

**LUZVIMINDA J. VILLAREAL, DIOGENES VILLAREAL AND
CARMELITO JOSE, PETITIONERS, VS. DONALDO EFREN C. RAMIREZ
AND SPOUSES CESAR G. RAMIREZ JR. AND CARMELITA C. RAMIREZ,
RESPONDENTS.**

G.R. No. 144214. July 14, 2003

Ponente: PANGANIBAN, J.

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PANGANIBAN, J.:

A share in a partnership can be returned only after the completion of the latter's dissolution, liquidation and winding up of the business.

The Case

The Petition for Review on Certiorari before us challenges the March 23, 2000 Decision[1] and the July 26, 2000 Resolution[2] of the Court of Appeals[3] (CA) in CA-GR CV No. 41026. The assailed Decision disposed as follows:

"WHEREFORE, foregoing premises considered, the Decision dated July 21, 1992 rendered by the Regional Trial Court, Branch 148, Makati City is hereby SET ASIDE and NULLIFIED and in lieu thereof a new decision is rendered ordering the [petitioners] jointly and severally to pay and reimburse to [respondents] the amount of P253,114.00. No pronouncement as to costs."[4]

Reconsideration was denied in the impugned Resolution.

The Facts

On July 25, 1984, Luzviminda J. Villareal, Carmelito Jose and Jesus Jose formed a partnership with a capital of P750,000 for the operation of a restaurant and catering business under the name "Aquarius Food House and Catering Services." [5] Villareal was appointed general manager and Carmelito Jose, operations manager.

Respondent Donaldo Efren C. Ramirez joined as a partner in the business on September 5, 1984. His capital contribution of P250,000 was paid by his parents, Respondents Cesar and Carmelita Ramirez. [6]

After Jesus Jose withdrew from the partnership in January 1987, his capital contribution of P250,000 was refunded to him in cash by agreement of the partners. [7]

In the same month, without prior knowledge of respondents, petitioners closed down the restaurant, allegedly because of increased rental. The restaurant furniture and equipment were deposited in the respondents' house for storage. [8]

On March 1, 1987, respondent spouses wrote petitioners, saying that they were no longer interested in continuing their partnership or in reopening the restaurant, and that they were accepting the latter's offer to return their capital contribution. [9]

On October 13, 1987, Carmelita Ramirez wrote another letter informing petitioners of the deterioration of the

restaurant furniture and equipment stored in their house. She also reiterated the request for the return of their one-third share in the equity of the partnership. The repeated oral and written requests were, however, left unheeded.[10]

Before the Regional Trial Court (RTC) of Makati, Branch 59, respondents subsequently filed a Complaint[11] dated November 10, 1987, for the collection of a sum of money from petitioners.

In their Answer, petitioners contended that respondents had expressed a desire to withdraw from the partnership and had called for its dissolution under Articles 1830 and 1831 of the Civil Code; that respondents had been paid, upon the turnover to them of furniture and equipment worth over P400,000; and that the latter had no right to demand a return of their equity because their share, together with the rest of the capital of the partnership, had been spent as a result of irreversible business losses.[12]

In their Reply, respondents alleged that they did not know of any loan encumbrance on the restaurant. According to them, if such allegation were true, then the loans incurred by petitioners should be regarded as purely personal and, as such, not chargeable to the partnership. The former further averred that they had not received any regular report or accounting from the latter, who had solely managed the business. Respondents also alleged that they expected the equipment and the furniture stored in their house to be removed by petitioners as soon as the latter found a better location for the restaurant.[13]

Respondents filed an Urgent Motion for Leave to Sell or Otherwise Dispose of Restaurant Furniture and Equipment[14] on July 8, 1988. The furniture and the equipment stored in their house were inventoried and appraised at P29,000.[15] The display freezer was sold for P5,000 and the proceeds were paid to them.[16]

After trial, the RTC[17] ruled that the parties had voluntarily entered into a partnership, which could be dissolved at any time. Petitioners clearly intended to dissolve it when they stopped operating the restaurant. Hence, the trial court, in its July 21, 1992 Decision, held them liable as follows:[18]

"WHEREFORE, judgment is hereby rendered in favor of [respondents] and against the [petitioners] ordering the [petitioners] to pay jointly and severally the following:

- (a) Actual damages in the amount of P250,000.00
- (b) Attorney's fee in the amount of P30,000.00
- (c) Costs of suit."

The CA Ruling

The CA held that, although respondents had no right to demand the return of their capital contribution, the partnership was nonetheless dissolved when petitioners lost interest in continuing the restaurant business with them. Because petitioners never gave a proper accounting of the partnership accounts for liquidation purposes, and because no sufficient evidence was presented to show financial losses, the CA computed their liability as follows:

"Consequently, since what has been proven is only the outstanding obligation of the partnership in the amount of P240,658.00, although contracted by the partnership before [respondents'] have joined the partnership but in accordance with Article 1826 of the New Civil Code, they are liable which must have to be deducted from the remaining capitalization of the said partnership which is in the amount of P1,000,000.00 resulting in the amount of P759,342.00, and in order to get the share of [respondents], this amount of P759,342.00 must be divided into three (3) shares or in the amount of P253,114.00 for each share and which is the only amount which [petitioner] will return to [respondents'] representing the contribution to the partnership minus the outstanding debt thereof."[19]

Hence, this Petition.[20]

Issues

In their Memorandum,[21] petitioners submit the following issues for our consideration:

"9.1. Whether the Honorable Court of Appeals' decision ordering the distribution of the capital contribution, instead of the net capital after the dissolution and liquidation of a partnership, thereby treating the capital contribution like a loan, is in accordance with law and jurisprudence;

"9.2. Whether the Honorable Court of Appeals' decision ordering the petitioners to jointly and severally pay and reimburse the amount of [P]253,114.00 is supported by the evidence on record; and

"9.3. Whether the Honorable Court of Appeals was correct in making [n]o pronouncement as to costs." [22]

On closer scrutiny, the issues are as follows: (1) whether petitioners are liable to respondents for the latter's share in the partnership; (2) whether the CA's computation of P253,114 as respondents' share is correct; and (3) whether the CA was likewise correct in not assessing costs.

This Court's Ruling

The Petition has merit.

First Issue:

Share in Partnership

Both the trial and the appellate courts found that a partnership had indeed existed, and that it was dissolved on March 1, 1987. They found that the dissolution took place when respondents informed petitioners of the intention to discontinue it because of the former's dissatisfaction with, and loss of trust in, the latter's management of the partnership affairs. These findings were amply supported by the evidence on record. Respondents consequently demanded from petitioners the return of their one-third equity in the partnership.

We hold that respondents have no right to demand from petitioners the return of their equity share. Except as managers of the partnership, petitioners did not personally hold its equity or assets. "The partnership has a juridical personality separate and distinct from that of each of the partners." [23] Since the capital was contributed to the partnership, not to petitioners, it is the partnership that must refund the equity of the retiring partners. [24]

Second Issue:

What Must Be Returned?

Since it is the partnership, as a separate and distinct entity, that must refund the shares of the partners, the amount to be refunded is necessarily limited to its total resources. In other words, it can only pay out what it has in its coffers, which consists of all its assets. However, before the partners can be paid their shares, the creditors of the partnership must first be compensated. [25] After all the creditors have been paid, whatever is left of the partnership assets becomes available for the payment of the partners' shares.

Evidently, in the present case, the exact amount of refund equivalent to respondents' one-third share in the partnership cannot be determined until all the partnership assets will have been liquidated -- in other words, sold and converted to cash -- and all partnership creditors, if any, paid. The CA's computation of the amount to be refunded to respondents as their share was thus erroneous.

First, it seems that the appellate court was under the misapprehension that the total capital contribution was equivalent to the gross assets to be distributed to the partners at the time of the dissolution of the partnership. We cannot sustain the underlying idea that the capital contribution at the beginning of the partnership remains intact, unimpaired and available for distribution or return to the partners. Such idea is speculative, conjectural and totally

without factual or legal support.

Generally, in the pursuit of a partnership business, its capital is either increased by profits earned or decreased by losses sustained. It does not remain static and unaffected by the changing fortunes of the business. In the present case, the financial statements presented before the trial court showed that the business had made meager profits.[26] However, notable therefrom is the omission of any provision for the depreciation[27] of the furniture and the equipment. The amortization of the goodwill[28] (initially valued at P500,000) is not reflected either. Properly taking these non-cash items into account will show that the partnership was actually sustaining substantial losses, which consequently decreased the capital of the partnership. Both the trial and the appellate courts in fact recognized the decrease of the partnership assets to almost nil, but the latter failed to recognize the consequent corresponding decrease of the capital.

Second, the CA's finding that the partnership had an outstanding obligation in the amount of P240,658 was not supported by evidence. We sustain the contrary finding of the RTC, which had rejected the contention that the obligation belonged to the partnership for the following reason:

"x x x [E]vidence on record failed to show the exact loan owed by the partnership to its creditors. The balance sheet (Exh. `4') does not reveal the total loan. The Agreement (Exh. `A') par. 6 shows an outstanding obligation of P240,055.00 which the partnership owes to different creditors, while the Certification issued by Mercator Finance (Exh. `8') shows that it was Sps. Diogenes P. Villareal and Luzviminda J. Villareal, the former being the nominal party defendant in the instant case, who obtained a loan of P355,000.00 on Oct. 1983, when the original partnership was not yet formed."

Third, the CA failed to reduce the capitalization by P250,000, which was the amount paid by the partnership to Jesus Jose when he withdrew from the partnership.

Because of the above-mentioned transactions, the partnership capital was actually reduced. When petitioners and respondents ventured into business together, they should have prepared for the fact that their investment would either grow or shrink. In the present case, the investment of respondents substantially dwindled. The original amount of P250,000 which they had invested could no longer be returned to them, because one third of the partnership properties at the time of dissolution did not amount to that much.

It is a long established doctrine that the law does not relieve parties from the effects of unwise, foolish or disastrous contracts they have entered into with all the required formalities and with full awareness of what they were doing. Courts have no power to relieve them from obligations they have voluntarily assumed, simply because their contracts turn out to be disastrous deals or unwise investments.[29]

Petitioners further argue that respondents acted negligently by permitting the partnership assets in their custody to deteriorate to the point of being almost worthless. Supposedly, the latter should have liquidated these sole tangible assets of the partnership and considered the proceeds as payment of their net capital. Hence, petitioners argue that the turnover of the remaining partnership assets to respondents was precisely the manner of liquidating the partnership and fully settling the latter's share in the partnership.

We disagree. The delivery of the store furniture and equipment to private respondents was for the purpose of storage. They were unaware that the restaurant would no longer be reopened by petitioners. Hence, the former cannot be faulted for not disposing of the stored items to recover their capital investment.

Third Issue:

Costs

Section 1, Rule 142, provides:

"SECTION 1. Costs ordinarily follow results of suit.- Unless otherwise provided in these rules, costs shall be allowed to the prevailing party as a matter of course, but the court shall have power, for special reasons, to adjudge that either party shall pay the costs of an action, or that the same be divided, as may be equitable. No costs shall be allowed against the Republic of the Philippines unless otherwise provided by law."

Although, as a rule, costs are adjudged against the losing party, courts have discretion, "for special reasons," to decree otherwise. When a lower court is reversed, the higher court normally does not award costs, because the losing party relied on the lower court's judgment which is presumed to have been issued in good faith, even if found later on to be erroneous. Unless shown to be patently capricious, the award shall not be disturbed by a reviewing tribunal.

WHEREFORE, the Petition is GRANTED, and the assailed Decision and Resolution SET ASIDE. This disposition is without prejudice to proper proceedings for the accounting, the liquidation and the distribution of the remaining partnership assets, if any. No pronouncement as to costs.

SO ORDERED.

Puno, (Chairman), Corona, and Carpio-Morales, JJ., concur.
Sandoval-Gutierrez, J., on official leave.

[1] Rollo, pp. 33-49.

[2] Id., pp. 52-53.

[3] Eighth Division. Composed of Justices Buenaventura J. Guerrero, chairman; Hilarion L. Aquino, member; and Mercedes Gozo-Dadole, member and ponente.

[4] Rollo, p. 49.

[5] Rollo, pp. 54-57.

[6] "Agreement"; rollo, pp. 59-60.

[7] Rollo, p. 213.

[8] Id., p. 13.

[9] Id., p. 78.

[10] Id., p. 217.

[11] Docketed as Civil Case No. 18289; rollo, pp. 73-77.

[12] Records, pp. 66-67.

[13] Id., pp. 95-101.

[14] Id., pp. 112-113.

[15] Id., p. 194.

[16] Id. at p. 340.

[17] Regional Trial Court of Makati, Br. 148, presided by Judge Oscar B. Pimentel.

[18] Rollo, p. 158.

[19] Rollo, p. 48.

[20] The case was deemed submitted for decision upon this Court's receipt of petitioners' Memorandum on July 18, 2001.

[21] Petitioners' Memorandum was signed by Atty. Teodoro L. Regala Jr., while the Memorandum for respondents was signed by Atty. Jose M. Ricafrente.

[22] Rollo, p. 171.

[23] Art. 1768 of the Civil Code.

[24] *Magdusa v. Albaran*, 115 Phil. 511, June 30, 1962.

[25] Article 1839 of the Civil Code provides thus:

"Article 1839. In settling accounts between the partners after dissolution, the following rules shall be observed, subject to any agreement to the contrary:

(1) The assets of the partnership are:

(a) The partnership property,

(b) The contributions of the partners necessary for the payment of all the liabilities specified in No. 2.

(2) The liabilities of the partnership shall rank in order of payment as follows:

(a) Those owing to creditors other than partners,

(b) Those owing to partners other than for capital and profits,

(c) Those owing to partners in respect of capital,

(d) Those owing the partners in respect of profits.

(3) The assets shall applied in the order of their declaration in No.1 of this article to the satisfaction of the liabilities.

(4) The partners shall contribute, as provided by article 1797, the amount necessary to satisfy the liabilities.

(5) An assignee for the benefit of creditors or any person appointed by the court shall have the right to enforce the contributions specified in the preceding number.

(6) Any partner or his legal representative shall have the right to enforce the contributions specified in No. 4, to the extent of the amount which he has paid in excess of his share of the liability.

(7) The individual property of a deceased partner shall be liable for the contributions specified in No. 4.

(8) When partnership property and the individual properties of the partners are in possession of a court for distribution, partnership creditors shall have priority on partnership property, saving the rights of lien or secured creditors.

(9) Where a partner has become insolvent or his estate is insolvent, the claims against his separate property shall rank in the following order:

(a) Those owing to separate creditors;

(b) Those owing to partnership creditors;

(c) Those owing to partnership by way of contribution."

[26] Annexes "D"-"D-8"; rollo, pp. 205-212.

[27] As an accepted business practice, furniture and equipment are depreciated over five years to recognize the decrease in their value due to wear and tear.

[28] As an accepted business practice, 1/5 of the original value of goodwill is charged as a business expense every year, such that at the end of five years goodwill no longer appears as an asset of the business.

[29] Esguerra v. Court of Appeals, 335 Phil. 58, 69, February 3, 1997; Sanchez v. Court of Appeals, 345 Phil. 155, 190-191, September 29, 1997.

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