Republic of the Philippines
Supreme Court
Manila

EN BANC

Y-I LEISURE PHILIPPINES, INC., YATS INTERNATIONAL LTD. and Y-I CLUBS AND RESORTS, INC., Petitioners,	**G.R. No. 207161**
	Present:
	SERENO, *C.J.,* CARPIO, VELASCO, JR., LEONARDO-DE CASTRO, BRION, PERALTA, BERSAMIN, DEL CASTILLO, VILLARAMA, JR., PEREZ, MENDOZA, REYES,* PERLAS-BERNABE, LEONEN, and JARDELEZA, *JJ.*
- versus -	
JAMES YU, Respondent.	Promulgated: September 8, 2015

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DECISION

MENDOZA, *J.*:

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

* On leave.

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

The Facts

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

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

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

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

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[1] Penned by Associate Justice Remedios A. Salazar-Fernando, with Associate Justices Mario V. Lopez and Amy C. Lazaro-Javier, concurring; *rollo*, pp. 31-57.
[2] Id. at 58-60.
[3] Penned by Judge Ma. Theresa L. Dela Torre-Yadao; id. at 61-76.
[4] Records, Vol. II, p. 787.
[5] Id. at 770-782.
[6] Id. at 783-785.
[7] Id. at 857.
[8] Records, Vol. I, pp. 1-6.

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

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

After the pre-trial, Yu filed an Amended Complaint,[13] wherein he also impleaded YIL, Y-I Leisure Phils., Inc. *(YILPI)* and Y-I Club & Resorts, Inc. *(YICRI)*. According to Yu, he discovered in the Registry of Deeds of Pampanga that, substantially, all the assets of MADCI, consisting of one hundred twenty (120) hectares of land located in Magalang, Pampanga, were sold to YIL, YILPI and YICRI. The transfer was done in fraud of MADCI's creditors, and without the required approval of its stockholders and board of directors under Section 40 of the Corporation Code. Yu also alleged that Sangil even filed a case in Pampanga which assailed the said irregular transfers of lands.

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

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[9] Id. at 97-100.
[10] Id. at 138-141.
[11] Id. at 142-149.
[12] Id. at 163.
[13] Id. at 239-248.
[14] Id. at 584-591.
[15] Records, Vol. II, p. 817.
[16] Id. at 822.

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

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

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

Wang further testified that the MOA stipulated that MADCI would execute a special power of attorney in his favor, empowering him to sell the property of MADCI in case of default in the performance of obligations.[23] Due to Sangil's subsequent default, a deed of absolute sale over the lands of

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[17] TSN, July 13, 2007, p. 10.
[18] Id. at 7.
[19] Id. at 25.
[20] TSN, November 7, 2008, p. 13.
[21] TSN, September 11, 2009, p. 10.
[22] TSN, November 7, 2008, p. 19.
[23] Id. at 25.

MADCI was eventually executed in favor of YICRI, its designated company.[24] Wang also stated that, aside from its lands, MADCI had other assets in the form of loan advances of its directors.[25]

The RTC Ruling

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

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

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

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

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[24] Id. at 29.
[25] Id. at 32.
[26] *Rollo*, pp. 75-76.

The CA Ruling

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

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

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

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

Anent Sangil's liability, the CA ruled that he could not use the separate corporate personality of MADCI as a tool to evade his existing personal obligations under the MOA. The dispositive portion of the decision reads:

> WHEREFORE, the appeals are PARTLY GRANTED. Accordingly, the assailed Decision dated August 31, 2010 in Civil Case No. Q-00-41579 of the RTC of Quezon City, Branch 81, is hereby AFFIRMED WITH MODIFICATION, in that defendants-

[27] 530 Phil. 149 (2006).

> appellees YIL, YILPI and YICRI are hereby held jointly and severally liable with defendant-appellee MADCI and defendant-appellant Sangil for the satisfaction of plaintiff-appellant Yu's claim.
>
> In all other respects, the assailed decision stands.
>
> SO ORDERED.[28]

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

Hence, this petition.

ISSUE

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

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

The petitioners also argue that fraud must exist to hold third parties liable. The sale in this case was not in any way tainted by any of the "badges of fraud" cited in *Oria v. McMicking*.[30] The CA itself stated that the alleged simulation of the sale was not established by respondent Yu. Moreover, Article 1383 of the Civil Code requires that the creditor must prove that he has no other legal remedy to satisfy his claim. Such requirement must be followed whether by an action for rescission or action for sum of money.

On September 20, 2013, respondent Yu filed his Comment.[31] He asserted that the CA correctly applied *Caltex* in the present case as the lands sold to the petitioners were the only assets of MADCI. After the sale, MADCI became incapable of continuing its business, and its corporate existence has just remained to this day in a virtual state of suspended

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[28] *Rollo*, p. 56.
[29] Id. at 17.
[30] 21 Phil. 243 (1912).
[31] *Rollo*, pp. 85-92.

animation. Thus, unless the creditors had agreed to the sale of all the assets of the corporation and had accepted the purchasing corporation as the new debtor, sufficient assets should have been reserved to pay their claims.

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

The Court's Ruling

The petition lacks merit.

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

Hence, the issue at hand presents a complex question of law - whether fraud must exist in the transfer of all the corporate assets in order for the transferee to assume the liabilities of the transferor. To resolve this issue, a review of the laws and jurisprudence concerning corporate assumption of liabilities must be undertaken.

Background on the corporate assumption of liabilities

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

> Generally, where one corporation sells or otherwise transfers all of its assets to another corporation, the latter is not liable for the debts and liabilities of the transferor, **except:**

[32] Id. at 99-103.
[33] 122 Phil. 825 (1965).

1. Where the purchaser expressly or impliedly agrees to assume such debts;

2. Where the transaction amounts to a consolidation or merger of the corporations;

3. Where the purchasing corporation is merely a continuation of the selling corporation; and

4. Where the transaction is entered into fraudulently in order to escape liability for such debts.

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

Legal bases of the Nell Doctrine

An evaluation of our contract and corporation laws validates that the Nell Doctrine is fully supported by Philippine statutes. The general rule expressed by the doctrine reflects the principle of relativity under **Article 1311**[34] of the Civil Code. Contracts, including the rights and obligations arising therefrom, are valid and binding only between the contracting parties and their successors-in-interest. Thus, despite the sale of all corporate assets, the transferee corporation cannot be prejudiced as it is not in privity with the contracts between the transferor corporation and its creditors.

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

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

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

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

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

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

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

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

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

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[36] 2010 ed., p. 682.
[37] 134 Phil. 796 (1968).
[38] See Villanueva, Philippine Corporate Law, 2010 ed., p. 684.

> Sec. 40. Sale or other disposition of assets. - Subject to the provisions of existing laws on illegal combinations and monopolies, a corporation may, by a majority vote of its board of directors or trustees, **sell, lease, exchange, mortgage, pledge or otherwise dispose of all or substantially all of its property and assets, including its goodwill,** upon such terms and conditions and for such consideration, which may be money, stocks, bonds or other instruments for the payment of money or other property or consideration, as its board of directors or trustees may deem expedient, when authorized by the vote of the stockholders representing at least two-thirds (2/3) of the outstanding capital stock, or in case of non-stock corporation, by the vote of at least two-thirds (2/3) of the members, in a stockholder's or member's meeting duly called for the purpose. Written notice of the proposed action and of the time and place of the meeting shall be addressed to each stockholder or member at his place of residence as shown on the books of the corporation and deposited to the addressee in the post office with postage prepaid, or served personally: Provided, That any dissenting stockholder may exercise his appraisal right under the conditions provided in this Code.
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> A sale or other disposition shall be deemed to cover substantially all the corporate property and assets if thereby the corporation would be **rendered incapable of continuing the business or accomplishing the purpose for which it was incorporated.**
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> After such authorization or approval by the stockholders or members, the board of directors or trustees may, nevertheless, in its discretion, abandon such sale, lease, exchange, mortgage, pledge or other disposition of property and assets, subject to the rights of third parties under any contract relating thereto, without further action or approval by the stockholders or members.
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> Nothing in this section is intended to restrict the power of any corporation, without the authorization by the stockholders or members, to sell, lease, exchange, mortgage, pledge or otherwise dispose of any of its property and assets if the same is necessary in the usual and regular course of business of said corporation or if the proceeds of the sale or other disposition of such property and assets be appropriated for the conduct of its remaining business.
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> In non-stock corporations where there are no members with voting rights, the vote of at least a majority of the trustees in office will be sufficient authorization for the corporation to enter into any transaction authorized by this section.
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> [Emphases Supplied]

To reiterate, Section 40 refers to the sale, lease, exchange or disposition of all or substantially all of the corporation's assets, including its goodwill.[39] The sale under this provision does not contemplate an ordinary sale of all corporate assets; the transfer must be of such degree that the transferor corporation is rendered incapable of continuing its business or its corporate purpose.[40]

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

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

Jurisprudential recognition of the business-enterprise transfer

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

In *A.D. Santos, Inc. v. Vasquez,*[43] a taxi driver filed a suit for workmen's compensation against the petitioner corporation therein. The latter's defense was that the taxi driver's employer was Amador Santos, and not the corporation. Initially, the taxi driver was employed by City Cab, a sole proprietary by Amador Santos. The taxi business was, however,

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[39] *Lopez Realty, Inc. v. Fontecha,* 317 Phil. 216, 229 (1995).
[40] See Paragraph 2, Section 40, Corporation Code.
[41] See Paragraph 3, Section 40, Corporation Code.
[42] Villanueva, Philippine Corporate Law, 2010 ed., p. 686, 687.
[43] 131 Phil. 262 (1968).

transferred to the petitioner. Applying the piercing doctrine, the Court held that the petitioner must still be held liable due to the transfer of the business and should not be allowed to confuse the legitimate issues.

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

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

The Court, however, applied the business-enterprise transfer doctrine independent of the piercing doctrine in other cases. In *San Teodoro Development Enterprises v. SSS,* [46] the petitioner corporation therein attempted to avoid the compulsory coverage of the Social Security Law by alleging that it was a distinct and separate entity from its limited partnership predecessor, Chua Lam & Company, Ltd. The Court, however, upheld the findings of the SSS that the entire business of the previous partnership was transferred to the corporation ostensibly for a valuable consideration. Hence, "[t]he juridical person owning and operating the business remain the same even if its legal personality was changed."[47]

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

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[44] 212 Phil. 723 (1984).
[45] Id. at 733.
[46] 118 Phil. 103 (1963).
[47] Id. at 106.
[48] 107 Phil. 833 (1960).

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

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

> While the Corporation Code allows the transfer of all or substantially all the properties and assets of a corporation, the transfer should not prejudice the creditors of the assignor. The only way the transfer can proceed without prejudice to the creditors is to hold the assignee liable for the obligations of the assignor. **The acquisition by the assignee of all or substantially all of the assets of the assignor necessarily includes the assumption of the assignor's liabilities,** unless the creditors who did not consent to the transfer choose to rescind the transfer on the ground of fraud. To allow an assignor to transfer all its business, properties and assets without the consent of its creditors and without requiring the assignee to assume the assignor's obligations will defraud the creditors. The assignment will place the assignor's assets beyond the reach of its creditors.
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> Here, Caltex could not enforce the judgment debt against LUSTEVECO. The writ of execution could not be satisfied because LUSTEVECO's remaining properties had been foreclosed by lienholders. In addition, all of LUSTEVECO's business, properties and assets pertaining to its tanker and bulk business had been assigned to PSTC without the knowledge of its creditors. Caltex now has no other means of enforcing the judgment debt except against PSTC.[50]
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> [Emphasis Supplied]

The *Caltex* case, thus, affirmed that the transfer of all or substantially all the proper from one corporation to another under Section 40 necessarily entails the assumption of the assignor's liabilities, notwithstanding the absence of any agreement on the assumption of obligations. The transfer of

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[49] Supra note 27 at 158.
[50] Id. at 159-160.

all its business, properties and assets without the consent of its creditors must certainly include the liabilities; or else, the assignment will place the assignor's assets beyond the reach of its creditors. In order to protect the creditors against unscrupulous conveyance of the entire corporate assets, *Caltex* justifiably concluded that the transfer of assets of a corporation under Section 40 must likewise carry with it the transfer of its liabilities.

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

Notably, an evaluation of the relevant jurisprudence reveals that fraud is not an essential element for the application of the business-enterprise transfer.[51] The petitioners in this case, however, assert otherwise. They insist that under the *Caltex* case, there was an assumption of liabilities because fraud existed on the part of PSTC, as the transferee corporation.

The Court disagrees.

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

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

The Court also agrees with the CA, in its assailed April 29, 2013 resolution, that there was no finding of fraud in the *Caltex* case; otherwise it

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[51] Id. at 688.
[52] 3. Where the purchasing corporation is merely a continuation of the selling corporation.
[53] Villanueva, Philippine Corporate Law, 2010 ed., p. 686.

should have been clearly and categorically stated.[54] The discussion in *Caltex* relative to fraud seems more hypothetical than factual, thus:

> If PSTC refuses to honor its written commitment to assume the obligations of LUSTEVECO, there will be a fraud on the creditors of LUSTEVECO. x x x To allow PSTC now to welsh on its commitment is to sanction a fraud on LUSTEVECO's creditors.[55]

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

Applicability of the business-enterprise transfer in the present case

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

According to its articles of incorporation, the primary purpose of MADCI was "[t]o acquire by purchase, lease, donation or otherwise, and to own, use, improve, develop, subdivide, sell, mortgage, exchange, lease, develop and hold for investment or otherwise, real estate of all kinds, whether improved, managed or otherwise disposed of buildings, houses, apartment, and other structures of whatever kind, together with their

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[54] *Rollo,* p. 59.

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

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

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

appurtenance."[57] During the trial before the RTC, Sangil testified that MADCI was a development company which acquired properties in Magalang, Pampanga to be developed into a golf course.[58]

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

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

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

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

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[57] Records, Vol. II, p. 788.
[58] TSN, September 22, 2006, p. 27.
[59] *Rollo,* p. 22.
[60] Records, Vol. I, p. 161.
[61] Id. at 162.
[62] Records, Vol. II, p. 817.
[63] Id. at 822.
[64] TSN, May 28, 2004, p. 13; TSN, July 2, 2004, p. 7.
[65] TSN, September 24, 2004, p. 11.
[66] TSN, July 13, 2007, p. 10.

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

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

Section 40 must apply.

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

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

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

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[67] TSN, September 11, 2009, p. 10.
[68] TSN, November 7, 2008, p. 29.
[69] *STRADEC v. Radstock*, 622 Phil. 431, 535 (2009).

The MOA cannot prejudice respondent

The MOA, which contains a provision that Sangil undertook to redeem MADCI proprietary shares sold to third persons or settle in full all their claims for refund of payments, should not prejudice respondent Yu. The CA correctly ruled that such provision constituted novation under **Article 1293**[70] of the Civil Code. When there is a substitution of debtors, the creditor must consent to the same; otherwise, it shall not in any way affect the creditor. In this case, it was established that Yu's consent was not secured in the execution of the MOA. Thus, insofar as the respondent was concerned, the debtor remained to be MADCI. And given that the assets and business of MADCI have been transferred to the petitioners, then the latter shall be liable.

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

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

Free and Harmless Clause

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

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[70] Art. 1293. Novation which consists in substituting a new debtor in the place of the original one, may be made even without the knowledge or against the will of the latter, but not without the consent of the creditor. Payment by the new debtor gives him the rights mentioned in Articles 1236 and 1237. (1205a)

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

business enterprise who can still go after the transferee for the enforcement of the liabilities.[72]

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

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

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

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

SO ORDERED.

JOSE CATRAL MENDOZA
Associate Justice

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[72] Villanueva, Philippine Corporate Law, 2016 ed., p. 692.
[73] 579 Phil. 418, 431 (2008).

WE CONCUR:

MARIA LOURDES P. A. SERENO
Chief Justice

ANTONIO T. CARPIO
Associate Justice

PRESBITERO J. VELASCO, JR.
Associate Justice

TERESITA J. LEONARDO-DE CASTRO
Associate Justice

ARTURO D. BRION
Associate Justice

DIOSDADO M. PERALTA
Associate Justice

LUCAS P. BERSAMIN
Associate Justice

MARIANO C. DEL CASTILLO
Associate Justice

MARTIN S. VILLARAMA, JR.
Associate Justice

JOSE PORTUGAL PEREZ
Associate Justice

(On Leave)
BIENVENIDO L. REYES
Associate Justice

ESTELA M. PERLAS-BERNABE
Associate Justice

MARVIC M.V.F. LEONEN
Associate Justice

FRANCIS H. JARDELEZA
Associate Justice

CERTIFICATION

Pursuant to Section 13, Article VIII of the Constitution, I hereby certify that the conclusions in the above Decision had been reached in consultation before the case was assigned to the writer of the opinion of the Court.

MARIA LOURDES P. A. SERENO
Chief Justice