



SyCipLaw COVID-19 Legal Bulletin: Litigation and Dispute Resolution

The enhanced community quarantine (ECQ), declared over many areas in the Philippines, including the island of Luzon where the National Capital Region is located, has caused significant business disruption¹. As in other jurisdictions, there are concerns that the country will see a rise in contract disputes and foreclosures, and even businesses invoking laws on suspension of payments, rehabilitation, and insolvency. The ECQ has also impacted court proceedings and other dispute resolution processes.

This legal briefing touches on Philippine issues in litigation and dispute resolution that may be triggered by the current COVID 19 crisis, or which have become more relevant because of it.

Court in Session? State of Philippine Dispute Resolution

The courts are physically closed during the ECQ, although designated judges may act on extremely urgent matters that largely relate to criminal cases such as the posting of bail and promulgation of judgment of acquittals, and to the measures imposed by the government to address the public health emergency. The conduct of hearings for other matters is suspended and the filing of appeals, pleadings and other submissions that fall due during the ECQ has been extended for 30 calendar days counted from May 16, 2020. It is anticipated that even after the ECQ, there will be delay in the resumption of regular procedures as courts may have to operate with a skeletal workforce and adjust to the continued imposition of social distancing measures.

The pandemic is challenging for the Philippine judicial system as it does not have rules or infrastructure in place for the extensive use of technology in court litigation. The challenge will become more profound as litigators and trial courts prepare for the implementation of the new rules of civil procedure and evidence, which have become effective on May 1, 2020.

¹ Luzon is one of the Philippines' main islands and is where the National Capital Region is located. The ECQ over Luzon began on March 17, 2020, and ended on April 30, 2020, but the ECQ was extended until May 15, 2020 over the National Capital Region and other high-risk areas.

A potential bright spot in the field of dispute resolution is the emergence of the capabilities of arbitral institutions and tribunals to continue functioning even as the world navigates through a global pandemic. A number of arbitral institutions favored by Philippine parties have remained in operation even as they implement precautionary measures, such as the Singapore International Arbitration Centre, the Hong Kong International Arbitration Centre, and the ICC International Court of Arbitration. These institutions appear to have the institutional capacity and the infrastructure for telecommuting and for utilizing technology in hearing cases and resolving disputes thus enabling them to administer cases. In the Philippines, the Philippine Dispute Resolution Center, Inc. has been able to continue administering its cases through the use of electronic filing of submissions and other communications.

Round-up: Remedies for Distressed Debtors under Philippine Law: Insolvency and Rehabilitation

The Philippine laws on insolvency are principally *Republic Act No. 10142, or the Financial Rehabilitation and Insolvency Act (FRIA)*, the *Financial Rehabilitation Rules of Procedure*, and specific provisions of the *Philippine Civil Code (Civil Code)*.

Under the FRIA, an insolvent debtor may voluntarily initiate either court-supervised rehabilitation or liquidation by filing a petition in court. In court-supervised rehabilitation, the debtor's rehabilitation will be supervised by the court principally through a court-appointed rehabilitation receiver. The FRIA also recognizes out-of-court or informal restructuring agreements or rehabilitation plans, provided that such agreements meet the minimum requirements prescribed by the law. An insolvent debtor may also be subject of rehabilitation or liquidation proceedings involuntarily if a petition is filed by creditor or group of creditors whose claims reach the thresholds specified in the FRIA.

Generally, creditors have the right to file a civil action in court for the collection of a debt. However, once rehabilitation proceedings commence, all other actions or proceedings for the enforcement of claims against a debtor would be suspended and all creditor claims would have to be submitted to the rehabilitation court. Nevertheless, a secured creditor may enforce his security or lien, or foreclose upon property of the debtor securing its claim if it is shown that such property is not necessary for rehabilitation.

Meanwhile, "suspension of payments" is the postponement, by court order, of the payment of debts of a financially distressed debtor who still has sufficient assets or property to cover all his debts, but nonetheless foresees the impossibility of meeting them when they fall due.

Under the FRIA, the solvent individual debtor can seek this by filing a petition with the Regional Trial Court designated as a special commercial court of the individual's residence for the last 6 months prior to the filing. When an individual debtor files for suspension of payments, no creditor may sue or initiate a collection proceeding against the debtor, except in certain cases as where the creditor is secured. The court-ordered stay on cases is automatically lifted when the proposed agreement is rejected or when no agreement is reached with the creditors within 3 months.

Who Gets Paid First: Preference of Credits

A question now in the mind of many lenders and creditors is, in a worst-case scenario for borrowers and debtors, would their credit be preferred?

Where an insolvent corporation undergoes rehabilitation or liquidation proceedings pursuant to the provisions of the FRIA, the payment of credits should follow the priority established under the *Civil Code* on concurrence and preference of credits and other applicable laws.

Philippine law classifies credits into three general categories, namely: (1) special preferred credits for specific movable properties and specific immovable properties; (2) ordinary preferred credits; and (3) common credits.

Special preferred credits are the highest priority claims and attach as a lien on the specific property to which they relate. Generally, there is no order of preference among special preferred credits and these credits will be satisfied on a pro-rated basis. However, taxes, duties, and fees due to the Philippine government has priority over all other special preferred credits and will be satisfied first before secured creditors are paid.

Ordinary preferred credits create no liens that attach to specific property. They only create rights in favor of certain creditors out of the residual value of the debtor's assets after the special preferred credits are satisfied. There is a preference for these credits based on the order set out in the law. However, credits for services rendered by the insolvent debtor by employees, laborers or household helpers will always enjoy priority over all other ordinary preferred credits.

Common credits do not enjoy preference and are satisfied pro rata regardless of dates.

Contract Disputes: What Clauses to Revisit

The economic and other effects of the pandemic may impact contracts that have, among others, provisions that refer to force majeure, legal impossibility, and change in circumstances. It would be prudent for parties to review agreements with these contractual provisions to determine whether they are already in play and, if so, what are appropriate courses of action.

1. Force Majeure

A *force majeure* clause typically suspends the operation of the contract or excuses a party from its contractual obligations in the event of a fortuitous event such as natural calamities, war, or any phenomenon as stipulated in the contract. In this connection, the *Civil Code* does provide that a party can be excused from its contractual obligations on account of a fortuitous event, or an unforeseen and unexpected occurrence must have been impossible to foresee or, if foreseeable, impossible to avoid.

Whether *force majeure* clauses are triggered by the pandemic will depend on the actual language of the clause, factual circumstances, and other provisions of the contract. Assumption of risk, if present, could argue against the application of a *force majeure* clause.

2. Change in Law /Legal Impossibility

A change in law clause is one which allows parties to stipulate as to what will happen in case the law which they relied upon has changed. The change in law clause may limit liability or even provide for the termination of the contract. In the absence of a change in law clause, a debtor or obligor may be able to look to Article 1266 of the *Civil Code* which releases a debtor from an obligation to perform a service when the fulfillment of an obligation has become legally impossible without the debtor's fault. This provision also applies to physical impossibility.

3. Renegotiation Clause; Change in Circumstances (*Rebus Sic Stantibus*)

Even if one's contractual obligations have not been rendered legally or physically impossible, a change in circumstances clause may provide a party an opportunity to compel a counterparty to sit down and renegotiate particular terms.

If a contract has no provision for renegotiation under certain circumstances, the principle of *rebus sic stantibus* might be considered. The principle is embodied in Article 1267 of the *Civil Code* which provides that "[w]hen 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." However, as explained in Philippine jurisprudence, the circumstances must be absolutely exceptional and should unfairly put the debtor at a disadvantage, because parties to a contract are generally considered to have assumed risks in case of unfavorable developments. Thus, reasons such as mere inconvenience, increased expenses, or pecuniary inability will not be enough for *rebus sic stantibus* to apply.

For more information about the legal issuances discussed in this bulletin, please contact any of the following:

Ricardo Ma. P.G. Ongkiko
Partner, Head of Litigation Department
rmpgongkiko@syciplaw.com

Ma. Patricia B. Paz
Partner
mpbpaz@syciplaw.com

This bulletin contains a summary of the legal issuances discussed above. It was prepared by SyCip Salazar Hernandez & Gatmaitan (SyCipLaw) to update its clients about recent legal developments.

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SyCip Salazar Hernandez & Gatmaitan

SyCipLaw Center, 105 Paseo de Roxas
Makati City 1226, The Philippines
t: +632 8982 3500; +632 8982 3600; +632 8982 3700
f: +632 8817 3145; +632 8817 3896
e: sshg@syciplaw.com
www.syciplaw.com