

## CHAPTER 4 EXTINGUISHMENT OF OBLIGATIONS

**Art 1231. Obligations are extinguished:**

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

**Other causes of extinguishment of obligations, such as annulment, rescission, fulfillment of a resolutive condition, and prescription, are governed elsewhere in this Code (1156a)**

### Additional causes of extinguishment of obligations

1. Death of a party (personal service obligation)
2. Mutual desistance or withdrawal
3. Arrival of resolutive period
4. Compromise
5. Impossibility of fulfillment
6. Happening of fortuitous event

### **SECTION 1 – Payment of Performance**

**Art. 1232. Payment means not only the delivery of money but also the performance, in any other manner, of an obligation**

#### Meaning of payment

1. Delivery of money
2. Giving of a thing, doing of an act, not doing of an act

In law, payment and specific performance are synonymous.

**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.**

#### When debt is considered paid

1. **Integrity of prestation** – debt is not understood to have been paid unless the thing or service has been completely delivered or rendered.
2. **Identity of prestation** – the very prestation due must be delivered or performed

#### Burden of proving payment

The burden of proving extinguishment by payment devolves upon the debtor who claims payment. When the debtor proves that obligation has been paid, burden shifts to the creditor.

**Art. 1234. If the obligation has been substantially performed in good faith, the obligor may recover as though there had been a strict and complete fulfillment, less damages suffered by the obligee.**

#### Recovery allowed in case of substantial performance in good faith

Article 1234 is the first exception to the rule laid down in Article 1233.

Article 1234 embodies the *doctrine of substantial performance*. There is substantial performance when the important or essential part of the contract has been performed. There is only a proportionate reduction in the amount recoverable by the obligor.

Good faith is always presumed in the absence of proof to the contrary.

#### Requisites for the application of Article 1234

1. There must be substantial performance
2. The obligor must be in good faith

**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.**

#### Recovery allowed when incomplete or irregular performance is waived (principle of estoppel)

1. If the payment is incomplete or irregular, the creditor may properly reject it.
2. In case of acceptance, the law considers that he waives his right. The whole obligation is extinguished.

#### Requisites for the application of Article 1235

1. Oblige knows the performance is incomplete or irregular
2. He accepts the performance without expressing any protest or objection

**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.**

Person from whom the creditor must accept payment

1. The debtor
2. Any person who has an interest in the obligation (guarantor)
3. Third person who has no interest in the obligation when there is stipulation that he can make payment

Creditor may refuse payment by a third person

Creditor cannot refuse payment by a third person. Moreover, creditor should not be compelled to accept payment from a third person whom he may dislike or distrust.

Effect of payment by a third person

1. **If made without the knowledge or against the will of the debtor** – payer can recover from the debtor only insofar as the payment has been beneficial to the latter.
2. **If made with the knowledge of the debtor** – payer shall have the rights of reimbursement and subrogation, recover what he has paid, acquire all the rights of the creditor

Right of third person to subrogation

Whoever pays on behalf of the debtor is entitled to subrogation if the payment is with the consent of the latter. If without or against the will of the debtor, third person cannot compel the creditor to subrogate.

May there be subrogation, if the creditor willingly permits the payor to be subrogated in his rights? Since Art. 1237 is for the benefit of the debtor, the subrogation can only take place with his consent.

Subrogation and reimbursement distinguished

<b>S</b> – person who pays for the debtor is put into the shoes of the creditor; payor acquires right to be reimbursed and all other rights which the creditor could have exercised
---

<b>R</b> – third person has merely the bare right to be refunded to the extent provided in the second paragraph of Article 1236.
--

**Art. 1238. Payment made by the 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.**

Payment by a third person who does not intend to be reimbursed

“embodies the idea that no one should be compelled to accept the generosity of another”

**Art. 1239. In obligations 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”**

Meaning of “free disposal of thing due” and “capacity to alienate”

1. **Free disposal of thing due** – thing to be delivered must not be subject to any claim or lien or encumbrance of a third person
2. **Capacity to alienate** – person is not incapacitated to enter into contracts

Free disposal of thing due and capacity to alienate required

GR: In obligations to give, payment by one who does not have the free disposition of the thing due and capacity to alienate it is not valid. Thing paid can be recovered.

XPN: Provided in Art. 1427. The creditor cannot be compelled to accept payment where the person paying has no capacity to make it.

**Art. 1240. Payment shall be made to the person in whose favor the obligation has been constituted, or his successor in interest, or any person authorized to receive it.**

### Person to whom payment shall be made

1. Creditor
2. Successor in interest
3. Any person authorized

Creditor referred to is the creditor at the time payment is to be made, not the constitution of the obligation.

### Meaning of "any person authorized to receive it"

Not only the person authorized by the creditor, but also person authorized by law.

Payment in good faith to any person in possession of the credit is valid although such person may not be authorized to receive the payment.

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

### Effect of payment to an incapacitated person

Payment to a person incapacitated to manage his property is not valid unless such incapacitated person kept the thing paid or delivered or was benefited by the payment. Proof of benefit is incumbent upon the debtor who paid.

### Effect of payment to a third person

Payment to a third person or wrong party is not valid except insofar as it has redounded to the benefit of the creditor. In the absence of proof, the payment in error and in good faith will not deprive the creditor of his right to demand payment.

### When benefit to creditor need not be proved by debtor

Debtor is relieved from proving benefit to the creditor in case of:

1. Subrogation of the payer in the creditor's rights
2. Ratification by the creditor
3. Estoppel on the part of the creditor

**Art. 1242. Payment made in good faith to any person in possession of the credit shall release the debtor**

### Payment to third person in possession of credit

"possession" referred to is possession of the credit itself and not merely of the document or instrument evidencing the credit. Payer must act in good faith, in honest belief that he is making a valid payment. Good faith is presumed.

**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**

### When payment to creditor not valid

In an action against the debtor who is the creditor of another, the latter (debtor-stranger), during the pendency of the case, may be ordered by the court to retain the debt until the right of the plaintiff, the creditor in the main litigation is resolved.

**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.**

### Very prestation due must be complied with

1. First paragraph refers to a real obligation to deliver a specific thing.
2. Second paragraph refers to personal obligations.

### When prestation may be substituted

Substitution can be made if the obligee consents. Article 1244 will not apply in case of waiver by the creditor or substitution is allowed by stipulation with the consent of the creditor

**Art. 1245. Dation in payment whereby property is alienated to the creditor in satisfaction of a debt in money, shall be governed by the law of sales.**

Special forms of payment

1. Dation in payment
2. Application of payments
3. Payment by cession
4. Tender of payment and consignment

Meaning of dation in payment (adjudication or dacion en pago)

Conveyance of ownership of a thing as an accepted equivalent of performance. It is not the ordinary way of extinguishing an obligation.

Governing law

The law of sales governs because dation in payment may be considered a specie of sale

**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.**

Rule of the medium quality

If the obligation consists in delivery of a specific thing, the very thing due must be delivered. If the obligation is to deliver a generic thing, the purpose of the obligation and other circumstances shall be taken into consideration to determine the quality or kind of thing to be delivered.

If there is disagreement between the parties, the law steps in and determines whether the contract has been complied with or not according to circumstances.

**Art. 1247. Unless it is otherwise 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.**

Debtor pays for extrajudicial expenses

Extrajudicial expenses of payment are for the account of the debtor. The reason is that the obligation is extinguished when payment is made and it is, therefore, the debtor who is primarily benefited. If the parties

have made stipulation as to who will bear the expenses, then their stipulation shall be followed.

Losing party generally pays judicial costs

Judicial costs are the statutory amounts allowed to a party to an action for his expenses incurred in the action. The costs of an action shall, as a rule be paid by the losing party.

**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.**

Performance of obligation should be complete

Contemplates obligations where there is only one creditor and only one debtor

When partial performance is allowed

1. When there is an express stipulation to that effect
2. When the debt is in part liquidated and in part unliquidated
3. When the different prestations in which the obligation consists are subject to different terms or conditions which affect some of them

**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 that they have been impaired.**

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

Meaning of legal tender

Currency which is offered by the debtor in the right amount, the creditor must accept in payment of a debt in money.

### Legal tender in the Philippines

Debts in money shall be paid in the currency stipulated. If it is not possible or in the absence of stipulation, payment shall be made in the currency which is legal tender in the Philippines. All coins and notes issued by BSP are legal tender.

### Payment by means of instruments of credits

1. **Right of creditor to refuse or accept** – promissory notes, checks, bills of exchange and other commercial documents are not legal tender; creditor cannot be compelled to accept them.
2. **Effect on obligation** – payment by means of mercantile documents does not extinguish the obligation:
  - a. Until they have been cashed
  - b. Unless they have been impaired through the fault of the creditor

**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 is an agreement to the contrary.

### Meaning of inflation and deflation

1. **Inflation** – sharp sudden increase of money or credit or both
2. **Deflation** – reduction in volume and circulation of the available money or credit

### Basis of payment in case of extraordinary inflation or deflation

the purchasing value of the currency at the time of establishment of the obligation shall be the basis of payment. This is subject to the agreement of the parties to the contrary.

**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 wherever 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 Rule of Court.**

### Place where obligation shall be paid

1. If there is stipulation, in the place designated
2. If there is a stipulation and the thing is specific, at the place where the thing was at the perfection of the contract
3. If there is no stipulation and the thing is generic, domicile of the debtor.

the order above is successive and exclusive. **Venue** is the place where a court suit or action must be filed or instituted. **Domicile** is the place of a person's habitual residence. **Residence** is only an element of domicile that simply requires bodily presence.

### SUBSECTION 1. – Application of Payments

**Art. 1252.** He who has various debts of the same kind in favor 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 payment is made, the former cannot complain of the same, unless there is a cause for invalidating the contract.**

### Meaning of application of payments

Designation of the debt to which should be applied the payment made by a debtor who has various debts of the same kind in favor of one and the same creditor.

### Requisites of application payments

1. One debtor and one creditor
2. Two or more debts
3. Debts must be of the same kind
4. Debts to which payment made by the debtor has been applied must be due
5. Payment made must not be sufficient to cover all the debts

### Application as to debts not yet due

Cannot be made unless:

1. There is stipulation that debtor may so apply; or
2. Made by the debtor or creditor

### Rules on application of payments

1. Debtor has the first choice; he must indicate at the time of making payment
2. Right to make the application once exercised is irrevocable unless creditor consents to the change
3. If the debtor does not apply payment, creditor may make designation
4. If the creditor has not also made the application, debt which is most onerous to the debtor among those due shall be satisfied
5. If the debts due are of the same nature and burden, payment shall be applied to all of them proportionately

**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.**

### Interest earned paid ahead of principal

1. **Rule in Art. 1253 mandatory** – debtor cannot choose to credit his payment to the principal before the interest is paid.
2. **Rule subject to agreement or waiver** – rule is subject to any agreement between the parties, or to waiver by the creditor

**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 more 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.**

### Application of payment to most onerous debt

In case no application of payment, payment shall be applied to the most onerous debt, and if debts are of the same nature, to all of them proportionately.

### When a debt more onerous than another

When it is more burdensome. The SC has given some rules which can be followed to determine whether one debt is more burdensome

1. Interest-bearing debt > non-interest bearing debt
2. Debt as a sole debtor > solidary debtor
3. Debts secured by a mortgage > unsecured debts
4. Of two interest bearing debt, one with higher rate
5. Obligation with penalty clause > without

### Where debts subject to different burdens

To all of them proportionately

### SUBSECTION 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.**

### Meaning of payment by cession

Special form of payment. It is the assignment of all the properties of the debtor for the benefit of his creditors in order that the latter may sell the same and apply the proceeds thereof to the satisfaction of their credits.

### Requisites of payment by cession

1. Two or more creditors
2. Debtor must be partially insolvent
3. Assignment must involve all the properties of the debtor
4. Cession must be accepted by creditors

### Effect of payment by cession

Assignment does not make the creditors the owners of the property. Debtor is released from his obligation only up to the net proceeds of the sale of the property assigned.

## Dation in payment and cession distinguished

<b>Dation</b>	<b>Cession</b>
One creditor	Several creditors
Does not presuppose insolvency of debtor	Debtor is insolvent at the time of assignment
Does not involve all property of debtor	Extends to all property of debtor
Creditor becomes the owner of the thing given	Creditor only acquire right to sell the thing
Act of novation	Not an act of novation
Both substitute forms of payment or performance	

### **SUBSECTION 3. – Tender of Payment and Consignation**

**Art. 1256. If the creditor to whom tender of payment has been refused without just cause to accept it, the debtor shall be released from responsibility by the consignation of the thing or some 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**

### **Meaning of “tender of payment” and “consignation”**

- 1. Tender of payment** – act on the part of debtor, of offering to the creditor the thing amount due.
- 2. Consignation** – act of depositing the thing or amount due with the proper court

### **Requisites of a valid consignation**

1. Existence of a valid debt which is due
2. Valid prior payment by debtor and refusal without justifiable reason by creditor
3. Previous notice of consignation to persons interested in the fulfillment
4. Consignation of the thing or sum due
5. Subsequent notice of consignation made to the interested parties

### **When tender of payment not required**

Tender of payment is not necessary before the debtor can consign the thing due with the court. A creditor who informs his debtor that payment will not be accepted waives payment on the date the payment is due. Debtor is excused from making a formal tender of the money on such date.

### **Requirements for valid tender of payment**

1. Must comply with the rules on payment or with the terms. The tender does not produce legal payment, unless it is completed by consignation
2. Must be unconditional and for the whole amount due and in legal tender
3. Must be actually made

**Art. 1257. In order that the consignation of the thing due may release the obligor, it must first be announced to the persons 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.**

### **Prior notice to person interested required**

In the absence of prior notice, consignation shall be void. The purpose is to give the creditor a chance to reflect on his previous refusal to accept payment

### **Consignation must comply with provisions on payment**

Payment should be made in legal tender. The GR is that an offer of a bank check for the amount due is not a good tender except where no objection is made on that ground.

**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 also be notified thereof.**

### **Consignation must be with proper judicial authority**

Consignation by depositing the thing or sum due with the proper judicial authority, is necessary to affect payment. Tender of payment must precede

consignation. When tender is not required, only prior notice to interested persons of the consignation needs to be proved.

#### Notice to be given to interested parties of the consignation made

After the consignation, interested parties must also be notified thereof. The purpose of second notice is to enable the creditor to withdraw the thing or sum deposited in case he accepts the consignation.

**Art. 1259. The expenses of consignation, when properly made, shall be charged against the creditor**

#### Creditor bears expenses of consignation

Consignation is made necessary because of the fault or unjust refusal of the creditor to accept payment. The expenses are chargeable to the debtor if the consignation is not properly made.

#### When consignation deemed properly made

1. When creditor accepts the thing or sum deposited without objection
2. When the creditor questions the validity of the consignation and the court declares that it has been properly made
3. When the creditor neither accepts nor questions the validity of the consignation and the court orders the cancellation of the obligation

**Art. 1260. Once the consignation has been duly made, the debtor may ask the judge to 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.**

#### Withdrawal by debtor of thing or sum deposited

Debtor can move for cancellation of the obligation by the court. Debtor may withdraw as a matter of right the thing or sum deposited

1. Before the creditor has accepted the consignation
2. Before a judicial declaration that the consignation has been properly made, he is still the owner of the same. The obligation shall

continue to remain in force. All expenses are paid by debtor.

**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.**

#### Effect of withdrawal with authority of creditor

Since consignation is for the benefit of the creditor, he may authorize the debtor to withdraw the deposit after he has accepted the same or after the court has issued an order cancelling the obligation.

1. As far as the debtor and the creditor are concerned, their relations will remain as they were before acceptance or cancellation. However, the creditor shall lose every preference which he may have over the thing.
2. The solidary debtors are released only from their solidary liability but not from their shares of the obligations.