

IN THE MATTER OF THE INVOLUNTARY INSOLVENCY OF RAFAEL FERNANDEZ. PHILIPPINE TRUST COMPANY AND SMITH, BELL & COMPANY, LTD., AS TRUSTEE OF THE PROPERTIES OF THE SAN NICOLAS IRON W...

G.R. No. 38398. December 08, 1933

Ponente: MALCOLM, J.

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MALCOLM, J.:

The issue in this case is whether or not the claims of the Philippine Trust Company and Smith, Bell & Company, Ltd., in its capacity as trustee of the properties of the San Nicolas Iron Works, Ltd., presented in the involuntary insolvency proceedings of Rafael Fernandez, should be classified as ordinary or preferred. A resolution of the issue in turn depends on an answer to the question of whether or not claims not classified as preferred under the Insolvency Law, Act No. 1956, gain a special right of priority under the Civil Code. In passing it may be remarked that this is neither a new issue nor a new question, and that our purpose is to reexamine the issue and the question in the light of present knowledge of the law, the authorities, and legal reason, with the hope that the discussion which has intermittently taken up the time of the court for many years may be definitely closed.

The facts are not in dispute. As stated by the trial judge and as accepted by the parties, the Philippine Trust Company granted to Rafael Fernandez a credit up to P100,000, and Fernandez, as security for the repayment thereof, pledged to the bank seven hundred shares of stock of the Peoples Bank and Trust Company. Fernandez defaulted, and on petition being made to the court, the pledged property was sold at public auction and the sale was approved and confirmed by the court. After crediting Fernandez' obligation with the proceeds of the sale, there remained a balance due from him to the Trust Company of P62,151.70.

Fernandez was also indebted to Smith, Bell & Co., Ltd., as trustee of the San Nicolas Iron Works, Ltd., in the sum of P93,444.67, the repayment of which was guaranteed to the company by Fernandez by a real estate mortgage of certain properties in the City of Manila. Fernandez defaulted, and the company caused the mortgaged properties to be sold at public auction. After crediting Fernandez' obligation with the proceeds of the sale, there remained a balance due from him to the company of P8,861.39.

In the insolvency court claimants asked that the deficiencies remaining of the credits be paid by the assignee as preferred claims. Opposition was entered by the assignee. An order was promulgated by the trial judge disallowing the claims as preferred and simply admitting them as ordinary claims.

The action taken by the two companies in causing the pledged properties to be sold at public auction was asserted in the insolvency proceedings under authority of section 59 of the Insolvency Law. Although the record is not entirely clear, the parties proceed under the assumption, and so we can assume, that the pledge as well as the mortgage were public instruments. The parties further mutually concede that if the Insolvency Law alone controls, there is no such thing in that law as a preferred claim for deficiency; that if the Civil Code be given effect, the claims are preferred, articles 1924 and 1929 applying, and that the precise question now before the court was

decided in the case of the Involuntary Insolvency of Mariano Velasco & Co. ([1930], 55 Phil., 353). It is thus apparent that the issue is not encumbered or complicated by extraneous matter.

The law which is sought to be applied to the facts comes from varied sources: from the Spanish civil law, from American procedural law, and from the statute law of the State of California. In the Civil Code, articles 1924 and 1929 are invoked by the movants. The Code of Civil Procedure was mentioned by the trial judge, and in section 524 provides that, "No new bankruptcy proceedings shall be instituted until a new bankruptcy law shall come into force in the Islands. All existing laws and orders relating to bankruptcy and proceedings therein are hereby repealed. * * *" The third source of authority is the Insolvency Law, Act No. 1956, which is in great part a copy of the Insolvency Act of California. Sections 29 and 59 thereof provide the procedure for a creditor who holds a mortgage or pledge of real or personal property to participate in the insolvency proceedings and to benefit by the Insolvency Law. Sections 48, 49, and 50 are given up to the subject of classification and preferences of creditors. Section 49 provides in part that "All creditors, except those whose claims are mentioned in the next following section, whose debts are duly proved and allowed shall be entitled to share in the property and estate pro rata, after the property belonging to other persons referred to in the last preceding section has been deducted therefrom, without priority or preference whatever * * *." Section 50 enumerates the preferred claims, without including mortgages or pledges, adding that "all other creditors shall be paid pro rata." Section 83 of the Insolvency Law repeals all Acts and part of Acts inconsistent with the provisions of the Law.

The applicable authorities relied upon by the claimants find their beginnings in the cases of *Smith, Bell & Co. vs. Estate of Maronilla* ([1916], 41 Phil., 557); *Kuenzle & Streiff vs. Villanueva* ([1916], 41 Phil., 611); and *Tec Bi & Co. vs. Chartered Bank of India, Australia and China* ([1917], 41 Phil., 819). The doctrine in these cases was carried forward to culmination in the *Involuntary Insolvency of Mariano Velasco & Co.*, *supra*. In effect it was the ruling in these cases that the preferential right of the civil law should be treated as approximately equivalent to the lien of the Insolvency Law and that the statutory preferences furnished by the Civil Code were not destroyed by the Insolvency Law.

The current of antagonistic authority goes way back to the year 1906, when in the case of *Peterson vs. Newberry* (6 Phil., 260), the opinion was expressed that article 1924 of the Civil Code, in so far as it is applicable to bankruptcy and estates of deceased persons, was repealed by the enactment of the Code of Civil Procedure. The burden of the theme was then taken up in the elaborate concurring and dissenting opinion of Justice Moreland in *Kuenzle & Streiff vs. Villanueva*, *supra*, in which he announced as a grave question whether or not the Insolvency Law does not repeal articles 1922 to 1926 of the Civil Code as well as the other provisions of the old law contained in that Code. Later, dissenting and concurring opinions in a number of cases, principally written by the writer of this opinion, have given force to a more emphatic presentation of the viewpoint that the Insolvency Law is complete in itself. In the same field stand expressions, whether obiter or not we will not attempt to say, to be found in the majority opinion in the case of *Ingersoll vs. National Bank* ([1922], 43 Phil., 308), namely:

"Upon the question of preference of the claim of the Philippine Guaranty Company, Act No. 1956 of the Philippine Legislature, known as the Insolvency Law, is complete within itself. Section 48, Chapter 6, specifically defines the 'classification and preference of creditors.' There are nine subdivisions in this section, each of which specifies and defines what claims are preferred in insolvency proceedings, and claims of the nature of the Philippine Guaranty Company or kindred thereto are not mentioned or included in either subdivision. Neither can it be construed to come within any of the provisions of section 50 of the Act.

"Where the law specifies and defines what claims are to be preferred, it must follow that any claim, which is not in the nature of, or kindred to, those specified, is not a preferred claim, and should not have a preference."

In the case of the *Involuntary Insolvency of Mariano Velasco & Co.*, *supra*, a credit was secured by a mortgage,

and after the foreclosure of the mortgage a portion of the credit was left unpaid. It was held that the deficiency was still evidenced by a public instrument and in accordance with the Civil Code must be allowed as a preferred claim. That was the view of the majority in which five members of the court agreed. Four members of the court dissented.

Is the court with new membership compelled to follow blindly the doctrine of the Velasco case? The rule of stare decisis is entitled to respect. Stability in the law, particularly in the business field, is desirable. But idolatrous reverence for precedent, simply as precedent, no longer rules. More important than anything else is that the court should be right. And particularly is it not wise to subordinate legal reason to case law and by so doing perpetuate error when it is brought to mind that the views now expressed conform in principle to the original decision and that since, the first decision to the contrary was sent forth there has existed a respectable opinion of non-conformity in the court. Indeed, on at least one occasion has the court broken away from the revamped doctrine, while even in the last case in point the court was as evenly divided as it was possible to be and still reach a decision.

Freeing ourselves from the incubus of precedent, we have to look to legislative intention. The legislative purpose was as plainly indicated as words may convey it by the express repeal in the Code of Civil Procedure of all existing laws relating to bankruptcy. The legislative purpose was a second time evidenced by the passage of the Insolvency Law. That law was carefully framed with the purpose of covering the entire subject of bankruptcy and insolvency. In all material respects the law was meant to be and is complete in itself. Just as a provision in an insolvency law can not continue to be in force with provisions on the same subject in a later law, so is the former civil law modified by implication by the special statute without the necessity of an express repealing clause. Any attempt to fuse the elements of the Insolvency Law inspired by modern commercial practice, with the elements of the Civil Code intended to harmonize with Spanish laws, is impracticable. It has been taken for granted that the Code of Civil Procedure and the Insolvency Law swept away numerous parts of the Spanish Code of Commerce. If those laws did that, it needs no elaborate argumentation to prove that the same laws had a somewhat similar effect on the Spanish Civil Code.

When a party avails himself of the Insolvency Law, he does so acknowledging its supremacy and cannot take advantage of it and at the same time take advantage of an old law which, at least in so far as it relates to insolvency, has been supplanted by a modern law given up to that subject. To permit that would be to run counter to the Insolvency Law, to render worthless and inoperative fundamental provisions of that law, and to nullify the legislative purpose. Public policy will be best served by accepting the Insolvency Law as it is without a strained effort to join it up with a code which never contemplated the ends which the Insolvency Law was enacted to advance.

On a survey of the entire field of insolvency in its relation through the Code of Civil Procedure and the Insolvency Law to the Civil Code, we unhesitatingly revoke the doctrine announced in the case of the Involuntary Insolvency of Mariano Velasco & Co., *supra*. We rule that claims not classified as preferred under the Insolvency Law cannot be thus classified with the aid of the Civil Code and gain no special right of priority under the Insolvency Law which is exclusively controlling. Accordingly, the order appealed from will be affirmed, with costs against the appellants.

Abad Santos, Hull, Vickers, Butte, and Diaz, JJ., concur.

DISSENTING

IMPERIAL, J., with whom concur Avanceña, C. J., and Villa-Real, J.:

The facts of the case are recited correctly in the majority opinion as follows:

"* * * the Philippine Trust Company granted to Rafael Fernandez a credit up to P100,000, and Fernandez, as security for the repayment thereof, pledged to the bank seven hundred shares of stock of the Peoples Bank and Trust Company. Fernandez defaulted, and on petition being made to the court, the pledged property was sold at public auction and the sale was approved and confirmed by the court. After crediting Fernandez' obligation with the proceeds of the sale, there remained a balance due from him to the Trust Company of P62,151.70.

"Fernandez was also indebted to Smith, Bell & Co., Ltd., as trustee of the San Nicolas Iron Works, Ltd., in the sum of P93,444.67, the repayment of which was guaranteed to the company by Fernandez by a real estate mortgage of certain properties in the City of Manila. Fernandez defaulted, and the company caused the mortgaged properties to be sold at public auction. After crediting Fernandez' obligation with the proceeds of the sale, there remained a balance due from him to the company of P8,861.39.

"In the insolvency court claimants asked that the deficiencies remaining of the credits be paid by the assignee as preferred claims. Opposition was entered by the assignee. An order was promulgated by the trial judge disallowing the claims as preferred and simply admitting them as ordinary claims."

Almost since its organization this court has consistently held that the preferences and priorities created by the Civil Code in Title XVII, Book IV, continue in force in this jurisdiction as long as they are not expressly or by implication repealed by the provisions of the Code of Civil Procedure (Martinez vs. Holliday, Wise & Co., 1 Phil., 194; Olivares vs. Hoskyn & Co., 2 Phil., 689; Peterson vs. Newberry, 6 Phil., 260; Gochuico vs. Ocampo, 7 Phil., 15; Soler vs. Alzoua and Mitchell, 8 Phil., 539; Peña vs. Mitchell, 9 Phil., 587 and 10 Phil., 739; Meyers vs. Thein, 15 Phil., 303; McMicking vs. Co Piaco, 24 Phil., 439; McMicking vs. Lichauco, 27 Phil., 386; Molina Salvador vs. Somes, 31 Phil., 76; E. Viegelmann & Co. vs. Perez, 37 Phil., 678; Javellana vs. Mirasol and Nuñez, 40 Phil., 761; Tec Bi & Co. vs. Chartered Bank of India, Australia and China, 41 Phil., 819; and Kuenzle & Streiff vs. Villanueva, 41 Phil., 611).

As regards the Insolvency Law (Act No. 1956) this court has also invariably declared that said preferences and priorities were not repealed by it, but they are included in the word "lien" as used in section 59 of said Act, as amended. (E. Viegelmann & Co. vs. Perez, supra; Tec Bi & Co. vs. Chartered Bank of India, Australia and China, supra; Hunter, Kerr & Co. vs. Murray, 48 Phil., 499; and O'Brien vs. China Banking Corporation, 55 Phil., 353.)

In Tec Bi & Co. case this court, after a careful review of all the laws relating to the provisions of section 59 of the Insolvency Law, said:

"It has been suggested that under our former rulings, these 'statutory preferences' cannot be treated as liens affecting the property of the debtor, as that word is used in the above cited section of the Bankruptcy Act. But while it is true that we have held in a number of decisions, that these 'statutory preferences' of the Civil Code are not liens in the strict and limited sense of that word as used in Anglo-American jurisprudence, and while we have taken considerable pains to distinguish the nature and effect of these 'statutory preferences' (sometimes called 'civil law liens' by American law writers), from that of 'liens', as that word is used in the strict technical parlance of the American and English authorities; nevertheless, there can be no question that when a right to one of these 'statutory preferences' has actually been asserted, in the course of judicial proceedings which have for their object the distribution of funds derived from the sale of all or any part of the assets of the debtor, by a proper party to such proceedings, as intervenor or otherwise; the consequences flowing therefrom are closely assimilated to, and substantially identical with those arising as a result of the assertion in the course of such proceedings, of a recorded 'lien' upon the assets of the debtor with a view to its

enforcement therein. We are of opinion, therefore, that the word 'liens' as used in section 59 of the Insolvency Law should be held to include 'statutory preferences' such as those now under consideration if and when they are duly asserted in the course of bankruptcy proceedings.

"We are not unaware of the fact that this construction of the language of the statute may give rise to some practical difficulties in the administration of insolvency proceedings; but we do not apprehend that these difficulties will prove to be any less surmountable than similar practical difficulties with which our courts have been confronted, in applying and construing the terms of many other statutes, enacted in recent years, wherein the general provisions and the terminology in which they are expressed have been borrowed directly from American or English precedents, in the enactment of which the legislator had in mind provisions of substantive law radically different from those of the Spanish substantive law still in force in these Islands.

* * * * *

"Strong and compelling reasons of public policy, in this jurisdiction as elsewhere, have resulted in the enactment of legislation providing special security in one form or another, for credits for construction, repair and preservation of personal property; transportation charges; seeds and other agricultural advances; rents; credits evidenced in solemn judgments; and the like. The security in such cases, furnished under statutory authority in the United States, in the form of liens on the property of the debtor, was not affected, nor intended to be affected by the enactment of the American prototypes of the provisions of our Insolvency Law and our Code of Civil Procedure; and we are satisfied that it was not the intention of the legislature to destroy, without providing a substitute therefor, the security in the form of 'statutory preferences' furnished in our Civil Code in like cases, and that the language of these statutes does not sustain such a contention."

Merchants, manufacturers, bankers and the public in general have relied upon the uniform decisions and rulings of this court and they have undoubtedly been guided in their transactions in accordance with what we then said to be the correct construction of the law. Now, without any new and powerful reason we try to substantially modify our previous rulings by declaring that the preferences and priorities above referred to are not recognized by the Insolvency Law. The Legislature has had occasion to review our rulings in the cases above cited and it could readily have amended the law had it been of the opinion that said policy was unsound or inadvisable.

In our opinion the principle of stare decisis et non quieta movere should be maintained and respected and for this reason we dissent from the opinion of the majority and we believe that the appealed decision should be reversed.

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