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G.R. No. 207161 ***(Y-1 Leisure Philippines, Inc., Yats International Ltd., and Y-1 Clubs and Resorts, Inc. v. James Yu)***

Promulgated:

September 8, 2015

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CONCURRING OPINION

VELASCO, JR., *J.*:

I concur with the findings and conclusions of the *ponencia* that the purchase by the petitioners of substantially all of Mt. Arayat Development Co., Inc.'s (MADCI) assets which resulted in the cessation of the latter's operations carried with it the assumption of MADCI's liabilities to third persons, including respondent James Yu.

The Court is once again faced with the question of whether the sale by a corporation of all or substantially all of its assets to another entity would carry with it the obligation to settle the transferor's liabilities.

Let us briefly recall the facts. MADCI, a real estate development corporation, ventured in the development of a golf and country club in its 120-hectare property located in Mt. Arayat, Pampanga. Sometime in 1997, pending the commencement of the project, MADCI sold to respondent golf and country club shares totaling ₱650,000.00, which respondent paid on installment.

Thereafter, or on May 29, 1999, MADCI and its president Rogelio Sangil (Sangil) entered into a Memorandum of Agreement (MOA) with petitioner Yats International Ltd. (YIL), an investment company likewise engaged in the development of real estate, projects, leisure, tourism, and related businesses. Under the MOA, Sangil controlled 60% of MADCI's capital stock and YIL was to subscribe to the remaining 40%, priced at ₱31M, conditioned on the securing by MADCI and Sangil of the necessary government permits. It was also embodied therein that MADCI owned said 120-hectare property which is intended for the development of a golf course. Furthermore, Sangil undertook to redeem MADCI proprietary shares sold to third persons or settle in full all their claims for refund of payments. YIL also gave ₱500,000.00 to acquire the shares of minority stockholders. Lastly, per the Agreement, the parties agreed that should MADCI and Sangil fall short in their obligations, YIL can recover the amounts that it paid to the former, plus interest, and that should they fail to deliver said amounts, YIL would be authorized to sell said 120-hectare property to satisfy their obligation.

Thus, pursuant to the Agreement, YIL, together with Y-I Leisure Phils., Inc. (YILPI) and Y-I Club & Resorts, Inc. (YICRI), bought some of MADCI's corporate shares. As it turned out, however, MADCI and Sangil violated the terms

of the MOA. The property was eventually sold to YICRI, its designated company, for □9.3M.

Then, sometime in 2000, Yu discovered that the project never pushed through. This prompted him to demand from MADCI the return of his payment for the golf and country club shares. While MADCI recognized Yu's investment, it did not heed the latter's demand, reasoning that said payment was no longer possible because MADCI's new set of officers did not give their imprimatur thereto. This prompted Yu to file with the RTC a complaint for sum of money. Yu later filed an Amended Complaint, impleading YIL, YILPI, and YICRI on the basis of the allegedly suspicious transfer of MADCI's property to petitioner which, according to him, was done in fraud of MADCI's creditors.

In their defense, MADCI and petitioners YIL, YILPI, and YICRI insist, among other things, on the observance of the MOA's stipulations, particularly Sangil's categorical undertaking to settle all claims for refund of third parties. For his part, Sangil alleges that Yu dealt with MADCI as a juridical person and that he personally did not benefit from the sale of shares. Too, according to Sangil, MADCI's new set of officers blocked the approval of the refund.

The RTC, in its August 31, 2010 Decision, ruled in Yu's favor, holding MADCI and Sangil solidarily liable for the refund. Petitioners YIL, YILPI, and YICRI were, however, exonerated since, according to the trial court, they were not part of the transactions between Yu, MADCI, and Sangil. Furthermore, the stipulation in the MOA whereby Sangil obliged himself to settle third party claims for refund was considered by the trial court as foresight on petitioners' part to protect MADCI's creditors.

On appeal, the CA modified the RTC's decision and ruled that petitioners are jointly and severally liable for the satisfaction of Yu's claim. Citing *Caltex (Philippines), Inc. v. PNOC Shipping and Transport Corporation*,[1] the appellate court ruled that the transfer of the entire assets of MADCI to YICRI carried with it the assumption by the transferee of the transferor's liabilities and should not prejudice the transferor's creditors, in this case, respondent Yu. Aggrieved, transferees YIL, YILPI, and YICRI come before this Court insisting on the reversal of the CA's modification and the reinstatement of their exoneration from liability by the trial court.

Simply put, the instant petition seeks to put an end to respondent James Yu's quandary as to who should be liable for his claim, the existence of which was admitted by the transferor.

Petitioners fault the CA for relying heavily on *Caltex*,[2] arguing that the instant case is not on all fours with said case, for in the latter case, there was an express assumption of all obligations of the judgment debtor by the transferee.

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[1] *Caltex (Philippines) Inc. v. PNOC Shipping and Transport Corporation*, G.R. No. 150711, August 10, 2006, 498 SCRA 400.

[2] Id.

They likewise insist that fraud, which if present would make the transferee liable for the transferor's obligations to third persons, does not obtain in the instant case. Yu, for his part, contends that the facts of the case properly call for the application of *Caltex* since the transfer resulted in MADCI's paralysis.

In affirming the modification by the CA, the *ponencia* applied Section 40 of the Corporation Code which reads:

> **Section 40.** *Sale or other disposition of assets.* – Subject to the provisions of existing laws on illegal combinations and monopolies, **a corporation may**, by a majority vote of its board of directors or trustees, **sell**, lease, exchange, mortgage, pledge or otherwise dispose of **all or substantially all of its property and assets, including its goodwill, upon such terms and conditions and for such consideration, which may be money, stocks, bonds or other instruments for the payment of money or other property or consideration,** as its board of directors or trustees may deem expedient, when authorized by the vote of the stockholders representing at least two-thirds (2/3) of the outstanding capital stock, or in case of non-stock corporation, by the vote of at least two-thirds (2/3) of the members, in a stockholder's or member's meeting duly called for the purpose. x x x.
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> **A sale or other disposition shall be deemed to cover substantially all the corporate property and assets <u>if thereby the corporation would be rendered incapable of continuing the business or accomplishing the purpose for which it was incorporated</u>**. (emphasis and underscoring added)

The provision adverted to, as correctly enunciated by the *ponencia*, citing *Lopez Realty, Inc. v. Fontecha*,[3] contemplates a **business-enterprise transfer** whereby one corporation (transferor) sells to another entity (transferee) all or substantially all of its corporate assets, including its goodwill, rendering it incapable of continuing its business or its purpose.

Object of the sale: Meaning of "all or substantially all of the corporation's business"

In SEC-OGC Opinion No. 13-13,[4] the Securities and Exchange Commission (SEC), Office of the General Counsel, clarifying the meaning of a sale of all or substantially all of the corporation's assets within the context of Paragraph 2 of Sec. 40, explained that:

> In interpreting paragraph 2 of Section 40, this Commission has been guided **not so much by the number or volume of assets transferred but by the effect of such transfer on the corporation's business**. Any disposition which does not involve all or substantially all of the corporate assets x x x, made in the ordinary course of business does not require the approval of the stockholders or members.(emphasis added)

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[3] 317 Phil. 216, 229 (1995).

[4] Dated December 5, 2013. http://www.sec.gov.ph/investorinfo/opinions/ogc/cy%202013/13-13.pdf, last accessed, August 10, 2015.

The SEC then emphasized that in determining whether the sale is made in the ordinary course of business, "the test is not the amount involved but the nature of the transaction."[5] Hence, according to the SEC, "if the sale thereof will not render the corporation incapable of continuing its business or if the disposition is necessary in the usual or regular course of business, the requirements under Section 40 will not apply."[6]

Continuation by the transferee of the transferor's business

Along with the above explanation from the SEC that the nature of the transaction determines the applicability or non-applicability of Sec. 40, it is likewise material that, in addition to the transferor's paralysis, said transfer **must result in the continuation by the transferee of the former's business**. The sale or transfer by one corporation of all of its assets to another corporation for value, does not, *by that fact alone*, render Sec. 40 applicable and make the transferee liable for the debts of the transferor.[7] The business-enterprise transfer doctrine involves an acquisition by the transferee of the transferor's *business enterprise* which effectively results in:

> (1) the termination of the transferor's entire operations and the prevention of the fulfillment of the transferor's purpose for incorporation; and
> (2) the continuation by the transferee of said venture.

It does not, therefore, contemplate a mere **purchase or sale of assets**.

To distinguish a mere sale of assets from a business-enterprise transfer, the Court's ruling in *China Banking Corporation v. Dyne-Sem Electronics Corporation*,[8] on the basic but crucial characteristic of a sale of assets, is instructive.

Briefly, *China Banking Corporation* involved the assertion by the creditor bank that the transferor's unpaid loan with them should be paid by the transferee. There, the creditor bank argued that this should be so since the transferee and the transferor are both engaged in the same line of business and that the transferee acquired some of the transferor's machineries and equipment before the transferor ultimately ceased its operations.[9]

There, the Court ruled in favor of the transferee and held that the "acquisition of some of the machineries and equipment of [the transferor] was not proof that [the transferee] was formed to defraud petitioner. As the [CA] found, no merger took place between [the transferor and the transferee]. What took place was a sale of the assets of the former to the latter. x x x **Thus, where one**

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[5] See SEC-OGC Opinion No. 13-13, p. 5.
[6] Id.
[7] *China Banking Corp. v. Dyne-Sem Electronics Corporation,* G.R. No. 149237, July 11, 2006, 494 SCRA 493.
[8] Id.
[9] Id.

corporation sells or otherwise transfers all its assets to another corporation for value, the latter is not, by that fact alone, liable for the debts and liabilities of the transferor." [10] (emphasis and words in brackets added)

It was therein cited that "[i]n a sale of assets, the transferee is only interested in the raw assets of the selling corporation perhaps to be used to establish his own business enterprise or as an addition to his on-going business enterprise.[11] In other words, the object of the disposition in a **sale of assets** is not the very business itself, but simply the properties of the transferor. The Court further noted that in a sale of assets, the purchasing corporation is not generally liable for the debts and liabilities of the selling corporation, the selling corporation contemplates a liquidation of the enterprise, the transfer of title is by virtue of a contract, and *the selling corporation is not dissolved by the mere transfer of all its property*.[12] Clearly, this kind of alienation of corporate assets is **not** the sale contemplated under Section 40.

These facets and legal effects of a **sale of assets** became pivotal in *Bank of Commerce v. Radio Philippines Network, Inc.*,[13] which involved the issue of whether the purchase by the transferee of the transferor's assets carried with it the liability for the latter's judgment debts.

In resolving the case and ultimately holding that the purchaser is not liable for the transferor's judgment debt subject of the case, the Court clarified that no merger took place between the transferee and the transferor, since **therein transferor was still able to continue its operations despite the sale of its banking venture to the transferee**.[14] There, this Court categorized the sale as one simply of the transferor's assets (its entire banking business) with assumption of liabilities,[15] and not a purchase of all or substantially all of its corporate assets which would ultimately cripple it as a business entity. Therein transferee, therefore, according to this Court, could not be considered as the transferor's successor-in-interest.

Unlike *Bank of Commerce*, in the present petition, the transfer rendered MADCI incapable of continuing its business. This is so since the only property that MADCI had in order for it to be able to conduct the very reason for its incorporation - that is, "[t]o acquire by purchase, lease, donation, or otherwise, and to own, use, improve, develop, subdivide, sell, mortgage, exchange, lease, develop, and hold for investment or otherwise, real estate of all kinds, whether improved, managed or otherwise disposed of buildings, houses, apartments, and other structures of whatever kind, together with their appurtenance - is the 120-hectare property later sold to YICRI. Petitioners were unable to show that MADCI was

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[10] Id. at 501.

[11] Footnote No. 21, id. at 501.

[12] Footnote No. 22, id.

[13] G.R. No. 195615, April 21, 2014, 722 SCRA 520. (While the Decision is not yet final, *Bancom* is cited to make clear the dissimilar factual milieu in *Bancom* and the instant Petition).

[14] Id. at 545. "The evidence in this case fails to show that Bancommerce was a mere continuation of TRB. TRB retained its separate and distinct identity after the purchase. Although it subsequently changed its name to Traders Royal Holding's, Inc. **such change did not result in its dissolution.** xxx. (emphasis Ours).

[15] Id.

still able to continue its operations or to purchase other properties for that purpose. As such, the purchase by YICRI of the said property effectively resulted in the cessation of MADCI's business.

It may be noted that MADCI actually still had other assets comprised of loan advances of its directors. Petitioners, however, failed to show that said remaining assets were sufficient in order for MADCI to be able to continue its operations. It is well to emphasize that Section 40 contemplates not only of a sale of all of the corporation's assets, but also **substantially all** of said assets. This being the case, it is not necessary for the transferor not to be left with any corporate property. What is only required under Sec. 40 is that, as opined by the SEC, the nature of the transfer prevents the transferor from continuing its business or the purpose for which it was incorporated.

Consideration in exchange for transferor's assets

Aside from the nature of the transaction, the consideration to be paid in exchange for the transferor's assets is likewise significant in determining the applicability of Sec. 40. In this respect, the Court distinguishes between a *de facto* merger and a business-enterprise transfer.

For one, this Court has previously clarified that Sec. 40 does not contemplate a *de facto* merger because the provision recognizes the separate existence of the two corporations that transact the sale.[16]

Further, and more importantly, even though a business-enterprise transfer and a de facto merger may both involve the acquisition by another entity of all or substantially all of the transferor's assets which would ultimately result in the continuation by the transferee of the transferor's business venture, the distinction hinges on the **consideration in exchange for said assets.**

Citing with approval Dean Cesar Villanueva's explanation on the characteristics of a *de facto* merger, this Court stated that:

> "a de facto merger can be pursued by one corporation acquiring all or substantially all of the properties of another **corporation in exchange of shares of stock of the acquiring corporation.** The acquiring corporation would end up with the business enterprise of the target corporation; whereas, **the target corporation would end up with basically its only remaining assets being the shares of stock of the acquiring corporation."**[17] (emphasis Ours)

Thus, unlike in a business-enterprise transfer where the transfer is not in exchange for shares of stock in the transferee and that the transferor does not become a stockholder thereat, in a *de facto* merger, the acquisition of all or substantially all of the transferor's assets is precisely **in exchange of shares of stock of the acquiring corporation**.

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[16] Id. at 548.
[17] Id. at 544.

Here, suffice it to state that the consideration for the sale was not shares of stocks in any of the petitioners. It was admitted by the parties that the amount of □9.3M was paid by petitioner YICRI for and in consideration of the 120-hectare property, which, as argued, was way below the market value of said lot. Thus, the MOA in the instant case could not be said to have resulted into a de facto merger.

Absorption of Liabilities

Anent the issue of absorption or non-absorption by the transferee of the transferor's liabilities, the *ponencia* pointed out that **under the business-enterprise transfer doctrine, the transferee inherits the liabilities of the transferor as a consequence of the purchase.** This is so since the transaction is not only limited to the assets of the transferor, as in a sale of assets as previously discussed, but also extends to its goodwill. Additionally, holding the transferee liable for the debts of the transferor is a protection afforded by law to the transferor's creditors.[18] It, therefore, does not require a contractual stipulation to that effect, nor must the transfer itself be in fraud of creditors before liability may attach to the transferee. The mere operation of Section 40 imposes upon the transferee the obligation to answer for the transferor's debts, as correctly observed by the *ponencia*.

The factual situation in the instant case can be distinguished from *Bank of Commerce*.[19]

In the instant dispute, **petitioners, as transferees, replaced the transferor, MADCI, in the undertaking of the development of the golf and country club, as a necessary consequence of the sale**. As observed by the *ponencia*, no evidence existed to show that MADCI subsequently acquired other lands for its development projects. It was, thus, rendered incapable of continuing its operations and accomplishing the purpose for which it was incorporated as it was left without any property to develop. As held, after the transfer, MADCI was left **in a state of suspended animation**. But with respect to the golf and country club development project, per Sangil's testimony, this was being undertaken by the managing director of petitioner YIL. In other words, petitioners ventured in the project which MADCI could no longer undertake. To my mind, this, in addition to MADCI's resulting state, calls for the application of Sec. 40.

In contrast, in *Bank of Commerce*, the transferee therein was not considered by the Court to be the transferor's successor-in-interest. There, the Court categorized the sale therein as a mere **sale of assets** and not a *de facto* merger. Furthermore, for the sake of discussion, neither can it be considered as a business-enterprise transfer because the transferee remains existent and is able to continue its operations, although not its banking venture - the business, the assets for which

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[18] While the Corporation Code allows the transfer of all or substantially all the properties and assets of a corporation, the transfer should not prejudice the creditors of the assignor. The only way the transfer can proceed without prejudice to the crditors is to hold the assignee liable for the obligations of the assignor. The acquisition by the assignee of all or substantially all of the assets of the assignor necessarily includes the assumption of the assignor's liabilities. [*Caltex (Philippines) Inc. v. PNOC Shipping and Transport Corporation,* supra note 1 at 411-412].

[19] Supra note 13.

were sold to the transferee. In the latter case, the transferee would still be able to, in fact continued to, operate since it has other ventures remaining, unlike in the present case where MADCI only had one business – the development of the 120 hectare property into a golf and country club.

More important is the fact that in *Bank of* Commerce, an escrow fund of □50M was set aside for the payment of the transferor's liabilities, in addition to the stipulation as to what liabilities are specifically shouldered by the transferee. The intent is clear - **to limit the liabilities of the transferee to those agreed upon and those covered by the escrow fund**. This, in proper cases, bolsters the fact that the transaction is a mere **sale of assets** and this intention is undoubtedly absent in the present case.

Considering these basic but material distinctions show that the requirement under Sec. 40 that the transfer must render the transferor incapable of continuing its operations is not present in *Bank of Commerce*. That being the case, therein transferee was not held liable for the debts of the transferor which it did not expressly assume under their Agreement. The transferor, therefore, continued to be liable for its excluded liabilities[20] and the only liabilities that the transferee had to absorb and settle were those which it expressly assumed under their Purchase and Assumption Agreement.

In *Caltex (Phils.), Inc. v. PNOC,*[21] the Court also recognized this contractual assumption by the transferee of the transferor's liabilities. There, the transferor - Luzon Stevedoring Corporation – and the transferee – PNOC Shipping and Transport Corporation – entered into an *Agreement of Assumption of Obligations* whereby the former "transferred, conveyed and assigned unto [the latter] all of the [former's] business, properties and assets pertaining to its tanker and bulk all (sic) departments, *together with all the obligations relating to said business, properties and assets*.[22]

At this point it is well to mention that even in a mere *sale of assets*, as opposed to a business-enterprise transfer, liability may still attach to the transferee if the alienation was done in fraud of the transferor's creditors.[23] In *Bank of Commerce*, this non-attachment of liability for excluded obligations was not only supported by the fact that the existence and operations of the transferor continued even after the sale but also, as observed by the Court, the transfer was entered into by the parties *at arm's length*.[24] This bona fide quality of the execution of said Agreement reinforced the transferee's exclusion from the entities upon which the judgment debt may be enforced.

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[20] [Bancommerce agreed to assume those liabilities of TRB that are specified in their P & A Agreement. That agreement specifically excluded TRB's contingent liabilities that the latter might have arising from pending litigations in court, including the claims of respondent RPN, et al.] *Bank of Commerce v. Radio Philippines Network, Inc. et al.*, G.R. No. 195615, April 21, 2014, 772 SCRA 520, 454.

[21] Supra note 1.

[22] Id. at 409.

[23] *Bank of Commerce v. Radio Philippines Network, Inc. et al.*, supra note 13 at 574-575.

[24] Id. at 547.

This element of fraud, however, is not required in order for the transferee to be liable under Section 40 of the Corporation Code, as previously mentioned. This is so since the basis for the liability thereon is not that the transfer was done in fraud of creditors but that it included the goodwill of the transferor, as discussed by the *ponencia*, and to protect the creditors of the transferor since the alienation effectively removes the transferor's properties from its creditors' reach.[25]

With the above disquisition, I concur with the conclusion of the *ponencia* that the sale between MADCI and petitioners of the 120-hectare property was a business-enterprise transfer contemplated under Section 40 of the Corporation Code, which results in the solidary assumption by petitioners of MADCI's admitted obligation.

I vote to **DENY** the present petition.

PRESBITERO J. VELASCO, JR.
Associate Justice

[25] Supra note 1 at 412.