STATE INVESTMENT HOUSE, INC. PETITIONER, VS. COURT OF APPEALS AND ALLIED BANKING CORPORATION, RESPONDENTS.

G.R. No. 106795. November 16, 1999

Ponente: GONZAGA-REYES, J.

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GONZAGA-REYES, J.:

Petitioner State Investment House, Inc. ("SIHI") appeals from the Decision dated June 11, 1992 and the Resolution dated August 21, 1992 rendered by the Court of Appeals in CA-G.R. SP No. 27142 entitled "Allied Banking Corp. vs. Hon. Martin S. Villarama, Jr., et al."

SIHI is the plaintiff in Civil Case No. 59449 entitled "State Investment House, Inc. vs. Cheng Ban Yek Co., Inc. et al.", an action for foreclosure of mortgage.

The antecedents are recited in the questioned decision as follows:

> "(1) Defendant CBY is a domestic corporation engaged in the business of manufacturing edible oil bearing the brand "Baguio Oil", and in the conduct of its business, it has incurred millions of pesos of obligations with plaintiff SIHI and many other creditors, including defendant Allied Banking Corporation (ALLIED for short) who is the creditor of SIHI in the principal amount of P10 million, exclusive of interests, service charges, penalties, and attorney's fees.
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> (2) On December 28, 1982, defendant CBY , plaintiff SIHI, and other creditors of CBY entered into an Agreement for the restructuring of CBY's existing obligations to its creditors, but excluding defendant ALLIED and several other creditors who did not sign said Agreement (pp. 72-72, Rollo).
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> (3) To secure the prompt and full payment of all amounts owed by CBY to its creditors who participated in said Agreement and as required thereunder, the parties thereto executed a Mortgage Indenture dated December 28, 1982 with CBY and FOUR SEAS as Mortgagors and SIHI and 15 other creditors of CBY as mortgagees involving 23 parcels of registered lands and the improvements therein (pp. 17-19, id.), which Mortagage Indenture was subsequently modified several times (pp. 19-20, id.). Moreover, as additional security to said Agreement, the parties also agreed that the Existing Comprehensive Surety Agreement previously executed by defendant Alfredo Ching would continue to subsist and that he would remain jointly and severally liable with CBY for the payment of the amounts owed by the latter to the creditors who were parties to the aforesaid Agreement (p. 20, id.).
>
> (4) On June 28, 1986, CBY defaulted in the payment of its obligations, and in a letter dated August 8, 1988, the CBY Creditors' Committee, pursuant to the aforesaid Agreement and Mortgage Indenture, declared all of CBY's obligations due and payable (p. 24, id.). This letter was followed by a letter dated August 9, 1989 of plaintiff SIHI likewise declaring all of CBY's particular obligations to it immediately due and payable (id.). Then on April 16, 1990, SIHI notified the Creditors' Committee of CBY that it would institute proceedings for the enforcement of the remedies granted under the Mortgage Indenture earlier mentioned, and in a resolution dated April 20, 1990, said Creditors' Committee authorized SIHI to institute the appropriate foreclosure proceedings provided that the proceeds of the foreclosure sale would be distributed and applied to all of CBY's

obligations under the terms of the Agreement previously mentioned (p. 25, id.).

(5) Hence, plaintiff SIHI filed on May 10, 1990, C.C. No. 59559 with the respondent court against CBY, FOUR SEAS, and Alfredo Ching, and impleading twenty-two (22) other creditors of CBY including herein petitioner ALLIED, allegedly because they hold inferior or subordinate mortgage rights to the properties sought to be foreclosed (pp. 8-28, id.).

(6) On January 31, 1991, defendant ALLIED filed its Answer to the complaint, denying that its interests in the mortgaged properties in question are subordinate in right to that of plaintiff SIHI; alleging that it was not a party to the Agreement attached to the complaint as Annex "B" and, therefore, not bound by its provisions; likewise denying that it was a party to the Fourth Amendatory Agreement also attached to the complaint as its Annex "S" which it claimed "was never valid, binding and effective for lack of consent on the part of the other creditors as shown by the fact that they did not sign the same"; claiming that defendant CBY owes it the principal amount P10 million, exclusive of interest, service charges, penalties, and attorney's fees; alleging that as defendant CBY's biggest, single, creditor, plaintiff SIHI "was able to work its way and secure for its representatives/nominees/designees key positions in defendant CBY, including but not limited to seats with full voting rights in defendant CBY's Board of Directors, Executive Committee, and Creditors' Committee, and that in taking control and management of CBY's operations, it "committed irregularities, abuses, excesses, and other acts inimical to defendant CBY draining its resources and driving the latter to the financial quagmire it now faces, to the prejudice of herein defendant creditors", as a consequence of which acts, CBY allegedly suffered losses of not less than P50 million or such amount as may be proved at the trial, which losses it claims represent assets of CBY answerable to its creditors other than plaintiff SIHI; and that plaintiff should be held liable for such losses, as well as for defendant ALLIED's moral damages and attorney's fees which it alleged in its counterclaim (pp. 29-33, id.). Defendant ALLIED thus prayed for the dismissal of the complaint or, in the alternative, for plaintiff to be ordered to pay CBY's creditors including ALLIED the amount of P50 million to be deducted from the proceeds of the foreclosure sale of the mortgaged properties in question to be distributed among CBY's creditors, and that plaintiff be also ordered to pay ALLIED moral damages and attorney's fees (29-34, id.).

(7) However, on January 31, 1991, plaintiff SIHI, for the consideration of P33 million, entered into a Deed of Assignment with FIL-NIPPON transferring to the latter all its rights, interests, claims, and causes of action arising out of the Agreement mentioned in and annexed to its complaint in C. C. No. 59449 and certain promissory notes and mortgages contracts upon which said civil case was brought, and in which Deed of Assignment FIL-NIPPON also agreed to assume all the obligations of SIHI as party-plaintiff in said civil case (pp. 40-44, 64, id.).

(8) Thereafter, FIL-NIPPON filed in C. C. No. 59449 on April 16, 1991 a "Motion for Substitution of Party Plaintiff" in lieu of plaintiff SIHI (pp. 35-39, id.), which motion was opposed by defendant ALLIED on the grounds that it has a counterclaim against SIHI arising from irregularities, excesses, abuses and inimical acts committed by it in managing defendant CBY; that as long as said counterclaim has not been finally resolved, the substitution of plaintiff SIHI would be improper; and that if at all, FIL-NIPPON can intervene and be a co-plaintiff in C. C. No. 59449 (pp.45-46, id.).

(9) On July 4,1991, the respondent court, finding no legal basis for the objections of ALLIED and another defendant, Producers Bank of the Philippines, to the motion for substitution of movant Fil-NIPPON for plaintiff SIHI, granted the motion for substitution (p. 8, id.) and when defendant ALLIED moved for a reconsideration of said order, it denied the motion for reconsideration on August 22, 1991 (p. 9, id.)."[1]

Allied Banking Corp. ("Allied") filed a petition for certiorari in the Court of Appeals assailing the above mentioned orders of the Regional Trial Court granting Fil-Nippon's motion for substitution of SIHI as plaintiff in Civil Case No. 59449.

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The Court of Appeals granted the petition and ordered SIHI to continue as plaintiff. The dispositive portion of the decision, now assailed in the instant petition, reads:

> "WHEREFORE, the instant petition is GRANTED; the respondent court's orders of July 4, 1991 and August 22, 1991 are hereby SET ASIDE; and herein private respondent State Investment House, Inc. (SIHI) shall continue to be the plaintiff in C. C. No. 59449 before the respondent court, with the other private respondent herein Fil-Nippon Holdings, Inc. (FIL-NIPPON) ordered impleaded therein as co-plaintiff."[2]

In this petition for review on certiorari, SIHI submits the following grounds:

> (1)
> THE CA ERRED IN FINDING THAT ALLIED'S PERMISSIVE COUNTERCLAIMS CREATE A DEBTOR-CREDITOR RELATIONSHIP BETWEEN SIHI AND ALLIED; ALLIED IS NOT SIHI'S CREDITOR.
>
> (2)
>
> THE CA ERRED IN FINDING THAT A WITNESS WHO MAY BE CALLED TO TESTIFY HAS A MATERIAL INTEREST IN CASE AS TO MAKE HIM A PARTY-LITIGANT.
>
> (3)
>
> THE CA ERRED IN NOT FINDING THAT SUBSTITUTION OF A PARTY-PLAINTIFF PENDENTE LITE IS ALLOWED AND IS LARGELY A MATTER OF DISCRETION; THE LOWER COURT DID NOT COMMIT ARBITRARINESS OR GRAVE ABUSE OF DISCRETION IN ALLOWING THE SUBSTITUTION.[3]

We find no merit in the petition.

The issue is whether respondent court erred in ruling that the substitution of SIHI by its assignee Fil-Nippon in C. C. No. 59449 is improper.

Respondent court ruled that even without substitution Fil-Nippon, as assignee of all of SIHI's rights, interests claims and causes of action arising out of the Agreement, would be bound by any judgment for or against SIHI. Moreover, Allied had a counterclaim for damages against SIHI of not less than P50 million allegedly caused by SIHI's taking over the control and management of defendant CBY (Cheng Ban Yek Co. Inc.) through its men which it had put in key positions in the latter's Board of Directors, Executive Committee and Creditors Committee, and who allegedly committed gross mismanagement, nepotism, irregularities, abuses, excesses and other acts inimical to CBY which drained the latter's resources and drove it to the financial quagmire that now faces it to the prejudice of all its creditors. Such acts of SIHI do not arise out of the foreclosure of mortgage which is the subject of C. C. No. 59449 but constitute a permissive counterclaim. Moreover, SIHI had no choice but to actively participate in C. C. No. 59449 in order to defend its assignee Fil-Nippon against Allied's permissive counterclaim. Finally, Fil-Nippon cannot be substituted as debtor under said counterclaim without its consent in view of Article 1293 of the Civil Code which provides that novation which consists in substituting a new debtor in the place of the original one cannot be made without the consent of the creditor.

It is petitioner's position, in defending the substitution of parties ordered by the trial court, that Allied is not SIHI's creditor; what Allied admitted is that it is a creditor of CBY for P10 million. Equally important is that Allied's permissive counterclaim for damages does not make SIHI a debtor/obligor of Allied, as a counterclaim is not a source of obligation until a judgment is issued upholding it. Petitioner also submits that even assuming that SIHI, or its officers or employees, can be compelled to be witnesses regarding Allied's permissive counterclaim, the same does not justify the retention of SIHI as party plaintiff below. In fine, petitioner SIHI contends that the trial

court did not commit grave abuse of discretion in allowing the substitution of parties that should be corrected by certiorari.

On the other hand, respondent Allied submits that the substitution was improper; for as long as the counterclaim is not finally resolved, the substitution of party plaintiff despite the objection of private respondent and which may result in the discharge of the petitioner as original plaintiff, would be improper. If at all, Fil-Nippon can intervene in the case below and be co-plaintiff with SIHI. Allied also points out that the counterclaim for damages is based on quasi-delict, which is a legal source of obligation.

The rule on substitution of parties in case of transfer of interest is found in Section 19, Rule 3, which states:

> "Sec. 19. Transfer of Interest - In case of any transfer of interest, the action may be continued by or against the original party, unless the court upon motion directs the person to whom the interest is transferred to be substituted in the action or joined with the original party."

It has been held that a transferee pendente lite does not have to be included or impleaded by name in order to be bound by the judgment because the action or suit may be continued for or against the original party or the transferor and still be binding on the transferee.[4]

More specifically , this Court has ruled that a transferee pendente lite is a proper party in the case but it is not an indispensable party.[5]

Respondent court did not err in ruling that SIHI should continue to be the plaintiff, and Fil-Nippon should be impleaded as co-plaintiff. The order of the trial court authorizing the substitution of parties failed to take into account the fact that there is a counterclaim for damages contained in Allied Bank's Answer arising from the alleged inimical acts committed by SIHI in manipulating the operations of CBY that drained the latter's resources to the prejudice of its creditors. The counterclaim for damages is severable and independent of SIHI's cause of action under the Agreement dated December 28, 1982 entered into by SIHI, CBY and other creditors of CBY for the restructuring of CBY's existing obligations. As aptly ruled by the Court of Appeals, the alleged acts of SIHI that gave rise to the complaint (counterclaim) for damages do not arise out of the foreclosure of mortgage which is the subject of C. C. No. 59449. Thus-

> "Upon the other hand, if the substitution of party-plaintiff sought by FIL-NIPPON is granted, what would happen to petitioner ALLIED's claim for damages of not less than P50 million in its answer allegedly caused by plaintiff SIHI's taking over the control and management of defendant CBY's through its men which it had put in key positions in the latter's Board of Directors, Executive Committee, and Creditors' Committee, and who allegedly committed gross mismanagement, nepotism, irregularities, abuses, excesses and other acts inimical to defendant CBY which drained its resources and drove it to the financial quagmire that its faces at present, to the prejudice of all its creditors? Can petitioner ALLIED still prove and recover these damages against FIL-NIPPON if the latter is substituted as party-plaintiff in C. C. No. 59449? We do not think so, for the subject-matter of the Deed of Assignment between plaintiff SIHI and FIL-NIPPON (see pp. 40-44, 64, Rollo) are certain credits, rights, claims and interests which SIHI has against the principal defendants CBY, FOUR SEAS, and Alfredo Ching in C. C. No. 59449, and its SIHI's right to foreclose certain mortgages in favor of SIHI and other creditors of CBY arising out of the agreement between CBY and its creditors, including SIHI, attached to the complaint in C. C. No. 59449. True that SIHI's assignee FIL-NIPPON also assumed all the risks attendant to said civil case and agreed not to have any recourse or claim against SIHI regardless of the outcome of said case or if it is prevented for any reason from foreclosing the properties subject-matter of the case, but such assumption of risk clearly does not include liability for the purely personal acts of abuses, irregularities, nepotism, etc. which petitioner ALLIED charged plaintiff SIHI to have committed while managing and taking over the control of the business of defendant CBY which acts do not arise out of the foreclosure of mortgage which is the subject-matter of C. C. No. 59449, but which constitute,

> as even private respondent FIL-NIPPON admitted in its Comment to the instant petition, a permissive counterclaim in said civil case (p. 61, Rollo). Respondent FIL-NIPPON, impliedly recognizing that it cannot be liable for said alleged acts of SIHI, even suggests that after plaintiff SIHI is dropped from C. C. No. 59449, petitioner ALLIED can bring original plaintiff SIHI back into said case by filing a third-party complaint against the latter. But why should petitioner ALLIED resort to such a run-about process to hold SIHI liable for the aforementioned alleged personal acts of mismanagement and abuses while in the control of defendant CBY, when it has already claimed the damages supposedly arising from said acts in a permissive counterclaim in its answer to SIHI's complaint and the Rules allow it to do so?"[6]

Thus, although Fil-Nippon became an assignee of all of SIHI's rights, interests, claims, and causes of action arising out of the Agreement, the counterclaim for actual and moral damages and attorney's fees filed by Allied Bank was in no way contemplated in the assignment. It was accordingly error to discharge SIHI as original plaintiff from the case.

The Court of Appeals also correctly pointed out that Fil-Nippon could not be substituted as debtor of Allied with respect to the counterclaim for damages without the latter's consent; thus:

> "But there is yet still another reason why the respondent court should not have allowed the substitution of plaintiff SIHI's assignee Fil-Nippon as party-plaintiff in C. C. No. 59449, and it is petitioner ALLIED's contention, which we find valid and tenable, that plaintiff SIHI is its debtor/obligor as far as its permissive counterclaim for damages in its answer is concerned, and that FIL-NIPPON cannot be substituted as its debtor under said counterclaim without its consent, in view of Art. 1293 of the Civil Code of the Philippines providing that-
> "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. xxx" (Emphasis ours)

Private respondent SIHI answers this argument in its Comment to the instant petition by saying that the above-quoted article finds no application to this case because Sec. 17.7 of the Agreement which it and its creditors had executed expressly allows the assignment which it had made in favor of FIL-NIPPON (p. 67, Rollo). But as pointed out by petitioner ALLIED in its Reply to SIHI's aforesaid Comment, it was not a party to the Agreement in question as shown by the fact that it never signed the same (see p. 82, Rollo); hence, it is not bound by said Agreement including the provision therein allowing the parties to assign their respective rights thereunder.[7]

As stated earlier, Fil-Nippon, as transferee of SIHI's interests pendente lite, is not even an indispensable party in the case.

It bears emphasis that Allied claims to be not a party to the Agreement dated December 28, 1982 and therefore not bound by it. Even assuming that Fil-Nippon agreed to assume all the obligations of SIHI in the case and not only those arising under the said Agreement, the assignment cannot bind or prejudice Allied who did not consent to the assignment. It was improvident for the trial court to discharge SIHI on the basis alone of the transfer of its interests under the Agreement to Fil-Nippon. The counterclaim for actual, moral and other damages should be pursued and enforced against the real party-in-interest, which is SIHI, which cannot be discharged from the case over the opposition of Allied.

WHEREFORE, there being no reversible error in the decision and resolution appealed from, the instant petition is denied.

No pronouncement as to costs.

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SO ORDERED.

Melo, (Chairman), Vitug, Panganiban, and Purisima, JJ., concur.

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[1] Rollo, p. 20-23.

[2] Rollo, p. 29.

[3] Rollo p. 7.

[4] Asociacion de Agricultores de Talisay-Silay, Inc. vs. Talisay-Silay Milling Co., Inc., 88 SCRA 462.

[5] Heirs of Francisco Guballa, Sr. vs. Court of Appeals, 168 SCRA 518; Jose vs. Blue, 42 SCRA 351; Tanchoco vs. Aquino, 154 SCRA 1.

[6] Rollo, pp. 26-27.

[7] Rollo, p. 28.

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