COMMENT:

THE RIGHT OF SECURED CREDITORS TO FORECLOSE AGAINST CORPORATE DEBTORS IN SUSPENSION OF PAYMENTS OR REHABILITATION RECEIVERSHIP

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The country's desire to stabilize its financial market and to strengthen its banking sector has perhaps not encountered a more formidable and unrelenting adversary than Presidential Decree No. 902-A, or to be more precise, the ruling laid down by the Supreme Court in a number of cases[1] that when a corporation files a petition for suspension of payments (preparatory to, or as an incident of, rehabilitation receivership) their preferred creditors (e.g. those with mortgages or pledges on their properties) can no longer proceed against the property mortgaged or pledged to them to satisfy their claims but must await the outcome of the rehabilitation plan. In effect, during the rehabilitation receivership proceedings secured creditors are placed on equal footing with unsecured creditors who must wait to be paid in accordance with the rehabilitation plan of such distressed corporate debtor.

Lenders in general, and banks in particular, lend mainly on the strength of the security given by the borrower in the form of either a chattel or real estate mortgage. In case the borrower defaults, the lender can be assured of being paid its unpaid loan, or a substantial portion thereof, by foreclosing on the collateral.

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[1] *See, e.g.*, Alemar's Sibal & Sons v. Elbinias, G.R. No. 75414, 4 June 1990, 186 SCRA 94; BF Homes Inc. v. Court of Appeals, G.R. No. 76879, 3 October 1990, and G.R. No. 77413, 3 October 1990, 190 SCRA 262; Araneta v. Court of Appeals, G.R. No. 95253, 10 July 1992, 211 SCRA 390; Bank of the Philippine Islands v. Court of Appeals, G.R. No. 97178, 10 January 1994, 229 SCRA 223.

Moreover, just like any commodity for sale in the market, among the substantial determinants of the pricing of a loan (the commodity) is whether or not the borrower (the buyer) provides the lender (the seller) with security or collateral. Loans without collateral are priced more (i.e. a higher interest rate is charged by the lender) than loans with collateral. Thus, other things being the same, unsecured lenders earn higher returns on the money they lend than secured lenders. The higher price (higher interest) charged by unsecured lenders is the compensation or trade-off for their lack of security. The premium paid by unsecured borrowers to unsecured lenders is the price exacted by the lenders to compensate them for assuming a higher risk of not being paid. This price differential is determined by the law of supply and demand for loans in the marketplace. Having this law of the market in mind, there is an obvious inequity in putting secured creditors on equal footing with unsecured creditors when the debtor is unable to pay his loans. Unsecured creditors exacted payment for the risk they assumed while secured creditors did not. Any doctrine that blindly lumps together with secured and unsecured creditors of a distressed corporate debtor is oblivious to this basic law of the marketplace; it sanctions inequity.

Unless the corporate borrower has a proven track record as a good borrower that promptly pays its loans when they fall due, the fact that the borrower is able to provide collateral is a substantial factor in the bank's decision to lend to such borrower.

Recently, many large companies with hundreds of millions, if not billions, in defaulted loans, have trooped to the Securities and Exchange Commission (SEC) seeking suspension of payments as a step to rehabilitation receivership.[2] Under present case law, banks holding mortgages over properties of these corporate debtors seeking debt relief before the SEC have been left empty-handed over unpaid loans despite their collateral. The hands of these creditor banks are tied because they can no longer foreclose on their collateral securing their defaulted loan. Quite obviously, the banking sector has been a major casualty in many of these defaults.

This Comment examines the prevailing jurisprudence and addresses some of the difficult issues facing secured creditors in the light of this jurisprudence.

[2] For example, Victorias Milling Company, Inc.; Philippine Air Lines; the Uniwide Group of Companies.

Just what are the rights of secured creditors under prevailing jurisprudence? Are secured creditors required to submit themselves to the jurisdiction of the SEC? What if they do not? Do they lose the right to their security? If so, how will they be paid?

Is prevailing jurisprudence sound? Is there any rhyme or reason, or consistency, in the rules laid down by the Court? Do the rules suffer from any constitutional infirmity particularly in the light of the constitutional provision that protects contracts from impairment?

In *Alemar's Sibal & Sons v. Elbinias*,[3] the Supreme Court ruled that a judgment obtained in a regular court by an unsecured creditor against a corporate debtor that had been placed by the SEC under "rehabilitation receivership" could not be enforced through execution. The Court ruled that once a debtor has been placed under "rehabilitation receivership," all its assets "are held in trust for the equal benefit of all creditors to preclude one from obtaining an advantage or preference over another by expediency of attachment, execution or otherwise."[4] The Court enunciated the dictum that "equality is equity,"[5] such that when a receiver takes over the distressed company, "all the creditors should stand on equal footing."[6] Hence, when a corporation has been placed under receivership, all actions against it pending before any court are suspended, no matter what stage they are in, even if judgment had already been rendered.[7]

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[3] G.R. No. 75414, 4 June 1990, 186 SCRA 94. Although this case does not involve a secured creditor but merely an unsecured creditor that had obtained judgment before the debtor informed the court that it had been placed under rehabilitation receivership, this case is relevant because of the principles enunciated by the Court therein.

[4] Alemar's Sibal & Sons v. Elbinias, G.R. No. 75418, 4 June 1990, 186 SCRA 94, 99. The Court went on to state that "what would prevent an alert creditor, upon learning of the receivership, from rushing posthaste to the courts to secure judgments for the satisfaction of its claims to the prejudice of less alert creditors."

[5] Alemar's Sibal & Sons v. Elbinias, G.R. No. 75418, 4 June 1990, 186 SCRA 94, 99.

[6] Alemar's Sibal & Sons v. Elbinias, G.R. No. 75418, 4 June 1990, 186 SCRA 94, 99.

[7] Alemar's Sibal & Sons v. Elbinias, G.R. No. 75418, 4 June 1990, 186 SCRA 94, 98-99. After the trial court rendered judgment by default, the defendant asked to intervene and sought to set aside the same and that proceedings in the case be suspended because the SEC had prior to the commencement of the suit placed the company under receivership. The trial court, among other things, denied the defendant's motion to set aside the judgment by default, but ordered the proceedings suspended so that plaintiff may present its judgment to the receiver as a basis for the settlement of its claim. The trial court also issued a writ of execution that the Supreme Court later ordered discharged at the same time ordering the proceedings before the trial court suspended.

The commendable objective of putting creditors on equal footing and not letting any of them — particularly the more alert ones — obtain an unfair advantage "by the expediency of an attachment, execution or otherwise" may be appropriate as to unsecured creditors, but not as to secured creditors. Secured creditors should not be placed on equal footing with unsecured creditors precisely because secured creditors have security and unsecured creditors do not. Secured creditors usually obtain their preference, in the form of a pledge or mortgage on their corporate borrower's property, at the time they lend to such borrower. Quite obviously, this preference by "attachment, execution or otherwise" is not inequitably or unfairly obtained after the default has occurred. Thus, the evil that the Court in *Alemar's* sought rightfully to avert — of creditors making a mad scramble to attach or execute upon their debtor's property to obtain an unfair advantage over the debtor's other creditors — does not arise when secured creditors are concerned for they obtained their preference in the ordinary course of business before the corporate debtor became distressed.

In *BF Homes, Inc. v. CA,*[8] also involving an unsecured creditor, the Supreme Court explained that the reason for the suspension of actions against corporations placed under receivership is "to enable the management committee or rehabilitation receiver to effectively exercise its/his powers free from any judicial or extra-judicial interference that might unduly hinder or prevent the 'rescue' of the debtor company."[9] The Court ruled that a trial court is not even allowed to proceed with the action filed by the creditor to determine the amount of liability of the debtor company, because even if the exact amount of its liability is determined it nevertheless cannot be enforced so long as the debtor company is under receivership; moreover, "it disregards the possibility that such determination would not be necessary at all should the rehabilitation receiver favorably consider and fully acknowledge the claims."[10]

[8] G.R. No. 76879 and G.R. No. 77413, 3 October 1990, 190 SCRA 262.

[9] B.F. Homes, Inc. v. Court of Appeals, G.R. Nos. 76879 and 77413, 3 October 1990, 190 SCRA 262, 269. The Court further noted that "[t]o allow such other action to continue would only add to the burden of the management committee or rehabilitation receiver, whose time, effort and resources would be wasted in defending claims against the corporation instead of being directed towards its restructuring and rehabilitation."

[10] B.F. Homes, Inc. v. Court of Appeals, G.R. Nos. 76879 and 77413, 3 October 1990, 190 SCRA 262, 268.

In *BF Homes*, the Supreme Court ruled that actions in court against a distressed company are suspended beginning the date the rehabilitation plan is approved.[11] More importantly, the Court laid down the rule that the SEC has the authority under Presidential Decree No. 902-A "to extend the period" or rehabilitation "when warranted" and "even to order the liquidation" of the debtor company "if the plan is found to be no longer feasible."[12]

BF Homes, however, is not entirely adverse to unsecured creditors, for the Court, noting that the creditor had obtained from the court a writ of preliminary attachment "prior to the creation of the management committee,"[13] ruled that such preliminary attachment "should not be regarded as an undue advantage"[14] of an unsecured creditor over the other unsecured creditors of the debtor company. The Court also ruled that in the event the receivership is terminated with such claims not having been satisfied the creditors may also find themselves without security therefor in the civil action because of the dissolution of the attachment. This should not be permitted. Having previously obtained the issuance of the writ of attachment in good faith, they should not be deprived of its protection if the rehabilitation plan does not succeed and the civil action is resumed.[15]

There is no consistency between *Alemar's* and *BF Homes*. In *Alemar's* the Court reversed the order of the trial court denying the corporate debtor's motion to discharge the writ of execution upon a judgment in favor of the creditor.[16] In *BF Homes*, it ruled that a writ of preliminary attachment issued at

[11] B.F. Homes, Inc. v. Court of Appeals, G.R. Nos. 76879 and 77413, 3 October 1990, 190 SCRA 262, 270.

[12] B.F. Homes, Inc. v. Court of Appeals, G.R. Nos. 76879 and 77413, 3 October 1990, 190 SCRA 262, 270.

[13] B.F. Homes, Inc. v. Court of Appeals, G.R. Nos. 76879 and 77413, 3 October 1990, 190 SCRA 262, 270.

[14] B.F. Homes, Inc. v. Court of Appeals, G.R. Nos. 76879 and 77413, 3 October 1990, 190 SCRA 262, 270.

[15] B.F. Homes, Inc. v. Court of Appeals, G.R. Nos. 76879 and 77143, 3 October 1990, 190 SCRA 262, 271. The benefit to an attachment creditor under this rule is found in art. 2242 of the Civil Code under which "credits" annotated upon the title of an immovable property by virtue of a "judicial order, by attachments or executions" are preferred "only as to later credits." Under this provision, with respect to credits annotated upon the title of an immovable property by attachments or executions "the rule is still preference according to priority of the credits in the order of time" which is an exception to the general rule of *pro rata* under art. 2242. See Manabat v. Laguna Federation of Facomas, G.R. No. L-23888, 18 March 1967, 19 SCRA 621, 624.

[16] It is not clear, however, from the facts whether the judgment by default had become final and executory. Most likely it was not because it appears that a timely motion to intervene and to set aside the judgment on the basis of the SEC order placing the debtor company under receivership.

the onset of the case which was not allowed to proceed pending rehabilitation should be allowed to stand. The writ of preliminary attachment obtained by the creditor was not seen as an undue advantage because it would afford the creditor some protection "if the rehabilitation plan does not succeed and the civil action is resumed."[17]

If the Court in *BF Homes* recognized that the writ of preliminary attachment obtained in a civil action filed *after* the SEC petition for rehabilitation was commenced but *before* the SEC issued an order suspending actions against the corporation and creating a management committee should be preserved, as it cannot be regarded as an undue advantage, why did it not likewise preserve (as in fact it dissolved) the writ of execution issued upon a default judgment obtained in the *Alemar's* case, which was apparently also commenced *after* the SEC case was filed? If the Court did not view the writ of preliminary attachment obtained by the creditor in *BF Homes* as an undue advantage (which in *Alemar's* was the basis for its suspending suits against distressed corporate debtors) because it may afford the creditor some protection "if the rehabilitation plan does not succeed and the civil action is resumed,"[18] should it have viewed (and with even greater reason) the writ of execution in *Alemar's* as not an undue advantage since judgment had actually been rendered therein unlike in *BF Homes* where the action was suspended (after the complaint was filed and the writ of preliminary attachment issued and implemented) and the corporate defendant therein did not even get to file its answer?

While the ruling of the Court in *BF Homes* appears to be sound as applied to unsecured creditors, the Court has relied upon the *Alemar's* and *BF Homes* cases to justify suspending suits filed by secured creditors to foreclose on their mortgages when their distressed debtors go to the SEC.[19]

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[17] B.F. Homes, Inc. v. Court of Appeals, G.R. Nos. 76879 and 77143, 3 October 1990, 190 SCRA 262, 271.

[18] B.F. Homes, Inc. v. Court of Appeals, G.R. Nos. 76879 and 77143, 3 October 1990, 190 SCRA 271.

[19] *See, e.g.* Rizal Commercial Banking Corporation v. Intermediate Appellate Court, G.R. No. 74851, 14 September 1992, 213 SCRA 830, *en banc*, although as of this writing RCBC's motion for reconsideration has not yet been resolved by the Court; Bank of the Philippine Islands v. Court of Appeals, G.R. No. 97178, 10 January 1994, 229 SCRA 223; State Investment House, Inc. v. Court of Appeals, G.R. No. 123240, resolution dated 5 February 1996.

Thus, in *Rizal Commercial Banking Corporation v. Intermediate Appellate Court*,[20] involving a secured creditor (Rizal Commercial Banking Corporation, hereinafter RCBC) with a real estate mortgage on the property of its corporate debtor, the Court ruled that a secured creditor is prohibited "as soon as the petition for rehabilitation is filed"[21] from foreclosing extra-judicially upon the mortgaged property. Moreover, if the foreclosure is actually conducted (as in this case), title to the foreclosed properties cannot be consolidated in the name of the successful bidder. According to the Court, the reason for this rule is keep the distressed corporation's asset's "untouched during the period of rehabilitation so as not to render the SEC Management Committee irrelevant and inutile and give it unhampered 'rescue efforts' over the distressed firm."[22]

In *Bank of the Philippine Islands v. Court of Appeals*,[23] a secured creditor sought to judicially foreclose its mortgage which the debtor opposed in the light of the SEC order creating a management committee and barring all actions against said debtor. There the Court reaffirmed its earlier rulings in *Alemar's*, *BF Homes*, and *RCBC*, and affirmed the lower courts' holding that a creditor "*whether secured or unsecured*, cannot enforce his credit against a distressed firm which has been placed by [the] SEC under receivership or

[20] G.R. No. 74851, 14 September 1992, 213 SCRA 830.

[21] Rizal Commercial Banking Corporation v. Intermediate Appellate Court, G.R. No. 74851, 14 September 1992, 213 SCRA 830, 838. In a dissenting opinion, however, Justice Feliciano noting that that the power of the SEC to freeze or suspend actions against a corporation "is an *extraordinary* authority, most specially where credits secured by specific liens on property, like real estate mortgages, are involved; such authority cannot lightly be assumed to have arisen simply because the corporation *on its own initiative* goes to the SEC and there seeks shelter from its lawful creditors." G.R. No. 74851, 14 September 1992, 213 SCRA 830, 843, stated that it is "[O]*nly upon the appointment of the management committee*" that the "*proviso in Section 6 (c) which decrees suspension of actions* for claims against the petitioning corporation takes effect." This dissenting opinion was subsequently adopted by the Court in Bank of the Philippine Islands v. Court of Appeals, G.R. No. 97178, 10 January 1994, 229 SCRA 223, 227, where the Court ruled, among other things, that the jurisdiction of a trial court is suspended when the SEC places the petitioning corporation under rehabilitation "through the creation of a management committee pursuant to Sec. 6, par. (d), Pres. Decree No. 902-A (1976)." The same rule was reiterated in Barotac Sugar Mills v. Court of Appeals, G.R. No. 123379, 15 July 1997, 275 SCRA 497, 503, where the Court ruled that "a court action is *ipso jure* suspended *only upon the appointment of a management committee or a rehabilitation receiver* (emphasis supplied)."

[22] Rizal Commercial Banking Corporation v. Intermediate Appellate Court, G.R. No. 74851, 14 September 1992, 213 SCRA 830, 838.

[23] G.R. No. 97178, 10 January 1994, 229 SCRA 223.

rehabilitation" (emphasis supplied).[24] Creditors, "instead of vexing the courts with suits against the distressed firm, were directed to file their claims with the duly appointed receiver of [the] SEC."[25] While the Court "recognized that petitioner is a *preferred creditor* whose claim is *secured by a real estate mortgage* on the properties" of the distressed firm "its right to enforce its claim in court is *suspended* with the placing by [the] SEC" of the debtor under rehabilitation. (emphasis supplied).[26] Under this ruling, although a mortgage creditor's lien on its debtor's properties is recognized and kept intact, it cannot enforce its lien or satisfy its credit out of such mortgaged property as soon as the SEC places the mortgagor under rehabilitation. Thus, the real estate mortgage becomes a worthless piece of paper the moment the debtor is placed under rehabilitation because it embodies a right that cannot be enforced. In fact, under the *RCBC* case, even if the property has been foreclosed, title of the property cannot be consolidated in the name of the buyer if the debtor should subsequently be placed under receivership.

Is there any legal basis for extending the *Alemar's* and *BF Homes* rulings to secured creditors?

The reasons invoked by the Supreme Court in *Alemar's* and *BF Homes* for suspending suits against distressed corporations are two-fold: First, to place all creditors "on equal footing with other creditors." Thus, any foreclosure (judicial or extra-judicial) is disallowed "so as not to prejudice other creditors, or cause discrimination among them."[27] Second, suits are suspended to enable the SEC to "effect a feasible and viable rehabilitation," which "cannot be achieved if one creditor is preferred over others."[28] Although these reasons may

[24] Bank of the Philippine Islands v. Court of Appeals, G.R. No. 97178, 10 January 1994, 229 SCRA 223, 226.

[25] Bank of the Philippine Islands v. Court of Appeals, G.R. No. 97178, 10 January 1994, 229 SCRA 223, 226.

[26] Bank of the Philippine Islands v. Court of Appeals, G.R. No. 97178, 10 January 1994, 229 SCRA 223, 228.

[27] Rizal Commercial Banking Corporation v. Intermediate Appellate Court, G.R. No. 74851, 14 September 1992, 213 SCRA 830, 838; *See* also Bank of the Philippine Islands v. Court of Appeals, G.R. No. 97178, 10 January 1994, 229 SCRA 223, 228.

[28] Rizal Commercial Banking Corporation v. Intermediate Appellate Court, G.R. No. 74851, 14 September 1992, 213 SCRA 830, 838; *see also* Bank of the Philippine Islands v. Court of Appeals, G.R. No. 97178, 10 January 1994, 229 SCRA 228, 228. Thus, in RCBC where an extra-judicial foreclosure was in fact conducted, the Court ruled that because the petition "*had been filed*, the certificate of sale shall not be delivered pending rehabilitation. Likewise, if this has also been done, no transfer of title shall be effected also, within the period of rehabilitation." (emphasis supplied)

be sound as to unsecured creditors, are they equally sound when applied to secured creditors?

The pertinent provisions of Presidential Decree No. 902-A, as amended by Presidential Decree Nos. 1653, 1758 and 1799, state that:

> Section 5. [T]he Securities and Exchange Commission . . . shall have original and exclusive jurisdiction to hear and decide cases involving . . .
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> [d] Petitions of corporations, partnerships or associations to be declared in the state of suspension of payments in cases where the corporation, partnership or association possesses sufficient property to cover all its debts but foresees the impossibility of meeting them when they respectively fall due or in cases where the corporation, partnership or association has no sufficient assets to cover its liabilities, but is under the management of a Rehabilitation Receiver or Management Committee created pursuant to this Decree.
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> Section 6. In order to effectively exercise such jurisdiction, the Commission shall possess the following powers . . .
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> [c] To appoint one or more *receivers* of the property, real and personal, which is the subject of the action pending before the Commission in accordance with the pertinent provisions of the Rules of Court, and *in such other cases whenever necessary in order to preserve the rights of the parties-litigants and/or protect the interest of the investing public and creditors*: *Provided, however,* That the Commission may, in appropriate cases, appoint a rehabilitation receiver of corporations, partnerships or other associations not supervised or regulated by other government agencies who shall have, in addition to the powers of a regular receiver under the provisions of the Rules of Court, such functions and powers as are provided for in the succeeding paragraph (d) hereof: *Provided, further,* That the Commission may appoint a rehabilitation receiver of corporations, partnership or other associations supervised or regulated by other government agencies, such as banks and insurance companies, upon request of the government agency concerned: *Provided, finally,* That upon appointment of a management committee, rehabilitation receiver, board or body, pursuant to this Decree, all actions for claims against corporations, partnership, or associations under management or receivership pending before any court, tribunal, board or body shall be suspended accordingly.
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> [d] To create and appoint a management committee, board, or body upon petition or *motu proprio* to undertake the management of

> corporations, partnerships or other associations not supervised or regulated by other government agencies *in appropriate cases when there is imminent danger or dissipation, loss, wastage or destruction of assets or other properties or paralyzation of business operations of such corporations or entities which may be prejudicial to the interest of minority stockholders, parties-litigants or the general public: Provided, further,* That the Commission may create or appoint a management committee, board or body to undertake the management of corporations, partnerships or other associations supervised or regulated by other government agencies, such as banks and insurance companies, upon request of the government agency concerned.
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> The management committee or rehabilitation receiver, board or body shall have the power to take custody of, and control over, all the existing assets and property of such entities under management; to evaluate existing assets and liabilities, earnings and operations of such corporations, partnerships or other associations; to determine the best way to salvage and protect the interest of the investors and creditors; to study, review and evaluate the feasibility of continuing operations and restructure and rehabilitate such entities if determined to be feasible by the Commission. It shall report and be responsible to the Commission until dissolved by order of the Commission. *Provided, however,* That the Commission may, on the basis of the findings and recommendation of the management committee, or rehabilitation receiver, board or body or on its own findings, determine that the continuance in business of such corporation or entity would not be feasible or profitable nor work to the best interest of the stockholders, parties-litigants, creditors, or the general public, order the dissolution of such corporation entity and its remaining assets liquidated accordingly. The management committee or rehabilitation receiver, board or body may overrule or revoke the actions of the previous management notwithstanding any provision of law, articles of incorporation or by-laws to the contrary (emphasis supplied).[29]

It will be noted that the foregoing provisions of Presidential Decree No. 902-A that grant the SEC extraordinary powers to act in cases involving petitions of distressed corporations for suspension of payments or rehabilitation receivership are premised:

(a) first, on the need to preserve the rights of parties-litigants, the investing public (this would refer particularly to shareholders in publicly listed companies), and creditors; and,

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[29] Pres. Decree No. 902-A, as amended (1976).

(b) second, on the need to *preserve the properties* of the corporation from "imminent danger or dissipation, loss, wastage or destruction" or against "paralyzation of business operations" "which may be *prejudicial to the interest of minority stockholders, parties litigants or the general public.*"

Any interference on the rights of secured creditors must therefore be tested against these specific standards or criteria; and it must be geared to attain the foregoing specific objectives. Any such interference must not be premised upon any broad or unbridled notions of what the SEC ought to be do, or be able to do, in cases of suspension of payments or rehabilitation receivership.

Do these specific criteria (i.e., the rationale for giving the SEC certain powers) justify the interference by the SEC on the rights of secured creditors to foreclose their collateral whenever their debtors are in default?

For a start, any interference on the rights of secured creditors can only find justification if it is necessary:

(1) to preserve the rights of [a] creditors; [b] parties litigants; [c] minority stockholders or stockholders in general; and [d] the general public; and

(2) to preserve the properties against "imminent danger or dissipation, loss, wastage or destruction" or the business against paralysis, that may be prejudicial to [a] minority stockholders; [b] parties litigants; or [c] the general public.

As to creditors, there is nothing in Presidential Decree No. 902-A that authorizes the SEC to disregard the priority or preference obtained by secured creditors or emasculate or render ineffective their right of security and in the process improve the rights of unsecured creditors against secured creditors — who are now placed on equal footing with unsecured creditors. The law itself speaks only of the "preservation" of the rights of creditors, not the augmentation or improvement of the rights of one (the unsecured) vis-à-vis the other (the secured).

Following *Alemar's* and *BF Homes*, there is nothing irregular or improper in lending on the strength of the security provided by a borrower and obtaining as a condition for the loan a lien or preference (as by pledge or mortgage) on the property of the borrower to secure payment of the loan in case of default. Mortgages or pledges are secured *in the ordinary course of business* by banks in their lending activities precisely to cover them in case of their borrower's default. What the law contemplates is not that unsecured creditors be deprived of their security and placed on equal footing with unsecured creditors, but that all *unsecured* creditors be placed on equal footing so as to prevent a mad scramble for the assets of the debtor company. Secured creditors are simply not on equal footing with unsecured creditors, precisely because their claims are covered by collateral that were obtained in the regular course of business, and not unfairly obtained by execution, attachment or any other similar schemes, after it has become evident that the debtor corporation is in distress.

As to parties litigants, there is no reason why their rights should override the right of secured creditors to their security. The right of a party litigant should be determined on the strength or merits of its case and should not be improved, vis-à-vis secured creditors, by the simple expedient of the borrower going to the SEC.

As to stockholders, there is no reason why they should be protected against their corporation's secured creditors. On the contrary, the trust fund doctrine recognizes the priority of creditors (and even more so, secured creditors) in case of failure of the corporation. "Stockholders, both common and preferred, are considered risk takers who invest capital in the business and who can look only to what is left after corporate debts and liabilities are fully paid."[30] In fact, in many cases of defaults particularly involving close or family corporations, the failure of the corporation is precisely due to the fault or negligence of its stockholders. Why then should such stockholders be protected from their creditors? To read into Presidential Decree No. 902-A a right in favor of stockholders in derogation of the rights of their creditors would bring Presidential Decree No. 902-A afoul of the Corporation Code. This could not have been the intention of Presidential Decree No. 902-A.

As to the general public, a much more direct and concrete showing of prejudice should be demonstrated for any such prejudice to be sufficient to override a secured creditor's specific and concrete contractual right to proceed against its security in case of its borrower's default.

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[30] Republic Planters Bank v. Agana, G.R. No. 51765, 3 March 1997, 269 SCRA 1, 10.

Perhaps the prejudice to the "general public" may be more appreciable in the case of public utilities that provide direct services to the general public. But in the case of corporate debtors that are not public utilities, such as, for instance, a supplier of home appliances or a retail store or sugar refinery within a free market characterized by healthy competition, is the prejudice to the "general public" such as to warrant, even under the guise of police power, interference by the SEC on the specific contractual right of secured creditors to proceed against their collateral in satisfaction of their secured claims?

Moreover, the satisfaction of claims of secured creditors over properties of corporate debtors mortgaged to such secured creditors can hardly be considered as a "dissipation, loss, wastage or destruction" of such assets so as to prevent or bar the satisfaction of such secured claims. The foreclosure of a corporate debtor's property to pay for its obligations is not a dissipation, loss, wastage or destruction of the corporation's assets in the contemplation of sec. 6 of Presidential Decree No. 902-A. It is simply a recognized and accepted mode of enforcing payment for a defaulted loan.

Also, the right of a preferred creditor to proceed against the collateral securing its credit in case of the debtor's default is a valuable contractual and property right protected by the Constitution.[31] If such right is to be subsequently negated, would this not amount to an impairment of such right?

Admittedly, the Supreme Court has held in many cases that contractual rights may give way to the exercise by the state of its police powers for according to the Court, "[t]he freedom to contract, under our system of government, is not meant to be absolute. The same is understood to be subject to reasonable legislative regulation aimed at the promotion of health, moral, safety and welfare."[32] But in these cases the statutes themselves either

[31] CONST. art. III, sec. 10 provides that "No law impairing the obligation of contracts shall be passed."

[32] Abe v. Foster Wheeler Corporation, 110 Phil. 198 (1960). The Court applied the provisions of Rep. Act No. 1052, requiring 30 days advance notice to an employee of his termination, non-observance of which subjects the employer to pay the employee a sum equivalent to the latter's compensation for one month, retroactively to employees who were employed before the law took effect but who were separated from service after its effectivity.

expressly[33] or by clear intention[34] authorized the impairment of pre-existing contracts for a concrete and specific public good.

The intention to impair the rights of secured creditors is neither expressly nor by clear intention embodied in Presidential Decree No. 902-A. On the contrary, as discussed above, there is nothing in Presidential Decree No. 902-A that authorizes the SEC to disregard the rights of secured creditors in respect of their contractual right to proceed against their security in case of default of their corporate debtors.

But granting, without conceding, that Presidential Decree No. 902-A is meant to impair the obligation of contracts, what the Court stated in *Rutter v. Esteban*[35] is particularly poignant, that when it comes to laws that have the effect of impairing contracts "the question is not whether the legislative action affects contracts incidentally, or directly or indirectly, but whether the legislation *is addressed to a legitimate end and the measures are reasonable and appropriate to that end.*" (emphasis supplied).[36]

As described above, the legitimate ends of Presidential Decree No. 902-A are: (a) to preserve the rights of certain persons (parties litigants, stockholders, and creditors); and (b) to preserve corporation's assets against wastage, loss, destruction or dissipation, or its business from paralysis to the

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[33] *See e.g,* Central Bank v. Cloribel, G.R. No. L-26971, 11 April 1972, 44 SCRA 307, involving the exercise by the then Central Bank of its power to fix the maximum interest rates paid by banks pursuant to sections 14 and 109 of Rep. Act No. 265. The same is true of laws providing for moratorium on the payment of debtor's obligations when the country is in a state of emergency. See general discussion in Rutter v. Esteban, 93 Phil. 68 (1953).

[34] Philippine National Bank v. Office of the President, G.R. No. 104528, 18 January 1996, 252 SCRA 5, involving the application of the pertinent provisions of Presidential Decree No. 957 to pre-existing mortgage contracts according subdivision lot buyers certain rights in case the property they purchase on installment is mortgaged by the developer prior to the time they fully pay the purchase price.

[35] 93 Phil. 68 (1953).

[36] Rutter v. Esteban, 93 Phil. 68, 74 (1953). See also Republic v. Agana, G.R. No. 57765, 3 March 1997, 269 SCRA 1, 12, where the Court sustained as a valid exercise of police power a directive of the then Central Bank (now Bangko Sentral) prohibiting a bank "suffering from chronic reserve deficiency" from "redeeming any preferred share, on the ground that said redemption would reduce the assets of the Bank to the prejudice of depositors and creditors" In reversing the trial court's holding that the Central Bank directive constituted an impairment of the obligation of contracts, the Court ruled that such guarantee "is limited by the exercise of the police power of the state, the reason being that public welfare is superior to private right." The protecting of public welfare is readily seen in this particular case since courts can take judicial notice that banks accept deposits from the general public, not from any specific or limited subsets of individuals.

prejudice of its minority stockholders, parties litigants or the general public. As described above, these objectives do not justify interference of the rights of secured creditors — as distinguished from unsecured creditors — to satisfy their claims out of their collateral.

In *BF Homes* the Court stated that the "real justification" for suspending actions against distressed corporations in the SEC is:

> [T]o enable the management committee or rehabilitation receiver to effectively exercise its/his powers free from any judicial or extra-judicial interference that might unduly hinder or prevent the "rescue" of the debtor company. To allow such other action to continue would only add to the burden of the management committee or rehabilitation receiver, whose time, effort or resources would be wasted in defending claims against the corporation instead of being directed towards its restructuring and rehabilitation.[37]

While the foregoing rationale may apply to unsecured creditors to prevent a mad scramble for the assets of the debtor company, it is difficult to imagine how the foregoing rationale applies to secured creditors whose claims are covered by collateral and who would have the slightest incentive to obtain an unfair advantage over other creditors. In fact, secured creditors of distressed corporations in the SEC are quite content to proceed only against their collateral in effect giving up any hope of recovering any deficiency in case such collateral is not enough to satisfy their claims.

Moreover, the avowed objective of keeping the SEC "free from any judicial or extra-judicial interference that might unduly hinder or prevent the "rescue" of the debtor company" if applied to secured creditors would be too unduly broad and unbridled and would lead to abuse. In fact, such standard or criterion has no basis in Presidential Decree No. 902-A itself. It is submitted that the proscribed "judicial or extra-judicial interference" with the "rescue" of a distressed corporation should refer to those that the Court in Alemar's sought to avert, namely, those that are envisioned to give a creditor "an advantage or preference [not theretofore enjoyed by it] over another by the expediency of an attachment, execution or otherwise."[38] To undermine the rights of secured creditors, at least in those cases where a specific, direct, and actual prejudice to

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[37] B.F. Homes Inc. v. Court of Appeals, G.R. Nos. 76879 and 77143, 3 October 1990, 190 SCRA 262, 269.

[38] Alemar's Sibal & Sons v. Elbinias, G.R. No. 75414, 4 June 1990, 186 SCRA 99 (1990).

the general public or the general welfare[39] is *not* demonstrated by the petitioning corporation (unlike for instance in the case of public utilities providing power or water to the metropolis where the cessation of their business operations would obviously adversely affect the general public or public welfare), but only on the broad and amorphous pretext that it would be necessary to "rescue" such corporation, would give the SEC the unlimited powers to deal with preferred creditors. This power could lead to abuse. This could not have been the intention of the law. The law itself provides specific standards, or to be more precise, the limitations by which the power of the SEC to "rescue" (using the Court's own words) is to be exercised. These specific limitations do not justify disregarding the rights of preferred or secured creditors.

Moreover, even in the guise of police power, any interference or infringement on the rights of secured creditors cannot be as indefinite and open-ended as to amount to a virtual denial of their right to foreclose. Even the Supreme Court in *Rutter* recognized that infringement, *when appropriate* in the exercise of the state's police powers, must be "limited to its proper bounds and must be addressed to a legitimate purpose."[40] This implies, among other things, that "[t]he State may postpone the enforcement of the obligation but cannot destroy it by making the remedy futile."[41] Furthermore, police power "may only be invoked and justified by an emergency, temporary in nature, and can only be exercised upon reasonable conditions in order that it may not infringe the constitutional provision against impairment of contracts."[42] With respect to the contractual value of a collateral (e.g., a mortgage or pledge), any such impairment or infringement under the mantle of police power must not amount to "an oppressive and unnecessary destruction of nearly all the incidents that give attractiveness and value to the collateral security."[43]

One attribute of collateral security that should be preserved so as not to render it useless is the ability of the creditor to foreclose within a specified time frame. In other words, police power infringement will not pass the test of

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[39] After all, as the Court said in Republic Planters Bank v. Agana, G.R. No. 51765, 3 March 1997, 269 SCRA 1, 12, "the reason" that the "guarantee of non-impairment of contracts is limited by the exercise of the police power" is that "public welfare is superior to private rights."

[40] Rutter v. Esteban, 93 Phil. 68, 75 (1953).

[41] Rutter v. Esteban, 93 Phil. 68, 75 (1953).

[42] Rutter v. Esteban, 93 Phil. 68, 75-76 (1953).

[43] Rutter v. Esteban, 93 Phil. 68, 75 (1953).

time frame. In other words, police power infringement will not pass the test of constitutionality if the infringement is without any limitation as to time.[44]

The foregoing limitations contained in Presidential Decree 902-A itself and the jurisprudence on the established limitations of the State's police power prerogatives are apparently lost to the SEC and even the Court, at least in the *RCBC* and *BPI* cases which involved secured creditors. Thus, in assuming its jurisdiction over petitions for suspension of payment and rehabilitation receivership the SEC normally issues a blanket and indefinite order of suspension barring all actions against the petitioning corporation "until further orders from this Commission."[45] The rights of secured creditors are thereafter suspended *indefinitely*. In fact, secured creditors are almost always never able to exercise their rights at all after the SEC issues the suspension order.

The case of *Philippine Blooming Mills Co. Inc.* or *PBM* for brevity, docketed as SEC Case No. 2250, is a classic example of the indefinite suspension of the rights of a secured creditor. *PBM* is one of the earliest, and perhaps longest running, rehabilitation proceedings in the SEC.

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[44] Thus, in Rutter v. Esteban, 93 Phil. 68, 77 (1953), the Court found "unreasonable, if not oppressive" a moratorium of eight years granted to debtors of monetary obligations contracted before World War II and who is a war sufferer with a claim duly approved by the Philippine War Damage Commission. As the Court said, "[w]hile the purpose of Congress is plausible, and should be commended, the relief accorded works injustice to creditors who are practically left at the mercy of the debtors. Their hope to effect collection becomes extremely remote, more so if the credits are unsecured. And the injustice is more patent when, under the law, the debtor is not even required to pay interest during the operation of the relief . . . ."

[45] *See, e.g.*, Order dated 18 June 1999 in SEC Case No. 06-99-6330 as published in the Manila Times on 3 July 1999. This order is typical of many other orders of the Commission suspending suits against a distressed corporation. In this petition, for instance, the relevant allegations relied upon by the petitioner to seek a suspension order are that: [a] the principal secured creditor that extended a loan used to import the plant to be established by the petitioner corporation served notice of the extra-judicial foreclosure of the plant to satisfy the defaulted loan; [b] the threat of the foreclosure "will totally derail and destroy the credibility of the manufacturing plant, its stockholders, officers, directors and employees;" and [c] there is a need for a receiver to be appointed "to take custody of and control the assets of the corporation and prevent the same from being dissipated, lost or wasted, as well as to oversee the continued operation of the plant as to give ample protection to the rights of other creditors, its employees and other parties interested in the realization of petitioner's pioneering business venture."

In the *PBM* case, State Investment House, Inc. (SIHI), a mortgage creditor of PBM filed an action for judicial foreclosure of its mortgage on various lots belonging to PBM not used in its business of producing steel due to PBM's default. SIHI obtained a partial summary judgment against PBM and a decree of foreclosure of the secured creditor's first and second mortgage over PBM mortgaged properties. The trial court eventually issued an order consolidating title to the foreclosed properties in the name of the creditor (as highest bidder at the sheriff's sale) upon the lapse of the ninety-day period to repurchase (under a judicial foreclosure) without such right having been exercised by PBM. PBM contested the foreclosure and the decree of consolidation.

The Supreme Court affirmed the finality of the partial summary judgment rendered in favor of the secured creditor, but as to the foreclosure of PBM's properties to satisfy such mortgage claims, the Court ruled that:

> [I]nsofar as the disposal of PBM properties to meet its various obligations are concerned, a different procedure applies. Creditors of PBM with court or administrative judgments in their favor cannot just seize through execution orders any PBM properties and have that seized property sold to satisfy the judgment in their favor.
>
> Similar cases among which are preferred credits such as laborers' claims for salaries have been referred to the Securities and Exchange Commission for proper determination of their preferences or priority under the law in the settlement of claims considering that PBM is under rehabilitation receivership with the Securities and Exchange Commission in SEC Case No. 2250 . . .
>
> Under such circumstances, there can be no execution of the partial summary judgment as prayed for by State Investment House until the Securities and Exchange Commission acts according to its rehabilitation receivership functions.[46]

The Court then set aside the order of the trial court authorizing the sale of the mortgage PBM properties and the order confirming the sale thereof. The Court referred the partial summary judgment in favor of SIHI to the SEC "for determination of the preferences or priorities under the law in the settlement of claims of firms under receivership or liquidation."

[46] State Investors House, Inc. v. Philippine Blooming Mills, SC Resolution, G.R. No. 87053, 29 November 1989.

In denying SIHI's motion for reconsideration of the foregoing resolution the Court further clarified in its resolution dated 7 August 1990 that:

> [T]he Court took into account the fact that among the creditors now before the SEC are practically all the major banks in Metro Manila, several financial institutions, the laid off workers and employees of PBM who have a judgment in their favor, and various other big creditors. Since PBM, Four Seas Trading Corporation, and Alfredo Ching did not bother to defend their case in the trial court, no evidence was presented and there is no showing as to whose mortgages and claims — those of the banks, other creditors, and the private respondents — enjoy a higher preference. This is a factual matter which the SEC will have to take into account together with other factors before it.[47]

The Court, in rendering its foregoing resolutions lost sight of the fact that SIHI was a preferred creditor with a first and second mortgage (a specific lien over real property) over the properties of PBM mortgaged to SIHI. The Court erroneously considered SIHI's claims to be of the *same category* as the *unsecured* claims of the PBM laborers,[48] and having earlier referred such *unsecured* laborers' claims to the SEC, likewise SIHI to the SEC.

Although SIHI relied exclusively on its collateral and filed suit to judicially foreclose the same, SIHI was compelled under the Court's resolution in G.R. No. 87053 to present its preferred claims to the SEC. This SIHI did pursuant to the 1990 resolution of the Court, for the limited purpose of having the SEC determine the "factual matter" as to who enjoyed the highest preference over the subject PBM properties.

[47] SC Resolution, G.R. No. 87053, 7 August 1990.

[48] These laborers' claims against PBM are not those covered by articles 2241 par. (6) and 2242 par. (3) of the Civil Code. Following the decision of the Supreme Court in the leading case of Republic v. Peralta, G.R. No. L-56568, 20 May 1987, 150 SCRA 37, 50, "[t]o the extent such claims for unpaid wages fall outside the scope of articles 2241 par. (6) and 2242 par. (3), they would come within the ambit of the category of ordinary preferred credits under article 2244" which unlike the credits under articles 2241 and 2242, "creates no liens on determinate property which follow such property. What article 2242 creates are simply rights in favor of certain creditors to have the cash and other assets of the insolvent applied in a certain sequence or order of priority." G.R. No. L-56568, 20 May 1987, 150 SCRA 37, 46. Mortgage claim, by contrast, such as that in favor of SIHI create specific liens over the mortgaged property under Article 2242.

PBM opposed and argued that because the SEC had in the meanwhile approved the PBM rehabilitation plan SIHI was bound by such plan and that SIHI's limited motion should be denied.

SIHI in the meanwhile informed the SEC that the Supreme Court in a related case[49] issued a resolution dated 6 September 1993 wherein the Court aptly ruled that:

> [F]oreclosure suits do not come within the ambit of Presidential Decree 902-A as it does not involve execution of judgment or money claims of unsecured creditors.
>
> It is well settled that the suspension of actions for claims applies only to claims of unsecured creditors, it cannot extend to creditors holding a mortgage, pledge or lien on the properties of the insolvent party.[50]

Instead of granting SIHI's limited motion, particularly in the light of the decision of the Court in G.R. No. 96407,[51] the Hearing Panel and subsequently, on appeal, the SEC en banc, denied SIHI's motion.

When the case reached the Supreme Court a second time in G.R. No. 123240 the Court in its resolution dated 11 August 1997 resolved, among other things, that:

> Stated plainly, the issue squarely raised in the main petition is whether or not petitioner SIHI, as mortgagee of respondent PBM, may be declared to have preference over specific property subject of the mortgage, despite the pendency of the rehabilitation/receivership proceeding pending before the SEC.[52]

The Court resolved this issue in the negative.

But the Court also ruled in the same resolution that "[i]n any rehabilitation/receivership proceedings where claims of several creditors shall have to be resolved, the provisions of Title XIX of the Civil Code - Concurrence and Preference of Credits applies;" and in the case under

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[49] SC Resolution, G.R. No. 96407, 6 September 1993.

[50] SC Resolution, G.R. No. 89604, 6 September 1993.

[51] This was the law of the case as far as SIHI and PBM are concerned, not to mention that it was the correct interpretation of the law.

[52] SC Resolution, G.R. No. 123240, 11 August 1997.

consideration "where a mortgaged piece of realty is involved," articles 2242, 2243 and 2249 apply. Further, the Court ruled that:

> It may easily be seen that petitioner's motion to declare and confirm the highest preference of its first mortgage lien is at the very least premature. There may or may not exist claims enumerated in the above-cited article 2242 which, by virtue of article 2243, shall be considered as mortgagees of the specific property involved. At best this issue should be resolved in the light of the rehabilitation plan approved by the SEC on January 3, 1990 which includes the schedule of payment. Verily, the rehabilitation plan is not included among the matters submitted for review in the present petition. On this score alone, without having to refer to any of the above-cited decisions yet, the instant petition may already be dismissed. We shall reserve our ruling on whether or not petitioner may be adjudged to be a preferred creditor at the proper opportunity when the entire judgment of the SEC shall be before us for review.[53]

If the "rehabilitation plan is not included among the matters submitted for review" to the Court, this means that the question of whether or not SIHI was bound by the plan, even if PBM included SIHI in the schedule of payments under such plan, was not decided by the Court.

Since the foregoing resolution left SIHI free to contest or question the rehabilitation plan itself, SIHI subsequently contested the rehabilitation plan particularly as it proposed to pay only a limited fraction of SIHI's claim evidenced by the final and executory judgment in its favor. SIHI argued that if the full amount of its final judgment were included in the rehabilitation plan, the plan would not be financially feasible simply because of the magnitude of SIHI's final judgment claim. Hence, the SEC is left with no alternative but to order the liquidation of PBM and determine the preferences of its creditors claims under the rules on "Concurrence and Preference of Credits" under the Civil Code.[54] In which case, as mortgagee of the real properties previously

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[53] SC Resolution, G.R. No. 123240, 11 August 1997.

[54] CIVIL CODE, arts. 2236-2251. In fact, following the 11 August 1997 ruling of the Court, the SEC was ordered to apply the provisions on "Concurrence and Preference of Credits" in the PBM rehabilitation case (SEC Case No. 2250), even without necessarily making a prior finding that the rehabilitation plan is not feasible, because "[i]n the present case where a mortgaged piece of realty is involved" the provisions on Concurrence and Preference of Credits "govern." In other words, the Court in effect ruled that when a mortgaged property of the corporate debtor is involved in the rehabilitation proceeding, "where claims of several creditors shall have to be resolved," the SEC must apply the rules on Concurrence and Preference of Credits. This ruling in effect reaffirms the Court's earlier resolution of 29 December 1962 in De Barreto v. Villanueva, 110 Phil. 896, 904-910 (1961), that articles 2242 and

foreclosed by it (which foreclosure the Court nullified), SIHI's claims would be the first to be paid from the proceeds of the sale of such properties following the rules embodied in articles 2242, 2243 and 2249 of the Civil Code.

In denying SIHI the right to foreclose upon its mortgage on the PBM properties, did not the Court ignore its own decision in G.R. No. 96407 (involving SIHI and PBM) wherein it specifically ruled that foreclosure suits of secured creditors, SIHI in that case, are not within the coverage of Presidential Decree No. 902-A?

Why did the Court fail to apply its own ruling in G.R. No. 96407, when such case involved the very same parties in G.R. No. 123240, where it affirmed SIHI's right as secured creditor to proceed against its collateral without being bound or hindered by the SEC case?

Whatever may be the final decision of the Court on the PBM rehabilitation plan, it is clear that SIHI's right as secured creditor to foreclose on its security has been indefinitely suspended in SEC Case No. 2250. In fact, this right has been effectively negated since the SEC itself is of the view that SIHI is bound by the rehabilitation plan and that SIHI's right to foreclose has in the meanwhile been suspended even if its mortgage continued to be valid and effective.

What was the rehabilitation plan approved by the SEC? To be sure, it did not provide for the rehabilitation of PBM itself. In essence, the plan provided that all the assets of PBM, at least those still available and which had not been appropriated by other creditors by extra-judicial foreclosure[55] were transferred to another company that took over the operations of PBM. This third company, in turn, contributed Php10 million to be used as a "sinking fund" to pay PBM's creditors the amounts specified in a schedule of payment of about Php378 million over a seventeen-year repayment period and was required to augment the sinking fund by additional contributions from out of the profit of its operations. In the meanwhile, this third company itself faced financial and business difficulties (diminished demand due to the economic

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2243 become effective in proceedings where preferred creditors are convened (although in SEC Case No. 2250 SIHI is the only mortgagee of the properties it had earlier foreclosed) "and the import of their claims ascertained." 110 Phil. 896, 906 (1961).

[55] Ironically, it was SIHI that resorted to a judicial foreclosure whose rights were suspended during the PBM rehabilitation while other creditors of PBM who resorted to extra-judicial foreclosure were not affected by rehabilitation proceedings.

slump and competition from cheap steel coming from abroad) prompting the PBM Receiver to even formally manifest to the SEC the difficulties of the third company.

The PBM rehabilitation in its actual implementation has nothing to do with reviving or rehabilitating PBM. It merely provides for a scheme whereby creditors, particularly the only secured creditor which is SIHI, would be forced to accept the amounts the debtor is willing to recognize as embodied in its rehabilitation plan on installment over an unreasonably long period of time, simply because PBM had gone to the SEC. Even if the SEC infringement of a mortgage creditor's right to foreclose on its collateral can be justified under the mantle of police power, is this the real objective of Presidential Decree No. 902-A?

The *PBM* case leaves many unanswered questions despite the fact that it has reached the Supreme Court two times - and most likely a third time to resolve the still unanswered questions brought about by the Court's resolution in G.R. No. 132240.

Is SIHI bound by the approved rehabilitation plan even if it was not a party thereto (and had in fact avoided the SEC for fear of losing its mortgage rights) before it filed its motion to confirm its preference? How should the SEC address SIHI's partial summary judgment? Is the SEC, despite its posture to the contrary, bound to take this judgment amount and revise the rehabilitation plan or schedule of payment embodied therein? If the SEC is required to take SIHI's final judgment into account what will become of the rehabilitation plan? Will not the SEC be compelled to order the liquidation of PBM?

All these questions could have been resolved by the Court in the two cases involving SIHI and PBM discussed above. That it has not ruled on the foregoing questions only highlights the lack of any fixed or definitive rule when it comes to rehabilitation proceedings. It is in the interest of justice, and stability in the business community, that the Court adopt uniform rules that take into account and protect the rights of secured creditors.

That the SEC should be given ample prerogative to effect a feasible and viable rehabilitation of distressed corporations admittedly finds support in the police powers of the state. But, as shown above, a careful reading of Presidential Decree No. 902-A itself, read particularly in the light of the countervailing constitutional proscription against the impairment of contracts reveals that Presidential Decree No. 902-A is hardly the vehicle to justify trampling upon the rights of secured creditors.

If at all, it is suggested that a viable argument, based upon the police power prerogatives of the State, could be made for infringing upon the rights of secured creditors only in the clearest cases (and of course the burden of proof is upon the petitioning debtor corporation) where the public interest or public welfare would be directly, concretely, and clearly affected if suits by secured creditors are not suspended pending the rehabilitation of the distressed corporation. This would be true, for instance, if the petitioning corporation is an on-going or active public utility the cessation of business operations of which would result in the cessation of the public service it provides. There would be no doubt that public service would be affected if, for instance, a company providing electricity or power to a city would file a petition for rehabilitation and the viability or feasibility of such rehabilitation is threatened by the foreclosure of its plant or properties. The argument for infringing the rights of secured creditors should not be premised upon mere imagined or speculative prejudice to the general public. To be sure, the fact that stockholders, or unsecured creditors, or even employees or laborers of the distressed corporation, would be affected by foreclosure suits of secured creditors, would not be the kind of prejudice to the general public that would justify infringing upon the rights of such secured creditors. The general public whose interest or welfare are sought to be protected by Presidential Decree No. 902-A cannot be equated with those specific sets of individuals who are directly involved with the distressed corporation, whether as stockholders, unsecured creditors, officers, or employees.

Moreover, any infringement, in the accepted mantle of police power, must not be so open-ended or indefinite as to effectively deprive secured creditors of their right to their security.[56] To be sure, it would be difficult to specify any time frame within which actions should be suspended. Each must be determined on its peculiar facts but a limited time frame is nevertheless an essential component of a valid interference of the rights of secured creditors - or even of ordinary creditors for that matter. If the rehabilitation is not feasible

[56] See, by analogy, the examples cited by the Court in Rutter v. Esteban, 93 Phil. 68, 79-80 (1953), where the courts therein found oppressive and unreasonable legislation modifying mortgage or monetary contracts by suspending the rights of creditors to enforce their claims and/or giving debtors an extension to satisfy their obligations.

within such time frame as the SEC determines to be a reasonable waiting period with due regard for the rights of a corporation's creditors, then the SEC should not proceed with the rehabilitation but rather proceed to promptly dissolve the corporation and settle the claims of its creditors in accordance with the law on preference of credits under the Civil Code.

Unfortunately, at present, there is even no need for a distressed corporation to make a clear and substantial showing that the general public would be prejudiced if suits of secured creditors to foreclose their collateral are not stopped. They only need to show that they (the distressed corporations) will be prejudiced unless all actions against them — even including those of secured creditors — are suspended. Presidential Decree No. 902-A is neither premised on the mere protection of a distressed corporation *per se* nor on assuring the feasibility or viability of its rehabilitation at all cost — particularly at the cost of infringing upon the rights of secured creditors. It is time this one-sided interpretation of Presidential Decree No. 902-A be reviewed by the Court — before the prejudice to secured creditors engendered by its present doctrine does any more harm.

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