

Assignment of Credit in Favor of Special Purpose Vehicle Corporation: Current Problems and Solutions

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I. INTRODUCTION

On 23 December 2002, the economic crisis then plaguing the Philippines moved Congress to enact Republic Act No. 9182, more commonly known as the Special Purpose Vehicle (SPV) Act.¹ Prior to that time, the Philippine financial system had been cloaked in non-performing assets (NPA),² worth Php317 billion as of 30 June 2001, and foreclosures, amounting to Php203 billion.³ This ailment only worsened a year later with non-performing loans (NPL)⁴ standing at Php520 billion, or 14.9 percent of the system's gross assets of Php3.5 trillion⁵—as reported in the Bangko Sentral ng Pilipinas' inventory list of bank NPLs and real and other properties acquired (ROPOA).⁶

In light of the above situation, the SPV Act of 2002 was enacted. Its purpose: to alleviate such a cumbersome economic problem by encouraging

1. An Act Granting Tax Exemptions And Fee Privileges To Special Purpose Vehicles Which Acquire Or Invest In Non-Performing Assets, Setting The Regulatory Framework Therefore, And For Other Purposes, Republic Act No. 9182 [SPECIAL PURPOSE VEHICLE ACT] (2002).
2. SPECIAL PURPOSE VEHICLE ACT, § 3 (g) ("Non-Performing Assets or NPAs" consist of the Non-Performing Loans and Real and Other Properties Owned or Acquired by FIs.).
3. Strengthening the Four Pillars of Government Structural Reform Legislation for a Strong Republic, at <http://www.op.gov.ph/publications/pillars.pdf> (last accessed Aug. 4, 2006) [hereinafter Strengthening the Four Pillars of Government Structural Reform Legislation].
4. SPECIAL PURPOSE VEHICLE ACT, § 3 (h), states:

"Non-performing loans or NPLs" refer to loans and receivables such as mortgage loans, unsecured loans, consumption loans, trade receivables, lease receivables, credit card receivables, and all registered and unregistered security and collateral instruments, including but not limited to, real estate mortgages, chattel mortgages, pledges, and antichresis, whose principal and/or interest have remained unpaid for at least one hundred eighty (180) days after they have become past due or any of the events of default under the loan agreement has occurred.
5. Bangko Sentral ng Pilipinas, Updates on BSP Supervision and Regulation (Mar. 2006).
6. SPECIAL PURPOSE VEHICLE ACT, § 3 (i), states:

"Real and other properties acquired" or ROPOAs refer to real and other properties owned or acquired by a financial institution in settlement of loans and receivables. They include real properties, shares of stocks, and chattels formerly constituting collaterals for secured loans which have been acquired by way of dation in payment (*dacion en pago*), or judicial or extra-judicial foreclosure, or execution of judgment).

the operation of companies specializing in the buying of bad debts and foreclosed assets at a discount.⁷ Section 2 of the SPV Act reads:

It is hereby declared the policy of the state:

- (a) To develop and maintain a sound financial sector for the country;
- (b) To address the non-performing asset problems of the financial sector;
- (c) To encourage private sector investments in non-performing assets;
- (d) To eliminate existing barriers in the acquisition of non-performing assets
- (e) To help in the rehabilitation of distressed business with the end in view of contributing to economic value added; and
- (f) To improve the liquidity of the financial system, which can be harnessed to propel economic growth.⁸

Through tax exemptions and fee privileges, the legislation aims to liquify NPA's to allow them to regain their contribution to the liquidity of the financial system.

The SPV Act of 2002 maps out the organization of SPV's,⁹ which, under the law, are to be established as stock corporations in accordance with the Corporation Code of the Philippines. The minimum authorized capital stock allowed is 500 million. If land is acquired, at least 60 percent of the corporation's outstanding capital stock shall be owned by Philippine nationals, pursuant to "The Foreign Investments Act."¹⁰

Insofar as the policy to rehabilitate distressed business, however, the SPV Act is a remedy that actually wreaks more havoc than the disease it seeks to cure. Due to its implementation, much detriment has been caused to the borrowers, stemming from misunderstandings between the assignors and the assignees of the credits concerning legal norms and policies of Philippine law regarding unjust enrichment, fair dealings, and good faith. When the assignor is a bank, the issue also extends to their extraordinary duty, imposed by law, to safeguard and protect the interests of their depositors and clients.

7. Strengthening the Four Pillars of Government Structural Reform Legislation, *supra* note 3.
8. SPECIAL PURPOSE VEHICLE ACT, § 2 (emphasis supplied).
9. Bangko Sentral ng Pilipinas, Primer on the SPV ACT OF 2002, 1 ("[t]he SPV has limited powers under the SPV Act. Its primary purpose is to invest in, or acquire the non-performing assets (NPAs) of financial institutions (FIs). Its secondary purposes are limited to those listed under the SPV Act (referring to Sec. 2 of R.A. No. 9182).").
10. SPECIAL PURPOSE VEHICLE ACT, § 4.

This article thus focuses on the substantive and procedural requirements necessary to perfect and implement the assignment of credit, and to clarify the legal norms and the highest fiduciary standards of good faith and extraordinary diligence that the creditor banks must abide by and exercise in such assignment — whether the same fall under the SPV Act, the law on obligations and contracts, assignment of credits, other incorporeal rights under the Civil Code¹¹ and the General Banking Law of 2000.¹²

II. SUBSTANTIVE AND PROCEDURAL REQUIREMENTS OF ASSIGNMENT OF CREDIT AND SUBSTITUTION OF CREDITORS

Is mere notice to the borrower sufficient to establish the legality of the transfer and the personality and legal standing of the assignee as the new creditor?

Sales and transfers of NPAs to an SPV are in the nature of a true sale,¹³ where the selling financial institution transfers or sells its NPAs for cash or property to an SPV without recourse.¹⁴ Section 12(a) of the SPV Act of 2000, details the notice and manner of transfer of assets:

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11. An Act to Ordain and Institute the Civil Code of the Philippines (1950) [NEW CIVIL CODE].
 12. An Act Providing for the Regulation of the Organization and Operations of Banks, Quasi-Banks, Trust Entities and for Other Purposes, Republic Act No. 8791 (2000) [GENERAL BANKING LAW OF 2000].
 13. SPECIAL PURPOSE VEHICLE ACT, § 13.

All sales or transfers of NPAs to an SPV shall be in the nature of a true sale after proper notice in accordance with the procedures as provided for in section 12: *Provided*, That GFIs and GOCCs shall be subject to existing law on the disposition of assets: *Provided, further*, That in the transfer of the NPLs, the provisions on subrogation and assignment of credits under the New Civil Code shall apply.

14. *Id.* § 3(l).

“True Sale” refers to a sale wherein the selling FI transfers or sells its NPAs without recourse for cash or property to an SPV with the following results:

- (1) The transferor relinquishes effective control over the transferred NPAs; and
- (2) The transferred NPAs are legally isolated and put beyond the reach of the transferor and its creditors

FI stands for Financial Institutions, which, under the law are credit-granting institutions, limited to: a) the BSP; b) banks; c) financing companies; d) investment houses; e) certain government financial institutions; and f) certain government-owned-or-controlled corporations.

Id. § 3(e).

(a) No transfer of NPLs to an SPV shall take effect unless the FI concerned shall give prior notice, pursuant to the Rules of Court, thereof to the borrowers of the NPLs and all persons holding prior encumbrances upon the assets mortgaged or pledged. Such notice shall be in writing to the borrower by registered mail at their last known address on file with the FI. The borrower and the FI shall be given a period of at most ninety (90) days upon receipt of notice, pursuant to the Rules of Court, to restructure or renegotiate the loan under such terms and conditions as may be agreed upon by the borrower and the FI's concerned.¹⁵

The misconception that mere notice to the borrower, as required by the law, is all that is necessary to perfect the transfer and establish the legal personality of the assignee as subrogee¹⁶ and new creditor may result in the delay of the implementation of the assignment. An assignee with such a belief would then refuse to comply with the substantive and procedural requirements of the law necessary to perfect and consummate the transfer. Due to that non-observance, confusion would inevitably arise as legal standing and personality as a substitute creditor under the assignment would *not* be perfected. Furthermore, neither the original creditor, who has already lost legal interest, nor the new creditor, who has not perfected the assignment, shall have any legal standing to enforce the assigned credit against the borrower.

Mere notice is thus not enough to legalize the assignment, as it overlooks certain substantive and procedural requirements for the assignment's perfection and consummation. The only real purpose served by the notice is

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15. SPECIAL PURPOSE VEHICLE ACT, § 12.

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(b) The transfer of NPAs from an FI to an SPV shall be subject to prior certification of eligibility as NPA by the appropriate regulatory authority having jurisdiction over its operations, which shall issue its ruling within forty-five (45) days from the date of application by the FI for eligibility.

(c) After the sale or transfer of the NPLs, the transferring FI shall inform the borrower in writing at the last known address of the fact of the sale or transfer of the NPLs (emphasis supplied).

16. 4 ARTURO M. TOLENTINO, CIVIL CODE OF THE PHILIPPINES 400 (1987 ed.) [hereinafter TOLENTINO, OBLIGATIONS AND CONTRACTS].

Subrogation is the transfer of all the rights of the creditor to a third person, who substitutes him in all his rights. It may either be legal or conventional. Legal subrogation is that which takes place without agreement but by operation of law because of certain acts... Conventional subrogation is that which takes place by agreement of the parties; this kind of subrogation requires the intervention and consent of three persons: the original creditor, the new creditor, and the debtor.

to avoid the discharge of the obligation — through payment by the borrower to the assignor before knowledge of the assignment on the part of the borrower. This is provided for in Article 1626 of the Civil Code.¹⁷ Hence, despite notice to the borrower, the proper substitution of creditors must still be made under the procedure and requirements of the law in order to establish the right of the assignee as new creditor.

The perfection of the assignment of credits, which legalizes the transfer contemplated in the SPV law and creates the legal personality of the assignee, should be done in accordance with Article 1475 of the Civil Code:¹⁸

The contract of sale is perfected at the moment there is a *meeting of minds* upon the thing which is the object of the contract and upon the price. From that moment, the parties may reciprocally demand performance, subject to the provisions of the law governing the form of contracts.¹⁹

The existence of the meeting of the minds between the parties is a rule of thumb in a contract of sale in relation to the assignment of credits. In the absence of mutual consent on the object and the price, the transfer cannot be perfected. Proof is needed, therefore, that the contract of sale involved in the assignment of credit first satisfies these requisites. Other rudimentary prerequisites of great import must still be explored.

In Article 1300, in relation to Article 1291, of the Civil Code, under the law on obligations and contracts, novation²⁰ of obligations by subrogating a third person in the rights of a creditor “must be clearly established in order that it may take effect.”²¹ Novation is never presumed. Essential in novation

17. CIVIL CODE, art. 1626 (“[t]he debtor who, before having knowledge of the assignment, pays his creditor shall be released from the obligation.”).

18. *Id.* art. 1624 (“An assignment of credits and other incorporeal rights shall be perfected in accordance with the provisions of article 1475.”).

19. *Id.* art. 1475 (emphasis supplied).

20. TOLENTINO, OBLIGATIONS AND CONTRACTS, *supra* note 16, at 381.

Novation is the extinguishment of an obligation by the substitution or change of the obligation by a subsequent one which extinguishes or modifies the first, either by changing the object or principal conditions, or by substituting the person of the debtor, or by subrogating a third person in the rights of the creditor.

See *id.* (citing 8 Manresa 428; 2-I Ruggiero 219). See also, De Cortes v. Venturanza, 79 SCRA 709, 722-23 (1977); Cochingyan v. R&B Surety, 151 SCRA 339, 349 (1987).

21. See CIVIL CODE, art. 1300 in relation to art. 1291.

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

is the extinguishment of the old contract to give way to a new one. “[I]t is imperative that [the extinguishment] be so declared in unequivocal terms, or that the old and the new obligations be on every point incompatible with each other.”²² Either an express novation²³ or an implied novation²⁴ is required. Either way, the old contract has been extinguished and a new one must be clearly proved.

Furthermore, there must be consent of parties to the substitution, because, as previously noted, novation requires the creation of a new contractual relation, resulting in the extinction of the old obligation.²⁵ The transaction under the SPV Law is likewise governed by the Civil Code provisions on subrogation,²⁶ a form of novation through substitution of the rights of creditors, one requiring the consent of the debtor.

As mentioned above, the SPV Act declares that, after notifying of the borrower of the same through writing and via registered mail, a transfer is completed.²⁷ This provision on mere notice runs directly contrary to the provisions of the Civil Code on subrogation of the rights of creditors which

Art. 1291. Obligations may be modified by:

- (1) Changing their object or principal conditions;
- (2) Substituting the person of the debtor;
- (3) Subrogating a third person in the rights of the creditor

22. CIVIL CODE, art. 1292.

23. TOLENTINO, OBLIGATIONS AND CONTRACTS, *supra* note 16, at 384.

Novation takes place only when the contracting parties expressly disclose that their object in making the new contract is to extinguish the old contract, otherwise the old contract remains in force and the new contract is added to it, and each gives rise to an obligation still in force.

24. *Id.*

No specific form is required for an implied novation. All that is required is incompatibility between the original and the subsequent contracts. The test of incompatibility between two obligations or contracts, is whether they can stand together, each one having an independent existence. If they cannot, they are incompatible, and the subsequent obligation novates the first. Upon such novation, the former obligation loses all its force and effect, and only the new obligation can be the basis of an action.

25. *Id.* (citing Izzo v. Ludington, 79 N.Y. Supp. 744 (1903); Zapanta v. De Rotache, 21 Phil. 154 (1912); 2 CASTAN 567 - 570; 4 SALVAT 262; BEVILAQUA, OBLIGACIONES 130-131).

26. CIVIL CODE, art. 1300-1304.

27. SPECIAL PURPOSE VEHICLE ACT, § 12.

lay down the requirements for perfect novation, including the consent of the debtor.

Apart from the requirements of clear establishment and consent, however, there are other important legal requirements that are similarly overlooked by the SPV Act. When an assignment of credit is secured by a Mortgage Trust Indenture involving real estate collateral, the same must be annotated on the Torrens titles of the mortgaged properties in order to bind third parties. The Civil Code provides:

Art. 1625. An assignment of a credit or right or action shall produce no effect against third persons unless... the instrument is recorded in the Registry of Property in case the assignment involves real property.²⁸

Art. 1627. The assignment of a credit includes all the accessory rights, such as a guaranty, *mortgage*, pledge or preference.²⁹

When a credit affects real property, the assignment must be registered. This assignment, so recorded, binds the property and third persons from the date of the registry.³⁰ Without the registration, it is thus legally doubtful if the credit may be enforced by extra-judicial foreclosure – an act that affects third parties – since an unregistered real mortgage may not be foreclosed extra-judicially under Act 3135, as amended. Similarly, the assignee of a real estate mortgage, without the registration of the assignment, does not have the legal personality to institute extra-judicial foreclosure of the real estate mortgage as it is registered in the name of the assignor as mortgagee in the Register of Deeds. Without the registration of the assignment and its annotation at the back of the title of the mortgaged property, the petition for extra-judicial foreclosure by the assignee may be challenged as improper in form and substance as legal basis to deny due course by the Executive Judge to the petition.

Article 152 of the Spanish Mortgage Law requires that the assignment in favor of a third party of the whole or any part of a credit secured by mortgage shall be done by means of a public instrument, that the debtor be informed thereof, and that the same be recorded in the register, the assignee

28. CIVIL CODE, art. 1625.

29. CIVIL CODE, art. 1627.

30. Public Land Act, Commonwealth Act No. 141, § 50 (1936) cited in Republic Of The Philippines v. Jeremias And David Herbieto 459 SCRA 183, 203 (2005).

Any person or persons, or their legal representatives or successors in right, claiming any lands or interest in lands under the provisions of this chapter, must in every case present an application to the proper Court of First Instance, praying that the validity of the alleged title or claim be inquired into and that a certificate of title be issued to them under the provisions of the Land Registration Act.

being subrogated to all the rights of the assignor. In order for the transfer to be effective as against a third party, recording in the registry of property is indispensable.³¹

Indeed, mere notice to debtor, and not his consent, is only relevant in relation to Article 1626 of the Civil Code, where it mandates the debtor not to pay the assignor after notice of the assignment is given to him. For, without notice of the assignment to the borrower, payment to the original creditor discharges the obligation.

Consequently, because of the nature of the assignment contemplated in the SPV Act, the substantive and formal requirements under the above provisions of the Civil Code, the Public Land Law (now the Property Registration Code) and the Spanish Mortgage Law, as interpreted by the decisions of the Supreme Court, must be complied with before an assignment of credit and substitution of creditors will be both effective and binding. Thus, aside from notice to the borrower, the following requisites must also be observed: first, the clear establishment of novation; second, the required consent of parties in the subrogation of the rights of creditors as a form of novation; and third, the registration of the assignment if real properties are involved. In case of failure to observe such procedural and substantial requisites, no transfer is perfected, and legal personality of the assignee is not established to enforce the real estate mortgage.

III. THE HIGHEST STANDARDS OF FIDUCIARY DUTY OF EXTRAORDINARY DILIGENCE, FAIR DEALING, HONESTY AND GOOD FAITH IMPOSED ON BANKS TO TAKE CARE OF THE BEST INTEREST OF ITS DEPOSITORS AND CLIENTS

Unwritten policies dictated by the law of nature and manifested in the natural principles of justice, equity, and fairness underlie Philippine law. The same rules of equity were rooted in the French Civil Code, from which both the Philippine Civil Code of 1950 and its precursor, the Spanish Civil Code of 1889, were patterned. Equitable principles such as unjust enrichment, fair dealings, good faith, acting with justice, and giving every one his due have thus been enshrined and deeply embedded in the Philippine legal framework.

A. Principles of Good Faith, Honesty, Fair Dealings and Proscription Against Unjust Enrichment

The principle that no person should unjustly enrich himself at the expense of another has been one of the mainstays of every legal system for centuries. The Philippine Civil Code that took effect on 30 June 1950 adopted the

31. Lopez v. Alvarez, 9 Phil. 28, 33(1907).

doctrine against unjust enrichment as a general formula. According to the Code Commission that drafted the Civil Code: "It is most needful that this ancient principle be clearly and specifically consecrated in the Civil Code to the end that in cases not foreseen by the lawmaker, no one may unjustly benefit himself to the prejudice of another."³² In this light, the Civil Code provides:

Art. 19. Every person must, in the exercise of his rights and in the performance of his duties, act with justice, give everyone his due, and observe honesty and good faith.

Art. 20. Every person who, contrary to law, willfully or negligently causes damage to another, shall indemnify the latter for the same.

Art. 21. Any person who willfully causes loss or injury to another in a manner that is contrary to morals, good customs or public policy shall compensate the latter for the damage.

Art. 22. Every person who through an act of performance by another, or any other means, acquires or comes into possession of something at the expense of the later without just or legal ground, shall return the same to him.

Art 2142. Certain lawful, voluntary and unilateral acts give rise to the juridical relation of quasi-contract to the end that no one shall be unjustly enriched or benefited at the expense of another.³³

Codified in Article 19 is a rule of conduct, the observance of an ideal decorum in a social environment where justice and fair play must be observed. It portrays a set-up consistent with the keeping of orderly and harmonious relationships between and among men and women for the continuous prevention of the abuse of a right by a person.³⁴

The rationale behind Article 20, on the other hand, was clarified by the Supreme Court in *Albenson v. Court of Appeals*.³⁵ The Court held that it speaks of "the general sanction for all other provisions of law which do not especially provide their own sanction."³⁶ It serves as a catch-all provision giving resort to indemnification when a victim of a willful or negligent damaging act of another thereby suffers injuries.

32. Report of the Code Commission 41 (1947).

33. CIVIL CODE, arts. 19-22, 2142.

34. MELENCIO S. STA. MARIA, JR., PERSONS AND FAMILY RELATIONS LAW 31 (2004 ed.) [hereinafter STA. MARIA, PERSONS LAW].

35. *Albenson v. Court of Appeals*, 217 SCRA 16, 25(1993) cited in STA. MARIA, PERSONS LAW, *supra* note 34, at 32.

36. STA. MARIA, PERSONS LAW, *supra* note 34, at 32.

Article 21, too, by nature mirrors the aim to serve as a catch-all provision as there are "countless gaps in the statutes, which leave so many victims of moral wrongs helpless, even though they have actually suffered material and moral injury."³⁷ Dealing with acts *contra bonus mores*, its elements are as follows: 1) there is an act which is legal; 2) but which is contrary to morals, good customs, public order, or public policy; 3) and it is done with the intent to injure.³⁸ Loss or injury, material or otherwise, is a result of such violation.³⁹

Finally, Article 22 highlights the doctrine of unjust enrichment. "No person can claim what is not validly and legally his or hers."⁴⁰ Markedly extant in the law is the right to enjoy one's own property vis-à-vis the duty to return something unjustly or illegally acquired at the expense of another. Giving form to the policy against unjust enrichment is Article. 2142, defining quasi-contracts, through which, and despite the lack of a meeting of the minds, a juridical relation is nevertheless created so that no person shall enrich himself at the expense of another.⁴¹

B. The Bank's Extraordinary Fiduciary Duty to its Depositors and the Public

The standards of honesty, good faith and fair dealings are more strictly imposed upon assigning creditor banks for the care and protection of their depositors and clients due, principally, to the fact that their particular line of business involves public service and is thus highly impressed with public interest.

In *Philippine Banking Corporation vs. Court of Appeals*,⁴² the Supreme Court underscored the fiduciary duty of a bank to exercise extraordinary diligence in the care and protection of their depositors, as follows:

Section 2 of Republic Act No. 8791 (General Banking Law of 2000) expressly imposes this fiduciary duty on banks when it declares that the State recognizes the "fiduciary nature of banking that requires high standards of integrity and performance." This statutory declaration merely echoes the earlier pronouncement of the Supreme Court in *Simex International (Manila) Inc. v. Court of Appeals* requiring banks to "treat the

37. Report of the Code Commission, *supra* note 32, at 39.

38. *Albenson Enterprises Corp. v. Court of Appeals*, 217 SCRA 16, 25 (1993).

39. *Cogeo-Cubao Operators and Drivers Association v. Court of Appeals*, 207 SCRA 343, 348 (1992).

40. STA. MARIA, PERSONS LAW, *supra* note 34, at 32.

41. MELENCIO S. STA. MARIA, JR., OBLIGATIONS AND CONTRACTS TEXT AND CASES (2003 ed.) [hereinafter STA. MARIA, OBLIGATIONS AND CONTRACTS].

42. *Philippine Banking Corporation v. Court of Appeals*, 419 SCRA 487, 505 (2004) (citations omitted).

accounts of its depositors with meticulous care, always having in mind the fiduciary nature of their relationship." The Court reiterated this fiduciary duty of banks in subsequent cases.

Although RA No. 8791 took effect only in the year 2000 (RA No. 8791 was approved on 3 May 2000), at the time that the BANK transacted with Marcos, jurisprudence had already imposed on banks the same high standard of diligence required under RA No. 8791. This fiduciary relationship means that the bank's obligation to observe "high standards of integrity and performance" is deemed written into every deposit agreement between a bank and its depositor."

Nor can it be said that the above case stands alone. Indeed, the Court has emphasized time and again the highest degree of care and diligence required of banks. In *Samsung Construction Company Philippines, Inc. v. Far East Bank and Trust Company*,⁴³ the Court, in a forgery case, held the bank liable irrespective of its good faith and even if it exerted due diligence and care in preventing the discharge of payment of a forged check. The Court thus explained:

Banks are engaged in a business impressed with public interest, and it is their duty to protect in return their many clients and depositors who transact business with them. They have the obligation to treat their client's account meticulously and with the highest degree of care, considering the fiduciary nature of their relationship. The diligence required of banks, therefore, is more than that of a good father of a family.⁴⁴

It therefore cannot be stressed enough that, inculcated in the responsibility of a financial institution is the extraordinary degree of care and diligence it owes to its depositors and the public, as the transactions in which they are involved strongly shape and directly affect the economic standing and fortune of the individuals and the country at large.

C. *The Same High Standards are Required under the Special Purpose Vehicle Act of 2002*

The standards of good faith, honesty, and fair dealings with the Borrower are likewise carried over in the Special Purpose Vehicle Law:

The borrower and the financial institution shall be given a period of at most ninety (90) days upon receipt of notice, pursuant to the Rules of Court, to restructure or renegotiate the loan under such terms and

43. *Samsung Construction Company Philippines, Inc. v. Far East Bank and Trust Company*, 436 SCRA 402 (2004).

44. *Id.* at 421 (citing *Westmont Bank v. Ong*, 375 SCRA 212, 220-221).

conditions as may be agreed upon by the borrower and the financial institutions concerned⁴⁵

Because perfection of the assignment requires prior notice to the borrower and because a 90-day renegotiation is provided wherein the borrower has a chance to save the subject loan, the law itself implicitly recognizes the principles of good faith, honesty, and fair dealings. But, given that high standards are imposed upon banks, their extraordinary fiduciary duty mandates that observance of such principles be taken to a much higher degree.

D. *The Harsh Realities of the Law.*

One such example, blending the general equitable policy of unjust enrichment and the extraordinary duty of diligence and fairness to the borrowers, is the right of first refusal. A right of first refusal is a promise on the part of the owner that if he decides to sell the property in the future he would sell it to the promisee.⁴⁶ The exercise of such right depends on the promisor's final intention to enter into a binding juridical relation with another and on terms that are yet to be concluded. The promisor's "offer" may be withdrawn anytime by communicating the withdrawal to the other party.⁴⁷

While no right of first refusal is written into the law, the demands of good faith, honesty, fair dealings, and the extraordinary fiduciary duty of diligence in caring for the interest of the borrower require that the bank should first offer to the borrower the best terms of settlement and at the price or consideration that the bank is willing to sell the credit to a third party. Oftentimes however, the SPVs or other third parties are preferred by the banks, instead of the borrowers. Under the law, SPVs are awarded tax exemptions and fee privileges because of their participation in the SPV scheme.⁴⁸ Unfortunately, such incentives can never be availed of by the borrower, regardless of whether or not the latter offers better terms.

Such a situation is not fair, not just nor equitable, and neither is it in keeping with the tenets of honesty, fair dealings, and good faith. Indeed, a breach of the right of first refusal may fall within violations of the principles of justice and fair play underscored in Article 19 of the Civil Code.

Failure to sell the credit to the borrower at the discounted price not only runs against the ideals of conduct outlined above, but it also directly collides

45. SPECIAL PURPOSE VEHICLE ACT, § 12 (a).

46. CESAR L. VILLANUEVA, *LAW ON SALES* 172 (2004 ed.).

47. *Vasquez vs. Ayala Corporation*, 443 SCRA 231, 256 (2004).

48. See SPECIAL PURPOSE VEHICLE ACT, § 15-§ 18.

with the express policy of the SPV Act "to help in the rehabilitation of distressed businesses."⁴⁹ The nature of the subject NPAs presupposes the involvement of distressed businesses in the persons of the borrowers. The undue preference that hinge on SPV incentives consequently falls short in reaching the very goal it seeks to attain i.e., to help in the rehabilitation of persons in financial distress. By no means can distressed businesses be rehabilitated when they are cast aside via the bias and unjust enrichment at their expense set in place for preferring SPVs.

To repeat, the Supreme Court has pronounced that it is the duty of the banks to protect their clients who transact business with them. For that reason, the legal relationship between the bank and its clients entails a degree of diligence higher than that of a good father of a family.⁵⁰ It is without cavil that no good father (the bank) would exercise acts to the detriment of his family (the clients). However, exclusion from the auction of the credit is one such glaring detrimental act.

In sum, the SPV Act opens the door to a breach of the right of first refusal, amounting to undue preference and resulting in a violation of the bedrock principles of justice and fair play, and a breach of legally mandated extraordinary fiduciary duties to protect the interests of the depositors and borrowers.

Acts done in contravention of mandatory provisions of law are null and void.⁵¹ A mandatory provision of law is one, the omission of which renders the proceeding or acts to which it relates generally illegal or void.⁵² General principles of unjust enrichment, fair dealings, good faith, acting with justice and giving every one his due are carried over, enshrined, and deeply embedded in the Philippine Civil Code. The instances illustrated above delineate and highlight precisely the clear infringement of these principles.

E. Resolving the Quandary

The solution to this seeming conflict is the installation of the equitable right of redemption coupled with a right of the assignee suffering damage to

49. SPECIAL PURPOSE VEHICLE ACT, § 2.

50. *Samsung Construction Company Philippines, Inc. v. Far East Bank and Trust Company*, 436 SCRA 402, 421 (2004).

51. CIVIL CODE, art. 5 ("[a]cts executed against the provisions of mandatory or prohibitory laws shall be void, except when the law itself authorizes their validity.").

52. STA. MARIA, PERSONS LAW, *supra* note 34, at 8.

recover from whoever proximately caused the same.⁵³ The assignee thus becomes the trustee of an implied trust. Under the Civil Code:

There is an implied trust when property is sold, and the legal estate is granted to one party but the price is paid by another for the purpose of having the beneficial interest of the property. The former is the trustee, while the latter is the beneficiary....⁵⁴

An implied trust forms by law in favor of the one who pays the purchase money of a property and places the title in the name of another, with the presumption that he who pays for a thing (the trustee) intends a beneficial interest therein.⁵⁵ Within the system, as the trustee is the assignee-SPV, if the SPV suffers loss, it may recover from he who proximately causes such a loss. Because of the quasi-contract created, the SPV (as the assignee-trustee) therefore has the duty to reconvey the credits to the borrower by allowing the exercise of equitable right of redemption or any similar equitable arrangement, in line with the mandate found in Article 2142 of the Civil Code.⁵⁶

Under the SPV Act, "the provisions on subrogation and assignment of credits under the New Civil Code shall apply."⁵⁷ This includes Article. 1634, which reads as follows:

When a credit or other incorporeal right in litigation is sold, the debtor shall have a right to extinguish it by reimbursing the assignee for the price the latter paid therefore, the judicial costs incurred by him, and the interest on the price from the day on when the same was paid.

A credit or other incorporeal right shall be considered in litigation from the time the complaint concerning the same is answered.

The debtor may exercise his right within thirty days from the date the assignee demands payment from him.⁵⁸

From the foregoing, it appears that the right of legal redemption under the Civil Code is premised on the pendency of litigation at the time of the assignment of credit. However, this requirement may be challenged for being unconstitutional insofar as it discriminates against borrowers who have not gone to court and in favor of those who have done so thus violating the

53. CIVIL CODE, art. 20.

54. CIVIL CODE, art. 1448.

55. TOLENTINO, OBLIGATIONS AND CONTRACTS, *supra* note 16, at 678.

56. CIVIL CODE, art. 2142 ("[c]ertain lawful, voluntary and unilateral acts give rise to the juridical relation of quasi-contract to the end that no one shall be unjustly enriched or benefited at the expense of another.").

57. SPECIAL PURPOSE VEHICLE ACT, § 13.

58. CIVIL CODE, art. 1634.

equal protection clause of the Constitution that “[n]o person shall be deprived of life, liberty, and property, without due process of the law nor shall any person be denied the equal protection of the laws.”⁵⁹ There exists no reasonable classification between those who have gone to court and those who have resorted to extinguish the assignment of credit by reimbursing the assignee for the price the latter has paid to the assignor.

In addition, the distinction encourages rather than prevents litigation, hence it is void for being contrary to public policy⁶⁰ against barratry.⁶¹ Because the right of redemption only arises through the course of a pending suit, the provision, in effect, encourages parties to go to court simply for the purpose of availing themselves of the consequent right to extinguish the assignment by reimbursement.

Besides, this artificial distinction would frustrate the philosophy and equitable rationale behind both the legal right of redemption – as preventing unjust enrichment on the part of the assignee or buyer of the credit – and the SPV Act itself – which protects the borrower by allowing him to pay only the amount which the creditor is willing to accept in order to accomplish “the rehabilitation of distressed businesses.”⁶²

Moreover, the right of redemption under Article 1634 of the Civil Code must still be harmonized with the policies of the Civil Code on honesty, good faith and fair dealings, and the highest fiduciary extraordinary duty of care and diligence of the banks in the protection the borrowers, as well as the specific express policy of the SPV Act, as mentioned above.

IV. THE APPLICABILITY OF THE TRUTH IN LENDING ACT

The Truth in Lending Act (R.A. 3765), which remains in full force and effect despite the suspension of Act 2655, as amended, or the Usury Law, specifically includes “any purchase, or acquisition of, or any credit upon the security of, any obligation of claim”⁶³ among the covered transactions requiring disclosure of the costs of credit; this shall be in a Disclosure Statement that must be given by the creditor to the borrower.

59. PHIL. CONST. art III, § 1.

60. See *Teves v. People's Homesite and Housing Corporation* 23 SCRA 1141, 1148 (1968).

61. CIVIL CODE, art. 1306 (“[t]he contracting parties may establish such stipulations, clauses, terms and conditions as they may deem convenient, provided they are not contrary to law, morals, good customs, public order, or public policy.”).

62. SPECIAL PURPOSE VEHICLE ACT, § 2.

63. An Act to Require the Disclosure of Finance Charges in Connection with Extensions in Credit, Republic Act No. 3765, § 3(2) (1963).

The applicability of the Truth in Lending Act is a material consideration in transactions under the SPAV Law expressly characterized as assignments of credit. In practice, the SPAVs refuse to divulge the transfer prices of the NPLs, which are the considerations for the assignment, claiming information. What they do is execute a detached Deed of Assignment on the specific credits of individual borrowers without disclosing the transfer price. They refuse the request of borrowers for a copy of the Master Deed of Sale or Deed of Assignment covering all that the NPLs purchased by block as these documents indicate the transfer price.

Since execution of a public document is a formal requirement, and annotation at the back of the mortgaged titles of the assignment is necessary to bind third parties, the requirement that the costs of credit must be disclosed by the new creditor in a Disclosure Statement under the Truth in Lending Act is an incontrovertible indication that the transfer price cannot be concealed from the borrower, who is liable for the repayment of the assigned credit. Failure to comply with the disclosure requirement under the Truth in Lending Act even carries a criminal sanction.

V. CONCLUSION

The economic crisis that beset the country at the turn of the century posed a challenge to the administration, leading to the enactment of the SPV Act of 2002. Yet, even today, the country's financial system is burdened by NPAs that have only worsened through the years. The SPV Act of 2002 was enacted for the very reason of alleviating this depressing economic state by encouraging the operation of companies specializing in the buying of bad debts and foreclosed assets at a discount.

Pinpointed in this argument are the loopholes dotting the legislation, focusing primarily on the transfer of assets. First is the wrongful presumption that mere notice is sufficient to perfect the assignment of credit. Because of the nature of the assignment as a novation, the following requisites, aside from notice must also be observed: the clear establishment of novation; the required consent of parties in either form of novation; and, the registration of the assignment involving real properties. The danger that upholding such a misconceived mere-notice rule poses is the potential failure to observe the procedural and substantial requisites which are necessary for perfection of the transfer and establishment of legal personality on the part of the assignee to enforce the real estate mortgage registered and annotated in favor of the assignee as mortgagee at the back of the Torrens title of the mortgaged property.

The SPV Act also houses a breach of the right of first refusal amounting to undue preference and resulting in a violation of the bedrock principles of justice and fair play, and a breach of fiduciary duty. The equitable principles of unjust enrichment, fair dealing, good faith, and acting with justice and

giving every one his due have been carried over, enshrined, and deeply embedded in the Civil Code for a purpose. Therefore, a piece of legislation runs amuck when it contains a provision in contravention of these rudimentary principles. Indeed, acts done in contravention of mandatory provisions of law are null and void.

The solution suggested is an equitable right of redemption, and if the assignee happens to suffer loss or damage, recovery may be made from whoever is the proximate cause thereof. Due to the quasi-contract resulting from the three-party set-up of the SPV Act, the SPV is beholden, as the assignee-trustee in an implied trust, to reconvey the credits to the borrower through the exercise of the right of redemption or other similar equitable arrangement.

Similarly, while Article 1634 of the Civil Code is made applicable to the SPV Act, thereby allowing reimbursement of the transfer price as a recourse to extinguish the assignment, this was made subject to the requirement that it may only be availed of by those with cases pending litigation. The provision may be challenged as unconstitutional and violative of the equal protection clause, discriminating as it does against borrowers who have not gone to court in favor of those who have. Furthermore, because it also encourages litigation, it is therefore void for being contrary to public policy against barratry. Finally, it frustrates both the policy against unjust enrichment on the part of the assignee or buyer of the credit and the policy to protect the borrower by allowing him to pay only the amount which the creditor is willing to accept.

In light of the above considerations, the substantive and procedural requirements should be met in order to perfect and implement the assignment of credit; the provisions should be placed in line with elementary legal norms; and, the creditor banks must abide by the highest fiduciary standards of good faith and extraordinary diligence in the assignment of credits.

Office of the Government Corporate Counsel: The Statutory Legal Counsel

By Government Corporate Counsel Agnes VST Devanadera*

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I. INTRODUCTION

It took 70 years for the Office of the Government Corporate Counsel (hereinafter OGCC) to evolve into the institution that it is now. Its powers and duties were shaped through time by laws and jurisprudence.

From a mere division of the Department of Justice, the OGCC has grown into an autonomous and separate legal institution whose principal duty is to act as the statutory legal counsel of all government-owned and controlled corporations (hereinafter GOCCs).

The OGCC is also mandated to exercise effective control and supervision over legal departments maintained by GOCCs to ensure that their corporate and other objectives are aligned with those of the national government.

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