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A CRITICAL STUDY OF THE INSOLVENCY LAW

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(Continued from the October Number)

CHAPTER VI
PARTNERSHIPS AND CORPORATIONS

1. *Partnerships.*—Under section 51 of our Insolvency Law, a partnership during the continuance of the partnership business, or after its dissolution and before the final settlement thereof, may be adjudged insolvent either on the petition of the partners, or any one of them, or on the petition of three or more creditors of the partnership, qualified as provided in section 20 of that Act. When the petition is filed by some of the partners only, those partners who do not join in the petition should be ordered to show cause why they as individuals, and the partnership as an entity, should not be adjudged insolvent, and those partners who are found not to be insolvent shall not be included in the proceedings. When the petition is filed by the creditors, they must allege the act or acts of insolvency committed by the partnership or its members. All the property of the partnership and, also, all the separate property of each of the partners, if they are liable, shall be made to bear all the debts of the partnership and the separate debts of each partner, but separate accounts of the property of the partnership and of the separate estate of each member thereof shall be made. The expenses of the proceedings shall be paid in such proportion as the court shall direct from the property of the partnership and from the separate property of the partners. The net proceeds of the partnership property shall be appropriated for the payment of the partnership debts and the net proceeds of the individual estate of each partner for the payment of his individual debts, but, should any surplus remain of the property of any partner after paying his individual debts, such surplus shall be added to the partnership assets and be applied to the payment of the partnership debts, and *vice versa*, in proportion to the respective interests of the partners in the partnership. If the partners reside in different provinces, the court in which the petition is first filed shall retain exclusive jurisdiction over the case. By section 77 the word "debtor" includes partnerships, corporations, and "sociedades anónimas." The provisions of our Insolvency Law, therefore, with regard to debtors, apply to partnerships; however, in the construction of the general provisions of our law regarding partnerships, various questions present themselves for solution.

a. What is meant by the word "partnership" as used in our Insolvency Law?—As our Insolvency Law does not attempt to define "partnership," the Philippine Legislature must have intended to give to it the same meaning given by the Civil Code and the Code of Commerce. Another reason for this construction is the fact that our Insolvency Law applies to all classes of persons, be they merchants or not. This being the case, it must also be understood to apply to all kinds of partnership, be they commercial or civil, general or limited. On December 17, 1904, the District Court for the Eastern District of Pennsylvania, in deciding a case before it, held that a mercantile association, organized under a law providing for the formation of partnership associations in which the capital subscribed shall alone be responsible for the debts of the associations, is within the terms of the bankruptcy law and subject to be adjudged an involuntary bankrupt whether regarded as an unincorporated company, or a corporation.[1]

b. Is a partnership a separate legal entity, distinct from its members, in insolvency proceedings?—According to the provisions of our Insolvency Law, a partnership is an entity for certain purposes. This is also true under the bankruptcy law in force in the United States at the present time.[2] As we have already seen, our law provides that when the petition is filed by one or more members of the partnership, the other members may oppose it by proving that they and the partnership are not insolvent, and, when this is established, adjudication shall be made against the petitioning members only. In the United States it has been held that insolvency of the partnership can not coexist with solvency of any member of the firm.[3] In the Philippines this is only true as respects general partners, who are liable for all the debts of the partnership to the extent of all their property, so that before the partnership can be insolvent, all the property of the general partners must first be exhausted. And as limited partners are only liable to the extent of the amount they have contributed to the partnership, it is clear that the insolvency of the partnership may coexist with the solvency of the limited members of the firm. It has not been authoritatively determined whether there can be an adjudication against a partnership as an entity without an adjudication of bankruptcy against its individual members,[4] but the writer is of the opinion that under our law there can be such an adjudication against a partnership as an entity without an adjudication of insolvency against its limited partners. A solvent partnership may be adjudged bankrupt if it has made a general assignment for the benefit of creditors, and perhaps in such a case adjudication of bankruptcy of the individual members would not be necessary, especially if the order of adjudication of the partnership expressly states that it binds only the partnership entity and not the partners as individuals.[5]

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1 In re Hercules Atkin Co., Ltd., 133 Fed. Rep. 813.
2 Francis *vs.* McNeal, 228 U. S. 695.
3 Tumlin *vs.* Bryan, 21 L. R. A. (N. S.) 960; 165 Fed. Rep. 166.
4 Mills *vs.* J. H. Fisher & Co., 16 L. R. A. (N. S.) 656; 159 Fed. Rep. 897; American Steel and Wire Co. *vs.* Coover, 30 L. R. A. (N. S.) 787; 111 Pac. 217.
5 3 Ruling Case Law, 210.

c. *Is a partnership affected by an act of insolvency committed by one or more of its partners?*—Under the principles of the law of partnerships, a partner is an agent of the partnership, and, when he commits an act of bankruptcy while acting as such agent, the partnership may be adjudged insolvent, especially if the partnership derives some benefit from the act, or if this is committed with respect to partnership property.[1] But a surviving partner will be adjudged bankrupt on an act of bankruptcy committed by him in the course of the administration of the assets of the deceased partner, notwithstanding the fact that the separate estate of the deceased partner may be sufficient to pay all his debts, joint and separate.[2]

d. *Can insolvency proceedings against a partnership or its partners be voluntary and involuntary at the same time?*—It is clear that when the petition is filed by all the partners, the proceedings are voluntary, and, when it is filed by the creditors, they are also voluntary. But when the petition is filed by some of the partners only, the proceedings as to them (those partners who file the petition) are voluntary, and as to the other partners, the proceedings may be involuntary or voluntary, according to the circumstances of each case. If the partners who did not join in the filing of the petition opposed the adjudication, the proceedings would be involuntary as to them, but if, after due notice, they remained silent or failed to appear in the hearing, the proceedings would also be deemed voluntary as to them.

e. *How can the insolvency of a partnership be determined?*—There are authorities which hold that all the property of the individual partners must be added to the property of the partnership in ascertaining whether the partnership is insolvent or not. Others insist that, as the partnership possesses a legal entity distinct from its members, the property of the partnership alone is to be taking into account in determining its insolvency. It seems that the two opinions can be harmonized by a reasonable construction of each. The first opinión is applicable to general partners, while the second is applicable to limited partners. General partners are liable for the debts of the partnership to the extent of all their estates, while the limited partners are liable only to the extent of the amount they have contributed to the partnership.

2. *Corporations.*—By Section 52 of our Insolvency Law, the provisions of that Act are made applicable to all corporations and "sociedades anónimas," except corporations engaged principally in the banking business and those as to which there is any special provision of law for their liquidation in case of insolvency. In case the articles of association or by-laws of any corporation or "sociedad anónima" provide a method for such proceedings, such method shall be followed. "Sociedades anónimas" as used in this Act must be understood to apply only to such "sociedades anónimas" as are organized under the Code of Commerce which continued their existence as such after the passage of the Corporation Law, as authorized by the last proviso of section 191 thereof. Corporations must be understood to be those organ-

[1] Strang *vs.* Bradner, 114 U. S., 555.

[2] In re Stevens, Fed. Case No. 13393.

ized under our laws, and an unincorporated company is not entitled to the privileges of the Insolvency Law as an entity, but proceedings must be made by or against the members as individuals. In the United States, municipal corporations are expressly excluded from the operation of the Bankruptcy Act, and, even though our Insolvency Law does not make any express exclusion, one is inclined to think that, as they are public corporations exercising in some respect part of the sovereign power of the State, such exclusion was intended by the Philippine Legislature. Moreover, special means are generally provided for in our law by which funds may be raised to meet their just debts, and in other cases for their liquidation. Railroad, insurance, and banking corporations are also excluded from the operation of the Federal Bankruptcy Law of the United States, while in Spain all public service corporations may suspend payments and be adjudged bankrupts. Under our law, banking corporations are expressly excluded, and the exclusion extends to other corporations, be they civil or commercial, charitable, mutual benefit, or educational institutions, when there is a special law providing for their liquidation or when their articles of association or by-laws provide a method for such proceedings. Can foreign corporations, authorized to do business in the Philippines, be adjudged insolvent in proceedings before our courts? If so, what law shall be applied? Section 73 of the Corporation Law, Act 1459, provides that foreign corporations authorized to do, and which are lawfully doing, business in the Philippine Islands, are bound by all laws, rules, and regulations applicable to domestic corporations of the same class, save and except such only as provide for the creation, formation, organization, or dissolution of corporations or such as fix the relations, liabilities, responsibilities, or duties of members, stockholders, or officers of the corporation to each other or to the corporation. The Insolvency Law does not regulate the formation, organization, or dissolution of corporations. It is true that when a corporation becomes insolvent and is adjudged bankrupt, its dissolution follows as a natural consequence, but not for that reason alone may the Insolvency Law be considered as a law governing the dissolution of corporations. The Insolvency Law is not intended merely to fix the relations, liabilities, responsibilities, or duties of members, stockholders, or officers of the corporation to each other or to the corporation. It is designed to have a wider scope, embracing third persons who are creditors of the corporation. The Insolvency Law, therefore, applies to foreign corporations doing business in the Philippines, at least to the extent it is applicable to domestic corporations of the same class. Of course, our courts can not enforce its orders on the property of corporations situated outside the Philippine Islands.

3. *Further Provisions Regarding Corporations.*—The Insolvency Law, in section 52 thereof, already cited, after stating that all the provisions of that Act shall apply to corporations and "sociedades anónimas," further provides that, upon the petition of any officer of the corporation, duly authorized by the board of directors or trustees, at a meeting called for that purpose, or by the assent in writing of a majority of the

directors or trustees, as the case may be, or upon a creditor's petition made and presented in the *manner provided in respect to debtors*, like proceedings shall be had and taken as are provided in the case of debtors. All the provisions of that Act which apply to the debtor, or set forth his duties, examination, and liabilities, or prescribe penalties, or relate to fraudulent conveyances, payments, and assignments, apply to each and every officer of a corporation in relation to the same matters. Whenever any corporation is declared insolvent, its property and assets shall be distributed among the creditors, but no discharge shall be granted to any corporation. In view of this provision of law, we are led to inquire whether a corporation may be adjudged insolvent upon the petition of a single creditor. Section 20 of the Insolvency Law provides that a petition for an involuntary insolvency must be made by at least three of the debtor's creditors, but section 52 provides that like proceedings shall be had as are provided in the case of debtors upon a creditor's petition, and that all the provisions of the Insolvency Law shall apply to corporations. Under section 20, therefore, at least three creditors must file the petition, while under section 52 one creditor of the corporation is sufficient, and yet it declares by its own wording that section 20 shall also apply to corporations. Judge George R. Harvey, of the Court of First Instance for the City of Manila, in an order dated November 10, 1915, sustaining a demurrer to a petition for involuntary insolvency filed by Jennie Florida against The Oriental Moving Picture Corporation (Case No. 13523), among other things said:

> "In this case we are construing a statute which provides in section 20 that 'an adjudication of insolvency may be made on the petition of three or more creditors, residents of the Philippine Islands, whose credits or demands accrued in the Philippine Islands, and the amount of which credits or demands are in the aggregate not less than one thousand pesos;' etc., etc., and in another section provides that the provisions of this Act shall apply to corporations and *sociedades anónimas*, and upon the petition of any officer of any corporation, or *sociedad anónima*, duly authorized * * * or upon a creditor's petition made and presented in the manner provided in respect to debtors, like proceedings shall be had and taken as are provided in the case of debtors; etc., etc.
>
> "It does not say that the corporation must be indebted in any particular amount, nor does it say what shall constitute an act of bankruptcy on the part of a corporation. We must go elsewhere to find what constitutes an act of bankruptcy on the part of a corporation, or else we must imply that the mere filing of the petition by a single creditor, showing any amount whatever of indebtedness to the petitioner, is an act of bankruptcy. Necessarily, we must look to other sections of the Act for the provisions as to what constitutes an act of bankruptcy, as to what is necessary to make or establish a fraudulent preference, as to whether the credits or demands accrued in the Philippine Islands, and as to the amount of the credits or demands. The petitioner has apparently construed section 20 as partially applicable to the case of a corporation by alleging that her credit or demand accrued in the Philippine Islands,

> and amounts to more than one thousand pesos. If said requirements of section 20 are applicable under said section 52, why is not the requirement as to three creditors also applicable? It is to be noted that the petition must be made and presented in the *manner* provided in respect to debtors.
>
> "At first glance, this court was inclined to take the view that the petition for the involuntary insolvency of a corporation could be presented under section 52 by one creditor whose demand was not less than one thousand pesos, but, since studying the provisions of the law and the decisions on similar questions in the United States, some of which are quoted above, I am constrained to hold that it was not the intention of the Legislature to provide that a single creditor could throw a corporation into bankruptcy."

The United States Federal Bankruptcy Act of March 2, 1867, provided, in section 37 thereof, as follows:

> "That the provisions of this act shall apply to all moneyed business or commercial corporations and joint-stock companies, and that upon the petition of any officer of any such corporation or company, duly authorized by a vote of a majority of the corporators at any legal meeting called for the purpose, or upon the petition of any creditor or creditors of such corporation or company, made and presented in the manner hereinafter provided in respect to debtors, the like proceedings shall be had and taken as are hereinafter provided in the case of debtors; * * *."

This section was incorporated into the Revised Statutes as section 5122, omitting the words "or creditors," in speaking of proceedings in involuntary bankruptcy.

Section 39 of the Federal Bankruptcy Act of 1867, as amended by section 12 of the Act of Congress of June 22, 1874, provided:

> "That any person residing, and owing debts, as aforesaid, who, after the passage of this Act, shall depart from the State, District, or Territory of which he is an inhabitant, with intent to defraud his creditors; or, * * * shall be adjudged a bankrupt on the petition of one or more of his creditors, who shall constitute one-fourth thereof, at least, in number, and the aggregate of his debts provable under this Act amounts to at least one-third of the debts so provable; * * * and the provisions of this section shall apply to all cases of compulsory or involuntary bankruptcy commenced since the first day of December, eighteen hundred and seventy-three, as well as to those commenced hereafter."

The case mostly relied upon by Judge Harvey, construing the above Act of 1867, as amended by the Act of June 22, 1874, is "In re Oregon Bulletin Printing and Publishing Company," Federal Case No. 10558. The Federal District Court of Oregon held in that case that a petition to have a corporation adjudged bankrupt might be maintained under section 5122 of the Revised Statutes by any creditor of such corporation, and that the provision of section 12 of the Act of June 22, 1874,

in relation to the number of the creditors and the aggregate amount of their claims required to join in such petition against a natural person, does not apply. On writ of error, this case was reversed by the Circuit Court for the District of Oregon, which held that "since the passage of the amendatory and supplemental bankruptcy Act of June 22, 1874, the same proportion of creditors must join in a petition seeking an adjudication of bankruptcy against a corporation as is required in the case of natural persons."

The above holding of the Court was based upon the following reasoning:

> "It must be born in mind that the principles upon which the Act proceeds, and all the details and specific provisions relating to matters of bankruptcy, are prescribed in the other sections; and that the provisions of section 5122, relating to corporations, are intentionally brief, general, and incomplete, specifically providing merely for inherent differences between corporations and natural persons, and referring to the other provisions of the title for particulars unaffected by such inherent differences.
>
> In my judgment, after a careful consideration of the various provisions of the Act, the specific provisions of section 5122, so far as they go, are controlling in respect to corporations; but all other provisions of the title of an additional character omitted to be mentioned in this section not repugnant to any of its express provisions, and not in the nature of things intrinsically inapplicable, are made applicable to corporations by the introductory clause of the section.
>
> Upon the construction adopted, the provisions of the bankrupt Act operate uniformly, and are harmonious in all particulars where there are no inherent characteristic differences between corporations and natural persons, and different provisions are made only to meet such differences. This is what we should expect to find in a statute."

The decision of the Federal District Court of Kansas in the case entitled "In re Leavenworth Savings Bank," Fed. Case No. 8166, 15 Federal Cases, p. 118, affirmed by the Circuit Court for the District of Kansas, and that of the Federal District Court for the Eastern District of Michigan in "In re Detroit Car Works," Fed. Case No. 3833, 7 Fed. Cases, p. 553, established the same principle as that upheld in "In re Oregon Bulletin Printing and Publishing Company," Fed. Case No. 10558, 18 Fed. Cases, p. 770.

The author desires to state, however, that he entertains an opinion directly opposite to and entirely distinct from that of Judge Harvey. The writer is inclined to believe that under our Insolvency Law a single creditor can by petition throw a corporation into involuntary insolvency, and the reasons supporting this opinion will now be discussed briefly. In the first place, after a more deliberate examination of the provisions of our Insolvency Law and those of the United States Bankruptcy Statute already cited, the alleged similarity between these particular provisions does not reach such a point as to warrant us to take the decisions of courts in the United States as authoritative precedents in construing and harmonizing the appar-

ent ambiguity of sections 20 and 51 of our Insolvency Law. The United States statute provides that a person "shall be adjudged a bankrupt on the petition of one or more of his creditors, who shall constitute one-fourth thereof, at least, in number, and the aggregate of his debts provable under that Act amounts to at least one-third of the debts so provable, etc." Under the above provision it is unquestioned that a single creditor may file a petition against an individual debtor in case there are only four or a lesser number of creditors (one-fourth, at least) and provided the claim of the single petitioning creditor amounts to at least one-third of all the debtor's debt. In a prior section of the same statute it is provided that "the provisions of that act shall apply to corporations, and that upon the petition of any creditor of the corporation, made and presented in the manner in respect to debtors, like proceedings shall be had and taken," etc. Of course, this section must be construed, as it has been construed by the courts in the United States, that a single creditor of a corporation can file the petition only when the other requisites mentioned in the other provisions as respects debtors are complied with; that is, the single petitioning creditor must constitute at least one-fourth in number of all the creditors and his claim must be at least one-third of all the provable debts of the corporation. On the other hand, while our law calls for the same rule of construction, yet the wording of its provisions and their relation to each other point to a different conclusion. Our law provides in general that "an adjudication of insolvency may be made on the petition of three or more creditors, residents of the Philippine Islands, whose credits or demands accrued in the Philippine Islands, and the amount of which credits or demands are in the aggregate not less than one thousand pesos," etc. Then it provides in another section that "the provisions of that Act shall apply to corporations, and, upon a creditor's petition, made and presented in the manner provided in respect to debtors, like proceedings shall be had and taken," etc. This provision must be construed to mean that a single creditor of the corporation is entitled to make the petition, provided it is made and presented in the manner provided in respect to debtors; that is, the petitioning creditor must be a resident of the Philippine Islands, his credits must have accrued in the Philippine Islands, and the amount thereof must not be less than one thousand pesos. The decisions of the courts in the cases relied upon by Judge Harvey are in harmony with this construction, *i. e.*, that a single creditor may throw a corporation into involuntary bankruptcy, provided the requisites as respects debtors are present and complied with. The construction given by the courts in the United States to the Federal statute did not defeat the provision contained therein, that a single creditor of a corporation may make the petition, but such construction only limited the operation of the provision by requiring that the other requisites must be complied with. On the other hand, the construction given to our statute that a single creditor of a corporation can not make the petition even if such creditor complies with the other requisites provided in respect to debtors, would not only limit the operation of section 52 of our Insolvency Law, but would entirely

defeat the express provision of that section that the petition may be made by a creditor of a corporation. The writer believes that his conclusion is warranted by the following rules of statutory construction:

> "The object of all interpretation and construction of statutes is to ascertain the meaning and intention of the legislature, to the end that the same may be enforced." (Black, p. 45.)
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> "This meaning and intention must be sought first of all in the language of the statute itself. For it must be presumed that the means employed by the legislature to express its will are adequate to the purpose and do express that will correctly." (Black, p. 45.)
>
> "If two statutes, or two parts or sections of the same statute, cover the same matter in whole or in part, and are not absolutely irreconcilable, it is the duty of the court, if possible, to give effect to both." (Black, p. 325.)

Moreover, while it is true that the provisions of section 52 relating to corporations are brief, general, and incomplete, specifically providing merely for inherent differences between corporations and natural persons, and that we must seek in other sections of the Act for particulars unaffected by such inherent differences, yet we are not authorized by the rules of statutory construction to defeat what is expressly and unmistakably provided in section 52 by importing particulars from other sections. Finally, section 51, which relates to partnerships, expressly provides that the petition shall be made by three or more creditors. Section 51 is also brief, general, and incomplete, specifically providing merely for inherent differences between partnerships and natural persons; yet the Legislature has expressed therein that the petition shall be made by at least three creditors. If the Legislature intended to place corporations on the same footing as partnerships and natural persons, why did it not state, in section 52, "upon at least three creditors' petition," instead of saying, "upon a creditor's petition?" It is, therefore, clear that it was the will and intention of the Legislature to treat corporations differently from natural persons, and that that will and intention are clearly expressed by the provisions of section 52.

CHAPTER VII

PROOF OF DEBTS AND CLASSIFICATION AND PREFERENCE OF CREDITORS

1. *Proof of Debts.*—In general, only debts due and payable at the time of the adjudication of insolvency may be proved against the estate of the debtor, but debts then existing but not payable until a future time may also be proved. A discount must, however, be made if no interest is payable by the terms of the contract. (Sec. 53.) Besides the above general provisions, the following are expressly mentioned in our Insolvency Law as provable debts:

> 1. When the debtor is bound as indorser, surety, bail, or guarantor (Sec. 54).

2. When debtor is liable for contingent debts, if contingency shall happen before the order of final dividend. (Sec. 55.)

3. When a third person is liable as bail, guarantor, or surety for the debtor when the former has paid the debt (Sec. 56).

4. Proportionate part, up to the time of the insolvency, of debts due at fixed and stated periods. (Sec. 57.)

5. In cases of mutual debts or mutual credits, the balance thereof against the insolvent (Sec. 58), and other balance obligations (Sec. 59).

First of all, before any claim can be pronounced provable against the estate, the court must determine that it is a "debt."[1] If it is found to be a debt, it must be determined whether or not it is due and payable at the time of the adjudication of insolvency, and, if not, a discount must be made if no interest is payable by the terms of the contract. In our Insolvency Law, under the chapter on "Proof of Debts," none of the provisions expresses in clear terms the formal manner of presenting claims, but, from what can be gathered from other sections of the Act, we may say that all claims shall contain a statement showing the amount and nature of the claim and security, if any, and the claim must be verified by the claimant or his duly authorized agent, and must not be barred by the statute of limitations (Sec. 29). When claims are proved by authorized agents, the authority must be sufficient to represent the creditor for that purpose. Corporations may prove their claims through their legal representatives. Married women may prove their claims for dowry and paraphernal property. Written securities must accompany all secured claims. A creditor proving his claims shall not be allowed to sue the debtor for the same, but he must wait until the question of the debtor's discharge shall have been determined, because, in case a discharge is denied a debtor, the creditor may further prosecute the rest of his claims by a suit, but, if the debtor is discharged, the creditor shall not have that right. If the amount due the creditor is in dispute, the suit, by leave of the court in insolvency, may proceed to judgment for the purpose of ascertaining the amount due, which amount may be allowed in the insolvency proceedings, but execution shall be stayed (Sec. 60). Any person who has accepted preference, having reasonable cause to believe that it was made contrary to the law, shall not be allowed to prove his claims until he surrenders the property received by him under such preference. (Sec. 61.)

2. *Classification and Preference of Creditors.*—Creditors under our Insolvency Law may be classified as follows:

(1) Persons having property in the possession of the insolvent or whose property is found among that of the insolvent, the ownership of which has not been conveyed to him by a legal and irrevocable title. (Sec. 48.)

(2) Preferred creditors. (Sec. 50.)

(3) Ordinary creditors. (Sec. 49.)

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[1] Wetmore *vs.* Markoe, 196 U. S. 68.

The first class of creditors can not, however, be properly considered as creditors in the ordinary sense. They are persons who, having property in the possession of the insolvent, are by law given a special remedy for its recovery, so that it may be exempt from the claims of the creditors of the insolvent. At a proper hearing had upon the petition of the assignee or a creditor, the court may order the delivery to its respective owners of such property found in the possession of the insolvent but not belonging to him. In order that such property may be considered as property belonging to other persons, the ownership of the same must not have been transferred to the insolvent by a legal and irrevocable title. By such transfer, the creditors of the insolvent retain such rights in said property as belong to the insolvent, subrogating themselves in his place whenever they shall have complied with all obligations concerning said property. Section 48 enumerates the following as property belonging to other persons, even if found among the property of the insolvent, or is under his control:

(*a*) Dowry property of the wife,
(*b*) Paraphernal property of the wife,
(*c*) Property deposited with the insolvent,
(*d*) Property in the possession of the insolvent on commission for purchase or sale,
(*e*) Negotiable papers, not indorsed or assigned to the insolvent,
(*f*) Money or property remitted to the insolvent otherwise than on account current, to be paid or delivered to a definite person in the name and for the account of the remitter,
(*g*) Amounts due the insolvent for sales of merchandise on commission, etc.,
(*h*) Merchandise purchased by him on credit, but not actually delivered to him, and, if delivered, the price thereof, and
(*i*) Goods and chattels wrongfully taken, converted, or withheld by the insolvent.

With the exception of item "(*i*)", the provisions of the above section are of Spanish origin, having been taken from article 909 of the Code of Commerce.

As to the preferred creditors, section 50 of our Insolvency Law provides as follows:

> "Sec. 50. The following shall be preferred claims which shall be paid in the order named:
>
> (*a*) Legal expenses and expenses incurred in the administration of the insolvent's estate for the common interest of creditors, when properly authorized and approved by the court;
>
> (*b*) Necessary funeral expenses of the debtor or of his wife, or children who are under their parental authority and have no property of their own, when approved by the court;
>
> (*c*) Debts, taxes, and assessments due the Insular Government;
>
> (*d*) Debts, taxes, and assessments due any province or provinces of the Philippine Islands;
>
> (*e*) Debts, taxes, and assessments due any municipality or municipalities of the Philippine Islands;

> (*f*) Debts for personal services rendered the insolvent by clerks, laborers, or domestic servants during the sixty days immediately preceding the commencement of proceedings in insolvency, not to exceed two hundred pesos for each claimant."

Similar provisions are found in section 735 of the Code of Civil Procedure, Act 190 of the Philippine Commission, for the payment of a decedent's debts. Expenses of the last sickness and debts due the United States are found in that section of the Code of Civil Procedure as preferred debts, but they are not mentioned as such in our Insolvency Law. The reason for this difference, perhaps, lies in the fact that it is the intention of the law-making body to restrict the debts of an insolvent person and, also, to give all the creditors of the insolvent equal rights as far as justice permits. It may also be noted that debts under items "(*a*)" and "(*b*)" must be approved by the court before they can be considered as preferred debts. As a general rule, courts hesitate in approving preferred debts under item "(*a*)" unless they are reasonable legal expenses and expenses of administration for the common interest of the creditors. The principal reason for considering these debts (under item "(*a*)") as preferred over all other claims, is that they are expenses incurred for the common interest of all the creditors. As to necessary funeral expenses, they must be determined according to the circumstances of each particular case, taking into consideration the social standing of the deceased and the customs of the place; but, as they are debts incurred by an insolvent, they are subject to strict consideration as preferred debts. Debts under "(*f*)" are preferred because, as merchants and traders are usually the subject of insolvency proceedings, the aid of clerks, laborers, and domestic servants is necessary to their business. These debts, are, however, not preferred under the Code of Civil Procedure.

All debts other than those named as preferred are ordinary debts, and they shall be paid *pro rata* after all the preferred debts have been paid.

CHAPTER VIII

COMPOSITION AND DISCHARGE

1. *Composition.*—Composition under our Insolvency Law is the agreement between the debtor and his creditors initiated by the former after he has filed the schedule of his property and list of his creditors, for the purpose of the proceedings in insolvency, by giving to the creditors certain valuable considerations for his discharge. The provision governing composition as found in section 63 of our Insolvency Law were taken from the United States bankruptcy system,

Terms of composition may be offered:

(*a*) By the insolvent,
(*b*) To the creditors of the insolvent, and
(*c*) After, but not before, the insolvent has filed in court a schedule of his property and list of his creditors.

The law requires that the terms of composition must be offered after the insolvent has filed in court the schedule and list of creditors, so that the court may know whether all the creditors are notified of the terms of the composition offered and whether a majority of the creditors in number and amount of claim accept the same.

An application for the confirmation of a composition may be filed in the insolvency court—

(*a*) After, but not before, it has been accepted in writing by a majority of all creditors whose claims have been allowed. (This majority must be both in number and amount, as is required for the election of an assignee.)

(*b*) After depositing in such place as the court may designate (1) the consideration to be paid to his creditors, (2) money necessary to pay preferred debts, and (3) costs of the proceedings.

The law requires that the consideration to be paid to the creditors must be deposited in a place to be designated by the court and is made subject to its control, so as to insure the fulfillment of the terms of the composition on the part of the insolvent. It will be observed that, as the insolvent is required to deposit money sufficient to pay the preferred debts, such debts shall not be affected by the terms of the composition. For this reason, the writer is of the opinion that the majority of the creditor required to sign the acceptance does not include the preferred creditors. A composition in money may be offered, and the insolvent may obtain the money required for the purpose of the composition by the use of his credit. [1]

In a hearing upon application, the court shall confirm a composition if satisfied—

(*a*) That it is for the best interest of the creditors,

(*b*) That the insolvent has not been guilty of any of the acts, or of a failure to perform any of the duties, which would create a bar to his discharge,

(*c*) That the offer and its acceptance are in good faith, or not procured by means other than what the law prescribes. A promissory note or other security given by a debtor to a creditor as a secret preference in order to induce the creditor to join in a composition agreement with other creditors is fraudulent and void in the hands of the payee or the holder, other than a holder in due course; and the debtor may himself set up the invalidity of the security as a defense in an action wherein it is sought to be enforced. [2] Upon application of a party in interest, made at any time within six months after the composition has been confirmed, the court may set it aside for good cause shown. If the composition is confirmed, the consideration shall be distributed among the creditors, but, if it is not confirmed, the proceedings in insolvency shall be continued, and the property of the insolvent shall be administered accordingly.

2. *Discharge.*—The confirmation of a composition automatically effects a discharge, but a discharge may also be obtained by application made by the insolvent to the court at any time after three months, but not later than one year, from the

[1] Zavelo *vs.* Reeves, 227 U. S., 625.
[2] 3 Ruling Case Law, 130-131.

date of adjudication, unless the property of the insolvent has not been converted into money. As has already been said, corporations are not entitled to a discharge, but partnerships are. The application for a discharge must state: (*a*) that the insolvent has complied with all his duties as such, (*b*) that the insolvent has not committed any act named in the law as a ground for its refusal, (*c*) that a fair and equitable distribution of his property has been made among his creditors *pro rata*, and (*d*) his desire to be discharged of all his debts and obligations. The court shall order notices to be given to all the creditors to show cause why a discharge shall not be granted, which notice shall be served and published in like manner as in other cases already discussed. Any creditor may oppose the discharge, and, for that purpose, he shall file his objection thereto, specifying the grounds of his opposition. The case shall then be tried and decided by the court. The opposition may be based upon any of the grounds mentioned in section 65 of our Insolvency Law, which may be briefly stated as follows: (*a*) false swearing by the debtor, (*b*) concealment of any part of his property or books, (*c*) being guilty of fraud or willful neglect in the care or custody of his property, (*d*) procuring his property to be attached, (*e*) destroying or falsifying books, documents, or securities, (*f*) making fraudulent transfers or preferences, (*g*) not notifying the assignee of any false or fictitious debt proven when he has knowledge of its being false or fictitious, (*h*) failure to keep books of accounts when he is a merchant or tradesman, (*i*) influencing action of any creditor by pecuniary consideration, (*j*) in contemplation of insolvency, making transfer of property to prefer one or more of his creditors, (*k*) violating any of the provisions of the Insolvency Law, (*l*) in case of voluntary insolvency, having received the benefits of this Act within six years preceding the application for discharge, and (*m*) the fact that there is another insolvency proceeding pending against him.

With the exception of the two last-mentioned, all the grounds for opposition to a discharge are based on criminal conduct or actual dishonesty quasi-criminal in nature. The above provisions, being penal in character, are to be strictly construed; that is, liberally construed in favor of the insolvent, and all implications and doubts are not to be resolved against him.[1] A bankrupt is not guilty of making a false oath when he omits from his sworn schedule securities which are absolutely worthless. It would be possible for a bankrupt to have a legal interest in the principal or income of property under the terms of a will, which ought to be included in his schedule, and yet the interest might be of such an uncertain and involved nature that his omission to schedule it would not clearly constitute the making of a false oath fraudulently and knowingly.[2] The court, upon being satisfied, shall grant a discharge as a matter of right on the part of the insolvent, and the insolvent is thereby released of all his debts, except that created by the fraud or embezzlement of the debtor, or by his defalcation as a public officer or while acting in a fiduciary capacity.[3] The word

[1] Hardie *vs.* Swafford Bros. Dry Goods Co., 20 L. R. A. (N. S.) 785; 165 Fed. Rep. 588.
[2] 3 Ruling Case Law 135.
[3] Sections 68 and 69, Act 1956.

"fraud" in the clause defining the debt from which a bankrupt is not relieved by a discharge means positive fraud or fraud in fact, involving moral turpitude or intentional wrong, and not implied fraud, which may exist without bad faith.[1] Any creditor may contest the validity of a discharge at any time within one year after the date thereof by application made to the court setting forth the ground therefor.

CHAPTER IX

FRAUDULENT PREFERENCES AND TRANSFERS

1. *In General.*—As previously indicated, one of the objects of our Insolvency Law is to secure the equitable distribution of the insolvent's property among his creditors. The provisions regarding fraudulent preferences and transfers are designed to accomplish that object. According to our law, fraudulent preference must have the following requisites: (*a*) that the debtor is insolvent or is in contemplation of insolvency, (*b*) that it was made within thirty days before the filing of the petition by or against him, (*c*) that it was made with the precise object of giving preference to one or more of his creditors, (*d*) that the creditor received the preference, having reasonable cause to believe that the debtor is insolvent, and (*e*) that the preference was made with a view to prevent his property from going to the assignee or from being distributed *pro rata* among his creditors. The word "insolvent" as used in the above provisions must be given the same meaning as in the previous chapters. In transfers of property amounting to preferences, there must be a parting with the bankrupt's property for the benefit of the creditor, and the consequent diminution of the bankrupt's estate, and, unless a creditor takes by virtue of a disposition by the insolvent debtor of his property for the creditors' benefit, so that the estate of the debtor is thereby diminished, the creditor can not be charged with receiving a preference by transfer.[2] If the result of the transfer is the giving of preference to one or more of the creditors, the intent on the part of the debtor to make such preference will be presumed. The requirement of "reasonable cause to believe" does not demand actual knowledge or actual belief, nor does a mere suspicion in the creditor's mind charge him with having 'reasonable cause."[3] In determining whether the creditor had reasonable cause to believe that a preference was intended, the facts shown must be reasonably sufficient to put an ordinary prudent man upon inquiry by the exercise of reasonable diligence.[4] Our Insolvency Law (Sec. 70) states that in case of transfer, sale, or conveyance of property by the debtor other than in the usual and ordinary course of his business or seizure made under a judgment which the debtor has confessed, that fact shall be *prima facie* evidence of fraud.

2. *Kinds of Preference.*—According to our law, fraudulent preferences may be classified as follows: (*a*) when the debtor procures any part of his property to be

[1] Strang *et al*, *vs.* Bradner *et al*, 114 U. S. 555.
[2] 3 Ruling Case Law 271; New York County Nat. Bank *vs.* Massey, 192 U. S. 147; Rector *vs.* City Deposit Co., 200 U. S. 405.
[3] Suffel *vs.* McCartney Nat. Bank, 127 Wisconsin 208.
[4] Galbraith *vs.* Whitaker, 43 L. R. A. (N. S.) 427; 119 Minn. 447.

attached, sequestered, or seized on execution, (*b*) when he makes any payment, pledge, mortgage, assignment, transfer, or conveyance of any of his property to any one having reasonable cause to believe that such debtor is insolvent and it was made to prevent his property from going to the assignee or from being distributed among his creditors, or in any way to hinder the operation of the Insolvency Law, (*c*) when said transfer, sale, conveyance, etc., was made other than in the usual and ordinary course of business of the debtor, (*d*) when the seizure or attachment was made under execution which the debtor had suffered or permitted, and (*e*) when the transfer without any valuable pecuniary consideration was made in good faith. The above-mentioned preferences are considered as fraudulent and are void. The following are valid transfers: (*a*) when the debtor has received a valuable pecuniary consideration for the transfer, (*b*) when the transfer did not in any way diminish the property of the debtor, (*c*) when the transfer consisted in a deposit in a bank on the debtor's account, subject to his demand, (*d*) when it consisted in the payment of salaries to persons having the right to the same, and (*e*) when the debtor made the transfer in good faith and not in contemplation of insolvency. Payment to a lawyer for future services to defend the debtor in insolvency proceedings which he contemplates, is not a fraudulent transfer or preference, according to authorities in the United States, though our law is silent on this point. The reason for this is that the law recognizes the right of the debtor to seek the aid of a lawyer in this case.[1]

3. *Penal Provisions.*—For the purpose of this work and due to its limited scope, it suffices to say that our Insolvency Law provides penalties for various acts of the insolvent which are criminal or quasi-criminal in nature. These acts are grouped into three divisions with their corresponding penalties, which may be found in section 71 of the law. They consist mostly of fraudulent concealment, transfer, or conveyance by the debtor of his property to defraud his creditors or giving preference to some of them. In this connection it is time to inquire whether or not Articles 523 to 533, inclusive, of the Penal Code, on the subject of "Absconding, Fraudulent Bankruptcy or Insolvency" are still in force. As we have already said, section 524 of the Code of Civil Procedure, Act 190, expressly repealed all laws and orders relating to bankruptcy and proceedings therein existing at the time of its passage. Articles 523 to 533, of the Penal Code are provisions relating to bankruptcy, existing at the time of the passage of Act 190, and consequently they are repealed by section 524 thereof. Moreover, Article 524 to 528 of the Penal Code apply to acts committed in violation of the provisions of the Code of Commerce on the subject of bankruptcy That part of the Code of Commerce relating to bankruptcy and proceedings therein having been repealed by section 524 of Act 190, Articles 524 to 528 of the Penal Code *ipso facto* ceased to operate. Finally, the enumeration, in section 71 of our Insolvency Law, of acts punishable under that law excludes all other acts not mentioned therein,

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[1] Sobral on "Breves Comentarios Sobre las Leyes de Quiebras y Corp.," pages 96-97.

according to the maxim, "expressio unius est exclusio alterius." It must also be observed that by section 83 of our Insolvency Law, all Acts inconsistent with its provisions were thereby repealed.

CHAPTER X
APPEALS

1. *Appellate Court.*—The Supreme Court of the Philippine Islands has appellate jurisdiction over insolvency cases coming on appeal from the Courts of First Instance of the various provinces and of the City of Manila.

2. *Cases of Appeal.*—Section 82 of our Insolvency Law provides:

> "Sec. 82. Appeal may be taken to the Supreme Court in the following cases:
>
> 1. From an order granting or refusing an adjudication of insolvency and, in the latter case, from the order fixing the amount of costs, expenses, damages, and attorneys' fees allowed the debtor.
>
> 2. From an order made at the hearing of any account of an assignee, allowing or rejecting a creditor's claim, in whole or in part, when the amount in dispute exceeds three hundred pesos.
>
> 3. From an order allowing or denying a claim for property not belonging to the insolvent, presented under section forty-eight of this Act.
>
> 4. From an order settling an account of an assignee.
>
> 5. From an order against or in favor of setting apart homestead or other property claimed as exempt from execution.
>
> 6. From an order granting or refusing a discharge to the debtor.

Chapter forty-two of the Code of Civil Procedure, so far as applicable, shall govern appeals under our Insolvency Law, but an interlocutory appeal shall not stay proceedings unless a written undertaking be entered into on the part of the appellant, with at least two sureties, in an amount not less than double the value of the property involved.

PART III
CRITICISMS AND CONCLUSIONS

CHAPTER I
CRITICISMS

1. *Criticisms as to Form.*—The weight of reason and the trend of judicial adjudications have repeatedly established the rule that mere formal defects in statutes will not impair their operation. For this reason, we might well say nothing against the form in which our Insolvency Law is found were it not for the fact that the substance of the law can only be gathered from the language in which it is expressed, and that language can be best interpreted with the aid of the form in which it is

found. Moreover, the law is intended to govern the relations between men, and, for the benefit of society, it must be observed by all individuals. That being the case, the law must be in such form and language as to be comprehensible to every man of ordinary intelligence, so that it may be correctly observed by him. It is true that when the form of the law is defective and its language is ambiguous, the courts are vested with the duty of construing its provisions and declaring its substance and operation, but this is only done in connection with actual controversies brought before the courts for decision, and so a law which is defective in form may give rise to a multiplicity of actions, leading parties to waste time and incur unnecessary expense. According to modern conception, every law must not only be perfect in form but its provisions must be systematic and logical in their arrangement. Anything to be perfect must be complete in all its parts, not only in the sense that it must include all the parts that properly belong to it, but also in the sense that it must exclude all those parts which are beyond its scope. The first inquiry we shall make is whether or not our Insolvency Law contains all the parts which must necessarily belong to an insolvency law. To determine this, we must again inquire whether or not the provisions of our Insolvency Law sufficiently warrant the accomplishment of the objects common to insolvency laws of other civilized countries. Our Insolvency Law contains provisions for the relief of innocent debtors. It also provides for the speedy and equitable distribution of the debtor's property among his creditors. Furthermore, it contains provisions for the punishment of fraudulent debtors. Finally, it furnishes the procedure which, by the aid of some of the provisions of the Code of Civil Procedure embodied therein by reference, is sufficient for all practical purposes to carry out the objects mentioned above. Although, generally speaking, it contains all the parts which properly belong to an insolvency law, yet it lacks some provisions which are necessary for determining the meaning of the important words and phrases used therein. Section 77 provides that the word "debtor" includes partnerships, corporations, and "sociedades anónimas," but it does not state whether or not it includes minors, insane persons, and married women. The word "insolvent" is not clearly defined, and it is hard to tell whether it applies to a person whose assets fall short of his liabilities or to one who has defaulted in the payment of his current obligations. Neither is the word "assets" defined in such a way as to make it certain whether or not it includes property exempt from execution. There are no explicit definitions in our law of the words "debts," "discharge," "transfer," and "concealment," or the phrase "reasonable cause to believe," etc.

Our next inquiry is as to whether or not our Insolvency Law contains provisions which do not properly belong to it. Are the provisions regarding suspension of payments a part of an insolvency law? A state of suspension of payments can not properly be considered as a kind of insolvency. It is an intermediate state between solvency and insolvency, but, as it is a sign of future insolvency and most

of its provisions are similar to those of insolvency, the Legislature is justified in treating the two subjects in a single Act. Furthermore, it has been observed that our Insolvency Law contains remedial as well as penal provisions. That is justified by the fact that our Insolvency Law furnishes not only remedies for the creditors and innocent debtors but also punishments for fraudulent debtors. The penalties are intended to guard against fraud, so that one of the principal objects of the law—to make an equitable distribution of the debtor's property among his creditors—may be attained. Again, it has been observed that our Insolvency Law is substantive in part and procedural in part. The reason for this is that, as our Insolvency Law is a special law, standing by itself for all practical purposes, it must contain not only the substance of the remedies it intends to furnish but also the procedure by which such remedies may be substantiated.

While our Insolvency Law may be said to be complete for all practical purposes, yet the arrangement of its provisions is neither systematic nor logical. It is unsystematic and illogical because provisions which should be grouped together as treating of the same subject are scattered all over the different sections of the law. The duties of the assignee, for example, can be understood only by reading all the provisions of sections 27 to 47, inclusive. The powers of the assignee are enumerated in section 36, but at least one of them—that of selling at public auction the property of the insolvent upon order of the Court—is more of a duty than a power. Moreover, there are also powers or rights of the assignee mentioned in sections 33 and 35. Again, the duties of the insolvent, few as they are, can not be found in any one particular section, but they are scattered all over the law as seeds of doubts are sown in the field of confusion.

Let us analyze more carefully the arrangement of the provisions of our Insolvency Law. The law is divided into thirteen chapters, and each chapter is subdivided into sections. The writer is of the opinion that the divisions of the law can be reduced into nine chapters in the following order:

Chapter I.—Title of Act and Definitions of Terms.
Chapter II.—Suspension of Payments.
Chapter III.—Voluntary and Involuntary Insolvency and Proceedings Thereon.
Chapter IV.—Officers.
Chapter V.—Partnerships and Corporations.
Chapter VI.—Creditors and Proof of Debts.
Chapter VII.—Composition and Discharge.
Chapter VIII.—Fraudulent Transfers, Preferences, and Penalties.
Chapter IX.—Appeals.

The discussion of the Insolvency Law in this work was not arranged in the order given above, because it was the intention of the writer to preserve as much as possible the original arrangement of the law so that the force of his criticisms may be clearly shown. The first chapter must contain the title of the Act and the definitions of

terms therein used, because, if it is essential to give the title of the Act first of a it is equally necessary that we know the meaning of the important words and phrases used in the law before proceeding with the study of the law itself. The chapter on "Suspension of Payments" must come next in the natural sequence of things, because, suspension of payments is a preliminary state between complete solvency and insolvency. A chapter on "Voluntary and Involuntary Insolvency and Proceedings Thereon" must be substituted for the chapters on "Voluntary Insolvency" and "Involuntary Insolvency," because, as there are very few and slight differences between those two kinds of insolvency, a thorough understanding of them can be best attained by studying them together in a single chapter, pointing out their differences and similarities. Moreover, the majority of the sections under the chapter on "Miscellaneous" in our Insolvency Law as enacted can be placed under Chapter III as proposed, because they are common to both voluntary and involuntary insolvency. The proposed chapter on "Officers" should consist of the provisions regarding the duties, powers, and compensation of clerks of court, sheriffs, receivers, and assignees in insolvency proceedings. This chapter must come next, because the subject of which it treats is intimately related to proceedings in insolvency. Then the chapter on "Partnerships and Corporations" must follow, because, after understanding the proceedings in insolvency, we must be informed of the extent of the operation of the law. The proposed chapter on "Creditors and Proof of Debts" will take the place of the chapters on "Classification and Preference of Creditors" and "Proofs of Debts" as are now found in our Insolvency Law. The chapters on "Compositions" and "Discharge" must be united into one chapter only. So also must the two chapters on "Fraudulent Preferences and Transfers" and "Penal Provisions" be treated in a single chapter, under the title, "Fraudulent Transfers, Preferences, and Penalties." Finally, there must be a chapter on "Appeals," and the chapter on "Miscellaneous" must be eliminated and its sections placed under their respective topics in other chapters.

As we have said before, each chapter of our Insolvency Law is subdivided into sections. Most of these sections are very long, and it is advisable to divide them into several parts. Take, for instance, sections 11, 18, 20, 24, 26, 27, 29, 30, 35, 43, 48, 51, 52, 63, 65, 70, 71, and 82. Each of these sections contains at least 300 words, which, instead of elucidating the meaning of its provisions, only breed ambiguities and doubts. These are but a few instances of the numerous defects in the arrangement of the provisions of our Insolvency Law.

2. *Criticism as to Language.*—It is the duty of the courts to give effect, if possible, to every word used in statutes. It is, therefore, the duty of the Legislature in enacting statutes to avoid the use therein of unnecessary words; otherwise the courts would be likely to be misled in ascertaining the intention of the Legislature as expressed in statutes. In the discussion of this topic, we shall ascertain whether or not our Insolvency Law contains unnecessary clauses, phrases or words, and,

with that purpose in view, we shall now examine its provisions. Section one provides as follows:

> "This Act shall be known and may be cited as 'The Insolvency Law,' and in accordance with its provisions every insolvent debtor may be permitted to suspend payments or be discharged from his debts and liabilities."

The above-quoted section should be changed to read as follows:

> "This Act shall be known as 'The Insolvency Law.' "

The words "and may be cited" are unnecessary in the above section, because, if the Act shall be known as the Insolvency Law, only naked nonsense will authorize anyone to cite it as something else, unless it is also known under a different name. If it is known as the Insolvency Law, by reasonable implication it may be cited as such, and to express in the law that reasonable implication is superfluous. The words "and in accordance with its provisions every insolvent debtor may be permitted to suspend payments or be discharged from his debts and liabilities" must also be discarded, although they can not be strictly said to be mere surplusage. Those words expressing the general subject of the Act are unnecessary in this particular case, because the enacting provisions of the law as found in subsequent sections shall control its scope and operation. It is true that, if the enacting provisions of the Act are ambiguous and unintelligible, the general subject of the Act may be consulted to ascertain the true meaning intended by the Legislature, but to admit such ambiguity in the Act is to admit that its language is defective. Moreover, the general description of the Act, which comes before section one states: "*An Act Providing for the Suspension of Payments, The Relief of Insolvent Debtors, The Protection of Creditors, and The Punishment of Fraudulent Debtors.*" Can not this general description of the Act take the office of its general subject contained in section one, and suggested to be eliminated, in case ambiguity arises in the enacting sections? If the answer is in the affirmative, then section one can be changed to read:

> "This Act shall be known as 'The Insolvency Law.' "

Our Legislature in emphasizing the meaning of the law, so that the same may be made clear, lost sight of the rule that a statute must be in ordinary and concise language, sufficient to express the meaning intended, avoiding unnecessary repetitions. Section two of our Insolvency Law in part provides as follows:

> "The debtor who, possessing sufficient property to cover all his debts, be it an individual person, be it a 'sociedad' or corporation, etc."

The following provisions are found in section 52 of our Insolvency Law:

> "The provisions of this Act shall apply to corporations and 'sociedades anónimas,' etc. * * * * * * All the provisions of this Act which apply to the debtor, or set forth his duties, examinations, and liabilities, or prescribe penalties, etc. * * * * * * apply to each and every officer of any corporation or 'sociedad anónima' in relation to the same matters concerning the corporation."

Then section 77, among other things, provides:

> "* * * * * * and the word 'debtor' includes partnerships, corporations, and 'sociedades anónimas.' "

If the words "be it an individual person, be it a 'sociedad' or corporation," found in section 2 of our Insolvency Law be omitted therefrom, such omission will in the least neither change the meaning of the law nor impair its operation, because section 52 states that its provisions shall apply to corporations and "sociedades anónimas," and section 77 provides that the word "debtor" includes partnerships, corporations, and "sociedades anónimas."

Paragraph two of section two provides:

> "He shall necessarily annex to his petition a schedule and inventory, etc."

What meaning is intended to be conveyed by the word "necessarily" as used in that section? It may be claimed that the use of the word "necessarily" imposes upon the petitioner the duty of annexing to his petition the schedule and inventory, requiring the fulfillment of that duty as a condition precedent to any action of the court upon the petition. If the word "necessarily" is omitted, the provision will read:

> "He shall annex to his petition a schedule and inventory, etc."

According to the rules of grammar, the word "shall" when used with a third person expresses certainty, rather than futurity. Moreover, the provision we are commenting on is mandatory, and, even if the word "may" were used instead of "shall," the meaning conveyed would that of "must." It is obvious, therefore, that the use of the word "necessarily" as used in paragraph two of section two of our Insolvency Law is mere verbosity.

The use of verbose language in our Insolvency Law may again be observed if we examine section 3 thereof, which says:

> "Sec. 3. Upon receiving and filing the petition with the schedule and documents mentioned in the next preceding section, the court or the judge thereof in vacation shall make an order calling a meeting of creditors to take place in not less than two weeks nor more than eight weeks from the date of such order. Said order shall designate the day, hour, and place of meeting of said creditors, as well as a newspaper of general circulation published in the province or city in which the petition is filed, if there be one, and, if there be none in a newspaper which, in the judgment of the judge, will best give notice to the creditors of said debtor, and in the newspaper so designated said order shall be published as often as may be prescribed by the court or the judge thereof.
>
> Said order shall further contain an absolute injunction forbidding the petitioning debtor from disposing in any manner of his property, except in so far as concerns the ordinary operations of commerce or of industry in which the petitioner is engaged, and, furthermore, from making any payments outside of the necessary or legitimate expenses of his

> business or industry, so long as the proceedings relative to suspension of payments are pending, and said proceedings for the purpose of this Act shall be considered to have been instituted from the date of the filing of the petition."

Will there be any substantial difference if the above section be made to read as follows:

> "Sec. 3. Upon receipt of the petition with the documents mentioned in the next preceding section, the court shall make an order calling a meeting of creditors."
>
> "Sec. 3½. Said order shall contain: (*a*) The time and place of meeting, which shall take place not less than two nor more than eight weeks from the date of the order. (*b*) A designation of a newspaper wherein the order shall be published and which will best give notice to the creditors. (*c*) An injunction forbidding the petitioner from disposing of his property and making any payments outside of the ordinary operation and legitimate expenses of his business or industry during the pendency of the proceedings."

The above proposed change is based upon the following reasons: (1) The words "upon receiving and filing" are equivalent to the words "upon receipt," because the petition can not be said to have been filed until it is received by the court. The word "schedule" is included in the word "documents," because, if the inventory is considered as a document, the schedule can also be considered as a document. The words "or the judge thereof in vacation" are omitted, because section 2 already states that the judge in vacation has jurisdiction over these proceedings. For like reasons, various words and phrases have been omitted.

Again, section 2, in speaking of the court before which a petition for suspension of payments may be filed, does not specify what court is meant, while section fourteen, in speaking of voluntary insolvency, states that the petition must be filed in the Court of First Instance. The writer understands that the word "court" as used in section two means Court of First Instance, but the law must clearly specify the court intended to be meant to avoid any possible misunderstanding, or else the word "court" as used in the law must be defined under the proposed chapter on "Title and Definitions."

Section 14 of our Insolvency Law provides:

> "An insolvent debtor, owing debts exceeding in amount the sum of one thousand pesos, may apply to be discharged from his debts, etc."

Section 20 contains the following provisions:

> "An adjudication of insolvency may be made on the petition of three or more creditors * * * * * * whose credits * * * * and the amount of which credits or demands are in the aggregate not less than one thousand pesos, etc."

At first sight, it seems that a debtor owing debts in the amount of one thousand pesos can not petition for voluntary insolvency, because section 14 requires that his

debts must exceed one thousand pesos, but the writer is of the opinion that it is a mere defect in language, and the spirit of section 20 as to amount controls. Therefore, the wording of section 14 must be changed to read:

> "An insolvent debtor, owing debts amounting to a sum not less than one thousand pesos, etc."

The proviso of section 60 of our Insolvency Law states:

> "*Provided*, That, if the amount due the creditor is in dispute, the suit, by leave of court in insolvency, may proceed to judgment for the purpose of ascertaining the amount due, which amount, when adjudged, may be allowed in the insolvency proceedings, but execution shall be stayed as aforesaid."

Here it must be observed that when the amount is in dispute, the suit may proceed for the purpose of ascertaining the amount, so that the same may be allowed in the proceedings. In this case, the amount remaining in dispute until it is made certain by the findings in court; therefore, the words "when adjudged" as used in section 60 are superfluous.

The words "nor shall he receive any dividend thereon," found in section 61, are also unnecessary, because, if the creditor shall not be allowed to prove the debt or claim on account of which the preference was made or given, he shall not by reasonable implication receive any dividend thereon. A creditor's claim must first be proven before he can receive any claim thereon.

Finally, section 71 provides:

> "From and after the taking effect of this Act, a debtor who commits any one of the following acts shall, upon conviction thereof, be punished by imprisonment for not less than three months nor more than five years for each offense."

The words "upon conviction thereof," used in the above-quoted section are mere surplusage, because it is a well-established principle in law that no man can be punished for an offense until he is convicted of same. No man can be deprived of his liberty or property without due process of law, so that, in order that a man may be imprisoned or fined for an offense, he must first be convicted of such offense.

3. *Criticism as to Substance.*—More than once the writer has expressed the opinion that in general the Insolvency Law is beneficial to the country. There are, however, persons who believe that the expenses, delay, and litigation incident to proceedings in insolvency and the abuses and fraud to which the system leads, notwithstanding the vigilance and integrity of those to whom the administration of the laws may be committed, render the system undesirable. Admitting that our Insolvency Law is beneficial as a whole, we shall now discuss whether or not it contains provisions susceptible of substantial reform.

Our Insolvency Law applies to all classes of person. The Spanish and some of the English writers believe that the benefits of an insolvency law must be extended to actual merchants and traders only. They say that trade can not be carried on

without mutual credit on both sides, and, as merchants and traders are usually subject to accidental losses, upon them alone must an insolvency law operate for the benefit of trade; and that to include all persons within its operation is to encourage prodigality and extravagance. It will be easy to see why the Spanish bankruptcy law as found in the Code of Commerce applies to merchants alone, if we bear in mind two things. First, that the Code of Commerce is intended to govern commercial transactions, and second, that Title XVII of Book IV of the Civil Code governed the insolvency of persons other than merchants. This part of the Civil Code has also been repealed by section 524 of the Code of Civil Procedure, Act 190, and it was but proper for the Philippine Legislature to extend the scope of the operation of our Insolvency Law to all classes of person, be they merchants or not.

The writer is of the opinion that our law must be reformed so as to exclude from its operation tillers of the soil and wage-earners. By including tillers of the soil and wage-earners in the scope of our law, it is easy to see that they could be adjudged insolvents every day, due to their deplorable financial condition. As has already been stated, Judge Sobral, in his "Breves Comentarios sobre las Leyes de Quiebras y Corporaciones," expresses the opinion that, although our law does not exclude those classes of persons, they must be deemed to be excluded. The writer, however, believes that our law, as it now stands, does not exclude tillers of the soil and wage-earners, and only by proper legislative action, in the form of an amendment, can such exclusion be made. The universal maxim, "expressio unius est exclusio alterius," and the fact that at this time courts have abandoned what is known as "the equitable construction" and substituted for it "the construction in accordance with legislative intent," support this belief.

There are also writers who believe that the provisions on suspension of payments are unjust and undesirable, because they claim that by its provisions a person who lacks skill in the management of his business is given opportunity to further spend what he has, which in fact belongs to his creditors. The writer's personal opinion is that a person should be granted an order to suspend payments only when he can show that his inability to pay his debts is due to accidental causes; otherwise he should be adjudged an insolvent.

Our law provides that in an involuntary insolvency an adjudication may be made on the petition of three or more creditors, the total amount of whose claims must not be less than one thousand pesos. Suppose that a debtor has only five creditors. The claims of two of these five creditors amount to one thousand pesos, while the claims of the other three amount to three hundred pesos only, so that the total amount of the debtor's liabilities is one thousand three hundred pesos. Under our present law, the two creditors whose claims amount to one thousand pesos can not petition for an adjudication of the debtor's insolvency. Is there justice in this particular case? Our law should contain a proviso that in case the total number of creditors is less than six, any two creditors whose claims amount to not less than one thou-

sand pesos may file the petition. The provisions of section 8 (*e*) of our law, which states that majority means two-thirds of the creditors voting and who represent three-fifths of the total liabilities of the debtor, may be made subject to similar criticism.

In section 12 of our Insolvency Law, the following must be included as one of the causes for which objection may be made to the decision of the meeting:

> "Lack of capacity or authority in some of those whose votes formed part of the majority."

Under our law, when a debtor departs from the Philippine Islands or conceals himself to avoid service of legal process to defraud his creditors, he commits an act of insolvency. Under the Bankruptcy Law of the United States in force at present such act is not an act of bankruptcy. The remedy under the American law is to commence a suit against the debtor's property and, in case the debtor is solvent, the creditors may secure their debts without resorting to bankruptcy proceedings In case the property is insufficient to cover all claims made and to satisfy all attachments issued, or one creditor is gaining preference over another by such proceedings, if such attachments, or any one of them, are not released five days before the sale of the property attached, an act of bankruptcy is committed. The creditors may file a petition to adjudge the debtor a bankrupt, and all attachments so levied, or liens of any nature gained by legal proceedings within four months before the filing of the petition, are null and void. The above-mentioned system should be adopted in our Insolvency Law.

Finally, the words "upon a creditor's petition," found in section 52 of our Insolvency Law, should be amended to read "upon three creditor's petition." It has already been shown in this work that our law permits a single creditor to throw a corporation into bankruptcy, and the courts are likely to decide that a single creditor is sufficient. We must bear in mind that the courts have abandoned the rule of equitable construction.

CHAPTER II

CONCLUSIONS

1. *Conclusions.*—From a critical study of our Insolvency Law the writer has arrived at the following conclusions:

(1) That our Insolvency Law is constitutional in so far as debts contracted after its passage are concerned.

(2) That our Insolvency Law is a remedial statute and must be liberally construed, but some of its provisions which are penal in nature must be construed in favor of the insolvent debtor.

(3) That our Insolvency Law applies to all classes of person, be they merchants or not, but its application as to aliens, minors, insane persons, and married women is qualified.

(4) That the objects of our Insolvency Law are—

(*a*) To allow a debtor to suspend payments under certain conditions;

(*b*) To discharge an innocent debtor from his debts and liabilities;

(*c*) To furnish an equitable means of distributing the debtor's property among his creditors;

(*d*) To punish fraudulent debtors.

(5) That the effect of an adjudication of insolvency upon the debtor is to qualify his capacity before he is granted a discharge and a community of property is established among the creditors as to the property of the debtor before the division of the same is ordered by the court.

(6) That our Insolvency Law, generally speaking, is complete, but the arrangement of its provisions is unsystematic and illogical, and its language is verbose.

(7) That our Insolvency Law must be amended, not only as to its form and language, but also as to its substance, as suggested.