CHAPTER 4
EXTINGUISHMENT OF OBLIGATIONS

GENERAL PROVISIONS

ART. 1231

Obligations are extinguished:

1. **By the payment or performance;**
2. **By the loss of the thing due;**
3. **By the condonation or remission of the debts;**
4. **By the confusion or merger of the rights of the creditor and debtor;**
5. **By compensation;**
6. **By novation.**

Other causes of extinguishment of obligations, such as annulment, rescission, fulfillment of resolutory condition, and prescription, are governed elsewhere in this Code.

EXTINGUISHMENT OF OBLIGATIONS (*PaL C³ NARF Pre*)

1. ***Pa***yment or performance
2. ***L***oss of the thing due
3. ***C***ondonation or remission
4. ***C***onfusion or merger
5. ***C***ompensation
6. ***N***ovation
7. ***A***nnulment
8. ***R***escission
9. ***F***ulfillment of resolutory condition
10. ***P***rescription

OTHER FORMS OF EXTINGUISHMENT (*FC - MAID*)

1. Happening of ***f***ortuitous event (*Art. 1174*)
2. ***C***ompromise (*Art. 2028*)
3. ***M***utual desistance or withdrawal
4. ***A***rrival of resolutory period (*Art. 1193, par. 2*)
5. ***I***mpossibility of fulfillment of condition (*Art 1266*)
6. ***D***eath, for personal or intransmissible obligation. (*Art. 1311 par. 1*)

Illustration of Death:

On 1 Jan 2017, A promised to B the amount of P5M to be paid on 31 Dec. 2018. On 1 June 2017, A died leaving X as the only heir.

B cannot compel X to pay the debt of his father for Art. 1178 states that only rights shall be transmissible, obligation not included.

SECTION 1
PAYMENT OR PERFORMANCE

ART. 1232

Payment means not only the delivery of money but also the performance, in any other manner, of an obligation.

CONCEPT OF PAYMENT AND PERFORMANCE

It consists in the normal and voluntary fulfillment of the obligation by the realization of the purposes for which it was constituted.

ART. 1233

A debt shall not be understood to have been paid unless the thing or service in which the obligation consists has been completely delivered or rendered, as the case may be.

ART. 1234

If the obligation has been substantially performed in good faith, the obligor may recover as though there had been strict and complete fulfillment, less damages suffered by the obligee.

ART. 1235

When the obligee accepts the performance, knowing its incompleteness or irregularity, and without expressing any protest or objection, the obligation is deemed fully complied with.

GENERAL RULE

An obligation is understood to have been paid or performed when:

- **TO GIVE**
  The debtor or obligor has completely delivered the thing which he had obligated himself to deliver.
- **TO DO**
  The obligor has completely rendered the service which he had obligated himself to render.
- **NOT TO DO**
  The obligor has completely refrained from doing that which he had obligated himself not to do.

EXCEPTIONS [*SAC*]

1. When the obligation has been ***s***ubstantially performed in good faith.
   REASON: In the case of substantial performance, the obligee is benefited.
2. When the obligee ***a***ccepts the performance, knowing its incompleteness or irregularity, and without expressing any protest or objection.
   REASON: Base on the principle of estoppels.
3. When the obligation to give, to do or not to do is ***c***onverted into an obligation to indemnify the obligee or creditor because of breach or non-fulfillment.

NOTE: For payment to properly exist, the creditor has to accept the same, expressly or implicitly. Payment, for valid reasons, may properly be rejected.

BURDEN OF PROVING PAYMENT
GENERAL RULE

Debtor has the burden of showing with legal certainty that the obligation has been discharged by payment.

EXCEPTION

When the debtor introduces evidences that the obligation has been extinguished, the burden shifts to the creditor.

REQUISITES OF PAYMENT [*I³ FCM*]

1. ***I***dentity – only the prestation agreed upon and no other must be complied with;
2. ***I***ntegrity/Completeness – the thing or service must be completely delivered or rendered;
3. ***I***ntention – the debtor must have the intention to fulfill the obligation;
4. ***F***ree and voluntary fulfilled.
5. The debtor and creditor must have the ***c***apacity to give and receive the payment respectively;
6. Must be ***m***ade by the proper payor to proper payee.

KINDS OF PAYMENT

1. Normal – when the debtor voluntarily performs or pays
2. Abnormal – the debtor is forced by means of a judicial proceeding either to comply with the prestation or pay indemnity.

PRINCIPLE OF INTEGRITY/COMPLETENESS OF PAYMENT

For debt to have been paid, the thing or service in which the obligation consists must have been completely delivered or rendered, as the case may be.

REQUISITES

1. The very thing or service contemplated must be paid;
2. Fulfillment must be complete.

HOW PAYMENT IS MADE

DEBT	PAYMENT
Monetary	Delivery of money. The amount paid must be full, unless otherwise stipulated in the contract.
To give	Delivery of the thing/s
To do	Performance of the personal

	undertaking.
Not to do	Refraining from doing the action.

ART. 1236

The creditor is not bound to accept payment or performance by a third person who has no interest in the fulfillment of the obligation, unless there is a stipulation to the contrary.

Whoever pays for another may demand from the debtor what he has paid, except that if he paid without the knowledge or against the will of the debtor, he can recover only insofar as the payment has been beneficial to the debtor.

NOTE In case the third person acquired the consent of the debtor, there arise a new juridical relationship between the debtor and the third person.

NOTE Extinguishment of the principal obligation gives rise to extinguishment of the accessory obligation such as mortgage, surety, and guarantee.

ART. 1237

Whoever pays on behalf of the debtor without the knowledge or against the will of the latter, cannot compel the creditor to subrogate him in his rights, such as those arising from a mortgage, guaranty, or penalty.

NOTE Whether or not a third person secured the consent of the debtor, the obligation with respect to the creditor is validly extinguished.

ART. 1238

Payment made by a third person who does not intend to be reimbursed by the debtor is deemed to be a donation, which requires the debtor's consent. But the payment is in any case valid as to the creditor who has accepted it.

NOTE If a third person intends to pay the debtor's obligation as a donation without securing first the debtor's consent, the third person shall have the right for reimbursement.

NOTE A third person who intends to pay the debtor's obligation must secure the debtor's consent (*Art. 734*) in order to eradicate the sense of obligation on the part of the debtor to return the favour owed to the third person (to avoid the so called "*utang na loob*").

NOTE If the value of the donation is P5,000 or less, the donation may be made either orally or in writing. Should the donation exceed P5,000, the donation must be written in public or private document (*see Art. 748*).

PERSON WHO MAY PAY THE OBLIGATION

1. Debtor himself
2. His legal representative
3. Any third person interested in the fulfillment of obligation.

NOTE The rule on the third person does not apply in case a third person who pays the redemption price in sales with right of repurchase (*pacto de retro*) because the vendor *a retro* is not a debtor within the meaning of the law.

THIRD PERSON INTERESTED IN THE PARTY

1. Co-debtor
2. Sureties
3. Guarantors
4. Owners of mortgages property or pledge
5. When there is a stipulation to the contrary (*JURADO, 235*)

EFFECTS OF PAYMENT

1. The obligation is extinguished;
2. The debtor is to fully reimburse the third person who is an interested party;
3. The third person interested is subrogated to the rights of the creditor.

THIRD PERSON WHO IS NOT AN INTERESTED PARTY BUT WITH DEBTOR'S CONSENT

GENERAL RULE

The creditor is not bound to accept payment or performance by a third person who has no interest in the fulfillment of the obligation.

EXCEPTION

Unless there is a stipulation to the contrary.

REASON

The creditor should have the right to insist on the liability of the debtor. The creditor should not be compelled to accept payment from a third person whom he may dislike or distrust. He may not desire to have any business dealings with a third person; or the creditor may not have confidence in the honesty of the third person who might deliver a defective thing or pay with a check which may not be honoured.

EFFECTS OF PAYMENT

1. Third person is entitled to full reimbursement;
2. There is legal subrogation as the third person, i.e., steps into the shoes of the creditor.

NOTE The creditor may refuse to accept payment.

THIRD PERSON, NOT INTERESTED AND WITHOUT CONSENT
GENERAL RULE

Whoever pays for another may demand from the debtor what he has paid.

EXCEPTION

If payment was made without the knowledge or against the will of the debtor. In such case, he can only recover insofar as the payment has been beneficial to the debtor, also known as beneficial reimbursement.

EFFECT OF PAYMENT

Third person can only be reimbursed insofar as payment has been beneficial to the debtor.

Illustration:

A owes P5M to B payable on 31 Dec. 2018. C, the father of A, went to B and said, "compañero, I'm going to pay na yung debt ng magaling ko na son." Is B compelled to accept the same?

No. C, though he may be the father of A, is not an interested party in the fulfillment of the obligation for he is not a party to the contract.

Some instances wherein a third person can pay the obligation of the debtor:

In Arts. 94, 121, 146 of the Family Code.

SUBROGATION

The person who pays for the debtor is put into the shoes of the creditor thereby acquiring not only the right to be reimbursed for what he has paid but also all other rights which the creditor could have exercised pertaining to the credit either against the debtor or against the third persons, be they guarantors or possessors of mortgages.

Only applies when the payment by a third person is with the knowledge of the debtor.

SUBROGATION	REIMBURSEMENT
Third person is entitled to demand reimbursement and exercise all the rights which the creditor could have exercised against the debtor and against the third persons.	A simple personal action available to the third person or payor against the debtor to recover from the latter what he has paid insofar as the payment has been beneficial to said debtor.

Illustration:

In 2018, A executed a promissory note promising to pay to B P1M within a period of 4 years. The payment of debt was guaranteed by C. In 2022, D, a third person, paid the entire amount of the indebtedness with the knowledge and consent of A.

D shall be subrogated to all the rights of B not only against A but also against C. This is so because the law expressly states that if a third person pays the obligation with the express or tacit approval of the debtor, he shall be legally subrogated to all the rights of the creditor, not only against the debtor, but even against third persons, be they guarantors or possessors of mortgages.

Illustration:

If in the above problem, B had condoned one-half of the obligation in 2021, and subsequently, in 2022, E, an epal third person, unaware of the

partial remission of the indebtedness, paid, without the knowledge and consent of A, the entire amount to B, who accepted it. What would be the effect of payment of the epal third person E upon the rights and obligations of the parties?

With respect to A, the only right which E has against him is to recover P500K because, it is only to that extent that he had been benefited by the payment. With respect to C, if A cannot pay the P500K because of insolvency, E can no longer proceed against him, because payment was made without the knowledge and consent of A, and consequently, he cannot be subrogated to the rights of B against C. With respect to B, E can still proceed against him for the recovery of the P500K, applying the principle that no person can unjustly enrich himself at the expense of another.

GRATUITOUS PAYMENTS (*Art. 1238*)

1. Presumed to be a donation and must be with the consent of the debtor;
2. Once the consent of the debtor is secured, the rules on ordinary donations will apply;
3. If the consent is not secured, Art. 1236 and 1237 will apply;
4. As far as the creditor who has accepted the payment is concerned, the debtor's consent is immaterial; the payment is valid in any case.

ART. 1239

In obligation to give, payment made by one who does not have the free disposal of the thing due and capacity to alienate it shall not be valid, without prejudice to the provisions of Article 1427 under the Title on "Natural Obligations."

CAPACITY TO MAKE PAYMENT

The person who pays the obligation should have the necessary legal capacity to effect such payment; it is essential for the validity of the payment that the payor should have the 1) free disposal of the thing due, and 2) the capacity to alienate it. The absence of one or the other will make the payment invalid. Even if the creditor has already accepted it, it may still be annulled by a proper action in court at the instance of the payor or his legal representative, unless it falls within the purview of the exception expressly provided for in Art. 1427.

If the creditor refuses to accept the payment because he is aware of the payor's incapacity, the obligation still subsists.

ART. 1240

Payment shall be made to the person in whose favour the obligation has been constituted, or his successor in interest, or any person authorized to receive it.

ART. 1241

Payment to a person who is incapacitated to administer his property shall be valid if he has kept the thing delivered, or insofar as the payment has been beneficial to him.

Payment made to a third person shall also be valid insofar as it has redounded to the benefit of the creditor. Such benefit to the creditor need not be proved in the following cases:

1. **If after the payment, the third person acquired the creditor's rights;**
2. **If the creditor ratifies the payment to the third person;**
3. **If the creditor's conduct, the debtor has been led to believe that the third person had authority to receive the payment.**

REASON FOR THE THIRD EXCEPTION

It is because of the principle of estoppel.

ART. 1242

Payment made in good faith to any person in possession of the credit shall release the debtor.

NOTE Good faith must be viewed on the part of the creditor in possession of the credit.

Illustration:

If a third person stole the note of "order" from the creditor, and the debtor paid the debt in good faith to the third person, it will be invalid for the note states "order," in which case the creditor must endorse the note to the third person.

The ruling would be otherwise if the note states that the payment should be made to the "bearer" of the note.

TO WHOM PAYMENT MUST BE MADE

1. The person whose favour the obligation has been constituted;
2. The creditor's successor;
3. Any person authorized to receive it.

EFFECT OF PAYMENT TO UNAUTHORIZED PERSONS
GENERAL RULE

If the payment is made to a person other than those enumerated in Art. 1240, it shall not be valid.

EXCEPTIONS

1. To a third person, provided that it has redounded to the benefit of the creditor (*Art. 1241, par. 2*);
   NOTE: The rule cannot be invoked without conclusive proof of the benefit to the creditor. It cannot be presumed except in the three cases specified in the second paragraph of Art 1241.
2. To the possessor of the credit, provided that it was made in good faith (*Art. 1242*).
   NOTE: The possession referred to in the above article is the possession of the credit, not the possession of the document evidencing it.
3. "The debtor who, before having knowledge of the assignment, pays his creditor shall be released from his obligation." (*Art. 1626*)

PAYMENT TO INCAPACITATED PERSONS

Payment made to an incapacitated person shall be valid:

1. If he has kept the amount or thing paid or delivered;
2. Payment has been beneficial to the incapacitated person.

ART. 1243

Payment made to the creditor by the debtor after the latter has been judicially ordered to retain the debt shall not be valid.

PAYMENT AFTER JUDICIAL ORDER OF RETENTION

If the debtor pays the creditor after he has been judicially ordered to retain the debt, such payment shall not be valid. After the debtor has received the notice of attachment or garnishment, payment can no longer be made to the creditor whose credit has been attached to satisfy a judgment in favour of another person.

ART. 1244

The debtor of a thing cannot compel the creditor to receive a different one, although the latter may be of the same value as, or more valuable than that which is due.

In obligations to do or not to do, an act or forbearance cannot be substituted by another act or forbearance against the obligee's will.

ART. 1245

Dation in payment, wherein property is alienated to the creditor in satisfaction of a debt in money shall be governed by the law of sales.

ART. 1246

When the obligation consists in the delivery of an indeterminate or generic thing, whose quality and circumstances have not been stated, the creditor cannot demand a thing of superior quality. Neither can the debtor deliver a thing of inferior quality. The purpose of the obligation and other circumstances shall be taken into consideration.

NOTE the rule stated in Art. 1246 is based on equity and justice.

WHAT MUST BE PAID

1. If the obligation is to give and the object is a thing which is specific or determinate, the debtor cannot fulfill his obligation by delivering a thing which is different from that which is due.
2. If the obligation is to do or not to do and the object is an act or forbearance which is specific or determinate, the obligor cannot

fulfill his obligation by substituting another act or forbearance against the obligee's will.

GENERAL RULE

In both cases, the creditor cannot be compelled to accept the delivery of the thing or the substitution of the act or forbearance.

EXCEPTION

If the creditor accepts the same, such acceptance shall give the same effect as a fulfillment or performance of the obligation, which shall be governed by the law on sales or dation (*dacion en pago*).

OTHER EXCEPTION

Aside from *dacion en pago*, a debtor can compel the creditor to accept another thing or *vice versa* when:

1. There is an express stipulation by the contracting parties;
2. The nature of the obligation is facultative.

SPECIAL FORMS OF PAYMENT

1. Dacion en Pago
2. Application of Payment
3. Cession
4. Consignation

DATION (*DACION EN PAGO*)

The delivery and transmission of ownership of a thing by the debtor to the creditor as an accepted equivalent of the performance of obligation. A special form of payment which is most analogous to a contract of sales. The law on sales shall govern with the credit as the price of the thing.

REQUISITES

1. Existence of a money obligation;
   It is in obligations which are not money debts, in which the true juridical nature of dation in payment becomes manifest. A prior agreement of the parties on the delivery of the thing in lieu of the original prestation shows that there is a novation which extinguishes the original obligation, and the delivery is a mere performance of the obligation. If the creditor is evicted from the thing given in dation, the original obligation is not revived.
2. Alienation to the creditor of a property by the debtor with the consent of the former;
3. Satisfaction of the money obligation of the debtor.

Illustration:

If A executed a promissory note in 2018 promising to pay to B P1M with four years from the execution of the note, and in 2021 when the obligation became demandable the two entered into an agreement by virtue of which A shall deliver his automobile to C as the equivalent of the performance of the obligation, the effect is the transformation of the previous contract into a contract of sale with the automobile as the object and the loan of P1M as the purchase price.

Illustration:

A bound himself to pay B P5M on 31 Dec. 2018. The said date arrived and A gave to B, instead of the P5M cash, a particular cellular phone which he bought in the very lucrative and luxurious Divisoria amounting to P5M. In this case, there is no dation of payment but rather novation.

LAW ON SALES GOVERNS DACION EN PAGO

Dacion en pago is governed by the law on sales for both have the same elements.

1. There is a consent on both parties;
2. There is a specific object stipulated to be delivered;
3. There is a price consideration.

DIFFERENCE OF DATION AND CONTRACT OF SALE

- *DATION* - there is a pre-existing contract or obligation.
  SALE – there is none.
- *DATION* – once the dation is perfected, it results to extinguishment of the obligation.
  SALE – once the contract of sale is perfected, it gives rise to 2 obligations: to deliver the thing and to pay the price.

EFFECT IF OBJECT IS GENERIC

If there is no precise declaration in the obligation with regard to the quality and circumstances of the indeterminate thing which constitutes its object, the creditor cannot demand a thing of the best quality; neither can the debtor deliver a thing of the worst quality. If there is disagreement, the law steps in and declares whether the obligation has been complied with or not, depending upon the purpose of such obligation and other circumstances.

ART. 1247

Unless it is other stipulated, the extrajudicial expenses required by the payment shall be for the account of the debtor. With regard to judicial costs, the Rules of Court shall govern.

NOTE Payment made to the creditor by the debtor after the latter has been judicially ordered to retain the debt shall not be valid (*Art. 1243*), unless otherwise stipulated, extrajudicial expenses required by the payment shall be for the account of the debtor (*Art. 1247*)

EXPENSES OF PAYMENT

If the debtor changes his domicile in bad faith or after he has incurred in delay, the additional expenses shall be borne by him (*Art. 1251*).

ART. 1248

Unless there is an express stipulation to that effect, the creditor cannot be compelled partially to receive the prestations in which the obligation consists. Neither may the debtor be required to make partial payments.

However, when the debt is in part liquidated and in part unliquidated, the creditor may demand and the debtor may effect the payment of the former without waiting for the liquidation of the latter.

GENERAL RULE

Art. 1248 (1) only applies to obligation where there is only one debtor and one creditor.

RULES IN DELIVERY OF GENERIC THINGS

1. Creditor cannot demand a thing of superior quality but, he may demand and accept one of inferior quality;
2. Debtor cannot deliver a thing of inferior quality but he may deliver one of superior quality, provided it is not of a different kind.

EXCEPTION

1. When the obligation expressly stipulates the contrary;
2. When different prestations which constitute the object of obligation are subject to different terms and conditions;
3. When the obligation is part liquidated and in part unliquidated.

ART. 1249

The payment of debts in money shall be made in the currency stipulated, and if it is not possible to deliver such currency, then in the currency which is legal tender in the Philippines.

The delivery of promissory notes payable to order, or bills of exchange or other mercantile documents shall produce the effect of payment only when they have been cashed, or when through the fault of the creditor they have been impaired.

In the meantime, the action derived from the original obligation shall be held in abeyance.

RULE IN MONETARY OBLIGATIONS

1. Must be made in the currency stipulated; if it is impossible to deliver such or when there is no stipulation regarding the currency, then in the Philippine currency.
2. For mercantile documents, it shall only produce the same effect only when:
   a. They have been cashed;
   b. They have been impaired by the fault of the creditor.

   REASON: For the 2nd rule, the reason behind is that the creditor cannot be compelled to accept another thing other than that agreed upon.

NOTE The impairment of the negotiable instrument through the fault of the creditor contemplated by Art. 1249 is applicable only to a document executed by a third person and delivered by the debtor to the creditor and does not apply to instrument executed by debtor himself and delivered to the creditor.

NOTE Pending the cashing of the mercantile document, the creditor cannot bring an action against the debtor during the intervening period as the action derived from the original obligation shall be held in abeyance.

R.A. No. 529 (Sec. 1)

"Every provision contained in, or made with respect to any obligation which provision purports to give the oblige the right to require payment…other than Philippine currency…is hereby declared against public policy, and null, void and of no effect…"

NOTE RA 529 was repealed by RA 8183. There is no longer any legal impediment to having obligations or transactions paid in a foreign currency as long as the parties agree to such arrangement. (DBP v CA, 494 SCRA 25 [2006])

LEGAL TENDER

Any currency which may be used for the payment of all debts, whether public or private. Its significance is manifested by the fact that it is such which the debtor may compel a creditor to accept in payment of the debt.

NOTE Under BSP Circular No. 537 which took effect on 11 Aug. 2006, the maximum amount of coins to be considered legal is adjusted Sec. 25 of RA 7653 as follows:

1. P1,000, for denominations P1, P5, and P10;
2. P100, for denominations P.01, P.05, P.10, P.15 and P.25.

R.A. No. 8183

All monetary obligations shall be settled in the Philippine currency. However, the parties may agree that the obligation or transaction shall be settled in any other currency at the time of payment.

PAYMENT BY MEANS OF INSTRUMENTS OF CREDITORS

Promissory notes, checks, bills of exchange and other commercial documents are not legal tender and the creditor cannot be compelled to accept them. Nevertheless, the creditor may accept them without producing the effect of payment.

Illustration:

On 1 Jan. 2017, A borrowed money from B amounting to P5M to be paid on 1 Mar. 2018. Upon the arrival of the stipulated date, A gave a personal check to B to pay his debt. Is the obligation already extinguished?

No. Art. 1249 (2) provides that monetary papers shall only extinguish the obligation if it was already converted to cash. Upon the delivery of the personal check of A to B, the obligation still subsists.

ART. 1250

In case an extraordinary inflation or deflation of the currency stipulated should supervene, the value of the currency at the time of the establishment of the obligation shall be the basis of payment, unless there in an agreement to the contrary.

REASON It is a debt in value.

INFLATION

It is caused by an increase in the volume of money and credit relative to available goods resulting in a substantial and continuing rise in the general price level.

DEFLATION

It is the reduction in volume and circulation of the available money or credit, resulting in a decline of the general price level.

EXTRAORDINARY INFLATION OR DEFLATION

It is the uncommon decrease or increase in the purchasing power of the currency which could not have been foreseen or which was manifestly beyond the contemplation at the time when the obligation was established

REQUISITES

1. There must be a decrease or increase in the purchasing power of the currency which is unusual or beyond the common fluctuation in the value of the currency;
2. Such decrease or increase could not have been reasonable foreseen or which was manifestly beyond the contemplation of the parties at the time the obligation was established;
3. The obligation is contractual in nature.

   REASON From the employment of the words "extraordinary inflation or deflation of the currency stipulated," it can be seen that the legal rule in Art. 1250 envisages "contractual" obligations where a currency is selected by the parties as the medium of payment.

NOTE The value of the currency at the time of the establishment of the obligation shall be the basis of payment. The law does not say it should be the amount paid.

NOTE Even if the price index of the goods and services may have risen during the intervening period, this increase, without more, cannot be considered as resulting in "extraordinary inflation" as to justify the application of Art. 1250. There must be a declaration of such extraordinary inflation or deflation by the *Bangko Sentral.*

DEVALUATION

Involves an official reduction in the value of one currency from an officially fixed level imposed by monetary authorities.

DEPRECIATION

Refers to the downward change in the value of one currency in terms of the currency of other nations which occurs as a result of market forces in the foreign exchange market.

ART. 1251

Payment shall be made in the place designated in the obligation.

There being no express stipulation and if the undertaking is to deliver a determinate thing, the payment shall be made whenever the thing might be at the moment the obligation was constituted.

In any other case, the place of payment shall be the domicile of the debtor.

If the debtor changes his domicile in bad faith or after he has incurred in delay, the additional expenses shall be borne by him

These provisions are without prejudice to venue under the Rules of Court

NOTE Art. 1251 must be read with Art. 1521.

NOTE Art. 1251 governs unilateral obligations. Reciprocal obligations are govern by special rules.

NOTE The term "domicile," as used in Art. 1251, connotes "actual" or "physical" habitation of a person as distinguished from "legal" residence (De Leon, 320).

Illustration:

A and B constituted a contract binding A to pay P5M to B. A is from Cagayan and B is from Sulo. In this case, the place of payment should be in Cagayan.

Illustration:

A bound himself to give a specific motorcycle with the plate number FVCK 1111 to B on 31 Dec 2018 . At the time of the constitution of the obligation, the car FVCK 1111 was parked in San Beda University. The said date arrived and for an unknown reason, the motorcycle is now parked on the roof of the Manila City Hall. In this case, the place of payment must be in San Beda University for the law provides that payment of the determinate thing must be at the place where the thing is during the time of constitution and not the time of fulfillment of the obligation.

NOTE In payment, any expenses incurred by the creditor must be borne by the creditor alone for it is incumbent for him to do such.

NOTE In putting the thing to be deliverable state, the expenses must be borne by the debtor.

S U B S E C T I O N 1
APPLICATION OF PAYMENT

ART. 1252

He who has various debts of the same kind in favour of one and the same creditor, may declare at the time of making the payment to which of them the same must be applied. Unless the parties so stipulate, or when the application of payment is made by the party for whose benefit the term has been constituted, application shall not be made as to debts which are not yet due.

If the debtor accepts from the creditor a receipt in which an application of the payment is made, the former cannot complain of the same, unless there is a cause for invalidating.

NOTE Art. 1252 must be read with Art. 1792.

APPLICATION OF PAYMENT

It is the designation of the debt to which the payment must be applied when the debtor has several obligations of the same kind in favour of the same creditor.

REQUISITES [*12 AN*]

1. There must be only ***one*** debtor and creditor;
   EXCEPTIONS:
   1. *Obligations with solidary debtors;*
   2. *Obligation with a guarantor;*
   3. *Partnership.*

   Illustration

   On 1 Jan 2017, A borrowed P5M from D payable on 1 Dec. 2018. On 5 Jan 2017, A, together with his best friends forever B and C borrowed P5M from D payable on 5 Dec. 2018. On 6 Dec. 2018, A paid P5M to D. In this case, A can designate the payment either to his debt (1 Jan 2017) or the solidary debt (5 Jan 2017).

   Same thing with respect to an obligation with a guarantor.

2. There must be ***2*** or more debts of the same kind;
   It is also essential that each of the debt must be identical, the same in nature or of homogenous specie.

   EXCEPTION: When some of the obligations are not identical specie at the time of their constitution, and at the time of designation or application is made, such obligation had already been converted into obligations to indemnify with damages by reason of breach or non-fulfillment

   Illustration:

   On 1 Jan 2017, A bound himself to give B P5M on 1 Dec 2018. On 5 Jan 2017, A bound himself again to give a specific dog named "dog" which he bought at SM Savemore for P5M on 5 Dec 2018. On 5 Dec 2018, A paid B P5M. In this case, A cannot designate the payment whether the same should be for the case or for the dog.

   Nevertheless, if on 1 June 2018, for no apparent reason A ate the dog named "dog." The obligation is thus converted into one which indemnifies the creditor. On 5 Dec 2018, A paid B P5M. In this case, A can designate the payment whether the same should be for the case or for the dog named "dog."

   NOTE The determination of the nature of the obligation is determined at the time of payment and not at the time of the constitution of the obligation.

3. ***A***ll of the debts must be due;
   EXCEPTION:
   a. *When there is a stipulation to the contrary;*
   b. *The application of payment is made by the party for whose benefit the term or period has been constituted.*

4. The amount paid by the debtor must ***n***ot be sufficient to cover the total amount of all the debts.

APPLICATION AS TO DEBTS NOT YET DUE

The application of payments as to debts not yet due cannot be made unless:

1. There is a stipulation that the debtor may so apply;
2. It is made by the debtor or creditor for whose benefit the period has been constituted (Arts. 1196, 1792).

RULES ON APPLICATION OF PAYMENTS (*DE LEON, 321*)

1. The debtor has the first choice, unless the debtor does not apply in such case will the right be granted to the creditor, which must be indicated at the time of making payment which particular payment is being paid. After applying the payment to a debt, he cannot claim that it should be applied to another debt;
2. The right to make the application once exercise is irrevocable unless the creditor consents to the change;
3. The debtor's right to apply payment is not mandatory but merely directory as evidenced by the word "may" rather than "shall" in Art. 1252;
4. If the creditor has not also made the application, or if the application is not valid (par. 2), the debt, which is most onerous to the debtor among those due, shall be deemed to have been satisfied (Art. 1254, par. 1);
5. If the debts due are of the same nature and burden, the payment shall be applied to all of them proportionately (Art. 1252, par. 2);
6. If neither of the party has exercised the right or if there is a disagreement, the court will apply the payment according to the justice and equity of the case, taking into consideration all its circumstances.

Illustration

A owes to B the following debts:

1. *P1,500 payable on 1 Jan 2018;*
2. *P1,200 payable on 2 Jan 2018;*
3. *A specific table worth P2,000 to be delivered on 3 Jan 2018;*
4. *P1,000 payable on 1 Sept 2018.*

On 1 June 2018, A paid B P1,500. A may apply the P1,500 to debt 1,or to both debt 1 and 2 (partial payment only, provided that B does not object).

If A paid only P1,000, he cannot choose to apply his payment to debt 1 because B cannot be compelled to receive partial payment (Art. 1248). A cannot apply his payment to debt 3 because it is not the same kind for A must deliver the thing agreed upon (Art. 1244). Neither can A apply it to debt 4 because it is not yet due, unless there is a stipulation to the contrary or he has the benefit of the period.

If A does not make a choice, B can make the designation with the consent of A ("if the debtor accepts" in Art. 1252, par 2).

If B does not make the application in the receipt or no receipt was issued b him, then the legal rules in Art. 1254 will govern.

ART. 1253

If the debt produces interest, payment of the principal shall not be deemed to have been made until the interests have been covered.

NOTE In a contract where there is instalment payments with interest against the remaining balance, it is the duty of the creditor to inform the debtor of the amount of interest that falls due and that he is applying the instalment to cover said interest.

NOTE A party to a contract who unqualifiedly and unconditionally accepts the settlement of his claim for damages without reservation as to interest or any other further claim from the other party is estopped from claiming interest thereafter. But accepting from a surety does not waive the right to recover interest from debtor.

ART. 1254

When the payment cannot be applied in accordance with the preceding rules, or if application cannot be inferred from other circumstances, the debt which is most onerous to the debtor, among those due, shall be deemed to have been satisfied.

If the debts due are of the same nature and burden, the payment shall be applied to all of them proportionately.

LEGAL APPLICATION OF PAYMENT

The debt which is more onerous to the debtor, among those due, shall e deemed to have been satisfied.

1. When the payment cannot be applied in accordance with the preceding rules;
2. If the application cannot be inferred from the circumstances.

REASON In making the application of payment, the law considers particularly the interest of the debtor. It is assumed that if the debtor had chosen the debt to be paid, he would have relieved himself first of the most burdensome debt.

RULES WHEN DEBTS ARE NOT OF SAME BURDEN

The most onerous to the debtor shall be deemed to have been satisfied.

1. The oldest are more onerous to the debtor than the more recent ones.
2. Interest bearing debts are more onerous than those which do not, even if the latter were incurred at an earlier date.

3. As between two debts with interest, that with higher interest rate is more onerous.
4. A secured debt is more onerous than that which is not.
5. A debt in which the debtor is principally bound is more onerous than that which he is merely a guarantor or surety.
6. A debt in which he is solidarily bound is more onerous than that which he is only a sole debtor.
7. An obligation for indemnity is more onerous than that which is by way of penalty.
8. Liquidated debts are more onerous than unliquidated ones.

NOTE When it is fairly impossible to determine which of the debts due is the most onerous or burdensome to the debtor, or when the debts due are of the same nature and burden, payment shall be applied proportionately or *pro rata*, in accordance to the general rules on payment in Arts. 1232-1251.

NOTE If the debt produces interests, payment of the principal shall not be deemed to have been made until the interests have been covered (*Art. 1253*); applies only in the absence of an agreement to the contrary and is merely directory and not mandatory, hence, the benefits of Art. 1253 may be waived by way of stipulation.

Illustration:

The debtor owes his creditor several debts, all of them due: 1) an unsecured debt; 2) a debt secured with mortgage of the debtor's property; 3) a debt bearing interest; 4) a debt in which the debtor is solidarily liable with another. Partial payment was made by the debtor. Assuming that the debtor had not specified the debts to which the payment should be applied and, on the other hand, the creditor had not specified in the receipt he issued the application of payment, the order of payment should be: 4, 2, 3 and 1.

S U B S E C T I O N 2
PAYMENT BY CESSION

ART. 1255

The debtor may cede or assign his property to his creditors in payment of his debts. This cession, unless there is stipulation to the contrary, shall only release the debtor from responsibility for the net proceeds of the thing assigned. The agreements which, on the effect of the cession, are made between the debtor and his creditors shall be governed by special laws.

CESSION OR ASSIGNMENT

A special form of payment whereby the debtor abandons all of his property for the benefit of his creditors in order that from the proceeds thereof the latter may obtain payment of their credits.

NOTE What is transferred in cession, unlike dacion en pago which transfers ownership, is the management and/or administration of the property in order to sell the thing of the debtor for the fulfillment of obligation.

REQUISITES [*22 – IAA*]

1. ***2*** or more debts;
2. ***2*** or more creditors;
3. ***I***nsolvency of the debtor;
4. ***A***bandonment of all debtor's property not exempt from execution in favor of creditors, unless exemption is validly waived by the debtor;
5. ***A***cceptance of the cession by the creditors.

Illustration:

A owes P5M to B payable on or before 31 Dec 2018. On 28 Feb 2018, A went to B to deliver a personal check amounting to P5M. B refused to accept the same. Can A go to court to compel B to accept the personal check?

No. (see Art. 1249).

NOTE In case the creditors do not accept the cession, a similar result may be obtained by proceeding in accordance with the Insolvency Law, Act No. 1956.

EFFECT OF PAYMENT BY CESSION

The assignment does not make the creditors the owners of the property and the debtor is released from obligation only up to the net proceeds of the sale of the property assigned. Unless there is a stipulation to the contrary.

KINDS OF CESSIONS

1. Contractual (*Art. 1255*)
   NOTE Refers to voluntary or contractual assignment which requires the consent of all the creditors. It involves a change of the object of the obligation by agreement of the parties and at the same time fulfilling the same voluntarily.
2. Judicial (*regulated by Insolvency Law*)
   a. Voluntary
   b. Involuntary

[*#FOE³N*]

DATION	CESSION
As to *number* of parties	
One creditor	Plurality of creditors
As to *f*inancial condition of parties	
Debtor is not necessarily in state of financial difficulty or insolvency.	Debtor must be insolvent.
As to *o*bject	
Thing delivered is considered as equivalent of performance.	Universality of property of debtor is what is ceded.
As to *e*ffect to the obligation	
Extinguishes obligation to the extent of the value of the thing delivered as agreed upon; implied from the conduct of the creditor.	Merely releases debtor for net proceeds of things ceded or assigned, unless there is contrary intention.
As to the *e*xtent of properties involved	
Does not involve all properties of debtor.	Involves all the properties of the debtor.
As to the *e*ffect to the creditor	
Creditor becomes owner of the property of the debtor.	The creditors only acquire the right to sell the thing and apply the proceeds to their credits *pro rata.*
As to *n*ature	
An act of novation (*Art. 1291 [1]*)	Not an act of novation.

NOTE Both are substitute forms of payment or performance. They are governed by the law on sales.

S U B S E C T I O N 3
TENDER OF PAYMENT AND CONSIGNATION

ART. 1256

If the creditor to whom tender of payment has been made refuses without just cause to accept it, the debtor shall be released from responsibility by the consignation of the thing or sum due.

Consignation alone shall produce the same effect in the following cases:

1. **When the creditor is absent or unknown, or does not appear at the place of payment;**
2. **When he is incapacitated to receive the payment at the time it is due;**
3. **When, without just cause, he refuses to give a receipt;**
4. **When two or more persons claim the same right to collect;**
5. **When the title of the obligation has been lost.**

NOTE For the 2nd enumeration, kindly read Art. 1241.

ART. 1257

In order that the consignation of the thing due may release the obligor, it must first be announced to the person interested in the fulfillment of the obligation.

The consignation shall be ineffectual if it is not made strictly in consonance with the provisions which regulate payment.

ART. 1258

Consignation shall be made by depositing the things due at the disposal of judicial authority, before whom the tender of payment shall be proved, in a proper case, and the announcement of the consignation in other cases.

The consignation having been made, the interested parties shall be notified thereof.

TENDER OF PAYMENT

It consists in the manifestation made by the debtor to the creditor of his intention to comply immediately with his obligation. Even if it is valid, it does not by itself produce legal payment, unless it is completed by consignation.

It is the act, on the part of the part of the debtor, of offering to the creditor the thing or amount due. It is an act preparatory to consignation, which is the principal, and from which are derived the immediate consequences which the debtor desires or seeks to obtain.

NOTE There must be a fusion of intent, ability and capability to make good such offer, which must be absolute and must cover the amount due.

REQUIREMENTS FOR VALID TENDER OF PAYMENT [*CUA*]

1. Must ***c***omply with the rules on payment (*Arts. 1256-1258*);
2. Must be ***u***nconditional and for the whole amount;
3. Must be ***a***ctually made for manifestation of a desire or intention to pay is not enough;

EFFECTS ON INTEREST

1. *When a tender of payment is followed by consignation* – accrual of interest on the obligation will be suspended from the date of such tender;
2. *When the tender of payment is not accompanied by consignation* – then interest is not suspended from the time of such tender.

EXERCISE OF RIGHT OF REPURCHASE

In case of exercise of right of repurchase by tender of check, such tender is valid because it is an exercise of a right and not made as a mode of payment of an obligation. Art. 1249 is not applicable.

WHEN TENDER OF PAYMENT NOT REQUIRED BEFORE DEBTOR CAN CONSIGN THE THING DUE WITH THE COURT

1. When the creditor waives payment on the date when the payment will be due (*Kapisanan Banahaw v Dejarme and Alvero, 55 Phil 229 [1930]*);
2. When the mortgagee had long foreclosed the mortgage extrajudicially and the sale of the mortgaged property had already been scheduled for non-payment of the obligation, and that despite the fact that mortgagee already knew of the deposit made by the mortgagor because the receipt of the deposit was already attached to the record of the case. (*Rural Bank of Caloocan v CA, 104 SCRA 151 [1981]*).

CONSIGNATION

The act of depositing the thing or amount due with the proper court when the creditor does not desire, or refuses to accept payment, or cannot receive it, after complying with the formalities required by law.

NOTE Consignation, being a form of payment, presupposes that there must be a debt that must be paid. Tender of payment alone would be sufficient to preserve the right of the redemptioner or the vendee *a retro*.

NATURE OF CONSIGNATION

A *facultative remedy* which the debtor may or may not avail of.

If made by the debtor, the creditor merely accepts it if he wishes; or the court declares that it has been properly made, in either of which events the obligation is extinguished. The debtor *can withdraw the thing before acceptance by the creditor or cancellation by the court*.

The *debtor has the right to refuse to make the deposit and has the right to withdrawal*. If he refuses, the creditor must fall back on the proper coercive processes provided by law to secure or satisfy his credit.

RATIONALE OF CONSIGNATION

Tender of payment and consignation produces the effect of payment and extinguishes an obligation in order to *avoid greater liability.*

1. Failure to consign, the debtor may become liable for damages and/or interest but such failure is not tantamount to a breach where by the fact of tendering payment he was willing and able to comply with his obligation (*see Art. 1260*).
2. The matter of suspension of the running of interest on the loan is governed by principles which regard reality rather than technicality, substance rather than form. Good faith of the offeror or ability to make good the offer should in simple justice excuse the debtor from paying interest after the offer was rejected. (*Gregorio Araneta, Inc. v De Palerno, 91 Phil. 786 [1952]*).

TENDER OF PAYMENT	CONSIGNATION
As to description	
Manifestation of the debtor to the creditor of his decision to comply immediately with his obligation.	Deposit of the object of the obligation in a competent court in accordance with the rules prescribed by law, after refusal or inability of the creditor to accept the tender of payment.
As to the at involved	
Preparatory act	Principal act
As to character	
Extrajudicial	Judicial

GENERAL REQUISITE OF CONSIGNATION

Refers to those requisites in connection with payment in general (*Art. 1232-1251*) such as person who pays, the person to whom payment is made, the object of the obligation which must be paid or performed, and the time when obligation or performance becomes demandable.

SPECIAL REQUISITES OF CONSIGNATION [*VRP - PlaceS*]

1. There is a valid debt (*Art 1256, par. 1*);

2. The creditor ***r***efused to accept the payment without just cause, or because any of the causes stated by law for effective consignation without previous tender of payment exists (*Ibid.*);

   *In order that consignation will be effective, there must have been a tender of payment made by the debtor to the creditor. It is required [**PUR**]*
   a. *That tender of payment must have been made **p**rior to the consignation;*
   b. *That it must have been **u**nconditional;*
   c. *That the creditor must have **r**efused to accept the payment without just cause*

3. That ***p***revious notice of the consignation had been given to the persons interested in the fulfillment of the obligation;
   NOTE Lack of prior or previous notice will not make the obligation void or invalid; the debtor will bear all the expenses for the consignation was not made properly (see Art. 1259).

   NOTE The purpose of the notice is to give the creditor a chance to reflect on his previous refusal to accept payment considering that the expenses of consignation shall be charged against him (Art. 1259)

4. That the thing or amount due had been ***place***d at the disposal of judicial authority;
   This requirement is complied with if the debtor deposits the thing or amount, which the creditor had refused or had been unable to accept, with the Clerk of Court.

5. ***S***ubsequent notice made to the person interested with the fulfillment of the obligation
   REASON To enable the creditor to withdraw the goods or money deposited.

   NOTE The court gives the subsequent notice in order to acquire the jurisdiction over the parties particularly the defendant creditor. Hence, lack of subsequent notice will render the consignation void for lack of jurisdiction of the court.

NOTE The absence of any of the requisites is enough ground to render consignation ineffective. Compliance with the requirements is mandatory. The law speaks of "thing." It makes no distinction between real and personal property.

VALID CONSIGNATION WITHOUT PRIOR TENDER OF PAYMENT [AIR – TL]

1. Creditor is ***a***bsent or unknown, or does not appear at the place of payment;

NOTE absence need not be judicially declared. He must, however, have no legal representative to accept the payment.

2. When he is ***i***ncapacitated to receive the payment at the time it is due;
3. When without just cause, he ***r***efuses to give a receipt;
4. When ***t***wo or more persons claim the right to collect;
5. When the title of the obligation has been ***lo***st.

NOTE The list is not exclusive. The rule also applies if the creditor, prior to the tender of payment, intimidated that he will not accept the debtor's payment.

EFFECT OF VALID TENDER OF PAYMENT

The obligation is not extinguished, unless it is completed by consignation. It exempts the debtor from payment of interest and/or damages.

NOTE Consignation must be with proper judicial authority (*i.e.*, court) and not elsewhere (*e.g.*, bank) unless otherwise prescribed by special law.

NOTE A written tender of payment alone, without consignation in court of the sum due, does not suspend the accruing of regular or monetary interest. Tender of payment must be accompanied or followed by consignation in order that the effects of payment may be produced.

NOTE The consignation has a retroactive effect. The payment is deemed to have been made at the time of the deposit of the thing in court or when it was placed at the disposal of the judicial authority.

NOTE Property deposited with court is exempt from attachment and not subject to execution.

ART. 1259

The expenses of consignation, when properly made, shall be charged against the creditor.

NOTE The consignation is made necessary because of the fault or unjust refusal of the creditor to accept payment; it is but just that the expenses should be charged against him. But it will be chargeable to the debtor if the consignation is not properly made.

ART. 1260

Once the consignation has been duly made, the debtor may ask the judge or order the cancellation of the obligation.

Before the creditor has accepted the consignation, or before a judicial declaration that the consignation has been properly made the debtor may withdraw the thing or the sum deposited, allowing the obligation to remain in force.

ART. 1261

If the consignation having been made, the creditor should authorize the debtor to withdraw the same, he shall lose every preference which he may have over the thing. The co-debtors, guarantors and sureties shall be released.

NOTE Kindly read alongside with Art. 1261 the provisions of Art. 2079.

CONSIGNATION, WHEN PROPERLY MADE

1. When creditor accepts the thing or amount deposited as payment of the obligation without contesting the efficacy or validity of the consignation (*Art. 1260, par. 2*);
2. When the creditor contests the efficacy or validity of the consignation and the court finally decides that it has been properly made or cancels the obligation at the instance of the debtor in accordance with the provision of Art. 1260 (1).

NOTE The creditor may accept the consignation with reservation or qualification; therefore, he is not barred from raising the claims he reserved against the debtor.

EFFECTS OF CONSIGNATION

1. If the creditor accepts the thing without contesting the validity of the consignation, it is logical that the obligation is extinguished;
2. It will be litigation should the creditor contest the validity of the same, is not interested, or is unknown or absent. If during the trial, the plaintiff-debtor is able to establish that all the requisites of consignation have been complied with, the obligation is extinguished.

EFFECTS OF WITHDRAWAL

1. Before acceptance or judicial declaration of valid consignation
   a. Obligation remains in force;
   b. Withdrawal by the debtor at this stage is a matter of right because he still owns the thing.
2. With the consent of the creditor
   a. Creditor loses every preference which he may have over the thing;
   b. Solidary co-debtors, guarantors and sureties are released;
   c. Solidary debtors are released only from their solidary liability but not from their shares of their obligation;
   d. The obligation is revived but without prejudice to other interested parties.
   e. Withdrawal by the debtor at this stage is a matter of privilege.

Q Before the creditor has accepted the consignation or before judicial declaration of valid consignation, the debtor opted not to withdraw the thing. Can the creditor attach the same property since the debtor still owns the thing?

A No. Property deposited with court is exempt from attachment and not subject to execution; it is said to be in *custodia legis* and cannot be withdrawn without an express order from the court.

RISK OF LOSS OF THING OR SUM CONSIGNED

1. To be suffered by the creditor;
   All the requisites for a valid consignation have been complied with and the debtor is without fault before the acceptance or approval of the consignation.
2. To be suffered by the debtor.
   The risk of loss before acceptance or approval is mutual because if it be determined that there was no valid consignation, the loss must be suffered by the debtor. (Sia v CA, 91 Phil. 355, [1952])

NOTE To have the effect of payment, the law requires the twin acts of tender of payment and consignation. Tender of payment without consignation only frees the debtor from the obligation to pay interest on the outstanding amount from the time the unjustified refusal takes place.

NOTE Creditor can be held liable for damages under Art 19 for unjustified refusal to accept.

S E C T I O N 2
LOSS OF THE THING DUE

Art. 1262

An obligation which consists in the delivery of a determinate thing shall be extinguished if it should be lost or destroyed without the fault of the debtor, and before he has incurred in delay.

When by law or stipulation, the obligor is liable even for fortuitous events, the loss of the thing does not extinguish the obligation, and he shall be responsible for damages. The same rule applies when the nature of the obligation requires the assumption of risk.

NOTE Kindly read alongside with Art. 1262 the provisions of Art. 1174.

LOSS OF THE THING DUE

The thing which constitutes the object of the obligation

1. Perishes;
2. Goes out of the commerce of man;
3. Disappears in such a way that its existence is unknown or it cannot be recovered.

It means impossibility of compliance with the obligation through any cause (*see Art. 1266*). It extends to both obligations to give and obligations to do.

EFFECTS OF LOSS IN DETERMINATE OBLIGATIONS TO GIVE

The obligation is extinguished.

REQUISITES

1. The thing which is lost must be determinate;
2. The thing is lost without any fault of the debtor; otherwise, it will not be extinguished but will be converted into one with indemnity for damages;

3. The thing is lost before the debtor has incurred in delay.

EFFECTS OF FORTUITOUS EVENT

If the thing which constitutes the object of obligation is lost or destroyed through a fortuitous event, the debtor cannot be held responsible ; the obligation is extinguished.

EXCEPTIONS [*PLAS - OTOG*]

1. Loss of thing is ***p***artly due to the fault of the debtor;
2. When the ***l***aw so provides (*Art. 1262*);
3. When the nature of the obligation requires an ***a***ssumption of risk (*Art. 1262*);
4. When the ***s***tipulation so provides (*Art. 1262*);
5. Loss of the thing ***o***ccurs after the debtor incurred in delay (*Art. 1262*);
6. When the debtor promised to deliver the same thing to ***t***wo person who do not have the same interest (*Art. 1165*);
7. When the obligation to deliver arises from a criminal ***o***ffense (*Art. 1268*);
8. When the obligation is ***g***eneric (*Art. 1263*).

NOTE If the loss is through theft, the debtor is considered negligent having placed the thing within the reach of thieves and not in a secure and safe place. In theft, taking is accomplished without the use of violence or force.

ART. 1263

In an obligation to deliver a generic thing, the loss or destruction of anything of the same kind does not extinguish the obligation.

GENERAL RULE

The loss or destruction of anything of the same kind even without the debtor's fault and before he has incurred in delay will not have the effect of extinguishing the obligation.

REASON The genus of a thing can never perish (*genus nunquam peruit*). Hence, the debtor can still be compelled to deliver a thing which must be neither of superior nor inferior quality.

EXCEPTION

Delimited Generic Thing – when there is a limitation of the generic object to a particular existing mass or a particular group of things, the obligation is extinguished by the loss of the particular mass or group or limited quantity from which the prestation has to be taken.

ART. 1264

The Courts shall determine whether, under the circumstances, the partial loss of the object of the obligation is so important as to extinguish the obligation.

EFFECT OF PARTIAL LOSS

GENERAL RULE

Partial loss does not extinguish the obligation.

EXCEPTION

When the partial loss or destruction of the thing is of such importance that would be tantamount to a complete loss or destruction.

Illustration:

A obliged himself to deliver to B a specific race horse. The horse met an accident as a result of which it suffered a broken leg. The injury is permanent. Here, the partial loss is so important as to extinguish the obligation.

If the loss is due to the fault of A, he shall be obliged to pay the value of the horse with indemnity for damages.

If the horse to be delivered is to be slaughtered by B, the injury is clearly not important. Even if there was fault on the part of A, he can still deliver the horse with liability for damages, if any, suffered by B.

ART. 1265

Whenever the thing is lost in the possession of the debtor, it shall be presumed that the loss was due to his fault, unless there is proof to the contrary, and without prejudice to the provisions of Art. 1165. This presumption does not apply in case of earthquake, flood, storm or other natural calamity.

RULE IF THING IS IN DEBTOR'S POSSESSION

GENERAL RULE

If the thing is lost while in the possession of the debtor it shall be presumed that the loss was due to his fault, unless there is proof to the contrary and without prejudice to the provisions of Art. 1165.

EXCEPTION

No such presumption in case of earthquake, flood, storm or other natural calamity. Lack of fault on the part of the debtor is more likely. So it is unjust to presume negligence on his part.

Illustration:

A borrowed a specific car from B. on the due date of the obligation, A told A that the car was stolen and that he was not at fault. That is not enough to extinguish A's obligation. It is presumed that the loss was due to his fault. Hence, he is liable unless he proves the contrary.

Suppose the house of B was destroyed because of fire. It is admitted that there was a fire and it was accidental and that the car was in the house at the time it occurred. Here, A is not liable unless B proves fault on the part of A.

ART. 1266

The debtor in obligations to do shall also be released when the prestation becomes legally or physically impossible without the fault of the obligor.

The prestation constituting the object of the obligation must have become legally or physically impossible of compliance without the fault of the obligor and before he has incurred in delay, otherwise, the obligation shall be converted into one of indemnity for damages. Impossibility must have occurred after the constitution of the obligation.

KINDS OF IMPOSSIBILITY

1. *Legal impossibility* – the law imposes duties of a superior character upon the obligor which are incompatible with the work agreed upon, although the latter may be perfectly licit.
2. *Physical impossibility* – arises principally from the death of the obligor, when the act to be performed requires his personal qualifications, or from the death of the obligee, when the act can be of possible benefit only to him.

NOTE Does not apply to obligations to give.

NATURAL IMPOSSIBILITY	IMPOSSIBILITY IN FACT
As to the thing	
Must consist in the nature of the thing to be done and not the inability of the party to do so.	In the absence of inherent impossibility in the nature of the thing stipulated to be performed, which is only improbable or out of the power of the obligor.
As to the effect	
Renders the contract void.	Does not render the contract void.

NOTE Natural impossibility is reckoned from the time of constitution of the obligation. Thus, the obligation remains void even if the prestation subsequently becomes possible.

NOTE In subsequent partial impossibility, Art. 1264 applies.

NOTE Temporary impossibility does not extinguish the obligation but merely delays its fulfillment. This presupposes that the duration of impossibility has been contemplated by the parties; otherwise, the same may extinguish the obligation under Art. 1267. In the latter case, the fact that the prestation later becomes possible does not revive the obligation.

ART. 1267

When the service has become so difficult as to be manifestly beyond the contemplation of the parties, the obligor may also be released therefrom, in whole or in part.

EFFECT OF RELATIVE IMPOSSIBILITY

The impossibility is relative because the difficulty of performance triggers a manifest disequilibrium in the prestations, such that one party would be placed at a disadvantage by the unforeseen event.

Impossibility shall release the obligor.

There is no physical or legal loss but the object of the obligation belongs to another, the performance by the debtor becomes impossible. Failure of performance is imputable to the debtor. Thus, the debtor must indemnify the creditor for the damages suffered by the latter.

NOTE Under Art. 1267, the remedy of the obligor is not annulment but to be released from his obligation, in whole or in part.

DOCTRINE OF UNFORESEEN EVENTS/ FRUSTRATION OF ENTERPRISE

When the service has become so difficult as to be manifestly beyond the contemplation of the parties, the court should be authorized to release the obligor in whole or in part. The intention of the parties should govern and if it appears that the service turns out to be so difficult as to have been beyond their contemplation, it would be doing violence to that intention to hold the obligor still responsible.

DOCTRINE OF *REBUS SIC STANTIBUS*

Things thus standing. The parties stipulate in the light of certain prevailing conditions and once these conditions cease to exist, the contract also ceases to exist.

NOTE Art. 1267 speaks of a "service," – a personal obligation. Thus real obligations are not within its scope. It refers to the "performance" of the obligation.

EFFECT OF LOSS ON RECIPROCAL OBLIGATIONS

- If an obligation is extinguished by the loss of the thing or impossibility of performance through fortuitous events, the counter-prestation is also extinguished. The debtor is released from the liability but he cannot demand the prestation which has been stipulated for his benefit. He who gives nothing has no reason to demand.
- The loss or impossibility of performance must be due to the fault of the debtor. In this case, the injured party may ask for rescission under Art. 1191 plus damages. if the loss or impossibility was due to a fortuitous event, the other party is still obliged to give the prestation due to the other.

ART. 1268

When the debt of a thing certain and determinate proceeds from a criminal offense, the debtor shall not be exempted from the payment of its price whatever may be the cause for the loss, unless the thing having been offered by him to the person who should receive it, the latter refused without justification to accept it.

NOTE Kindly read alongside Art. 1268 the provisions of Art. 552

RULE IF OBLIGATION ARISES FROM CRIMINAL OFFENSE

Applicable not only to the case where there is an obligation of restitution of a certain and determinate thing on the part of the person criminally liable as provided for in the Penal Code, but also to the case where such obligation arises by virtue of reparation or indemnification. Also applies to those subsidiarily liable.

GENERAL RULE

Debtor shall not be exempted from the payment of the price whatever may be the cause for the loss.

EXCEPTION

When the thing having been offered by the debtor to the person who should receive it, the latter refused without justification.

NOTE The offer referred in Art. 1268 should not be confused with consignation; the latter refers only to the payment of the obligation, the former refers to the extinguishment of the obligation through loss by fortuitous event.

NOTE When the offer was refused to be accepted without justification, the debtor may either:

1. Make a consignation of the thing and thereby completely relieve himself of further liability;
2. He may keep the thing in his possession, in which the case, the obligation shall still subsist but if the thing is lost through fortuitous event, Arts. 1262 and 1265 shall govern.

NOTE Art. 1268 specifically applies only to determinate things.

ART. 1269

The obligation having been extinguished by the loss of the thing, the creditor shall have all the rights of action which the debtor may have against the third persons by reason of the loss.

RIGHT OF THE CREDITOR TO PROCEED AGAINST THIRD PERSON

The creditor is given the right to proceed against the third person responsible for the loss. There is no need for an assignment by the debtor. The rights of action of the debtor are transferred to the creditor from the moment the obligation is extinguished, by operation of law to protect the interest of the latter by reason of the loss.

S E C T I O N 3
CONDONATION OR REMISSION OF DEBT

ART. 1270

Condonation or remission is essentially gratuitous, and requires the acceptance by the obligor. It may be made expressly or impliedly.

One and the other kind shall be subject to the rules which govern inofficious donations. Express condonation shall, furthermore, comply with the forms of donation.

CONDONATION

It is an act of liberality by virtue of which the obligee, without receiving any price or equivalent, renounces the enforcement of the obligation, as a result of which it is extinguished in its entirety or in that part or aspect of the same to which the remission refers.

It is the gratuitous abandonment by the creditor of his right.

REQUISITES [*GAD-PIC*]

1. Must be ***g***ratuitous;
2. The obligor must ***a***ccept the same;
3. Obligation must be ***d***ue;
4. ***P***arties must be capacitated;
5. Must not be ***i***nofficious;
6. If made expressly, it must ***c***omply with the forms of donation.

EXTENT OF REMISSION

Whether express or implied, the extent of remission or condonation shall be governed by the rules regarding inofficious donation. Hence, the following rules are applicable:

- *Art. 750.* The donation may comprehend all the present property of the donor, or part thereof, provided he reserves, in full ownership or in usufruct, sufficient means for the support of himself, and of all relatives who, at the time of the acceptance of the donation, are by law entitled to be supported by the donor. Without such reservation, the donation shall be reduced on petition of any person affected.
- *Art. 751.* Donations cannot comprehend future property. By future property is understood anything which the donor cannot dispose of at the time of the donation.
- *Art. 752.* The provisions of Art. 750 notwithstanding, no person may give or receive by way of donation, more than he may give or receive by will. Donation shall be inofficious in all that it may exceed this limit.
- *Art. 771.* Donations which in accordance with the provisions of Art. 751, are inofficious, bearing in mind the estimated net value of the donor's property at the time of his death, shall be reduced with regard to the excess, but this reduction shall not prevent the donations from taking effect during the life of the donor, nor shall it bar the done from appropriating the fruits.

Illustration:

A is indebted of a certain amount of money to B. On the payment should be made, B condoned the debt of A because of their friendship. A

refused to be condone and he intends to pay B because he just won the "jueteng"

In this case, A can go to court for consignation due to the refusal of B to accept the payment.

EVIDENCE REQUIRED TO PROVE REMISSION

Remission, being an act of liberality, should be proved by cleared and more convincing evidence than what is required to establish payment.

REMISSION MUST BE GRATUITOUS

It is an essential characteristic of remission that there is no equivalent received for the benefit given, otherwise it would be:

1. Dation in payment, if a thing is received by the creditor instead of the amount due (*Art. 1245*);
2. Cession, if the assignment of property is for the benefit of the creditors (*Art. 1255*);
3. Novation, if the object or circumstances of the obligation are changed (*Art. 1291*);
4. Compromise, if what is renounced is a doubtful or litigious right in exchange of other concessions obtained by the creditor.
   Compromise – a contract whereby the parties, by making reciprocal concessions, avoid litigation or put an end to one already commenced. (Art. 2028)

Q Can the creditor renounce his credit even against the will of the debtor?

A Yes. Such unilateral renunciation is allowed. Art. 6 provides that "Rights may be waived, unless the waiver is contrary to law, public order, public policy, morals or good customs, or prejudicial to a third person with a right recognized by law." In such case, the debtor may consign the payment at the disposal of the judicial authority.

KINDS OF REMISSION

1. **As to extent**
   a. *Complete/total* – when it covers the entire obligation;
   b. *Partial* – when it does not cover the entire obligation.
2. **As to its form**
   a. *Express* – when it is made either verbally or in writing;
   b. *Implied* – When it can only be inferred from the conduct.
3. **As to its constitution**
   a. *Inter vivos* – when it is constituted by the agreement of the obligee and obligor;
   b. *Mortis cause* – when it constituted by law will and testament.

INOFFICIOUS REMISSION

No one can give more than that which he can give by will, otherwise, the excess shall be inofficious and shall be reduced by the court accordingly.

Those which are prejudicial to the legitimes of the compulsory heirs.

EFFECT OF INOFFICIOUS REMISSION

Testamentary dispositions which impair the legitime shall be reduced on petition of the heirs (*see. Art. 887*) insofar as they are inofficious or excessive. *Legitime* is that part of the testator's property which he cannot dispose of because the law has reserved it for certain heirs.

FORM OF EXPRESS REMISSION

The following provisions are applicable:

- *Art. 748*. The donation of a movable object may be made orally or in writing.

  An oral donation requires the simultaneous delivery of the thing or of the document representing the right donated.

  If the value of the personal property donated exceeds P5,000, the donation and the acceptance shall be made in writing. Otherwise, the donation shall be void.
- *Art. 749.* In order that the donation of an immovable may be valid, it must be made in a public document, specifying therein the property donated and the value of the charges which the done must satisfy.

  The acceptance may be made in the same deed of donation or in a separate public document, but is shall not take effect unless it is done during the lifetime of the donor.

  If the acceptance is made in a separate instrument, the donor shall be notified thereof in an authentic form, and this step shall be noted in both instruments.

ART. 1271

The delivery of a private document evidencing a credit, made voluntarily by the creditor to the debtor, implies the renunciation of the action which the former had against the latter.

If in order to nullify this waiver it should be claimed to be inofficious, the debtor and his heirs may uphold it by proving that the delivery of the document was made in virtue of payment of the debt.

ART. 1272

Whenever the private document in which the debt appears is found in the possession of the debtor, it shall be presumed that the creditor delivered it voluntarily, unless the contrary is proved.

PRESUMPTION OF IMPLIED REMISSION

In order that the presumption established by this article may be applicable, it is necessary that the delivery of the private document be a voluntary act of the creditor.

REQUISITES FOR PRESUMPTION OF IMPLIED REMISSION [*DePriV*]

1. The document evidencing the credit must have been ***d***elivered by the creditor to the debtor;
2. The document must be a ***pri***vate document;
3. The delivery must be ***v***oluntary.

EXTENT OF REMISSION

If the obligation is joint, the presumption of remission, when applicable, pertains only to the share of the debtor who is in possession of the document; if solidary, to the total obligation.

NOTE Presumption is applicable only to private document and does not apply to a public document because it is easy to obtain a copy of the same, being a public record.

IF THE DOCUMENT IS IN THE POSSESSION OF THE DEBTOR

Ordinarily, the document evidencing the debt is in the possession of the creditor. He has in his favour the legal presumption that his credit is yet uncollected, unless the debtor proves satisfactorily, by one of the rules recognized by law, that he has already paid the claim.

If it is not known how the debtor came into possession of the same, the presumption is that it was voluntarily delivered by the creditor, thus gives rise the presumption of remission.

NOTE Whether the remission or condonation is expressed or implied, the same must be accepted by the debtor.

ART. 1273

The renunciation of the principal debt shall extinguish the accessory obligations; but the waiver of the latter shall leave the former in force.

ART. 1274

It is presumed that the accessory obligation of pledge has been remitted when the thing pledged, after its delivery to the creditor, is found in the possession of the debtor, or of a third person who owns the thing.

NOTE While the accessory obligations cannot exist without the principal obligation, the latter may exist without the former.

NOTE If obligation is joint, the remission can only affect the share of the creditor who makes the remission and the corresponding share of the debtor in whose favor the remission is made. If the obligation is solidary, the provisions of Arts. 1215, 1219 and 1220 shall govern.

RULE IN PLEDGE

It is presumed that the accessory obligation of pledge has been remitted when the thing pledged, after its delivery to the creditor, is found in the possession of the debtor or of a third person who owns the thing.

Illustration:

If A pledged his watch to B as security for an indebtedness of P1,000, and subsequently, the watch is found in his possession, there arises a presumption of remission of the accessory obligation of pledge. The debt of

P1,000, however, is not affected. B may disapprove the remission by proving the he gave the watch temporarily to the debtor to be repaired or that A was able to take possession thereof without his consent or authority.

S E C T I O N 4
CONFUSION OR MERGER OF RIGHTS

ART. 1275

The obligation is extinguished from the time the character of creditors and debtor are merged in the same person.

CONFUSION

It is the merger of the character of the creditor and debtor in one and the same person by virtue of which the obligation is extinguished.

It is the meeting in one and the same person of the qualities of creditor and debtor with respect to one and the same obligation.

REASON OR BASIS FOR CONFUSION

Obligation is presumed extinguished for if a debtor is his own creditor, enforcement of the obligation becomes absurd since a person cannot claim payment from himself. Furthermore, the purposes of the obligation are deemed realized.

REQUISITES [*SEC*]

1. The merger of the character of creditor and debtor must be in the **s**ame person;
2. It must take place in the person of ***e***ither the principal creditor or the principal debtor;
3. It must be **c**omplete and definite.
   NOTE A confusion or merger is complete if the obligation is extinguished.

Illustration:

A owes B P5M for which A executed a negotiable promissory note in favor of B. B indorsed the note to C who, in turn, indorsed it to D. Now, D bought goods from the store of A. Instead of paying cash, D just indorsed the promissory note to A.

In the case at bar, A owes himself. Consequently, his obligation is extinguished by merger or confusion.

KINDS OF CONFUSION

As to cause or constitutions

1. *Inter Vivos* – constituted by agreement of the parties;
2. *Mortis Causa* – constituted by succession.

As to extent or effect

1. *Total* – if it results in the extinguishment of the entire obligation;
2. *Partial* – if it results in the extinguishment of only the part of the obligation or when obligation is joint.

EFFECT OF TRANSFER OF RIGHTS

Mere transfer to a third person of rights belonging to both the debtor and the creditor but not the credit as against the debt does not result in merger.

Illustration:

A and B were co-owners of a piece of property worth P5M. B paid P200,000 for some repairs thereof. Since they were co-owners, A had to share in said expenses, and so A owed B P100,000. A and B sold their shares to the property to C. Later, B brought this action to recover P100,000 from A but A refused contending that since C is now the owner, C owes himself.

In the case at bar, A should pay B, since there was really no merger. What had been sold to C were the half shares of each of the co-owners. C did not acquired the indebtedness of P100,000 for the repairs, hence there can be no merger with reference to that debt.

EXTINCTION OF REAL RIGHTS

Real rights like usufruct may be extinguished by merger when any of such rights is merged with ownership which is the most comprehensive real right, or when the owner himself become the usufructuary.

NOTE This is also denominated "consolidation of ownership" which may take place by any of the causes which are sufficient to transmit title to an obligation.

Illustration:

A had two brothers B and C. A gave a parcel of land to B in usufruct (Usufruct gives a right to enjoy the property of another with the obligation of preserving its form and substance, unless the title constituting it or the law otherwise provides. [Art. 562]), and the same parcel to C in naked ownership (ownership of a property which is subject to the usufructuary's rights). If later C donates the naked ownership of the land to B, B will now have the full ownership, and it is as if merger had resulted.

NOTE If the reason for the confusion ceases, the obligation is revived (*PARAS, 457*).

MORTGAGEE BECOMES THE OWNER OF THE MORTGAGED PROPERTY

If the mortgagee becomes the owner of the property that had been mortgaged to him, the mortgage is naturally extinguished, but the principal obligation may remain (*See Yek Ton Lin Five v Yusingco, 64 Phil. 1062*). In this case, there is a confusion or merger, but not complete or total.

Illustration:

A borrowed P5M from his brother B, and as security, A mortgaged his land in B's favor. Later A sold the parcel to B. The mortgage is extinguished but A still owe B P5M.

ART. 1276

Merger which takes place in the person of the principal debtor or creditor benefits the guarantors. Confusion which takes place in the person of any of the latter does not extinguish the obligation.

EFFECT OF MERGER IN THE PERSON OF PRINCIPAL DEBTOR OR CREDITOR

"*Accessory follows the principal*" (the guaranty being considered the accessory obligation); hence, if there is merger with respect to the principal debt, the guaranty is extinguished.

Illustration:

A owes B with C as guarantor. The merger of the characters of debtor and creditor in A shall free C from liability as guarantor.

Confusion which takes place in the person of B benefits C because the extinction of the principal obligation carries with it that of the accessory obligation of guaranty.

EFFECT OF MERGER IN THE PERSON OF GUARANTOR

The extinguishment of the accessory obligation does not carry with it that of the principal obligation. Consequently, merger which takes place in the person of the guarantor, while it extinguishes the guaranty, leaves the principal obligation in force.

Illustration:

Suppose, in the example above, B assigns his credit to D, who, in turn, assigns the credit to C, the guarantor.

In this case, the contract of guaranty is extinguished. However, A's obligation to pay the principal obligation subsists. C now, as the new creditor, can demand payment from A.

ART. 1277

Confusion does not extinguish a joint obligation except as regards the share corresponding to the creditor or debtor in whom the two characters concur.

CONFUSION IN JOINT OBLIGATIONS

Confusion with takes place in one of the debtors shall only refer to the share which corresponds to him. Consequently, there is a partial extinguishment of the debt. The creditor can still proceed against the other debtors.

Illustration:

A and B jointly owe C P5M. If C assigns the entire credit to A, A's share is extinguished, but B's share remains. In other words, B would still owe A the sum of P2.5M. In a joint obligation, the debts are distinct and separate from each other.

CONFUSION IN SOLIDARY OBLIGATIONS

The provision of Art. 1215 shall apply: the entire obligation is extinguished, without prejudice to the rights and obligations of the solidary creditors and solidary debtors among themselves.

EFFECT OF REVOCATION OF CONFUSION

- *Confusion is constituted by agreement* – may be revoked by the presence of any of the causes for the rescission, annulment, nullity or inexistence of contracts or by some special cause such as redemption;
- *Confusion is constituted by inheritance* – may be revoked by the nullity of the will, or by the subsequent appearance of an heir with a better right, or by any other cause which will nullify the merger.

In both cases, the original obligation is recreated in the same form and under the same condition before confusion took place. The period which has elapsed from the moment the merger took place until its revocation cannot be computed in the determination of the period of prescription, because during such period the creditor could not possibly have made a demand for the fulfillment of the obligation.

SECTION 5
COMPENSATION

ART. 1278

Compensation shall take place when two persons, in their own right, are creditors and debtors of each other.

COMPENSATION

From the Latin word *cum ponder*, which means "to weigh together."

It is a mode of extinguishing in their concurrent amount those obligations of persons who in their own right are creditors and debtors of each other.

It is a figurative operation of weighing two obligations simultaneously in order to extinguish them to the extent in which the amount of one is covered by the amount of the other.

Illustration:

A owes B the amount of P5M. B owes A the amount of P4M. Both debts are due and payable today. Here the compensation takes place partially to the concurrent amount of P4M. So, A shall be liable to B for only P1M. If the two debts are of the same amount, there is total compensation (see Art. 1281)

IMPORTANCE OF COMPENSATION

Simplified payment; a more convenient and less expensive realization of two payments.

COMPENSATION	PAYMENT
Partial extinguishment is permitted;	Must be *complete* and *indivisible*;
Takes place by *operation of law*;	Involves *action* or *delivery*;
It is *not required* that the parties have the capacity to give or to receive (*see Art. 1290*).	The parties *must have the free disposal* of the thing due and *capacity to alienate it* (see Art. 1239), and to receive payments (see Arts. 1240-1241).

COMPENSATION	CONFUSION
There must be two person who are mutually creditor and debtor to each other;	There is only one person in whom is merged the qualities of creditor and debtor;
There must be two obligations;	There can be only one obligation;
There is indirect payment.	There is impossibility of payment.

NOTE There may be compensation in joint and solidary obligations (*see Arts. 1207, 1208, and 1215*).

COMPENSATION	COUNTERCLAIM
Takes place by mere *operation of law*, and extinguishes reciprocally the two debts as soon as they exist simultaneously, to the amount of their respective sums;	*Must be pleaded* to be effectual;
Requires that both debts *consist in money*, or if the things due are consumable, they be of *the same kind and quality* (*Art. 1279*);	Such requirement is *not provided;*
Requires that *two debts must be liquidated.*	Such requirement is *not provided.*

KINDS OF COMPENSATION

As to effect or extent

1. *Total* – both obligations are of the same amount and are entirely extinguished (*Art. 1281*);
2. *Partial* – the two obligations are of different amounts and a balance remains (*Ibid.*). The extinctive effect of compensation will be partial only as regards the larger debt.

As to cause or origin

1. *Legal* – when it takes place by operation of law when all the requisites are present even without the knowledge of the parties (*Arts. 1279, 1290*);
2. *Conventional or voluntary* – when it takes place by agreement of the parties (*Art. 1282*);
3. *Judicial* – when it takes place by order from a court in a litigation (*Art. 1283*). Merely a form of legal or voluntary compensation when declared by the courts by virtue of an action by one of the parties, who refuses to admit it, and by the defense of the other who invokes it;
4. *Facultative* – when it can be set up only by one of the parties (*Arts. 1287, par. 1; 1288*).

Illustration:

A owes B P5M demandable and due on 1 Dec 2018. B owes A P5M demandable and due on or before 31 Dec 2018. On 1 Dec 2018 B, who was given the benefit of the term, may claim compensation because he could then choose to pay his debt on said date, which is "on or before 31 Dec 2018." If, upon the other hand A claims compensation, B can properly oppose it because B could not be made to pay until 31 Dec 2018.

NOTE Under the law, the two persons concerned are creditors and debtors of each other; therefore, a debtor of a corporation cannot compensate his debt with his share of stock in the corporation since the corporation is not considered his debtor.

ART. 1279

In order that compensation may be proper, it is necessary:

1. **That each one of the obligors be bound principally, and that he be at the same time a principal creditor of the other;**
2. **That both debts consist in a sum of money, or if the things due are consumable, they be of the same kind, and also of the same quality if the latter has been stated;**
3. **That the two debts be due;**
4. **That they be liquidated and demandable;**
5. **That over neither of them there be any retention or controversy, commenced by third persons and communicated in due time to the debtor.**

NOTE The requisites enumerated under Art. 1279 are those for Legal Compensation. Voluntary Compensation in general requires no requisites except that the agreement be voluntarily and validly entered into.

REQUISITES OF COMPENSATION [*BCD - LCR*]

1. The parties are principally ***b***ound as principal creditors and principal debtors each other;
2. Both debts ***c***onsist in a sum of money, or of consumable things of the ***s***ame kind and quality;
3. Both debts must be ***due***;
4. Both debts must be ***li***quidated and demandable;
5. There must be no ***r***etention or ***c***ontroversy commenced by third persons over either of the debts and communicated in due time to the debtor;
6. There must be no waiver of the compensation (*PARAS, 466*);
7. The compensation must not be prohibited by law (*JURADO, 313*).

PROHIBITED COMPENSATION OF DEBTS

1. Debts arising from depositum (except bank deposits which are by law considered as loans to bank) (*Arts. 1287, 1980*);
   a. There must be a relationship of debtor and creditor;
   b. There must be two debts and two credits;
   c. The debtor and creditor must be generally be bound as principals and not in their representative capacity.

Illustration:

A owes B P5M which is guaranteed by C. B owes C P5M. A cannot claim compensation.

2. Debts arising from the obligations of a depository (*Art. 1287*);
3. Debts arising from the obligations of a bailee in commodatum (*Ibid.*);
4. Debts arising from a claim for future support due by gratuitous title (*Ibid.*);
5. Debts consisting in civil liability arising from a penal offense (*Art. 1288*);
6. Damages suffered by a partnership through the fault of a partner cannot be compensated with profits and benefits which he may have earned for the partnership by his industry (*Art. 1794*)

   REASON Since the partner has the duty to obtain benefits for the firm, and a duty not to be at fault, there can be no compensation because both are duties, and the partner is the debtor in both instances.

CONSUMABLE

Must be taken to mean *fungible* (susceptible of substitution, if such be the intention). This is evident because of the fact that consumables are those movables which cannot be used in a manner appropriate to their nature without being consumed, while fungibles are those which may be exchanged or compensated by another of the same kind and quality.

DUE

It means that the period has arrived, or the condition has been fulfilled. It means that the debt is now presently or immediately matured and enforceable, or that it matured at some time in the past and yet remains unsatisfied.

NOTE A natural obligations, conditional obligations before the fulfillment of the event, and obligations with a period before the expiration of the period, cannot be compensated.

DEMANDABLE

Refers to the fact that neither of the debts has prescribed, or that the obligation is not invalid or illegal.

Enforceable in court (*TOLENTINO, 378*).

NOTE If one of the debts has been already prescribed, there can be no compensation because said debt is no longer demandable.

LIQUIDATED

Those where the exact amount has already been determined, though not necessarily in figures since capacity of being arrived at by simple arithmetical processes would be enough.

NOTE If damages are asked for, and the amount is disputed, the debt cannot be said to be already liquidated.

RETENTION

Consists in the application of the credit on one of the parties to the satisfaction of the claims of a third person.

NOTE If there is an excess or balance remaining after the application of the credit, compensation will still take place, but only to the extent that the credit is not affected by the retention.

CONTROVERSY

Refers to a case in which a third person claims to be the creditor. The party interested in the compensation and the third person each claims that he is the real creditor. Effect would be suspension of compensation.

- *Credit is adjudicated to the third person* – compensation takes place;
- *Credit is adjudicated to the read creditor* – compensation cannot take place.

COMPENSATION AGAINST THE GOVERNMENT

1. *Taxes* – cannot be subject to compensation, being obligations of public interest, unless when both the claims of the government and the taxpayer against each other have already become due and demandable as well as fully liquidated.
2. *Contractual obligations* – may be compensated, but claims must involve the same office, agency or subdivision of the government.

ART. 1280

Notwithstanding the provisions of the preceding article, the guarantor may set up compensation as regards what the creditor may owe the principal debtor.

NOTE This is an exception to Art. 1279, par. 1, because a guarantor is subsidiarily, not principally, bound.

REASON Extinguishment of principal obligation extinguishes the guaranty.

Illustration:

A owes B P5M. C is the guarantor of A. B owes A P1M. When B sues A and A cannot pay, C will only be liable for P4M, because he can set up the P1M credit of A as the basis for partial compensation.

ART. 1281

Compensation may be total or partial. When the two debts are of the same amount, there is a total compensation.

NOTE Total and partial compensation applies to all the different kinds of compensation.

TOTAL COMPENSATION

Two debts are of the same amount.

PARTIAL COMPENSATION

Debts are different amounts; compensation is total as regards the smaller debt, and partial only with respect to the larger debt.

ART. 1282

The parties may agree upon the compensation of debts which are not yet due.

NOTE The requisites enumerated in Art. 1279 do not apply for this kind of compensation has no special requisites. Art. 1279 pertains to Legal Compensation whereas, Art. 1282 pertains to Voluntary Compensation.

VOLUNTARY OR CONVENTIONAL COMPENSATION

Includes any compensation which takes place by agreement of the parties even if all the requisites for legal compensation are not present.

NOTE It is sufficient that the contract of the parties, which declares the compensation, is valid (*Art. 1306*). Absence of mutual creditor-debtor relation cannot negate the conventional compensation.

REQUISITES

1. Legal capacity or right to dispose the credit sought to compensate;
2. Freely give consent to the mutual extinguishment of credits.

ART. 1283

If one of the parties to a suit over an obligation has a claim for damages against the other, the former may set it off by proving his right to said damages and the amount thereof.

JUDICIAL COMPENSATION

A compensation which is declared by a final judgment of a court in a suit. A party may compensate his claim for damages against his obligation to the other party by proving his right to said damages and the amount thereof.

NOTE Both parties must prove their respective claims. In the absence from both parties on their claims, offsetting is improper. The right to offset may exist but the question of how much is to be offset is factual in nature.

NOTE What is set off against the other party is a counterclaim. The counterclaim defined by the Rules of Court is not the legal compensation contemplated by the Code. If the claim is not liquidated, compensation cannot take place.

JURISDICTION REGARDING THE VALUE OF THE DEMAND
GENERAL RULE

Jurisdiction of the court depends upon the totality of the demand in all the causes of action, irrespective of whether the plural cases arose out of the same or different transactions.

EXCEPTION

1. Where the claim joined under the same complaint are separately owned but, or due to, different parties, in which case each separate claim furnishes the jurisdictional test;
2. Where not all the causes of action joined are demands or claims for money.

ART. 1284

When one or both debts are rescissible or voidable, they may be compensated against each other before they are judicially rescinded or avoided.

NOTE Rescissible (*see Art. 1381*) and voidable obligations (*see Art. 1390*) are valid debts until rescinded or voided; hence compensation is allowed.

RULES OF RESCISSIBLE OR VOIDABLE DEBTS

If the action for rescission or annulment is not exercised, or is renounced, or if the debt/s are ratified the obligation/s are susceptible to compensation.

NOTE The above rule is an exception to the general rule of demandability in order that compensation shall take place. This is justified by the fact that rescissible or voidable obligations are considered demandable while the vices with which they are tainted are not yet judicially declared.

ART. 1285

The debtor who has consented to the assignment of rights made by a creditor in favor of a third person, cannot set up against the assignee the compensation which would pertain to him against the assignor, unless the assignor was notified by the debtor at the time he gave his consent, that he reserved his right to the compensation.

If the creditor communicated the cession to him but the debtor did not consent thereto, the latter may set up the compensation of debts previous to the cession, but not of subsequent ones.

If the assignment is made without the knowledge of the debtor, he may set up the compensation of all credits prior to the same and also later ones until he had knowledge of the assignment.

EFFECT OF ASSIGNMENT AFTER COMPENSATION

Compensation takes place automatically or *ipso jure* (*see Art. 1290*). If, after compensation has taken place one of the extinguished debts is assigned to a third person, ordinarily this would be a useless act since there is nothing more to assign (*PARAS, 473*).

It follows that the assignment by the creditor cannot in any way affect the debtor with respect to the compensation which has already taken place. The assignee can only demand indemnity for damages from the assignor on the ground of fraud (*JURADO, 321*).

EFFECT OF ASSIGNMENT BEFORE COMPENSATION

The assignment, once all of the requisites for compensation are present, shall depend upon whether it was made with the consent, or with the knowledge but without the consent, or without the knowledge of the debtor (*Ibid.*).

NOTE Art. 1285 speaks of three cases of compensation which take place after an assignment of rights made by the creditor, or assignment before compensation.

WITH CONSENT OF THE DEBTOR

Effect: Compensation cannot be set up because there has been consent and therefore, a waiver.

Exception: If the debtor notified the assignor, at the time he gave his consent, that he is reserving his right to the compensation, he can still set up

Illustration:

A owes B P5M, due on 31 Dec. 2017.

B owes A P2M, due on 31 Dec. 2017.

B assigned his right to C on 1 Nov. 2017 with consent of A.

On 31 Dec. 2017, A cannot set up against C, the assignee, the compensation which would pertain to him against B, the assignor. In other words, A is liable to C for P5M but he can still collect the P2M debt of B.

However, I A, while consenting to the assignment, reserved his right to the compensation, he would be liable only for P3M to C (see Art. 1285, par. 1)

WITH KNOWLEDGE, BUT WITHOUT CONSENT, OF DEBTOR

Debtor may set up compensation of debts prior to the assignment, but not of subsequent ones. This refers to the debts maturing before the assignment or before notice. This is to prevent fraud.

- *If notification precedes assignment* – the effects of the assignment are produced from the time it is made and not from the time the notification is given. Debtor can set up the defense of compensation of debts contracted prior to the assignment;
- *If notification and assignment are made simultaneously* – debtor can set up the defense of compensation of debts contracted prior to the assignment;
- *If notification is after assignment* – assignment must have been effected without knowledge and consent of debtor (*see Art. 1285, par. 3*).

Illustration:

A owes B P5M due 1 Dec 2017.

B owes A P10M due 10 Dec 2017.

A owes B P5M due 15 Dec 2017.

A assigned his right to C on 12 Dec 2017. A notified B but the latter did not give his consent to the assignment.

B can set up the compensation of debts on December 10 which was before the cession on 12 Dec 2017 (see Art. 1285, par. 2.). There being partial compensation, the assignment is valid only up to the amount of P5M. But B cannot raise the defense of compensation with respect to the debt of A due on 15 Dec 2017 which has not yet matured. So, on 12 Dec 2017, B is liable to C for P5M. Come 15 Dec 2017, A will be liable for his debt of P5M to B.

WITHOUT KNOWLEDGE OF DEBTOR

Debtor may set up the defense of compensation of all credits which he may have against the assignor and which may have become demandable, before he was notified of the assignment.

NOTE The crucial time here is the time of knowledge of the assignment, not the time of assignment itself (*PARAS, 476*).

Illustration:

In the preceding example, let us suppose that the assignment was made without the knowledge of B who learned of the assignment only on 16 Dec 2017.

In this case, B can set up the compensation of credits before and after the assignment. The crucial time is when B acquired knowledge of the assignment and not the date of the assignment. If B learned of the assignment after the debts had already matured, he can raise the defense of compensation; otherwise, he cannot.

NOTE A B C knowledge D →

In this case wherein assignment was made by the creditor without the knowledge of the debtor after contracting debt B, the debtor may set up compensation only with regards to debts A, B and C which are all prior to the notification or the knowledge of the debtor regarding the compensation.

PURPOSE OF THE ARTICLE

For the prevention of fraudulent deprivation of the benefits of total and partial compensation (*Ibid.*).

ART. 1286

Compensation takes place by operation of law, even though the debts may be payable at different places, but there shall be an indemnity for expenses of exchange or transportation to the place of payment.

NOTE This article applies to legal compensation.

EXPENSES OF EXCHANGE

The indemnity contemplated does not refer to the difference in the value of the things in their respective places but to the expenses of monetary exchange (in case of money debts) and expenses of transportation (in case of things to be delivered). (*DE LEON, 399*)

Illustration:

A owes B P5M payable in Cagayan and B owes A P5M payable in Hawaii. Whoever claims compensation must pay for the exchange rate of currency.

Illustration:

A obliged himself to deliver to B 100 sacks of rice in Davao. B is also bound to deliver to A 100 sacks of rice of the same kind in Bulacan. The expenses for transportation of the rice to Davao amount to P4,000.00 and to Bulacan, P1,000.00. If A claims compensation, he must indemnify B the amount of P3,000.00 for the expenses of transportation of the rice to Davao (Ibid.).

FOREIGN EXCHANGE

The conversion of an amount of money or currency of one country into an equivalent amount of money or currency of another.

EXCHANGE RATE

The price of one currency expressed or quoted in relation to another currency.

ART. 1287

Compensation shall not be proper when one of the debts arises from a depositum or from the obligations of a depositary or of a bailee in commodatum.

Neither can compensation be set up against a creditor who has a claim for support due by gratuitous title, without prejudice to the provisions of paragraph 2 of Article 301.

ART. 1288

Neither shall there be compensation if one of the debts consists in civil liability arising from a penal offense.

WHEN LEGAL COMPENSATION CANNOT TAKE PLACE

1. When one debt arises from a depositum (distinguished from bank deposit for it is in reality a loan);

   REASON:

   It is a matter of morality that the depositary or the borrower should in fact perform his obligation; otherwise, the trust or confidence of the depositor or lender would be violated.

   DEPOSITUM

   A deposit is constituted from the moment a person receives a thing belonging to another with the obligation of safely keeping it and of returning the same (Art. 1962).

   Illustration:

   A owes B P1,000.00. B, in turn, owes A the amount of P1,000.00 representing the value of a ring deposited by A with B, which B failed to return.

   In this case, B, who is the depositary, cannot claim legal compensation even if A fails to pay his obligation. The remedy of B is to file an action against A for the recovery of the amount of P1,000.00.

   The relation of the depositary to the depositor is fiduciary in character since it is based on trust and confidence. B's claim for compensation against A would involve a breach of that confidence.

   But A can set up his deposit by way of compensation against B's credit. This is an example of facultative compensation. (also Nos. 2 and 4, infra.) The benefit granted by law is available only to A, as depositor, and can be waived by him. (see Art. 6.) (DE LEON, 401)

2. When one debt arises from a commodatum

   COMMODATUM

   It is a gratuitous contract whereby one of the parties delivers to another something not consumable so that the latter may use the same for a certain time and retain it (Art. 1933).

3. When one debt arises from a claim for support due by gratuitous title.

   NOTE The law did not limit itself to legal support and thus would include other rights which have for their purpose the subsistence of the debtor, such as pensions.

4. Where one of the debts consists in civil liability arising from a penal offense.

   REASON

   If one of the debts consists in civil liability arising from a penal offense, compensation would be improper and inadvisable because the satisfaction of such obligation is imperative (Report of the Code Commission, p. 134).

5. Certain obligations in favor of the government, such as taxes, fees, duties and others of a similar nature.

ART. 1289

If a person should have against him several debts which are susceptible of compensation, the rules on the application of payments shall apply to the order of the compensation.

ART. 1290

When all the requisites mentioned in Article 1279 are present, compensation takes effect by operation of law, and extinguishes both debts to the concurrent amount, even though the creditors and debtors are not aware of the compensation.

EFFECT OF COMPENSATION

Extinguishes both debts to the extent that the amount of one is covered by the amount of the other.

Since the principal obligations to which the accessory obligation are subordinated are extinguished, it follows that such accessory obligations are also extinguished.

RULES ON APPLICATION OF PAYMENTS APPLICABLE TO ORDER OF COMPENSATION

If a debtor has various debts which are susceptible of compensation, he must inform the creditor which of when shall be the object of compensation. In case he fails to do so, then the compensation shall be applied to the most onerous obligation (*see Arts. 1252, 1254*).

WHEN COMPENSATION TAKES EFFECT

- *Legal Compensation* - *f*rom the moment all the requisites mentioned in Article 1279 concur even in the absence of agreement between the parties and even against their will, and extinguishes reciprocally both debts as soon as they exist simultaneously, to the amount of their respective sums (*see Art. 1290*);
- *Voluntary Compensation* – from the moment agreed upon by the parties (*Art. 1282*);
- *Judicial Compensation* – from the moment the judgment becomes final and executor (*Art. 1283*).

FACULTATIVE COMPENSATION

Compensation which can be set up only at the option of the creditor when legal compensation cannot take place because of want of some legal requisites for the benefit of the creditor. The latter can renounce his right to oppose the compensation and he himself can set it up. It differs from conventional compensation because it is unilateral while the latter depends upon the agreement of both parties (*TOLENTINO, 367*).

NOTE Full legal capacity of parties is not required for it takes place by mere operation of law, and without any act of the parties

NOTE Consent not required in legal compensation.

COMPENSATION, A MATTER OF DEFENSE

It is usually necessary to set it up a defense in an action demanding performance. Once proved, its effects retroact or relate back to the very day on which all the requisites mentioned by law concurred or are fulfilled.

SECTION 6
NOVATION

ART. 1291

Obligations may be modified by:

1. **Changing their object or principal conditions;**
2. **Substituting the person of the debtor;**
3. **Subrogating a third person in the rights of the creditor.**

NOVATION

The substitution or change of an obligation by another, which extinguishes or modifies the first, either changing its object or principal condition, or substituting another in place of the debtor, or subrogating a third person in the right of the creditor.

The total or partial extinction of an obligation through the creation of a new one which substitutes it.

TWO-FOLD PURPOSE

1. Extinguishment of the old obligation;
2. Giving birth to a new obligation to take the place of the old.

REQUISITES [*PAVE - C*]

1. ***P***revious valid obligation;
2. ***A***greement of the parties to a new obligation, intent to novate or *animus novandi*;
3. ***V***alidity of the new obligation;
4. ***E***xtinguishment of the old obligation;
5. ***C***apacity of the contracting parties to the new contract.

EXTINCTIVE NOVATION

An old obligation is terminated by the creation of a new obligation that takes the place of the former.

Results either by changing/substituting the

- Object or principal conditions (objective or real)
- Person of the debtor or subrogating a third person in the rights of the creditor (subjective or personal).

MODIFICATORY NOVATION

The old obligation subsists to the extent it remains compatible with the amendatory agreement.

KINDS OF NOVATION

As to object or purpose or as to essence

1. *Real or Objective* – changing of object or the principal conditions of the obligation (*Art. 1291, par. 1*);
2. *Personal or Subjective* – substitution of person of the debtor or to the subrogation of a third person in the rights of the creditor;
    a. *Passive or Substitution* – when substitution of the person of the debtor;
    b. *Active or Subrogation* – when there is a subrogation in the rights of the creditor.
3. *Mixed* – refers to a combination of objective and subjective novation.

As to the form of its constitution

1. *Expressed* – declared in unequivocal terms that the old obligation is extinguished by a new one which substitutes the same;
2. *Tacit or Implied* – when the old and new obligations are incompatible with each other on every point.

As to extent or effect

1. *Total or Extinctive* – when the old obligation is completely extinguished;
2. *Partial or modificatory* – also called imperfect or improper novation/ the old obligation is merely modified and still remain in force except insofar as it has been modified.

NOTE Should there be any doubt as to whether the novation is total or partial, it shall be presumed to be modificatory (*PARAS, 490*).

REAL OR OBJECTIVE NOVATION (*Art. 1291 [1]*)

May be effected by:

1. Changing the cause of the obligation;
2. Changing the object of the obligation;
3. Changing the principal or essential conditions of the obligation.
    NOTE Must refer to a principal, not incidental, condition resulting in the alteration or modification of the essence of the obligation.

ART. 1292

In order that an obligation may be extinguished by another which substitutes the same, it is imperative that it be so declared in unequivocal terms, or that the old and the new obligations be on every point incompatible with each other.

EXPRESS NOVATION

It is declared in unequivocal terms that the old obligation is extinguished by the new which substitutes it.

Takes place when the contracting parties disclose that the object in making the new contract is to extinguish the old one.

TACIT OR IMPLIED NOVATION

It is when the old and new obligations are incompatible on every point.

HOW IMPLIED NOVATION MAY BE MADE

Implied novation is done by making substantial changes:

1. In the object or subject matter of the contract (*E.g., delivery of a car instead of a diamond ring*);
2. In the cause or consideration of the contract;
3. In the principal terms or conditions of the contract (*E.g., if a debt subject to a condition is made an absolute one without a condition*).

GENERAL RULE

Novation can never be presumed; it must be clearly and unmistakably established by express agreement or by the acts of the parties.

EXCEPTION

1. The old and new obligations are incompatible in any of the elements of an obligation;
2. *Animus Novandi* – intent of the parties to substitute a new obligation for the old one.

TEST OF INCOMPATIBILITY

Whether they can stand together without conflict, each one having its own independent existence.

NOVATION OF JUDGMENT

A final judgment of a court that had been executed but not yet fully satisfied may be novated by compromise.

NOTE Novation does not extinguish criminal liability but may only prevent its rise.

Illustration:

A owed B P5M and P6M evidenced by two promissory notes. Later, a new loan of P4M was obtained. By express agreement, the three debts were consolidated into on promissory note for P15M. That the last promissory note was to take the place of the others was agreed upon.

In this case, there is novation in view of the changes made.

Illustration:

Mav Corporation was being established. A subscribed to some shares of stock in the proposed corporation. Without A's consent, the authorized capital of the corporation was increased.

A is heretofore relieved of his obligation to pay for said shares. " One who subscribe for stock of a proposed corporation is relieved of his obligation, if, without his consent, the authorized capital stock of the corporation is increased" (National Exchange Co., Ltd. v Ramos, 51 Phil. 310).

NOTE The burden of establishing a novation is on the party who asserts its existence.

EFFECT OF MODIFICATION OF ORIGINAL OBLIGATION

1. *Slight modification and variation* – do not abrogate the entire contract and the rights and obligations of the parties, but the original contract continues in force except as the altered terms and conditions of the obligation are considered to be essence of the obligation itself.
2. *Material deviation or changes* – original contract should be treated as abandoned.

ART. 1293

Novation which consists in substituting a new debtor in the place of the original one, may be made even without the knowledge or against the will of the latter, but not without the consent of the creditor. Payment by the new debtor gives him the rights mentioned in Articles 1236 and 1237.

NOTE Subjective or personal novation (substituting the debtor) must be effected with consent of the creditor at the instance of either the new debtor or the old debtor

KINDS OF PASSIVE OR SUBSTITUTION

1. Expromision
2. Delegación

EXPROMISION

That which takes place when a third person of his own initiative and without the knowledge or against the will of the original debtor assumes the latter's obligation with the consent of the creditor (*see Art. 1294*);

Illustration:

A owes B P5M. C, an "epal" friend of A, approaches B and tells him: "Bes, babayaran ko yung utang ng bessy ko na si A." B agreed.

In this case, there is no expromision because they did not agree that D would be released from his obligation. If C thereafter does not pay B, B will still be allowed to collect from A.

NOTE If a third person who has decided to assume the obligation, but there is no agreement that the first debtor shall be released from responsibility, no novation has yet taken place, and the creditor can still enforce the obligation against the original debtor (Magdalena Estates, Inc. v Rodriguez, GR No. L-18411, 17 Dec. 1966).

Illustration:

Consider the above illustration. C, friend of A, approaches B and tells him: "Boi, babayaran ko yung utang ng brad ko na si A. From now on 'tol, consider me your debtor na ha, and not A"

In this case, and even if C does not pay B A cannot be held liable anymore because obligation has already been extinguished (Art. 1294).

REQUISITES OF EXPROMISION

1. Initiative must come from a third person who will be the new debtor;
2. The new debtor and the creditor must consent;
3. The old debtor must be excused or released from his obligation.

NOTE The old debtor's consent or knowledge is not required.

DELEGACIÓN

When the creditor accepts a third person to take the place of the debtor at the instance of the latter. Creditor may withhold approval (*see Art. 1295.*). All the parties, the old debtor, the new debtor, and the creditor must agree.

It is caused by the replacement of the old debtor by a new debtor, who (the old debtor) has proposed him to the creditor, and which replacement has been agreed to by said creditor and by said new debtor (*PARAS, 507*).

Illustration:

One day, A, the debtor, called B, the creditor, and said: "hoy pangit, musta na?" ***fast forward*** *"Uhmm ganito kasi yon pre, babayaran daw ng kapitbahay naming yung utang ko sayo; hence, I wish to be released from the shackles of my obligation ha." All of the parties agreed, and they live happily ever after.*

In the case at bar, there is a valid delegación for if the friend of A failed to pay the obligation, A will not be liable anymore. But this is with the exception when the friend becomes insolvent and the insolvency was already existing and known to A when he delegated his debt. Nevertheless, an exception to the exception would be with bad faith.

PARTIES OF DELEGACIÓN

- *Delegante* – the original or old debtor;
- *Delegatario* – the creditor;
- *Delegado* – the new debtor.

REQUISITES OF DELEGACIÓN

1. Initiative comes from the old debtor;
2. All the parties concerned must consent or agree

NOTE In both methods of novation, the old debtor must be released from the obligation.

RIGHT OF NEW DEBTOR

1. *Expromision*

Substitution	Payment made by new debtor	Effect
With knowledge and consent of original debtor	With or without knowledge and consent of the original debtor	• Reimburse from the original debtor of the entire amount paid; • Subrogation in all the rights of the creditor.
Without the knowledge and consent of the original debtor	Without knowledge and consent of the original debtor	• Reimburse from the original debtor only insofar as the payment has been beneficial to such debtor; • No subrogation

2. *Delegación* – the new debtor is entitled to reimbursement from the original debtor of the entire amount he paid and subrogation the creditor under Art. 1237.

ACCEPTANCE OF PAYMENT FROM A THIRD PERSON

This may have the effect of adding to the number of persons liable, but does not necessarily imply the extinguishment of the liability of the first debtor.

The mere fact that the creditor receives a guaranty or accepts payment from a third person who has agreed to assume the obligation, when there is no agreement that the first debtor shall be released from responsibility, does not constitute a novation, and the creditor can still enforce the obligation against the original debtor.

Illustration:

Debtor tells creditor that A will pay the debt. Creditor agrees. This does not mean that there is delegación. But if debtor tells that A will pay his debts and he asks creditor to release him from his obligation, to which creditor agrees, delegación results.

Suppose, in the same example, it is X who approaches creditor and tells him that X will pay the debt to which the creditor agreed. There is no expromision unless there is an agreement that debtor will be released from his obligation.

EFFECT OF PAYMENT BY NEW DEBTOR

The original debtor shall reimburse to the new debtor whatever benefits he may have derived from the donation. If the substitution was affected by:

- *Expromision*, the relationship shall be regulated by the rules regarding payment of a debt by a third person.
- *Delegación*, the relationship among such parties shall be regulated by the special agreement of all the parties. However, in absence of an agreement, the relationship shall be regulated by the rules regarding payment of a debt by a third person with the debtor's consent.

NOTE Consent of the creditor is an indispensable requirement in the two modes of substitution (*De Cortez v Venturanza, 79 SCRA 709 [1977]*).

REASONS

1. Substitution implies waiver by the creditor of his credit;
2. Substitution may be prejudicial to the creditor;
3. Creditor has right to refuse payment by third person without interest in obligation;
4. Involuntary novation by substitution of debtor.

ART. 1294

If the substitution is without the knowledge or against the will of the debtor, the new debtor's insolvency or non-fulfillment of the obligation shall not give rise to any liability on the part of the original debtor.

ART. 1295

The insolvency of the new debtor, who has been proposed by the original debtor and accepted by the creditor, shall not revive the action of the latter against the original obligor, except when said insolvency was already existing and of public knowledge, or known to the debtor, when he delegated his debt.

EFFECT OF NEW DEBTOR'S INSOLVENCY OR NONFULFILLMENT BY THE NEW DEBTOR

1. *Expromision* – will not revive the action of the creditor against the old debtor whose obligation is extinguished by the assumption of the debt by the new debtor (*see Art. 1294*). Remember that in expromision, the replacement of the old debtor is not made at his own initiative.

   But if the substitution was effected with the knowledge and consent of the original debtor, it shall revive the original debtor's liability to the creditor.
2. *Delegación* – the old debtor is not liable to the creditor in case of insolvency of the new debtor, except:
   a. The said insolvency was already existing and of public knowledge (although it was not known to the old debtor) at the time of the delegación;
   b. The insolvency was already existing and known to the debtor (although it was not of public knowledge) at the time of the delegación.

NOTE Actual knowledge of the creditor that new debtor was insolvent at the time of delegation, will bar him from recovering from the old debtor.

NOTE A change in the incidental elements of, or an addition of such elements to an obligation, unless otherwise expressed by the parties, will not result in its extinguishment.

ART. 1296

When the principal obligation is extinguished in consequence of a novation, accessory obligations may subsist only insofar as they may benefit third persons who did not give their consent.

GENERAL RULE

Extinguishment of the principal obligation carries with it that of the accessory obligations.

EXCEPTION

An accessory obligation created in favour of a third person which remains in forces unless said third person gives his consent to the novation (*see Art. 1311*).

Illustration:

A owes B P5M with interest at 12% (which is equivalent to P600k).

B owes C P600,000.

It was agreed among the parties that A would pay the interest of P600,000 to C. In this case, besides the principal obligation of A, there is a stipulation in favour of C, a third party (see Art. 1311, par. 2).

Later on, A and B executed another contract whereby they agreed that A would deliver to B a dog worth P5M (mahal yung dog bes, kasi diamond and kinakain niya) in payment of the loan. In spite of the novation, the accessory obligation to pay the interest of P600,000 to C still subsist unless C gives his consent to the novation.

ART. 1297

If the new obligation is void, the original one shall subsist, unless the parties intended that the former relation should be extinguished in any event.

GENERAL RULE

There is no novation if the new obligation is void and, therefore, the original one shall subsist for the reason that the second obligation being inexistent, it cannot extinguish or modify the first (*DE LEON, 432*).

EXCEPTION

The parties intended that the old obligation should be extinguished in any event.

NOTE If the new obligation is subject to a condition and said condition does not materialize, the old obligation subsist (*PARAS, 514*).

NOTE If the new obligation is only voidable, novation can take place. But the moment it is annulled, the novation must be considered as not having taken placed, and the original one can be enforced, unless the intention of the parties is otherwise (*DE LEON, 432*).

ART. 1298

The novation is void if the original obligation was void, except when annulment may be claimed only by the debtor, or when ratification validates acts which are voidable.

EFFECT IF THE OLD OBLIGATION WAS VOID

Void obligation cannot be novated because there is nothing to novate.

EFFECT IF THE OLD OBLIGATION WAS VOIDABLE

Voidable obligation (*Art. 1390*) is valid until it is annulled in court, hence, valid until annulled.

ART. 1299

If the original obligation was subject to a suspensive or resolutory condition, the new obligation shall be under the same condition, unless it is otherwise stipulated.

REASON The efficacy of the obligation depends upon whether the condition which affects the old obligation is complied with or not. If the condition is suspensive, and it is not complied with, no obligation arises; and if it is resolutory and it is complied with, the old obligation is extinguished. In either case, one requisite of novation, i.e., a previous valid obligation, would be wanting.

ART. 1300

Subrogation of a third person in the rights of the creditor is either legal or conventional. The former is not presumed, except in cases expressly mentioned in this Code; the latter must be clearly established in order that it may take effect.

SUBROGATION

It is the substitution of one person in the place of another with reference to a lawful claim or right, so that he who is substituted succeeds to the right of the other in relation to a debt or claim, including its remedies and securities. It places the party subrogated in the shoes of the creditor, and he may use all means which the creditor could employ to force payment.

KINDS OF SUBROGATION

1. *Conventional or Voluntary* – when it takes place by express agreement of the original parties and the third person (*see Art. 1301*);
2. *Legal* – when it takes place without agreement but by operation of law (*see Art. 1302*).

NOTE Conventional subrogation must be clearly established, otherwise, it is as if no subrogation has taken place.

NOTE Legal subrogation is not presumed, except those enumerated in Art. 1302.

ART. 1301

Conventional subrogation of a third person requires the consent of the original parties and of the third person.

REASON

1. *Debtor* – because he becomes liable under the new obligation to a new creditor;
2. *Old or original creditor* – because his right against the debtor is extinguished.
3. *New creditor* – because he may dislike or distrust the debtor.

ASSIGNMENT OF CREDIT

The process of transferring the right of the assignor to the assignee who would then have the right to proceed against the debtor.

May be done gratuitously or onerously, in which case, it has an effect similar to that of a sale.

CONVENTIONAL SUBROGATION	ASSIGNMENT OF CREDIT
A credit is extinguished and another appears, which the new creditor claims as his own;	There is a transfer of same credit which belonged to another and which, upon being transferred, is not extinguished;
Consent of the debtor is required;	Consent of the debtor is not required, mere notification to him is

	sufficient;
The effects begin from the time of novation itself (from the moment all the parties have given their consent);	The effects with respect to the debtor begin from the date of notification (*see Art. 1626*);
The nullity or defects of the previous obligation may be cured by the novation;	The nullity or defects of the obligation are not remedied, because only the correlative right of the obligation is transmitted;
Governed by Arts. 1300 – 1304.	Governed by Arts. 1624 – 1627.

ART. 1302

It is presumed that there is legal subrogation:

1. **When a creditor pays another creditor who is preferred, even without the debtor's knowledge;**
2. **When a third person, not interested in the obligation, pays with the express or tacit approval of the debtor;**
3. **When, even without the knowledge of the debtor, a person interested in the fulfillment of the obligation pays, without prejudice to the effects of confusion as to the latter's share.**

LEGAL SUBROGATION

That which takes place without agreement of the parties but by the operation of law because of certain acts.

GENERAL RULE

Legal subrogation is not presumed

FIRST EXCEPTION

The word "preferred" should be understood in its broad sense and in connection with the rules on preference of credits.

Illustration:

A has 2 creditors: B, who is a mortgage creditor for P5M, and C who is an ordinary creditor for P3M. C, without A's knowledge, paid A's debt of P5M to B. Here C will be subrogated in the rights of B. This means that C will not be a mortgage creditor for P5M, and an ordinary creditor for P3M. If A fails to pay the P5M debt, C can have the mortgage foreclosed (i.e., the property can be sold at public auction, with C being paid from the proceeds thereof).

SECOND EXCEPTION

The provisions of Arts. 1236 and 1237 are applicable. When a person, not interested in the obligation, pays the obligation with the approval of the debtor, he is entitled not only to demand reimbursement for what he has paid, but also to be subrogated in all of the rights of the creditor. However, if he pays without the knowledge or against the will of the debtor, although he is entitled to demand reimbursement to the extent that the latter has been benefited by the payment, he is not subrogated.

THIRD EXCEPTION

The phrase "person interested in the fulfillment of the obligation" can only refers to a co-debtor, a guarantor, the owner of the thing which is given as security, or one who has a real right over the thing which is the object of the obligation.

Illustration:

A owes B P5M secured by a mortgage and by a guaranty of C. If C, without the knowledge of A, pays B the debt, C will be subrogated in B's place. But the guaranty is extinguished.

Q Is a solidary debtor included in the scope of "a person interested?"

A No. The solidary debtor pays the whole obligation to the creditor, solidary obligation itself is extinguished. It cannot be said that such solidary debtor steps completely into the shoes of the creditor. Although the other solidary debtors must reimburse him, this obligation to reimburse is not solidary, but merely joint, except that they are all proportionately liable in the meantime for the insolvency of one of them (*PARAS, 524*).

ART. 1303

Subrogation transfers to the person subrogated the credit with all the rights thereto appertaining, either against the debtor or against third persons, be they guarantors or possessors of mortgages, subject to stipulation in a conventional subrogation

EFFECT OF TOTAL SUBROGATION

Total subrogation transfers to the new creditor the credit and all the rights and actions that could have been exercised by the former creditors against the debtor or other persons interested in the fulfillment of the obligation.

Accessory obligations are not extinguished because in such obligations the person subrogated also acquires all the rights which the original creditor had against third persons.

NOTE The stated above only applies to legal subrogation. However, with respect to conventional subrogation, accessory obligations may be increased or reduced depending upon the agreement of the parties.

ART. 1304

A creditor, to whom partial payment has been made, may exercise his right for the remainder, and he shall be preferred to the person who has been subrogated in his place in virtue of the partial payment of the same credit.

EFFECT OF PARTIAL SUBROGATION

The creditor to whom partial payment has been made by the new creditor remains a creditor to the extent of the balance of the debt.

When debtor is insolvent, he is given a preferential right under the above article to recover the remainder as against the new creditor.

Illustration:

A is indebted to B for P5M. C pays B P3M with the consent of A.

There is here partial subrogation as to the amount of P3M. B remains the creditor with respect to the balance of P2M. Thus, two credits subsist. In case of insolvency of A, B is preferred to C, that is, he shall be paid from the assets of B ahead of C.