

Title: Philnico Industrial Corporation vs. Privatization and Management Office

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Facts:

1. **Background and Contract Execution:**

- The Development Bank of the Philippines and Philippine National Bank, following foreclosure, held all shares in Philnico Processing Corporation (PPC), later transferred to the Asset Privatization Trust (APT) in 1987.
- On May 10, 1996, a contract named the Amended and Restated Definitive Agreement (ARDA) was executed between the Privatization and Management Office (PMO), Philnico Industrial Corporation (PIC), and PPC for PIC's acquisition of 90% shares of PPC for the USD equivalent of \$333,762,000.

2. **Pledge Agreement:**

- As security, a Pledge Agreement was signed on May 2, 1997, where PIC pledged PPC shares to PMO.

3. **Amendments and Defaults:**

- In 1999, restructuring of payment terms under ARDA was agreed due to financial constraints.
- In 2002, PMO declared PIC in default for failing to pay obligations, triggering a clause that would revert shares to PMO.

4. **Legal Action and Preliminary Injunction:**

- On February 4, 2003, PIC filed a complaint to stop PMO from enforcing the reversion clause.
- The RTC issued a Temporary Restraining Order (TRO) and subsequently a Writ of Preliminary Injunction against PMO on grounds that the ipso facto reversion constituted **pactum commissorium** (an illegal clause where the creditor is automatically given the pledged property).

5. **RTC Decisions and Appeals:**

- PMO's attempts to dismiss and reconsider the RTC decisions were unsuccessful.
- The RTC found that the clause indeed constituted **pactum commissorium** and denied PMO's motions, compelling PMO to file an appeal with the Court of Appeals.

6. **Court of Appeals Ruling:**

- While the Court of Appeals agreed with PMO that the clause didn't fit the definition of **pactum commissorium**, it still ruled the clause invalid and upheld the Writ of Preliminary Injunction.

7. **Supreme Court Appeal:**

- Both parties filed petitions before the Supreme Court, PIC claiming the appellate court failed to recognize **pactum commissorium**, and PMO arguing the validity and necessity of the reversion clause.

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Issues:

1. **Does Section 8.02 of the ARDA constitute **pactum commissorium** under Philippine law?**
2. **Is the Writ of Preliminary Injunction issued by the RTC justifiable and should it continue in force?**

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Court's Decision:

Section 8.02 and Pactum Commissorium:

- The Supreme Court ruled that Section 8.02 of the ARDA did indeed constitute **pactum commissorium**. This clause allowed automatic reversion of PPC shares to PMO upon PIC's default, effectively appropriating the pledged property without foreclosure, violating Article 2088 of the Civil Code.

Writ of Preliminary Injunction:

- The Writ issued by RTC was affirmed. The Court held that the issues raised in the preliminary orders of 2003 had since attained finality and must be respected. The injunction was deemed essential to prevent PMO from illegitimately appropriating the PPC shares before a definitive resolution of the case.

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Doctrine:

****Doctrine of Pactum Commissorium:****

- ****Article 2088, Civil Code:**** Creditors cannot appropriate the things given as security without proper judicial proceedings; any stipulation to the contrary is null and void.
 - This case reaffirmed that stipulations allowing a creditor to automatically appropriate pledged property upon default are illegal and unenforceable.
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**Class Notes:**

****Key Elements and Concepts:****

1. ****Pactum Commissorium:**** Stipulation allowing automatic appropriation of pledged property by the creditor upon debtor default.
2. ****Requisites:****
 - Existence of a pledge/mortgage securing a principal obligation.
 - Stipulation for creditor's automatic appropriation of the property upon default.

****Relevant Sections:****

- ****Article 2088, Civil Code:**** Prohibits pactum commissorium.
- ****Article 1305, Civil Code:**** Allows contractual stipulations as long as not contrary to law, morals, public order, or policy.

****Application:****

- Analyze contract clauses for illegal automatic appropriations of securities.
 - Require judicial intervention for rescission or appropriation of mortgaged or pledged assets.
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**Historical Background:**

****Context of Privatization and Economic Dynamics:****

- The case lies within the Philippine government's strategy in the 1990s to privatize assets and improve the efficiency of national economic resources. The transition entailed transferring substantial business interests from public to private ownership and management.
- The financial difficulties and economic crises in the Asia-Pacific region during the late 1990s impacted agreements like the ARDA, imposing additional challenges on contractual

obligations and compliance.