).

b. Unsecured Claims — Best Interest Test[66]

The best interest test applies to creditors, irrespective of class votes. The plan proponent demonstrates compliance with the best interest test through a liquidation analysis showing the value of the debtor's assets, the secured claims against those assets, projected Chapter 11 and Chapter 7 administrative expenses, priority claims and unsecured claims, and a calculation of the percent of distribution to each type of claim.

For example, if liquidation will bring 10% to each creditor, each non-consenting creditor must get 10% or the plan fails even if such additional class votes for the sale.

c. Unsecured Claims — Absolute Priority Rule

The Code requires the fair and equitable treatment of dissenting classes of unsecured claims. If a class of unsecured claims dissents, the plan must eliminate junior claims and interests unless the dissenting class receives property with a present value equal to the allowed amount of their claims.[67] The debtor may pay creditors over time as long as the present value of the time payment at least equals the allowed amount of his claims.

d. Unsecured Interests (Stockholders)

To cramdown over a dissenting class of interests, junior interest holders must be eliminated, unless each interest holder receives property with a present value, as of the effective date of the plans, equal to the greater value of the allowed amount of any fixed liquidation preference, fixed redemption price, or the value of such interest.[68]

The absolute priority rule applies to each dissenting class — if a junior class receives anything at all, the plans must pay the dissenting class in full. A plan may propose that a senior class give up value to junior classes or interest, but the dissent of a senior or intermediate class will prevent confirmation.

The accepted general rule is that stockholder cannot keep equity interest in the reorganized corporation as contributor of new capital.[69]

Unless the payment be in cash or the given contribution is in property with a fixed value as their payment for an equity interest in the reorganized corporation[70] provided the following requirements are met:

66. *Id.* § 1129 (a) (7).

67. *Id.* § 1129 (b) (2) (B).

68. *Id.* § 1129 (b) (2) (c), EPSTEIN, NICKLES & WHITE, *supra* note 24, at 765.

69. Northwest Bank Worthington v. Ahlers, 485 U.S. 197, 108 S. Ct. 963, 99 L. Ed.2d 169 (1988).

The new value must be contributed in money or money's worth;

The contribution from the share holder or other junior interest must be "necessary"; and

The contribution must be substantial, or, as the rule is sometimes stated, must equal or exceed the going concern value of the company.

G. Effects of Confirmation

The Code provides for the following legal effects of confirmation of a reorganization plan:[71]

(a) The parties are bound by a confirmed plan;

(b) The property of the estate is returned to the debtor after the confirmation; and

(c) The property "dealt with by the plan" is free and clear of all claims and interests except as provided in the plan.

Confirmation of the plan discharges the debtor from any debt, with certain exceptions that arose prior to the date of the confirmation. In effect, Section 1141 is the discharge provision of Chapter 11 and one looks to it to see the legal effects of the various obligations owed by the debtor as a result of the confirmation of the particular plan.[72]

H. Priority Standing under Chapter 11[73]

The priority standing of the various stakeholders of the debtor under Chapter 11 are as follows:[74]

(a) Secured creditors stand first in line

70. Cases v. Los Angeles Lumber products Co., 308 U.S. 106, 60 S.Ct. 1, 84 L.Ed. 110 (1939).

71. Bankruptcy Code, § 1141.

72. EPSTEIN, NICKLES & WHITE, *supra* note 24, at p. 737.

73. *Id.* at 760: "Chapter 11 [proceedings] both require and encourage negotiations and compromise among parties affected by a plan of reorganization. S 1129(a)'s acceptance requirements and the alternatives S 1129(b), which allows confirmation despite a class's failure to accept, both add the stage and provide the tools for making a plan. Absent a cramdown, each class of claims or interests must either be unimpaired, or accept the plan if there is to be confirmation. Since the debtor rarely possesses sufficient resources to leave all creditors unimpaired, e.g., by payment in full, it must therefore negotiate with the creditors for acceptance. Even when the debtor attemps a cramdown under S 1129(b) the Code requires acceptance by at least one unimpaired class."

74. *Id.* at 757.

(b) Unsecured creditors do not play a substantial role in the negotiations for the plan because the Code specifies preferred treatment[75] for those groups and leaves little leeway for the debtor;

(c) Each party claiming administrative expense and each involuntary gap creditor has a right to cash on the effective date of the plan unless the individual creditor agrees to take something else;

(d) Other priority claims such as employee wages and benefits, consumer deposits, must also be paid in cash on the effective date only if their class votes against the plan; if their class accepts the plan they may receive other property with present value equal to the claim on the date of the petition;

(e) The debtor can pay the present value of priority tax claims over a period of up to six years;

(f) When unsecured creditors would receive nothing under a liquidation, they suffer the debtor's reorganization attempts because they have nothing more to lose; and

(g) Shareholders are at the bottom of the pecking order for persons holding claims or interest in the debtor.

I. Salient Points Drawn from the Chapter 11 Provisions

The review of Chapter 11 Reorganization Proceedings under the Bankruptcy Code of the United States provides us with the following salient point:

(a) Rehabilitation or reorganization is essentially a proposal coming from the management of the company which is in the best position to determine the feasibility and parameters of, and implement, the plan;

(b) The court where the proceeding are pending acts more as an arbiter to ensure that the rights of creditors are fully protected by such a plan;

(c) A rehabilitation plan must be shown to really be feasible, otherwise it cannot even be confirmed by the courts, because once confirmed, it serves to effectively discharge the debtor for all other claims not provided for in the plan;

(d) Every provision is taken to ensure that priority rights of secured creditors are available and their contractual and

75. Bankruptcy Code, § 1129 (a) (9).

proprietary interests are not impaired without their consent by treason of the implementation of the rehabilitation plan;

(e) All unsecured creditors and stockholders generally have no say in the plan if it can be shown that they effectively are entitled to nothing if liquidation were pursued; however, if it is shown that unsecured creditors would have realized a certain portion of their claims even if liquidation is pursued, then such claims cannot also be impaired without their consent; and

(f) Time is of the essence of the whole process because without time limitations, the automatic stay produces a corrosive effect on the rights and properties of the creditors the longer the delay is encountered.

With the foregoing points clear in mind, we can now proceed to analyze the existing legislation, rulings and court pronouncement on corporate rehabilitation in the Philippines.

J. Statutory Bases for Philippine Rehabilitation Proceedings

1. Jurisdiction Clause under PD 902-A

The concept of "absolute jurisdiction, supervision and control" of the SEC over corporations and other juridical entities is embodied in Section 3 of PD 902-A, which provides the SEC "shall have absolute jurisdiction, supervision and control over all corporations, partnership or associations, who are the grantees of primary franchises and/or a license permit issued by the government to operate in the Philippines."

Nevertheless, the Supreme Court clarified in one case[76] that the "absolute jurisdiction, supervision and control" language of Section 3 is only meant to cover the SEC power to grant juridical personality to a corporation under its primary franchise, but cannot be taken literally to mean absolute control over entire affairs, transactions, and operations of a corporation. In another case, the Court also explained that the language of Section 3 should be taken in implementation of the specific jurisdiction provisions of Section 5 of the Decree.[77]

The proper basis for the SEC's power and jurisdiction over rehabilitation proceedings for corporations and other juridical entities is properly Section

76. Peneyra v. Intermediate Appellate Court, 181 SCRA 244 (1990).

77. Union Glass And Container Corporation v. Securities And Exchange Commission, 128 SCRA 31 (1983); *See also* DMRC Enterprises v. Este De Sol Mountain Reserve, Inc., 132 SCRA 293 (1984).

5(d) of PD 902-A, which provides that the SEC shall have original and exclusive jurisdiction on hear and decide cases involving—

> (d) Petitions of corporations, partnerships or associations...in cases where the corporation, partnership or association has no sufficient assets to cover liabilities, but under the management of a rehabilitation receiver or management committee created pursuant to this Decree.[78]

Under Section 5(d) quoted above, rehabilitation proceedings essentially cover corporations that are insolvent as clearly qualified by the phrase "has no sufficient assets to cover liabilities." When corporation is insolvent, the priority rights of creditors to the remaining assets of the corporation is the guiding principles, since technically and legally speaking, the stockholders have no proprietary rights to protect under the circumstances because there will no longer be corporate assets available to them. It also means that the priority rights of secured creditors over assets over which they have a lien remains and becomes vital vis-à-vis the unsecured creditors of the corporation.

Rehabilitation of an insolvent corporation therefore must primarily be for the benefit of the corporate creditors. When the primordial goal is to save the business in order to provide for the shareholders and even other interests, that would be a violation of the primary rights of the creditors to seek redress from the assets of the corporation.

2. Supplemental SEC Powers under PD 902-A

To supplement the jurisdictional clause of Section 5(d), the PD 902-A provides in Section 6(c) that the SEC shall possess the following powers:

(a) To appoint a rehabilitation receiver of corporations, partnerships or other associations not supervised or regulated by other government agencies who shall have, in addition to the powers of a regular receiver under the provisions of the Rules of Court, such functions and powers as are provided for in the succeeding Section 6(d) of the Decree;

(b) To appoint a rehabilitation receiver of corporations, partnerships or other associations supervised or regulated by other government agencies, such as banks and insurance companies, upon request of the government agency concerned;

(c) To create an appoint a management committee, board or body upon petition or *motu proprio* to undertake the management of corporations, partnerships or other associations not supervised or regulated by other government agencies in appropriate cases when there is imminent danger of dissipation, loss, wastage or destruction of assets or other properties or paralyzation of business operations such corporations or

78. Emphasis supplied.

entities, which may be prejudicial to the interest of minority stockholders, parties-litigants or the general public; and

(d) To create or appoint a management committee, board or body to undertake the management of corporations, partnerships or other associations supervised or regulated by other government agencies, such as banks and insurance companies, upon request of the government agency concerned.

Section 6(d) specifically provides that the SEC may order the dissolution of a corporation or entity and its remaining assets liquidated accordingly, "when on the basis of the findings and recommendation of the management committee or rehabilitation receiver, or in its own findings, it determines that the continuance in business of such corporation or entity would not be feasible or profitable, nor work to the best interests of the stockholders, parties-litigants, creditors or the general public."

3. When Individual Petitioner is Joined in the Proceedings

When a petition for supervision of payments is filed with the SEC by a corporate entity and an individual stockholder who is the surety for the corporation's obligations, the SEC has jurisdiction in the proceedings as it pertains to the corporate petitioner under Section 5(d) of PD 902-A. However, the SEC has no jurisdiction over the individual petitioner,[79] and the individual petitioner cannot take advantage of the automatic stay provisions.[80]

The inclusion of an individual petitioner will not justify a dismissal of the entire proceedings, because the SEC can dismiss the petition insofar as it pertains to the individual petitioner under the rules pertaining to misjoinder of parties.[81] In such cases, the SEC can take custody and control of the assets of the corporation, the individual petitioner being merely a nominal party, his properties are not included in the rehabilitation receivership. Creditors are not prevented from filing suit against such individual petitioner even during the pendency of the rehabilitation receivership with the SEC.[82]

In all the rulings relating to the misjoinder of an individual petitioner in a petition for suspension of payments with rehabilitation proceedings with the SEC, the Supreme Court consistently pointed to the limited jurisdiction of the SEC under PD 902-A that does not warrant its expansion to include

79. Chung Ka Bio v. Intermediate Appellate Court, 163 SCRA 534 (1988).

80. *Id.*

81. Union Bank v. Court of Appeals, G.R. No. 131729, 19 May 1998.

82. Traders Royal Bank v. Court of Appeals, 177 SCRA 788 (1989); See also Modern Paper Products, Inc. v. Court of Appeals, G.R. No. 127166, 2 March 1998.

individual petitioners and their properties. "Administrative agencies like the Securities and Exchange Commission are tribunals of limited jurisdiction and, as such, can exercise only powers which are specifically granted to them by their enabling statutes."[83]

In determining the extent of powers of the SEC to adopt and enforce a rehabilitation plan, the point that should be stressed is that the SEC is an administration agency vested with exclusive and enumerative powers. There is no basis to expand such powers beyond the scope of which its jurisdiction can be invoked as to invade the private rights of parties, like creditors, who are not essentially within the jurisdiction of the SEC, nor are they within the definition of what the Supreme Court considers to be intra-corporate disputes under PD 902-A.

4. Powers of the Management Committee or the Rehabilitation Receiver to Undertake Rehabilitation Proceedings

The management committee or the rehabilitation receiver appointed by the SEC, has the following powers under Section 6(d) of the Decree:

(a) To take custody of, and control over, all the existing assets and property of such entities under management;

(b) To evaluate the existing assets and liabilities, earnings and operations of such corporations, partnership or other associations;

(c) To determine the best way to salvage and protect the interest of the investors and creditors;

(d) To study, review and evaluate the feasibility of continuing operations;

(e) To restructure and rehabilitate such entities if determined to be feasible by the SEC;

(f) To overrule or revoke the actions of the previous management and board of directors of the entities under the management notwithstanding any provisions of law, articles of incorporation or by-laws to the contrary; and

(g) To report and be responsible to the SEC until dissolved by order of the SEC.[84]

The enumerated powers of the management committee or rehabilitation receiver under Section 6(d) are at the heart of the controversy about the extent

83. Chung Ka Bio v. Intermediate Appellate Court, 163 SCRA 534, 545 (1988); also Union Bank v. Court of Appeals, G.R. No. 131729, 19 May 1998.

84. Section 6 (d) also provides that the management committee, or rehabilitation receiver, shall not be subject to any action, claim or demand for, in connection with, any act done or omitted to be done by it in good faith in exercise of its functions, or in connection with the power conferred.

of the powers of the SEC to adopt and enforce a rehabilitation plan that would bind all stakeholders in the petitioning corporation, because they are the only statutory provisions available for reference on corporate rehabilitation proceedings. Certain key issues on the matter are worth discussing.

Firstly, the section neither provides for rules or procedures by which a rehabilitation plan may be adopted and implemented, nor for the minimum contents and requisites thereof, or a basic timetable upon which certain actions must be taken or effected.

Indeed, the terms of Section 6(d) seem to imply that it is solely the discretion of SEC to determine whether rehabilitation is feasible, and if it so finds, it may authorize the management committee or rehabilitation receiver to "restructure and rehabilitate such entities." This goes against the very grain of the business judgment rule and deviates from the principle that the management of the petitioning corporation would be in the best position to determine if the corporation may be recognized and under what terms and conditions the rehabilitation shall be pursued to ensure the best means to achieve such end. It actually constitutes the SEC, as the government agency, through the management committee or rehabilitation receiver, to intrude into corporate business judgment, not only of the business affairs of the corporation on whether to proceed with operations or not, but also to determine and decide on the rights of creditors to enforce their claims against the corporation. Under PD 902-A therefore, SEC is asked not only to be an umpire, but actually the active agent to take over and run the business affairs of the corporation.

The SEC does not have the business background nor experience, much less the manpower and resources as a government agency, to be managing the basic business policies of a corporation. It may be true that it may recruit and appoint outside experts and managers into the management committee or rehabilitation receiver but it is rare that outsiders who are unfamiliar with the inner workings of the business of the corporation, would be in better position that current management to undertake the rehabilitation of the petitioning corporation.

In a true bankruptcy proceeding, the rehabilitation plan comes from the debtor-in-possession, i.e., the current management of the petitioning corporation because they are in a better position to properly evaluate whether the business enterprise still has a reasonable chance of succeeding in the future if it were granted breathing period. The SEC is not in the business of running businesses, and certainly any management committee or rehabilitation committee, who would fairly be new to the enterprise, would not even be qualified to begin to determine whether the business can still be made viable; and if they presume to have such competence, their lack of intimate knowledge into the business enterprise would certainly doom their plans.

Committees and trustees are the exception rather than the norm in rehabilitation proceedings precisely because they have no competence to run the day-to-day affairs of the corporation much less to put up a grand design for its future business survival.

The disdain which is shown against the incumbent management under PD 902-A is apparent in the sense that the management committee or rehabilitation receiver completely supplants the board of directors and management. Section 6(d) expressly provides that the management committee or rehabilitation receiver may overrule or revoke the actions of the previous management and board of directors of the entity under the management notwithstanding any provisions of law, articles of incorporation or by-laws to the contrary.

Secondly, the section does not provide for any voice on the part of the creditors of the petitioning corporation on the issue on whether rehabilitation should proceed, even in a situation when the corporation is definitely insolvent.

Instead, there are two broad tests provided for in Section 6(d) by which the SEC may proceed with the rehabilitation of the corporation, namely:

(a) Continuance in business would [be feasible or profitable]; "or"[85]

(b) "[w]ork to the best interest of the stockholders, parties litigants, creditors or the general public."

Which of the two (2) tests has primary application cannot be determined from the language of the section. Since the section does not provide any hierarchical application, then it may mean that the SEC may use any one or both of said factors in determining to move forward with rehabilitation which on its own or on the recommendation of its management committee or rehabilitation receiver, it can put together and implement.

The factors seem to include the situation where, in a rehabilitation proceeding the SEC is mandated in a rehabilitation proceeding to value and weigh various interests of different stakeholders whose interests may be at odds and even consider whether rehabilitation would work for the best interests of the "general public." In a true rehabilitation situation, the corporation is financially insolvent and therefore the priority claims of the creditors must be the primary concern; stockholders really have no proprietary interests to protect.

Consideration of public interests itself sets up a very dangerous criterion. Would public interests, such as the need to maintain jobs in a period of

85. The original text uses the word "nor" because the statement in Section 6 (d) against rehabilitation is in the negative; which would translate to the word "or" when the statement is placed in the positive.

economic crises and which may eventually eat-up the remaining assets of the corporation, be of important consideration against the right of the creditors to collect on the remaining assets, as would force the SEC to have to proceed with rehabilitation? The parameters are so broad as to lead to abuse, and there is great temptation to encourage graft.

E. Procedure for Rehabilitation Proceedings to Commence

The Memorandum issued by the SEC on 7 October 1997 governing suspensions of payments proceedings provided for the following supporting documents to be attached to the petition for the suspension of payments with the appointment of a management committee or rehabilitation receiver, namely:

(a) Audited financial statements of the petitioner at the end of its last fiscal year;

(b) Interim financial statements as of the end of the month prior to the filing of the petition;

(c) List of petitioner's creditors indicating the name and address of each creditor; the amount of the claim including the principal and interests due as of the date of the filing; nature of the claim if admitted, contingent, liquidated or disputed;

(d) List of petitioner's assets stating the specific nature, book value, market value, location of property, copies of titles to real property, and copies of the certificates of ownership of personal properties; and

(e) Certification of the BIR as to the petitioner's tax liability, which may submitted after the issuance of the initial order but prior to the resolution of the petition; or this requirement may be so stated in the petition itself which is verified.

The foregoing items would mainly show the financial condition of the company, solvency, and the existing liabilities, which are important in proceedings for liquidation of the company. Even when the petition seeks the appointment of a rehabilitation receiver, no plan for rehabilitation is sought to be attached thereto coming from the board and/or management of the petitioning corporation, nor any requirement as to the period when a proposed plan has to be submitted with the SEC.

Insofar as creditor participation is concerned, the SEC Memorandum only provides that the creditors shall be required to comment to the petition within twenty days from receipt of the copy thereof, but does not provide for any personality to comment or object upon the terms of the rehabilitation plan submitted for approval of the SEC.

The SEC Memorandum only provides that the non-production of the BIR certification shall be a ground for the dismissal of the petition; any misrepresentation in the petition committed by the petitioner and

determined as such by the hearing panel , during the pendency of the case shall be automatically a ground for the dismissal of the petition.

F. The Automatic Stay under PD 902-A

Section 6(c) of the Decree specifically provides that upon appointment of a management committee or the rehabilitation receiver, "all actions for claims against corporations, partnerships, or associations under management or receivership pending before any court, tribunal, board or body shall be suspended accordingly, "which is the equivalent of the "automatic stay" in American bankruptcy proceedings.[86]

No limitation is placed on the duration of the suspension, and therefore it is deemed to apply during the entire period that the corporate debtor is under the auspices of the management committee or the rehabilitation receiver.[87]

Although *Rizal Commercial Banking Corp. v. Intermediate Appellate Court*[88] held that the suspensive effect, such as the prohibition against foreclosure,

> Attaches as soon as a petition for rehabilitation is filed. Were it otherwise, what is to prevent the petitioner from delaying the creation of the Management Committee and in the meantime dissipate all its assets. The sooner the SEC takes over and imposes a freeze on all the assets, the better for all concerned.

Subsequently, *Barotac Sugar Mills, Inc. v. Court of Appeals*[89] held that the appointment of a management committee or rehabilitation receiver may only take place after the filing with the SEC of an appropriate petition for suspension of payments and therefore "the conclusion is inevitable that pursuant to Section 6(c), taken together with Sections 5(c) and (d), a court action is *ipso jure* suspended only upon the appointment of a management committee or a rehabilitation receiver."

G. Issues on the Coverage and Purpose of the Automatic Stay

86. Under the SEC Memorandum, in the case of a petition for suspension of payments with the appointment of a management committee or rehabilitation receiver where the petitioning corporation "has no sufficient assets to cover its liabilities," the hearing panel may *motu proprio* appoint an interim receiver, if warranted, for a period of thirty (30) days in which event a provisional suspension order for thirty (30) days from issuance thereof against all actions for claims against the corporation, partnership, or association shall ensure as a matter of course.

87. *See* BF Homes, Inc. v. Court of Appeals, 190 SCRA 262, 268 (1990).

88. 213 SCRA 830 (1992).

89. 275 SCRA 497 (1997).

Unlike The Insolvency Law which exempts secured creditors from the suspensive effect of the order issued by the court in an ordinary suspension of payments proceedings, the provisions of PD 902-A do not contain an exemption for secured creditors from the suspensive effects arising from the appointment of a management committee or a rehabilitation receiver by the SEC.. This all-encompassing coverage of the automatic stay under PD 902-A as it pertains to rehabilitation proceedings is consistent with American reorganization proceedings and is necessary in order to allow the petitioning corporation the breathing period to come-up with a rehabilitation plan. The downside is that PD 902-A, unlike the Bankruptcy Code, does not provide for specific time frames for the submission of a rehabilitation plan.

Earlier, relying on jurisprudential rule laid down prior to the enactment of PD 902-A, the Supreme Court held in *Philippine Commercial Bank v. Court of Appeals*[90] that the SEC's order for suspension of payments of a corporation, as well as for all actions of claims against the corporation, could only be applied to claims of unsecured creditors and "[s]uch orders can not extend to creditors holding a mortgage, pledge or any lien on the property unless they give up the property, security or lien in favor of all the creditors." The Court was forthright in admitting that it relied upon rulings that dealt with insolvency, thus: "It is true that the aforequoted ruling deals with insolvency but by analogy the same could be adopted in this case considering that the rights of a preferred creditor remain to be respected and recognized in every existing situation. To hold otherwise would render the said rights inutile and illusory. Besides, We find no substantial difference between the suspension of actions in the instant case and that under the Insolvency Law. Consequently, the herein order of suspension, could not have a different interpretation as regards secured credits than that already given by this Court."[91]

The *PCIB* ruling has since been abrogated in several subsequent decisions of the Supreme Court.[92]

Although jurisdiction was the more proper and critical issue, *PCIB* only resolved whether the suspensive effect would cover secured creditors. The facts in *PCIB* show that the ruling would still be correct even to date. There was no management committee or rehabilitation receiver appointed in *PCIB*; the SEC placed Philfinance under a suspension of payments "upon

90. 172 SCRA 436 (1989).

91. *Id.* at 441 (emphasis supplied).

92. Alemar's Sibal & Sons v. Elbinias, 186 SCRA 94 (1990);BF Homes, Inc.v.Court of Appeals,190 SCRA 262 (1990); Araneta v. Court of Appeals, 211 SCRA 390 (1992); Rizal Commercial Banking Corp. v. Intermediate Appellate Court, 213 SCRA 830 (1992); and State Investment House, Inc. v. Court of Appeals, G.R. No.123240, 1996.

directive of the President of the Philippines to conserve the assets of the Coporation and obtain an equitable payment to all its creditors."[93] And what was constituted was a "Receivership Committee" which later on ordered the dissolution and liquidation of Philfinance anyway.

The proceedings in *PCIB* were therefore essentially not suspension of payments proceedings, because the corporation was insolvent, but a liquidation process pending with SEC where the provisions of The Insolvency Law would apply and the automatic stay would only apply to unsecured creditors.

In any event, *Alemar's Sibal & Sons, Inc. v. Elbinias*[94] subsequently held that the suspensive effect of the appointment of the rehabilitation receiver covered all claims, whether secured or unsecured. Unfortunately , *Alemar's* promulgated a general ruling applicable to rehabilitation proceedings under PD 902-A which miserably failed to appreciate the proper legal effects of the automatic stay in rehabilitation proceedings when it held:

> During rehabilitation receivership, the assets are held in trust for the equal benefit of all creditors to preclude one from obtaining an advantage or preference over another by the expediency of an attachment, execution or otherwise. For what would prevent an alert creditor, upon learning of the receivership, from rushing posthaste to the courts to secure judgments for the satisfaction of its claims to the prejudice of the less alert creditors.

As between creditors, the key phrase is "equality is equity". When a corporation threatened by bankruptcy is taken over by a receiver, all the creditors should stand on an equal footing. Not anyone of them should be given preference by paying one or some of them ahead of the others. This is precisely the reason for the suspension of all pending claims against the corporation under receivership. Instead of creditors vexing the courts with suits against the distressed firm, they are directed to file their claims with the receiver who is duly appointed officer of the SEC."[95]

Alemar's involved an unsecured creditor who obtained a judgment in an action for collection of a sum of money. The pronouncements therefore did not contravene the ruling in PCIB as the latter referred to the preferred rights of secured creditors. In fact, the decision in Alemar's made no reference at all to PCIB.

But *Alemar's* pronouncement in general terms as to the legal effect of the pendency of a rehabilitation receivership of "equality" among creditors, set the tone for the expansion of the doctrine to apply to all creditors, both secured and unsecured, of an insolvent corporation. This was an unfortunate development because the theory of "equality" among creditors is based on

93. Philippine Commercial Bank v. Court of Appeals, 172 SCRA 436, 438 (1989).

94. 186 SCRA 94 (1990).

95. *Id.* at 99-100 (emphasis supplied).

insolvency jurisprudence intended to cover unsecured creditors, since secured creditors have priority interests which cannot not be adversely affected by insolvency proceedings, upon which The Insolvency Law grants them the option not to participate in.

Alemar's pronouncement that the automatic stay in rehabilitation proceedings applies to claims against the insolvent corporation whether secured or unsecured, is correct and consistent with general principles on corporate reorganization, but the legal effect of the automatic stay is not to make all creditors equal and have the same preference to the assets of the petitioning corporation.

For the corporation, the automatic stay must necessarily cover all creditors, whether secured or unsecured, to give the corporation the breathing period upon which to be able to sort out its financial condition and come up with a rehabilitation plan for its future operations. Among creditors, the automatic stay covers all creditors to allow the petitioning corporation the breathing spell to come up with the rehabilitation plan; it preserves the status quo among the creditors including the priority interests existing between and among them, and it provides for equality among the unsecured creditors of the petitioning corporation. The better rationale on why the automatic stay in rehabilitation proceedings should include both secured and unsecured can be found in *BF Homes, Inc. v. Court of Appeals*[96] where the Supreme Court ruled that the reason for suspending actions for claims against a corporation is to enable the management committee or rehabilitation receiver to effectively exercise its powers free from any judicial or extra-judicial interference that might unduly hinder the "rescue" of the debtor company. Thus:

> To allow such other action to continue would only add to the burden of the management committee or rehabilitation receiver, whose time, effort and resources would be wasted in defending claims against the corporation instead of being directed towards its restructuring and rehabilitation.[97]

What is interesting in *BF Homes* was the portion of the decision that found that:

> As the revised rehabilitation plan approved by the SEC is expected to be implemented within ten years, the proceedings in the [RTC] should be suspended during that period ... This is without prejudice to the authority of the SEC to extend the period when warranted and even to order the liquidation of BF if the plan is found to be no longer feasible. On the other hand, on a more positive note, the SEC can also find within that period that BF has been sufficiently revived and able to resume its normal business operations without further need of rehabilitation.[98]

96. 190 SCRA 262 (1990).

97. *Id.* at 269.

Are we to take from *BF Homes* that creditors are at the mercy of the SEC in the approval and implementation of a rehabilitation plan especially since nothing in the decision mentioned creditors' approval of the rehabilitation plan approved by the SEC? The Court also found nothing wrong with a rehabilitation plan that involved a period of ten years and even held that the SEC would have full authority to extend the period further.

What is more disturbing is the pronouncement in BF Homes that even when the rehabilitation plan has been approved and is in the process of implementation, the SEC on its own imprimatur may just abandon or "lift" the rehabilitation plan to allow the corporation "to resume its normal business operations."

Does this mean rehabilitation plans are mere palliatives and are are neither definitive and binding nor an effective discharge once approved? Do we take that rehabilitation plans are just a more sophisticated version of the automatic stay, with no other intention than to give the debtor every opportunity to make a success of his business at the expense of the creditors?

Subsequent decisions of the Supreme Court have not shed any light at all on these issues.

Bank of P.I. v. Court of Appeals[99] ruled that even foreclosure of mortgage shall be disallowed so as not to prejudice other creditors or cause discrimination among them; if foreclosure is undertaken despite the filing of a petition for rehabilitation, the certificate of sale shall not be delivered pending rehabilitation; or if that has already been done, no transfer certificate of title shall likewise be effected within the period of rehabilitation. The Court held that the rationale behind PD 902-A is to effect a feasible and viable rehabilitation, which cannot be achieved if one creditor is preferred over the others.

Finasia Investments v. Court of Appeals[100] ruled that the "claims" covered by the automatic stay under Section 6(c) of the PD 902-A refer to "debts or demands of a pecuniary nature ... the assertion of a right to have money paid." Therefore, in spite of the appointment of a rehabilitation receiver, an action against a corporation seeking the nullification of the corporate documents cannot be suspended by reason thereof, since the civil action does not present a monetary claim against the corporation.

98. *Id.* at 270 (emphasis supplied).

99. 229 SCRA 223 (1994).

100. 237 SCRA 446 (1994)

Lately, *Ruby Industrial Corp. v. Court of Appeals*[101] reiterated the broad "equality among all creditors " ruling of *Alemar's* when it held that a member of the management committee, even when its uses its own resources, has no power to pay for existing obligations of the corporation under rehabilitation and assume them by way of assignment, thus:

> When a distressed company is placed under rehabilitation, the appointment of a management committee follows to avoid collusion between the previous management and creditors it might favor, to the prejudice of the other creditors. All assets of a corporation under rehabilitation receivership are held in trust for the equal benefit of all creditors to preclude one from obtaining an advantage or preference over another by the expediency of attachment, execution or otherwise. As between the creditors, the key phrase is "equality in equity". Once the corporation is threatened by bankruptcy is taken over by a receiver, all the creditors ought to stand on equal footing. Not any one of them should be paid ahead of the others. This is precisely the reason for suspending all pending claims against the corporation under receivership.

Although the main ruling in *Philippine Commercial International Bank v. Court of Appeals*[102] (that suspension of actions provided for under PD 902-A covers only unsecured creditors) has been abrogated by the Supreme Court, nevertheless, *PCIB* is still relevant when it held that:

> We take judicial notice of the fact that the SEC order for the dissolution and liquidation of [petitioning corporation] has already been upheld by this Court... In view of this development, it appears that the Rehabilitation Receiver has no more right to enjoin the auction sale since its prayer for injunctive relief was based on the order for suspension of payments.

Such pronouncement means that when the proceedings with the SEC have reached the point that rehabilitation is proven to be no longer feasible, then the automatic stay would be lifted and basically the secured creditors would be at liberty to foreclose on the securities constituted in their favor. The ruling belies the proposition that a rehabilitation process and the rehabilitation plan pursued can ignore or set-aside the priority rights of secured creditor since if rehabilitation does not prosper, there is a recognition of the constituted existence of such priority lien and the freedom to pursue them when stay is lifted.

G. Summation of Lessons Learned from Jurisprudential Rulings

The only clear conclusions that can be drawn from the various Supreme Court rulings interpreting the automatic stay provisions of PD 902-A in cases of rehabilitation proceedings are as follows:

101. G.R. No. 124185-87, 20 January 1998 at 20.

102. 172 SCRA 436 (1989).

(a) The automatic stay applies to all creditors of the corporation, whether secured and unsecured, and only to monetary claims interposed against the corporation;

(b) There is no period of effectivity for the automatic stay and continues during the entirety of the rehabilitation proceedings and the implementation thereof, and can even be extended by the SEC when required to pursue the rehabilitation of the petitioning company;

(c) When rehabilitation is shown not to be viable and is abandoned, the automatic stay is lifted and the secured creditors can go back to pursue the securities constituted in their favor and/or the SEC itself can decree the dissolution and liquidation of the company.

What may be clearly implied the rulings of the Supreme Court is that the whole issue of "equality" among creditors, both secured and unsecured, during the process of rehabilitation, should pertain only to the non-availment of actions on claims against the petitioning creditor during the period that rehabilitation is being pursued. But it cannot mean an actual treatment of the claims as "equal" to forgo the existence of contractual security rights in favor of secured creditors. A rehabilitation plan that "impairs" or destroys such security rights cannot be affirmed without the consent of the individual secured creditors; otherwise it would be a constitutional violation of due process and non-impairment clause.

If the rehabilitation plan pursued actually impairs or destroys such contractual rights, as for example the mortgaged properties are disposed of pursuant to the rehabilitation plan with proceeds being made available to the operations, secured creditors would be left holding the bag when it is apparent that rehabilitation is not feasible.

IV. Comparative Analyses with The Insolvency Law

1. *Structure of the Insolvency Law*

The Insolvency Law of the Philippines provides for two special proceedings governing financially distressed debtors: (a) suspension of payments[103] and (b) formal insolvency proceedings.[104]

103. The Insolvency Law, §§ 2 to 13. The provisions on suspension of payments were taken from the provisions of the Code of Commerce, and therefore Spanish in origin. Mitsui Bussan Kaisha v. Hongkong and Shanghai Bank, 36 Phil. 27 (1917).

104. *Id.* §§ 14 to 82. The provisions of The Insolvency Law covering voluntary and insolvency have been copied from the Insolvency Act of California, though the law contains also few provisions from the American Bankruptcy Law of 1898. Sun Life Assurance Co. of Canada v. Ingersoll and Tan Sit, 42 Phil. 331 (1921).

Proceedings for suspension of payments seek the postponement of the payments of the debts of a debtor who possesses sufficient property to cover his debts, but foresees the impossibility of meeting them when they respectively fall due.[105]

Insolvency proceedings work under the premise that the debtor has neither cash nor property of sufficient value with which to pay all his debts. There are two types of proceedings covered by the Law: (a) voluntary insolvency, where the debtor files the petition for insolvency, and (b) involuntary, where it is the creditors who seek for the declaration of the doctor's insolvency.

2. Summation of the Applicable Laws and Jurisdictional Issues Involving Corporate Suspensions of Payments/Rehabilitation/Insolvency Proceedings

In *Ching v. Land Bank of the Philippines*,[106] the Supreme Court summarized the jurisdictional rules governing financially distressed corporations, as follows:

> (a) Where the petition filed is one for declaration of a state of suspension of payments due to a recognition of the inability to pay one's debts and liabilities, and where the petitioning corporation either:
>
> (i) Has sufficient property to cover all its debts but foresees the impossibility of meeting them when they fall due (solvent but illiquid); or
>
> (ii) Has no sufficient property (i.e., is insolvent) but is under the management of a management committee or a rehabilitation receiver;

The applicable law is PD 902-A pursuant to Section 5 of par. (d) thereof, and the SEC has original and exclusive jurisdiction:

> (b) Where the petitioning corporation has no sufficient assets to cover its liabilities and is not under management committee or a rehabilitation receiver created under PD 902-A and does not seek merely to have the payments of its debts suspended, but seeks a declaration of insolvency, the applicable law is The Insolvency Law on voluntary insolvency and proper jurisdiction will be with the regular courts.

Ching also held that the SEC may still entertain a petition for declaration of insolvency of a private corporation "only as an incident of and in continuation of its already acquired jurisdiction over petitions to be declared in the state of suspension of payments in the two (2) cases provided in Section 5 (d) of PD 902-A, as amended."[107]

105. *Id.* § 2.

106. 201 SCRA 190 (1990).

107. *Id.* at 202.

This ruling in *Ching* is significant because it demonstrates clearly that even when PD 902-A grants a jurisdictional power to the SEC, albeit incidental in the case of corporate insolvency proceedings, the substantive law existing and not abrogated by the Decree, would still apply and be binding on the SEC. In spite of PD 902-A, the SEC does not operate exclusive of the Insolvency Law. The law therefore looms strongly over the powers of the SEC in bankruptcy proceedings, and the policies and public and private interests sought to be protected under the Insolvency Law bind the SEC.

3. Effects of Filing of Petition When Involving Indidvidual Debtors

The Insolvency Law, when it comes to suspension of payments proceedings, primarily now that it covers only individual debtors, provides specifically for the following effects upon the filing of a petition for suspension of payments:

> (a) All pending executions of the debtors property are suspended, except executions against properties specially mortgaged;[108]
>
> (b) No ordinary creditor may file an action in court against the debtor;[109]
>
> (c) The debtor may not dispose of his property, except in the ordinary course of the business in which he is engaged; and
>
> (d) The debtor cannot make any payments outside of the necessary or legitimate expenses of his business.[110]

The foregoing effects are also consistent with suspension of payments proceedings with the SEC involving a juridical entity, except that in the SEC proceedings the automatic stay affects all the creditors of the petitioning company, whether secured and unsecured.

Also, the automatic stay order under the Law lapses when three (3) months shall have passed without the proprosed agreement being accepted

108. The Insolvency Law, § 8.

109. *Id.* § 9, "Persons having claims for personal labor, maintenance, expenses of last illness and funeral of the wife or children of the debtor, incurred in the sixty days immediately preceding the filing of the petition, and persons having legal or contractual mortgages, may refrain from attending the meeting and from voting therein. Such persons shall not be bound by any agreement determined upon at such meeting but if they should join in the voting they shall be bound in the same manner as are the other creditors".should join in the voting they shall be bound in the same manner as are the other creditors."

110. *Id.* § 3.

by the creditors or as soon as it is denied,[111] whereas in a SEC proceeding the automatic stay remains indefinite until the suspension of payments proceedings are concluded.

The law also requires the attachment to the petition of the "proposed agreement he requests of his creditors,"[112] which is not even required under the SEC Memorandum covering simple suspension of payments proceedings.

4. Effects of Decision of Creditors in Suspension of Payments Proceedings

The following rules apply specifically under The Insolvency Law for suspension of payments proceedings as it pertains to the affected creditors:

(a) At the meeting of the creditors, the presence of creditors representing at least three-fifths (3/5) of the liabilities shall be necessary for holding a meeting.[113]

The debtor may modify his proposed plan of payment in view of the results of the debate during the creditors' meeting.[114]

(b) The majority vote required to make a plan of payment binding shall be:

(i) Two-thirds (2/3) of the creditors voting to unite upon the same proposition; and

(ii) The claims represented by said majority vote amount to at least three-fifths (3/5) of the total liabilities of the debtor mentioned in the petition.[115]

(c) The proposed plan of payment shall be deemed rejected if the number of creditors required for holding a meeting does not attend thereat, or the two majorities rules are not in favor thereof, even if the negative vote itself does not receive such majorities.[116]

(d) If the decision of the meeting be negative of if no decision is had in default of such number or of such majorities, the proceeding shall be terminated without recourse and the parties concerned shall be at liberty to enforce the rights which may correspond to them.[117]

111. *Id.* § 6.
112. *Id.* § 2.
113. *Id.* § 8.
114. *Id.* § 8 (c).
115. *Id.* § 8 (e).
116. *Id.* § 10.
117. *Id.* § 11.

(e) If the decision is favorable to the debtor it may be objected to within ten days following the date of the meeting by any creditor who attended the meeting and who dissented from and protested against the vote of the majority.[118]

(f) The opposition or objection to the decision of the majority favorable to the debtor shall be proceeded with as in any other incidental motion, the debtor and he creditors who shall appear declaring their purpose to sustain the decision of the meeting being the defendants.[119]

(g) A creditor may object to the decision reached at the meeting of creditors, on these grounds:[120]

(i) Defects in the call for the meeting, in the holding thereof, and in the deliberations had thereat, which prejudiced the rights of the creditors;

(ii) Fraudulent connivance between one or more creditors and he debtor to vote in favor of the proposed agreement; or

(iii) Fraudulent connivance of claims for the purpose of obtaining a majority.

The court shall hear and pass upon such objection which shall be final, it shall declare whether or not the decision of the meeting is valid.[121]

(a) In case that [the] decision of the meeting is held to be null, the court shall declare the proceeding terminated and the parties concerned at liberty to exercise the rights which may correspond to them. In case the decision of the meeting is declared valid, or when no opposition or objection to said decision has been presented, the court shall order the agreement be carried out and the persons concerned shall be bound by the decision of the meeting.[122]

(b) The court may also issue all orders which may be proper to enforce the agreement on motion of any of the parties litigant[s].[123]

(c) The order directing the agreement to be made affective shall be binding upon all creditors included in the schedule of the debtor who may have been properly summoned, but not upon creditors exempted from the automatic stay, and their rights shall not effected by the agreement unless they may have expressly or impliedly consented thereto.[124]

118. *Id.*
119. *Id.*
120. *Id.* § 12.
121. *Id.*
122. *Id.*
123. *Id.*
124. *Id.*

(d) If the debtor fails wholly or in part to perform the agreement decided upon at the meeting of the creditors, all the rights which the creditors had against the debtor before the agreement shall revest in them.[125]

5. Purpose and Relevance of Insolvency Proceedings to SEC Rehabilitation Proceedings

Ching v. Land Bank of the Philippines[126] has already clarified that the Insolvency Law applies to corporations and other juridical entities when the proceedings are solely for the liquidation of the entity and not for the purpose of rehabilitation, whether the proceeding is within the jurisdiction of regular courts, or as an incident to or in continuation of the exercise by the SEC of its original and exclusive jurisdiction under PD 902-A. This is an important consideration in determining the reach and bounds of SEC's own powers in rehabilitation proceedings under PD 902-A.

The purpose of an insolvency proceeding is to achieve an equitable distribution of the properties of the debtor among the creditors, and unlike in the case of an individual debtor, insolvency proceedings are not intended to afford the corporation a fresh financial life because the Law does not allow discharge to be granted to any corporation.[127] For all intents and purposes, the corporation ceases to be viewed as a going concern, and the corporate assets and properties are treated only insofar as they shall satisfy the debts and obligations of the corporation.

6. Procedural Rules for Insolvency Proceedings

Voluntary insolvency proceedings for a corporation commences upon the petition of any officers of the corporation, duly authorized by the board of directors in a meeting duly called for the purpose, or upon the written assent of majority of the board; however, in case the articles or by-laws of the corporation provide for a method for such proceedings, such method shall be followed.[128]

The following general procedure is followed in voluntary insolvency proceedings:

(a) Filing of petition by [the] debtor,[129]

(b) Order of court, among other things, declaring the petitioner insolvent (also known as the "order of adjudication");[130]

125. *Id.* § 13.

126. 201 SCRA 190 (1991).

127. The Insolvency Law, § 52.

128. *Id.*

129. *Id.* § 14.

(c) Meeting of creditors for election of an assignee in insolvency;[131]

(d) Conveyance of [the] debtor's property to assignee in insolvency;[132]

(e) Liquidation of assets and payment of debts;[133]

(f) Composition, if agreed upon;[134]

(g) Discharge of the debtor, except in case of a composition;[135]

(h) Objection to discharge of [the] debtor, if any;[136]

(i) Appeal in certain cases.[137]

Involuntary insolvency proceedings for individual debtor is instituted by three (3) or more resident creditors whose credits aggregating not less than ₱1,000.00 accrued in the Philippines against a debtor who has committed any of the acts of insolvency.[138] The petitioners must allege at least one act of insolvency, which in the case of a corporate debtor, would include the following:[139]

(a) The debtor remains absent in fraud of creditors, or conceals itself to avoid legal processes.

(b) The debtor is concealing property to avoid attachment; or has suffered judgment to be attached three (3) days; or has confessed judgment; or has suffered judgment to be attached to give preference to certain creditors.

(c) The debtor transferred property to creditors to defraud others; has made transfers to hinder or delay creditors; or has made transfers in contemplation of insolvency.

(d) If the corporate debtor can be considered a merchant, it has defaulted payments for thirty (30) days; has failed to deliver money received as fiduciary within thirty (30) days; or there is execution issued and returned unsatisfied.

130. *Id.* § 18.

131. *Id.* § 30.

132. *Id.* § 32.

133. *Id.* § 33.

134. *Id.* § 63.

135. *Id.* § 64.

136. *Id.* § 66.

137. *Id.* § 82.

138. *Id.* § 20.

139. *Id.* § 20.

The corporate debtor is ordered to show cause why it should not be declared insolvent.[140] After being summoned, it may file an answer or a motion to dismiss.[141] When the hearing on the petition proves that the debtor has committed an act of insolvency,[142] an order of adjudication shall be issued by the court declaring debtor insolvent. The subsequent proceedings would then be similar to those in voluntary insolvency proceedings.

7. The Scheme of "Composition"[143]

Composition is a proceeding available in both voluntary and involuntary insolvency proceedings. It is voluntary on the part of the debtor and his creditors, when a debtor offers to pay his creditors a certain percentage of their claims in consideration of his release from liability. The requisites of a valid composition are as follows:

(a) The offer must be made after the filing of the schedule of the debtor's property and the list of his creditors;

(b) The offer must be accepted in writing by a majority of the creditors representing a majority of the claims which have been allowed;

(c) The offer must be made only after the insolvent deposits the consideration to be paid to the creditors; and

(d) The offer accepted by the creditors must be confirmed by the Court.[144]

Composition amounts to an amicable settlement between the debtor and his creditors and needs concurrence of majority of creditors, representing majority of the claims.

The legal effects of composition are "to supersede the bankruptcy proceedings, and to reinvest the bankrupt with all his property, free from the claims of creditors ... [and] has the same effect of a written discharge, although no written discharge is granted."[145]

Composition, as a means to pay-off obligations and to discharge the debtor, is similar in principle to "payment in cession" governed under Article 1255 of the Civil Code which provides:

140. *Id.* § 21.

141. *Id.* § 23.

142. *Id.* § 24.

143. *Id.* § 63.

144. *Id.* § 53.

145. TOLENTINO, COMMERCIAL LAWS OF THE PHILIPPINES, 600-601, citing Cumberland Glass Mfg. Co. v. DeWitt, 237 U.S. 447.

> Art. 1225. The debtor may cede or assign his property to his creditors in payment of his debts. This cession, unless there is stipulation to the contrary, shall only release the debtor from responsibility for the net proceeds of the thing assigned. The agreements which, on the effect of the cession, are made between the debtor and his creditors shall be governed by special laws.
>
> Cession in payment is an initiative of the debtor but requires the consent of all creditors because a voluntary assignment cannot be imposed upon a creditor who is not willing to accept it.[146]

The requirement for composition to be effected under the Insolvency Law, as well as the terms of cession in payment governed by the Civil Code, specially on the need for the qualified approval by majority vote of the creditors, should present instructive substantive law provisions to both the SEC and to creditors of petitioning corporations, of the consistent respect always accorded by various pieces of legislation of obtaining the consent of the creditors as a necessary legal and equitable ingredient that would allow any benefit to the debtor that would undermine or even abrogate the contractual rights of creditors on their claims against the debtor.

8. Salient Points from the Comparative Analyses with The Insolvency Law

a. Binding Effects of The Insolvency Law on the SEC

Our review of the provisions of the Insolvency Law shows that the Law provides clear rules and procedural requirements which ought to be binding on the SEC even under the terms of PD 902-A. Since PD 902-A primarily seeks to provide for the organizational structure, jurisdiction and powers of the SEC and is not primarily intended to provide substantive law provisions in areas governed by existing substantive laws, the relevant provisions of substantive laws, such as the Insolvency Law, are applicable and binding upon the SEC, subject to the revisions, amendments or special rules provided for in the PD 902-A itself.

To the extent not otherwise amended under the terms of PD 902-A, the terms and provisions of The Insolvency Law are binding on the SEC in simple suspension of payments and insolvency proceedings. This principle was recognized in *Ching v. Land Bank of the Philippines*,[147] when it held: "The SEC, like any other administrative body, is a tribunal of limited jurisdiction and as such, could wield only such powers as are specifically granted to it by its enabling statute. Its jurisdiction should be interpreted in *strictissimi juris*."[148]

146. TOLENTINO, CIVIL CODE OF THE PHILIPPINES, 303 (1973).

147. 201 SCRA 190 (1991).

148. *Id.* at 198.

More importantly, in resolving the issue on whether Section 6 of PD 902-A is deemed to have repealed the provisions of the Insolvency Law, Ching held:

> A well-recognized rule in statutory construction is that repeals by implication are not favored and will not be so declared unless it be manifest that the legislature so intended. When statutes are in *pari materia* they should be construed together. In construing them the old statutes relating to the same subject matter should be compared with the new provisions and if possible by reasonable construction, both should be construed that effect may be given to every provision of each.[149]

The implication and conclusion are clear, that since PD 902-A has not expressly repealed the provisions of the Insolvency Law as they apply to corporations and other juridical entities, they must be construed as still binding on the SEC on suspension of payments and insolvency proceedings validly filed, insofar as they have not been amended or supplanted by specific provisions of PD 902-A. If this be the proper conclusion to draw on the binding effects of the Insolvency Law on the SEC, then the policies, thrusts and substantive requirements should also be binding upon the SEC as guiding principles when it pursues rehabilitation proceedings on corporations and other juridical entities.

b. Difference in Treatment of Secured and Unsecured Creditors

There is a clear consistent principle running through the provisions of the Insolvency Law that differentiates the treatment of secured creditors and unsecured creditors, namely: secured creditors are always afforded respect to their individual rights, whereas, unsecured creditors are treated as a group and then the will of the majority binds the group.

Whether it is in the suspension of payments proceedings or in insolvency proceedings, secured creditors are never bound by any of such proceedings unless they so choose and always are respected in their rights to proceed and obtain remedies on the basis of their secured claims. This principle is borne by their security rights being rights in rem from the time of constitution, binding on the world.

On the other hand, suspension of payments proceedings and insolvency proceedings are mainly carried out for the benefit of, or mainly to cover, unsecured creditors. The binding effects of the proceedings taken are based on the approval of the unsecured creditors taken as a group, based on the qualified majority vote defined by law. In other words, unsecured creditors are not looked upon individually to determine their treatment and to them the principle of "equality" does apply and they speak and are bound by the will of the qualified majority.

149. *Id.* at 202.

This treatment of unsecured creditors is based on the principle that the real "security" of unsecured creditors, or more properly speaking, the basis upon which they extended credits to debtors was primarily because they looked upon the continued operations of the business enterprise as an assurance that they would be paid the credits they extended. If that be the underlying principle, and the business has ceased to be a going concern by virtue of the insolvency of the debtor, then as the equity holders were bound by the majority rule in their group, so too should the unsecured creditors' group be bound by the rule of their qualified majority with respect to matters pertaining to the remnants of the business concern.

The importance of such considerations is that in rehabilitation proceedings, neither the petitioning corporation nor the SEC may choose to deal with secured creditors on a collective basis, and the rehabilitation plan must continue to respect their individual security interests upon the corporate assets and properties on which it has been fastened; and with respect to the unsecured creditors, any rehabilitation plan must obtain the conformity of such group through their majority voice or vote.

V. COMPARATIVE ANALYSES WITH THE CENTRAL BANK ACT

1. Enabling Law on the Power of Central Bank

A comparison with the much earlier provisions of the Central Bank Act[150] on the power of the Central Bank of the Philippines (now the Bangko Sentral ng Pilipinas) to provide for the dissolution and liquidation of banking institutions shows that the wordings for suspension of payments with rehabilitation proceedings under PD 1758 were actually copied or based on the language of then Section 29 of the Central Bank Act.[151]

150. Republic Act No. 265, which has been repealed by the New Central Bank Act, Republic Act No. 7653 (1993), which constituted the Bangko Sentral ng Pilipinas.

151. SEC.29 Proceedings upon insolvency. — Whenever, upon examination by the Superintendent or his examiners or agents into the condition of any banking institution, it shall be disclosed that the condition of the same is one of insolvency, or that its continuance in business would involve probable loss to its depositors or creditors, it shall be the duty of the Superintendent forthwith, in writing, to inform the Monetary Board of the facts, and the Board, upon finding the statements of the Superintendent to be true, shall forthwith forbid the institution to do business in the Philippines and shall take charge of its assets and proceeds according to law.

The Monetary Board shall thereupon determine within thirty days whether the institution may be reorganized or otherwise placed in such a condition so that it may be permitted to resume business with safely to its creditors and shall prescribe the conditions under which such resumption of business shall take

The Central Bank Act provisions for receivership and conservatorship of banking and quasi-banking institutions show that the power of the Central Bank was designated by specified periods upon which review and evaluation could be made on whether to reorganize or liquidate a bank, and even granted the bank the right to file an action with the regular courts to contest its placement under receivership by the Central Bank. More significantly, when discontinuance in business of a bank is necessitated in order to protect public interests, the Central Bank Act specifically provided that the Monetary Board may order the dissolution of the bank through proper court proceedings and for the payment of its debts "in accordance with their legal priority."

2. The Current Provisions of the New Central Bank Act

Under the New Central Bank Act,[152] it is now provided that whenever the Monetary Board finds that the a bank or a quasi-bank is in a state of continuing inability or unwillingness to maintain a condition of liquidity deemed adequate to protect the interest of depositors and creditors, the Monetary Board may appoint a conservator to take charge, for a period not exceeding one (1) year, of the assets, liabilities, and the management thereof, reorganized, the management, collect all monies and debts due said institution, and exercise all powers necessary to restore its viability, with

place. In such case the expenses and fees in the administration of the institution shall be determined by the Board and shall be paid to the Central Bank out of the assets of such banking institution.

At any time within ten days after the Monetary Board has taken charge of the assets of any banking institution, such institution may apply to the Court of First Instance for an order requiring the Monetary Board to show cause why it should not be enjoined from continuing such charge of its assets, and the court may direct the Board to refrain from further proceedings and to surrender charge of its assets.

If the Monetary Board shall determine that the banking institution cannot resume business with safety to its creditors, it shall, by the Solicitor General, file a petition in the Court of First Instance reciting the proceedings which have been taken and praying the assistance and supervision of the court in the liquidation of the affairs of the same. The Superintendent shall thereafter, upon order of the Monetary Board and under the supervision of the court and with all convenient speed, convert the assets of the banking institution to money.

SEC. 30. Distribution of Assets.- In case of liquidation of a banking institution, after payment of the costs of the proceedings, including reasonable expenses and fees of the Central Bank to be allowed by the court, the Central Bank shall pay the debts of such institution, under the order of the court, in accordance with their legal priority.

152. Republic Act No. 7653.

power to overrule or rebuke the actions of the previous management and board of directors of the bank or quasi-bank.[153]

The Monetary Board shall terminate the conservatorship when it is satisfied the institution can continue to operate on its own and the conservatorship is no longer necessary. The conservatorship shall be likewise terminated should the Monetary Board determine that continuance in business of the institution would involve probable loss to its depositors or creditors, in which case proceedings for receivership and liquidation shall be pursued.[154]

3. Acknowledgment of Constitutional Limitations

The seminal decision in *Central Bank of the Philippines v. Morfe*[155] ruled that under the Central Bank Act, when a banking institution has been placed under liquidation or receivership it would stay the execution of any judgment rendered by any court against the bank:

> A contrary rule or practice would be productive of injustice, mischief and confusion. To recognize such judgments as entitled to priority would mean that depositors in insolvent banks, after learning that the bank is insolvent as shown by the fact that it can no longer pay withdrawals or that it has closed its doors or has been enjoined by the Monetary Board from doing business, would rush to the courts to secure judgments for the payment of their deposits.
>
> In such eventuality, the courts would be swamped with suits of that character. Some of the judgments would be default judgments. Depositors armed with such judgments would pester the liquidation court with claims for preference on the basis of article 2244(14)(b) [of the Civil Code]. Less alert depositors would be prejudiced. That inequitable situation could not have been contemplated by the framers of section 29.[156]

In other case, the Supreme Court held that where upon the insolvency of a bank a receiver is appointed, the assets of the bank pass beyond its control into the possession and control of the receiver. The appointment of the receiver operates to suspend the authority of the bank and of its directors and officers over its property and effects, such authority being reposed in the receiver. In this respect, receivership is equivalent to an injunction restraining the bank officers from intermeddling with the property of the bank in any way.[157] But even then, the pronouncements only covered unsecured creditors.

153. New Central Bank Act, § 29.

154. *Id.*

155. 63 SCRA 114 (1975).

156. *Id.* at 119-20.

157. Villanueva v. Court of Appeals, 244 SCRA 395 (1995).

Lipana v. Development Bank of Rizal[158] has ruled on the issue of whether an indefinite automatic stay would amount to a deprivation of property without due process of law under the Central Bank Act:

> It is also contended by the petitioners that the indefinite stay of execution without ruling also how long it will last, amount to a deprivation of their property without due process of law.
>
> Said contention, likewise, is devoid of merit. Apart from the fact that the stay of execution is not only in accordance with law but it also supported by jurisprudence, such staying of execution is not without a time limit. In fact, the Monetary Board, in its resolution No. 433 approved the liquidation of respondent bank on April 26, 1985 and ordered, among others, the filing of a petition in the Regional Trial Court praying for assistance of said court in the liquidation of the bank ... The staying of the writ of execution will be lifted after approval by the liquidation court of the project of distribution, and the liquidator or his deputy will authorized payments to claimants concerned in accordance with the approved project of distribution.[159]

In spite of the enormous powers granted to the Central Bank, the Supreme Court has cautioned against the violation of contractual commitments to third parties of the banking institution under conservatorship.

In *First Phil. Int'l Bank v. Court of Appeals*,[160] a contract was entered into by the bank's responsible officer. When the bank subsequently became insolvent and a conservator was appointed by the Central Bank, the conservator repudiated the officer's authority on the ground that the contract was entered into without proper authority. It was contended that the conservator had the power to revoke or overrule actions of the management or the board of directors of a bank, pursuant to then Sec. 28-A of the Central Bank Act. The Court ruled:

> While admittedly the Central Bank Law gives vast and far reaching powers to the conservator of a bank, it must be pointed out that such powers must be related to the "preservation of the assets of the bank, (the restoration of) its viability." Such powers, enormous and extensive as they are, cannot extend to the *post facto* repudiation of perfected transactions, otherwise they would infringe against the non-impairment clause of the Constitution. If the legislature itself cannot revoke an existing valid contract, how can it delegate such non-existent powers to the conservator under Sec. 28-A of said law?

158. 154 SCRA 257 (1987).

159. *Id.* at 262-263.

160. 252 SCRA 259 (1996).

> Obviously, therefore, Sec. 28-A merely gives the conservator power to revoke contracts that are, under existing law, deemed to be defective— i.e., void. voidable, unenforceable or rescissible. Hence, the conservator merely takes the place of the bank's board of directors. What the said board cannot do-such as repudiating a contract validly entered into under the doctrine of implied authority-the conservator cannot do either. Ineluctably, his power is not unilateral and he cannot simply repudiate valid obligations of the Bank. His authority would be only to bring court actions to assail such contract— as he has already done so in the instant case. A contrary understanding of the law would simply not be permitted by the Constitution. Neither by common sense. To rule otherwise, would be to enable a failing bank to become solvent, at the expense of third parties, by simply getting the conservator to unilaterally revoke dealings which had one way or another come to be considered unfavorable to the Bank, yielding nothing to perfected contractual rights nor vested interest of the third parties who had dealt with the Bank.

The provisions of the Central Bank Act construed by the Supreme Court in First Phil. International Bank[161] used the same language of Section 6(d) of PD 902-A. Despite the acknowledgment that the banking industry is vested with public interest, rehabilitation proceedings for any banking institution cannot authorize the highly specialized Central Bank or Monetary Board from amending contractual obligations owed by the bank with third parties, specially creditors of the bank. All the more would the rule and doctrine apply to the SEC even under the terms of PD 902-A, specially when corporate business in general is not really vested with public interests.

4. Proceedings in Receivership and Liquidation:

Section 30 of the New Central Bank provides in detail the proceedings in receivership and Liquidation of banks and quasi-banks, as follows:

> (a) Basis of Taking Over: Whenever the Monetary Board finds that a bank or quasi-bank:
>
> (i) Is unable to pay its liabilities as they become due in the ordinary course of business; provided that this shall not include inability to pay caused by extraordinary demands induced by financial panic in the banking community;
>
> (ii) Has insufficient realizable assets to meet its liabilities;
>
> (iii) Cannot continue in business without involving probable losses to its depositors or creditors; or
>
> (iv) Has willfully violated a cease and desist order that has become final, involving acts or transactions which amount[s] to fraud or a dissipation of the assets of the institution;

161. Philippine Commercial and International Bank v. Court of Appeals, 269 SCRA 695 (1995).

(v) In which cases, the Monetary Board may summarily and without need for prior hearing forbid the institution from doing business in the Philippines[162] and designate the Philippine Deposit Insurance Corporation as receiver of the banking institution.

(b) Powers of Receiver: The receiver shall immediately gather and take charge of all the assets and liabilities of the institution, administer the same for the benefit of its creditors, and exercise the general powers of a receiver.

(c) Period Limitation on Receiver: The receiver shall determine as soon as possible, but not later than ninety (90) days from takeover, whether the institution may be rehabilitated or otherwise placed in such a condition so that it may be permitted to resumed business with safely to its depositors and creditors and the general public. Any determination for the resumption of business of the institution shall be subject to prior approval of the Monetary Board.

(d) When Rehabilitation is Not Feasible: If the receiver determines that the institution cannot be rehabilitated or permitted to resumed business, the Monetary Board shall notify the board of directors in writing of its findings and direct the receiver to proceed with the liquidation of the institution. The receiver shall then:

(i) File *ex parte* with the proper regional trial court, and without the requirement of prior notice or any other action, a petition for assistance in the liquidation of the institution pursuant to a liquidation plan adopted by the Philippine Deposit Insurance Corporation;

(ii) Upon acquiring jurisdiction, the court shall, upon motion by the institution, assist the enforcement of individual liabilities of the stockholders, directors and officers, and decide on other issues as may be material to implement the liquidation plan adopted;[163]

162. There is no requirement that a hearing be first conducted before a banking institution may be placed on receivership. The appointment of a receiver may be made by the Monetary Board without noticed and hearing but its action is subject to judicial inquiry. Rural Bank of Buhi v. Court of Appeals, 162 SCRA 288 (1988); also Central Bank v. Court of Appeals, 220 SCRA 536 (1993).

163. The regular courts have no jurisfiction over actions filed by claimants other than in the liquidation procdings. Under S 29, q. 3 of Rep. Act No. 265, as amended by Pres. Decree No. 1827, the Central Bank shall, by the Solicitor General, file a petition in the regional trial court, reciting the proceedings which have taken and praying the assistance of the court in the liquidation of such institution, and the court shall have jurisdiction in the same proceedings to adjudicate disputed claims against the bank.

The requirement that all claims against the bank be pursued in the liquidation proceedings filed by the Central Bank is intended to prevent multiplicity of actions against the insolvent bank and designed to establish due process and orderliness in the liquidation of the bank, to obviate the proliferation of litigations and to avoid injustice and arbitrariness Ong v. Court of Appeals, 253 SCRA 105 (1996).

(iii) Convert the assets of the institution to money, dispose of the same to creditors and other parties, for the purpose of paying the debts of such institution in accordance with the rules on concurrence and preference of credit under the Civil Code of the Philippines and he may in the name of the institution, institute such actions as may be necessary to collect and recover accounts and assets of, or defend any action against, the institution.

From the foregoing outline, one will notice that although the banking industry has been held to be one characterized with public interest, the New Central Bank Act provides basic limitations on the power and functions of the Monetary Board and the PDIC in undertaking the rehabilitation, receivership, conservatorship and liquidation of a bank in clear terms. It likewise ensures that the determination of whether a bank placed under conservatorship could be rehabilitated or placed in liquidation is to be resolved within a short period of three (3) months, and expressly recognizes the rules of preferences and concurrences in the disposition of the assets of the bank in liquidation.

VI. SEC AND SUPREME COURT IN ACTION: THE RUBY INDUSTRIAL DECISION

The issue of the power of the SEC to confirm a rehabilitation plan and pursue its implementation through the rehabilitation receiver seems to be taken for granted without zeroing in on the parameters under which it can be exercised even by the Supreme Court.

The Supreme Court seems to have taken the language of PD 902-A as a constitutional mandate for the SEC to undertake the super task of overseeing and controlling corporations and other juridical entities for the "public interests." The SEC is looked upon looked upon in corporate business as occupying the same role of Bangko Sentral ng Pilipinas in the banking industry, without realizing that the banking industry is really vested with public interest in that its activities go into the financial systems of the country and covers the savings of the members of society. Corporate business in

general cannot be deemed to have the same characterization as the banking industry.

But even the Bangko Sentral ng Pilipinas, which is considered well equipped and capable of overseeing the banking industry, is not authorized to enforce rehabilitation on its own terms and the covering law limits the extent and period by which conservatorship can be pursued. In fact, the Supreme Court has found that the conservator has no legal right under the Central Bank Act to amend or restrict existing contractual rights on the creditors of the insolvent bank.

In the recent 1998 decision in *Ruby Industrial Corporation v. Court of Appeals*,[164] which involved a rehabilitation plan approved by the SEC, the Supreme Court did not even bother to rule on the parameters of the confirming power of the SEC, in spite of the fact such parameters were raised by the oppositors to the rehabilitation plan approved by the SEC hearing panel. Readers of the decision are given an inclination of what may be the great leeway accorded by the courts to the SEC in approving and enforcing rehabilitation plans.

The facts in *Ruby Industrial* show that in the course of the proceedings for suspension for payments where a management committee had been constituted, the majority stockholders (about 60% of the equity) of RUBY approved and submitted to the SEC the "Benhar/Ruby Rehabilitation Plan" which provided for the following terms:

(a) Benhar shall lend Ruby its ₱60 million credit line in China Bank, payable within ten (10) years;

(b) Benhar shall purchase the secured credits of Ruby's creditors and mortgage Ruby's properties to btain credit facilities for Ruby; and

(c) Upon approval of the plan, Benhar shall control and manage Ruby's operations, and for which services, Benhar shall receive a management fee equivalent to 7.5% of Ruby's net sales.

One would see from the terms of the Benhar/Ruby Plan insofar as the existing secured creditors where concerned, that they would be paid-off through proceeds coming from a fresh loan to be obtained from China Bank. Nothing was provided for the settlement of the claims of unsecured creditors, and obviously it would bypass the proprietary interests of existing stockholders to vote for their own management group.

Forty percent (40%) of the stockholders of RUBY and Allied Leasing and Finance Corporation (the biggest unsecured creditor of RUBY), and the chairman of the management committee, opposed the Benhar/Ruby Plan "as it would transfer RUBY's assets beyond the reached and to the

164. G.R. No. 124185-87, 20 January 1998.

prejudice of its unsecured creditors," and submitted their own rehabilitation plan to the SEC providing for the following terms:

(a) To pay all Ruby's creditors without securing any bank loan;

(b) To run and operate Ruby without charging management fee;

(c) To buy out the majority shares or sell their shares to the majority stockholders;

(d) To rehabilitate Ruby's two plants; and

(e) To secure a loan at 25% interest, as against the 28% interest charged in the loan under the Benhar/Ruby Plan.

Although both plans were endorsed by the SEC to the management committee for evaluation, the SEC Hearing Panel nevertheless approved the Benhar/Ruby Plan. The minority stockholders appealed the approval to the SEC en banc, which enjoined its enforcement. The SEC *en banc* injunction was affirmed by both the Court of Appeals and Supreme Court.

In turned out that even before the approval of the Benhar/Ruby Plan the portion providing for the paying-off of secured creditors for their credits to be assigned to Benhar began to be implemented and completed during the effectivity of the injunction orders. The execution of the deeds of assignment were questioned by the minority stockholders and Allied Leasing. The deeds were declared null and void by the SEC Hearing Panel, the SEC *en banc*, and confirmed by both the Court of Appeals and Supreme Court.

In the meantime, Ruby filed with the SEC *en banc* a petition to create a new management committed and to approve its revised rehabilitation plan under which Benhar shall receive a good part of the credit facilty to be extended to Ruby as reimbursement for Benhar's payment of Ruby's secured creditors.

The SEC *en banc* submitted the Revised Benhar/Ruby Plan to the creditors for comment and approval, and together with the minority stockholder's Alternative Plan, were forwarded to the Hearing Panel for evaluation.

Over ninety percent (90%) of RUBY's creditors objected to the Revised Benhar/Ruby plan and the creation of a new management committee, and instead they endorsed the minority stockholders' Alternative Plan. Likewise, three (3) members of the original management committee (i.e., the members representing the minority stockholders and the unsecured creditors), also opposed the Revised Benhar/Ruby Plan, on the following specific grounds:

(2) The revised Benhar/Ruby Plan would legitimize the entry of Benhar, a total stranger, to RUBY as Benhar would become the biggest creditor of RUBY;

(b) The revised Plan would put RUBY's assets beyond the reach of the unsecured creditors and the minority stockholders; and

(c) The revised Plan was not approved by RUBY's stockholders in [a] meeting called for the purpose.

It would be noted that the issues raised by the oppositors went right into the heart of resolving the extent by which rehabilitation plans may be adopted and implemented under the aegis of the SEC.

In spite of such objections, the SEC Hearing Panel approved the Revised Benhar/Ruby Plan and dissolved the existing management committee to create a new management committee and appointed Benhar as one of its members under the condition that Benhar's membership in the new management committee is subject to the condition that Benhar will extend its credit facilities to RUBY without using the assets of RUBY as security or collateral. The new management committee was taked to oversee the implementation by the Board of Directors of RUBY of the Revised Benhar/Ruby Plan.

On appeal, the SEC *en banc* affirmed the approval of the Revised Benhar/Ruby Plan and the creation of a new management committee but prohibited Benhar from using Ruby's assets in order to secure credit facilities under the Plan; but even such condition was dropped later by SEC en banc.

On appeal, the Court of Appeals set aside SEC's approval of the Revised Benhar/Ruby Plan and remanded the case to the SEC for further proceedings, but only because the revision had the effect of circumventing its earlier decision nullifying the deed of assignment executed by RUBY's creditors in favor of Benhar, without touching on the specific objections raised by the oppositors.

On petition to the Supreme Court, it upheld the Court of Appeals decision that the approval of the revision actually circumvented the earlier rulings nullifying the deeds of assignments of the creditors of Ruby to Benhar, also without touching on the issues raised by the oppositors to the revised Benhar/Ruby Plan.

Therefore, the *ratio decidendi* in Ruby Industrial is that any payment to creditors during the pendency of rehabilitation proceedings when there has been no rehabilitation plan approved would be in violation of the automatic stay provisions under Section 5(d) of PD 902-A, thus:

> Rehabilitation contemplates a continuance of corporate life and activities in an effort to restore and reinstate the corporation to its former position of successful operation and solvency. When a distressed company is placed under rehabilitation, the appointment of a management committee follows to avoid collusion between the previous management and creditors its might favor, to the prejudice of the other creditors. All assets of a corporation under rehabilitation receivership are held in trust for the equal benefit of all creditors to preclude one from obtaining an advantage or preference over another by the expediency of attachment, execution or otherwise. As between the creditors, the key phrase is equality in equity. Once the corporation threatened by bankruptcy is taken over by a receiver, all the creditors ought to stand in equal footing. Not any one of them should be paid ahead of the others. This is precisely the reason for suspending all pending claims against the corporation under receivership.

It seems from the ruling that the revision to the Benhar/Ruby Plan was only deemed objectionable and void for it circumvented the previous rulings of the appellate courts, therefore, without the revisions favoring Benhar on the previous assignments of creditors, the Benhar/Ruby Plan was valid and effective, in spite of opposition thereto of ninety percent (90%) of the creditors of Ruby and opposition of forty percent (40%)of the stockholders, as well as the members of the original management committee. The only real vote of approval of the Benhar/Ruby Plan was the approval and endorsement of sixty percent (60%) of the stockholders of Ruby.

Perhaps, such issues were not even being considered by the Supreme Court when it promulgated the decision in Ruby Industrial but it seems odd why the Supreme Court narrating all the relevant facts would not find it objectionable that the SEC would approve a rehabilitation plan proposed by a mere majority (not the controlling two-thirds majority) of the stockholders of the corporation against the opposition of 90% of the creditors who have approved and endorsed the minority stockholders' alternative plan.

Three (3) points seem to come across from the *Ruby Industrial* scenario, namely:

(a) The approval of the stockholders of a rehabilitation plan seem[s] to carry more weight than the opposition thereto by the vast majority (in this case 90%) of the creditors of the corporation and against a rehabilitation plan endorsed and approved by the such creditors;

(b) The determination of the SEC as to which rehabilitation plan is best for the corporation overrides the interests and over whelming opposition of the corporation's creditors and minority stockholders, and even key members of the management committee; and

(c) The SEC and the Supreme Court give no special value to the key ingredient necessary to proceed with rehabilitation: that a rehabilitation plan must show that it]is] a adoption would lead to successful rehabilitation of the company and not end up in liquidation eventually.

VII. ESTABLISHING THE PARAMETERS ON SEC POWERS IN REHABILITATION PROCEEDINGS

The evolving doctrine in Philippine jurisdiction is that rehabilitation process is pursued to conserve and administer the corporation's assets and business operations, as contemplating a continuance of corporate life and activities, in

an effort to restore and reinstate the corporation to its former position of successful operation and solvency.[165] The thrust under the Philippine setting on the primary purpose of rehabilitation is in stark contrast to that under the American setting where debtor rehabilitation is mainly intended to provide creditors a better repayment scheme of their claims, not from the present property of the debtor, which are insufficient, but from future earnings of the business.

This particular slant in Philippine setting has perhaps led the Supreme Court to some incongruous doctrinal pronouncement relating to corporate rehabilitation; and even a condescending attitude on the part of the SEC to see itself in the role of the all-knowing supreme lord in determining what is best for the debtor corporation, its business operations, to the near exclusion of management and the creditors. It is as though it has almost become a sense of public duty for the Government, through the SEC, to find ways and means to sustain the operations of just about every corporation in financial distress.

This Paper has attempted to show that such approach to corporate rehabilitation and the presumption of all-encompassing powers and prerogatives of the SEC under PD 902-A are wholly unsupported by, and contrary to, constitutional and contract law principles underpinning the Philippine corporate setting.

In the hierarchy of remedies and proceedings for a financially distressed corporate debtor, suspension of payments and insolvency proceedings present two extremes, with rehabilitation or reorganization being the middle-ground proceeding. If both suspension of payments and insolvency proceedings make central the approval of majority of the creditors affected by the plan of payment of the composition agreement, then it is difficult to see how a rehabilitation or reorganization plan can be adopted and implemented without, at the very least, the prior consent or approval of the creditors of the petitioning corporation. In any type of bankruptcy proceedings, the voice and interests of the creditors always remain uppermost.

Even the "management committee" powers under PD 902-A which expressly authorize the management committee or the rehabilitation receiver to override the decisions of the management or the board of directors of the petitioning corporation, cannot be relied upon to allow unbridled power to the SEC to adopt a rehabilitation plan on its own accord. Managements and the boards of directors of corporations do not have rights and powers on their own to discharge or adversely affect the rights of the corporate creditors or the proprietary rights of stockholders in the corporation. Therefore, even the management committee and the rehabilitation receiver in a rehabilitation

165. Ruby Industrial Corp. v. Court of Appeals, G.R. No. 124185-87, 20 January 1998.

proceeding are saddled by the same limitations that govern managements and boards of directors.

When we consider that the proposed plan of simple suspension of payments proceedings at most merely defers the payment of the corporate debtor's obligations, it becomes difficult to see how a more pervasive rehabilitation plan can be pushed down the throat of creditors by SEC fiat by the mere shifting of for a from the regular courts to the SEC. The more highly specialized agency, Bangko Sentral ng Pilipinas, cannot do so in the banking industry already vested with public interests, as held in *First Phil. Int'l Bank v. Court of Appeals*.[166] Then why should the SEC be allowed to do such under the guise of rehabilitation proceedings in the area corporate business at large?

Certainly, nothing in PD 902-A provides the SEC, or the management committee or rehabilitation receiver, the clear power to enforce a rehabilitation plan without the approval or support of the creditors affected thereby. To put power where none has been expressly granted would not only contravene constitutional and contractual rights, but would also unduly expand the role of the SEC, a view already opposed by the Supreme Court in *Ching v. Land Bank of the Philippines*.[167] More importantly, Section 5(d) of PD 902-A is a provision providing for the jurisdiction of the SEC, which merely transferred suspension of payments proceedings involving corporate debtors from regular courts to the SEC, but the substantive law remains to be the provisions of the Insolvency Law, to the extent not amended by special rules under Section 6 of the Decree. As a remedial statutory provision, Section 5(d) cannot overturn, without express repeal provisions, the substantive requirements of the Insolvency Law on the enforceability of the proposed agreements in suspension of payments proceedings. This much has been recognized also in *Ching*.

When the SEC proceeds with the declaration of insolvency of the corporation and pursues its liquidation under the parameters discussed in *Ching*, it can do so only under the provisions of the Insolvency Law, which does treat secured and unsecured creditors equally or cancel or substantially modify the mortgages or security arrangements constituted in favor of secured creditor. Then, certainly a rehabilitation plan which seeks to invade such rights cannot be allowed, without safeguarding creditors' security interests or obtaining their approval thereto. This position is supported by the pronouncement in *BF Homes, Inc. v. Court of Appeals*,[168] where even when the rehabilitated corporation has achieve normal operations, the SEC

166. 252 SCRA 259 (1996).

167. 201 SCRA 190 (1991).

168. 190 SCRA 262 (1990).

can lift the rehabilitation plan to allow the creditors to then pursue their claims based on the original contractual terms.

The insolvency Law provides the legal bases upon which both secured and unsecured creditors have been accorded substantive rights when their debtor has fallen into financial distress or has become insolvent. It should continue to provide he source of rules for the SEC and the Supreme Court upon which to mold the parameters of rehabilitation proceedings under the Philippine setting.

The Insolvency Law does not allow a corporate debtor to obtain a discharge at the end of the Insolvency proceedings. This means that when the corporation remains a juridical entity after insolvency proceedings and does not proceed to dissolution, if the corporation in the future should once again be able to operate and accumulate assets, then the creditors who had participated in the insolvency proceedings continue to have a cause of action to recover their unpaid claims against future assets or properties of the corporate debtor. This shows stockholders cannot likewise have any priority against the creditors of the corporate debtor even when insolvency proceedings are concluded. Stockholders cannot even look upon future operations to have priority to the exclusion of old creditors of the corporation.

The corporate debtor being a mere juridical fiction, the SEC has no business and no power, both legally and under equity considerations, to enforce or champion a rehabilitation plan that is for the best interest of the corporation and/or its stockholders. The only interests that the SEC can protect are primarily the creditors of the corporation and perhaps on a residual basis, the proprietary rights of stockholders. The salvation of the corporation and its business operations does not therefore become the end itself; it only constitutes the means by which the stakeholders may best be able to protect their interests in the corporation. The whole process of rehabilitation, the adoption of the plan and its implementation, is therefore the business and territory of the management and the creditors of the petitioning corporation and the SEC uses the coercive powers granted by the law in order to convince all parties to negotiate and come up with a plan that would best protect the players's interests but it cannot decide for the various stakeholders.

The SEC even has the power to extend the process for a long time (and this itself may be an unfortunate situation), as long as may be necessary to convince the various parties involved to come into reasonable terms for a rehabilitation plan. But such coercive power cannot be abused and in the absence of specific legislation on this matter, the Supreme Court would have to rule on the extent of such coercive power when its prolongation would actually render in utile the contractual and priority rights of creditors.

In drawing the parameters of the nature and extent of the powers of the SEC to confirm and enforce a rehabilitation plan in a given situation, it must work within the nature and extent of the proprietary and contractual interests of the various stakeholders in the petitioning corporations, thus,

(a) The Plan Itself — The only purpose of not choosing liquidation for an insolvent corporation is a proper showing that rehabilitation if pursued would allow the company within a reasonable period to come back to financial health and be able to service all of its outstanding obligations. Without such clear showing, there is no legal and equitable basis to proceed with rehabilitation of the petitioning corporation. And obviously, the rehabilitation plan must respect the contractual and proprietary interests of the creditors in the event they do not consent to such plan.

(b) The Stockholders — If indeed it can be shown that the corporate debtor is financially insolvent, then liquidation should follow as a matter of course where the stockholders as a group would have no interests since the company would have no residual value on which to make a claim for their proprietary interests in the company; only a viable rehabilitation plan would serve to prevent liquidation.

Their vote may not be required to approve the rehabilitation plan which is essentially for the benefit of the creditors. However, if the stockholders can show that the corporate debtor is financially solvent, their vote may be important, but it would gain last priority, and since a rehabilitation seeks to continue with the "going concern" value of the company, they really have no legal right to object to it since it does not transgress any of their proprietary interest nor would it be contrary to their original contractual intentions and commitment at the time they invested into the equity of the company.

(c) Secured Creditors — For so long as their securities are not impaired, they continue to be within the original protection of substantive laws where they may interpose an objection to the rehabilitation plan. Therefore, if the rehabilitation plan does not impair their priority rights, secured creditors have no vote on the approval of the plan, and rehabilitation is pursued for the benefit of the unsecured creditors. However, if the rehabilitation plan prevents them from pursuing their enforcement of their security, there is an impairment, and their vote as a group in favor of the rehabilitation plan is essential. Otherwise, it would violate their property rights

(d) Unsecured Creditors — In the end, the rehabilitation plan is for their primary benefit, and if it is shown that the terms of the plans do not reduce their likely dividends if there had been liquidation, then even their approval vote may not required, since no proprietary rights will be adversely affected by the plan.

On the other hand, if the rehabilitation plan adversely affects their dividend claims, a majority approval vote is necessary to bind the unsecured creditors as a group, similar to the cases of suspension of payments

proceedings or composition in liquidation proceedings. Since the SEC is empowered to proceed to insolvency and dissolution of the corporate debtor in case rehabilitation is not possible, it should be reasonable to expect that the double majority rule for composition in insolvency proceedings under the Insolvency Law should also apply in order for the rehabilitation plan to be approved and be ready for confirmation by the SEC.

Indeed, the ideal situation is for the legislature to come up with a comprehensive piece of legislation to govern rehabilitation or reorganization proceedings for insolvent debtors. But since the Philippines is already engulfed in the Asian crisis, it is incumbent upon the SEC to come-up with the enabling rules and procedures to govern rehabilitation proceedings, as it held, but has not been able to accomplish, in its 7 October 1997 Memorandum:

> In the meantime, we have appointed a Special Task Force to revisit the rules on petitions for suspension of payments to make them more responsive to the times and to allow equity and fairness to prevail for both the petitioning corporations and the creditors.

A rationale corporate bankruptcy system in place which provides for a real threat of bankruptcy would act as good pressure upon all stakeholders to enter into earnest efforts and negotiations towards attempting to rehabilitate the petitioning corporation. Without at least the general reasonable binding parameters on corporate rehabilitation process in place, then abuses shall continue to abound: of debtors using the rehabilitation proceedings not as a means to settle claims but merely to blackmail creditors; of SEC hearing panels, because of seemingly unbridled powers and discretion to go or not to go into rehabilitation, of being under undue pressure and influence of the powers-that-be; of burned creditors, both local and foreign, running up millions in pesos of expenses seeking to get relief which would have little hope of resolution because of the slowness and the various opportunities of delays inherent in the country's judicial system; of the whole financial system grinding to a virtual halt, when lenders, both institutional and non-institutional, discouraged by the lack a system of rehabilitation that is shown to work fairly, would withhold necessary fundings for projects and operations necessary to get the economy going to avoid tipping-over into the precipice of recession.

In the midst of the vacuum and inaction of the SEC, the courts, particularly the Supreme Court, should therefore lead in establishing the parameters under which proper rehabilitation proceedings can proceed or cannot proceed, with due regard to the constitutional rights of the various stakeholders in the petitioning corporation, as well as the need to protect the sanctity of contracts and contractual commitments, so essential to achieve progress in modern society.