PNB MADECOR, PETITIONER, VS. GERARDO C. UY, RESPONDENT.

G.R. No. 129598. August 15, 2001

Ponente: QUISUMBING, J.

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QUISUMBING, J.:

This is a petition for review on certiorari filed by petitioner PNB Management and Development Corporation (PNB MADECOR) seeking to annul the decision of the Court of Appeals dated February 19, 1997, and its resolution dated June 19, 1997 in CA-G.R. CV No. 49693, affirming the order of the Regional Trial Court of Manila, Branch 38, dated August 21, 1995 in Civil Case No. 95-72685. In said order, the RTC directed the garnishment of the credits and receivables of Pantranco North Express, Inc. (PNEI), also known as Philippine National Express, Inc., in the possession of PNB MADECOR, and if these were insufficient to cover the debt of PNB MADECOR to PNEI, to levy upon the assets of PNB MADECOR.

The facts of this case, culled from the decision of the CA,[1] are as follows:

Guillermo Uy, doing business under the name G.U. Enterprises, assigned to respondent Gerardo Uy his receivables due from Pantranco North Express Inc. (PNEI) amounting to P4,660,558.00. The deed of assignment included sales invoices containing stipulations regarding payment of interest and attorney's fees.

On January 23, 1995, Gerardo Uy filed with the RTC a collection suit with an application for the issuance of a writ of preliminary attachment against PNEI. He sought to collect from PNEI the amount of P8,397,440.00. He alleged that PNEI was guilty of fraud in contracting the obligation sued upon, hence his prayer for a writ of preliminary attachment.

A writ of preliminary attachment was issued on January 26, 1995, commanding the sheriff "to attach the properties of the defendant, real or personal, and/or (of) any person representing the defendant"[2] in such amount as to cover Gerardo Uy's demand.

On January 27, 1995, the sheriff issued a notice of garnishment addressed to the Philippine National Bank (PNB) attaching the "goods, effects, credits, monies and all other personal properties"[3] of PNEI in the possession of the bank, and requesting a reply within five days. PNB MADECOR received a similar notice.

On March 1995, the RTC, through the application of Gerardo Uy, issued a subpoena duces tecum for the production of certain documents in the possession of PNB and PNB MADECOR: (1) from PNB, books of account of PNEI regarding trust account nos. T-8461-I, 8461-II, and T-8565; and (2) from PNB MADECOR, contracts showing PNEI's receivables from the National Real Estate Development Corporation (NAREDECO), now PNB MADECOR, from 1981 up to the period when the documents were requested.

At the hearing in connection with the subpoena, PNB moved to be allowed to submit a position paper on its behalf and/or on behalf of PNB MADECOR. In its position paper dated April 3, 1995, PNB MADECOR alleged that it was the owner of the parcel of land located in Quezon City that was leased to PNEI for use as bus terminal. Moreover, PNB MADECOR claimed:

> "2. PNEI has not been paying its rentals from October 1990 to March 24, 1994 -- when it (PNEI) vacated the property. As of the latter date, PNB MADECOR's receivables against PNEI amounted to P8,784,227.48, representing accumulated rentals, inclusive of interest;
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> 3. On the other hand, PNB MADECOR has payables to PNEI in the amount of P7,884,000.00 as evidenced by a promissory note executed on October 31, 1982 by then NAREDECO in favor of PNEI;
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> 4. Considering that PNB MADECOR is a creditor of PNEI with respect to the P8,784,227.48 and at the same time its debtor with respect to the P7,884,000.00, PNB MADECOR and PNEI are therefore creditors and debtors of each other; and
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> 5. By force of the law on compensation, both obligations of PNB MADECOR and PNEI are already considered extinguished to the concurrent amount or up to P7,884,000.00 so that PNEI is still obligated to pay PNB MADECOR the amount of P900,227.48. xxx"[4]

On the other hand, Gerardo Uy filed an omnibus motion controverting PNB MADECOR's claim of compensation. Even if compensation were possible, according to him, PNEI would still have sufficient funds in the hands of PNB MADECOR to fully satisfy his claim. He explained that:

> "The allegation of PNB MADECOR that it owes PNEI only x x x (P7,884,000.00) is not accurate. Apparently, PNB MADECOR only considered the principal amount. In the first place, to be precise, the principal debt amounts to exactly x x x (P7,884,921.10) as clearly indicated in the Promissory Note dated 31 October 1982 x x x. In accordance with the stipulations contained in the promissory note, notice of demand was sent by PNEI to PNB MADECOR (then NAREDECO) through a letter dated 28 September 1984 and received by the latter on 1 October 1984 x x x. The second paragraph of the subject promissory note states that '[F]ailure to pay the above amount by NAREDECO after due notice has been made by PNEI would entitle PNEI to collect an 18% [interest] per annum from date of notice of demand'. Hence, interest should be computed and start to run from November 1984 until the present in order to come up with the outstanding debt of PNB MADECOR to PNEI. And to be more precise, the outstanding debt of PNB MADECOR to PNEI as of April 1995 amounts to x x x (P75,813,508.26). Hence, even if the alleged debt of PNEI to PNB MADECOR amounting to x x x (P8,784,227.48) shall be compensated and deducted from PNB MADECOR's debt to PNEI, there shall still be a remainder of x x x (P67,029,380.78), largely sufficient enough to cover complainant's claim."[5]

Also in his omnibus motion, he prayed for an order directing that levy be made upon all goods, credits, deposits, and other personal properties of PNEI under the control of PNB MADECOR, to the extent of his demand.

PNB MADECOR opposed his omnibus motion, particularly the claim that its obligation to PNEI earned an interest of 18 percent annually. It argued that PNEI's letter dated September 28, 1984 was not a demand letter but merely a request for the implementation of the arrangement for set-off of receivables between PNEI and PNB, as provided in a dacion en pago executed on July 28, 1983.[6] Gerardo Uy again controverted PNB MADECOR's arguments.

Meanwhile, in the main case, the RTC rendered judgment on July 26, 1995 against PNEI. The corresponding writ of execution was issued on August 18, 1995.

As regards the issue between PNEI and PNB MADECOR, the RTC issued the assailed order on August 21, 1995, the decretal portion of which provided:

> "WHEREFORE, the Sheriff of this Court is hereby directed to garnish/levy or cause to be garnished/levied the amount stated in the writ of attachment issued by this Court from the credits and receivables/collectibles of PNEI from PNB MADECOR (NAREDECO) and to levy and/or cause to levy upon the assets of the debtor PNB MADECOR should its personal assets be insufficient to cover its debt with PNEI.

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> Furthermore, Mr. Roger L. Venarosa, Vice-President, Trust Department, Philippine National Bank, and other concerned officials of said bank, is/are hereby directed to submit the books of accounts of Pantranco North Express, Inc./Philippine National Express, Inc. under Trust Account Nos. T-8461-I, T-8461-II, T-8565 with its position paper within five (5) days from notice hereof.
>
> SO ORDERED."

Petitioner appealed said order to the CA which, however, affirmed the RTC in a decision dated February 19, 1997. Petitioner's motion for reconsideration was denied in a resolution dated June 19, 1997.

According to the CA, there could not be any compensation between PNEI's receivables from PNB MADECOR and the latter's obligation to the former because PNB MADECOR's supposed debt to PNEI is the subject of attachment proceedings initiated by a third party, herein respondent Gerardo Uy. This is a controversy that would prevent legal compensation from taking place, per the requirements set forth in Article 1279 of the Civil Code. Moreover, the CA stressed that it was not clear whether, at the time compensation was supposed to have taken place, the rentals being claimed by petitioner were indeed still unpaid. The CA pointed out that petitioner did not present evidence in this regard, apart from a statement of account.

The CA also questioned petitioner's inaction in claiming the unpaid rentals from PNEI, when the latter started defaulting in its payment as early as 1994. This, according to the CA, indicates that the debt was either already settled or not yet demandable and liquidated.

The CA rejected petitioner's contention that Rule 39, Section 43 of the Revised Rules of Court applies to the present case. Said rule sets forth the procedure to follow when a person alleged to have property or to be indebted to a judgment obligor claims an interest in the property or denies the debt. In such a situation, under said Rule the judgment obligee is required to institute a separate action against such person. The CA held that there was no need for a separate action here since petitioner had already become a forced intervenor in the case by virtue of the notice of garnishment served upon it.

Hence, this petition. Petitioner now assigns the following alleged errors for our consideration:

> I
>
> THE [COURT OF APPEALS] COMMITTED A CLEAR ERROR IN THE INTERPRETATION OF THE APPLICABLE LAW HEREIN WHEN IT RULED THAT THE REQUISITES FOR LEGAL COMPENSATION AS SET FORTH UNDER ARTICLES 1278 AND 1279 OF THE CIVIL CODE DO NOT CONCUR IN THE CASE AT BAR.
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> II
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> THE [COURT OF APPEALS] COMMITTED A CLEAR ERROR IN INTERPRETING THE PROVISIONS OF SECTION 45, RULE 39 OF THE RULES OF COURT, NOW SECTION 43, RULE 39 OF THE REVISED RULES OF COURT, AS AMENDED ON 1 JULY 1997, BY RULING THAT PETITIONER PNB-MADECOR, UPON BEING CITED FOR AND SERVED WITH A NOTICE OF GARNISHMENT BECAME A FORCED INTERVENOR, HENCE, DENYING THE RIGHT OF HEREIN PETITIONER TO VENTILATE ITS POSITION IN A FULL-BLOWN TRIAL AS PROVIDED FOR UNDER SEC. 10, RULE 57, WHICH REMAINS THE SAME RULE UNDER THE REVISED RULES OF COURT AS AMENDED ON 1 JULY 1997.
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> III
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> THE [COURT OF APPEALS] COMMITTED AN ERROR IN FINDING THAT A DEMAND WAS MADE BY PANTRANCO NORTH EXPRESS, INC. TO PNB MADECOR FOR THE PAYMENT OF THE

PROMISSORY NOTE DATED 31 OCTOBER 1982.[7]

After considering these assigned errors carefully insofar as they raise issues of law, we find that the petition lacks merit. We shall now discuss the reasons for our conclusion.

Petitioner admits its indebtedness to PNEI, in the principal sum of P7,884,921.10, per a promissory note dated October 31, 1982 executed by its precursor NAREDECO in favor of PNEI. It also admits that the principal amount should earn an interest of 18 percent per annum under the promissory note, in case NAREDECO fails to pay the principal amount after notice. Petitioner adds that the receivables of PNEI were thereafter conveyed to PNB in payment of PNEI's loan obligation to the latter, in accordance with a dacion en pago agreement executed between PNEI and PNB.

Petitioner, however, maintains that there is nothing now that could be subject of attachment or execution in favor of respondent since compensation had already taken place as between its debt to PNEI and the latter's obligation to it, consistent with Articles 1278, 1279, and 1290 of the Civil Code. Petitioner assails the CA's ratiocination that compensation could not have taken place because the receivables in question were the subject of attachment proceedings commenced by a third party (respondent). This reasoning is contrary to law, according to petitioner.

Petitioner insists that even the Asset Privatization Trust (APT), which now has control over PNEI, recognized the set-off between the subject receivables as indicated in its reply to petitioner's demand for payment of PNEI's unpaid rentals.[8] The APT stated in its letter:

> "xxx
>
> While we have long considered the amount of SEVEN MILLION EIGHT HUNDRED EIGHTY FIVE THOUSAND PESOS (P7,885,000.00) which PNEI had earlier transmitted to you as its share in an aborted project as partial payment for PNEI's unpaid rentals in favor of PNB-Madecor, being a creditor like your goodself of PNEI, we are unable to be of assistance to you regarding your claim for the balance thereof. We trust that you will understand our common predicament.
>
> xxx"

Petitioner argues that PNEI's letter dated September 28, 1984 did not contain a demand for payment but only notice of the implementation of the dacion en pago agreement between PNB and PNEI.

Petitioner contends that the CA's statement that PNEI's obligation to petitioner had either been settled or was not yet demandable is highly speculative and conjectural. On the contrary, petitioner asserts that its failure to institute a judicial action against PNEI proved that the receivables of petitioner and PNEI had already been subject to legal compensation.

Petitioner submits that Rule 39, Section 43 of the Revised Rules of Court applies to the present case. It asserts that it stands to lose more than P7 million if not given the opportunity to present its side in a formal proceeding such as that provided under the cited rule. According to petitioner, it was not an original party to this case but only became involved when it was issued a subpoena duces tecum by the trial court.

For his part, respondent claims that the requisites for legal compensation are not present in this case, contrary to petitioner's assertion. He argues that the better rule should be that compensation cannot take place where one of the obligations sought to be compensated is the subject of a suit between a third party and a party interested in the compensation, as in this case.

Moreover, respondent points out that, while the alleged demand letter sent by PNEI to petitioner was dated September 28, 1984, the unpaid rentals due petitioner from PNEI accrued during the period October 1990 to

March 1994, or before petitioner's obligation to PNEI became due. This being so, respondent argues that there can be no compensation since there was as yet no compensable debt in 1984 when PNEI demanded payment from petitioner.

Even granting that there had been compensation, according to respondent, PNEI would still have sufficient funds with petitioner since the PNB MADECOR's obligation to PNEI earned interest.

Respondent echoes the observation of the CA that petitioner failed to file a suit against PNEI at the time when it should have. This failure gave rise to the presumption that PNEI's obligation might have already been settled, waived, or otherwise extinguished, according to him. He contends that petitioner's explanation that it did not sue PNEI because there had been legal compensation is only an afterthought and contrary to logic and reason.

On petitioner's claim that it had been denied due process, respondent avers that he did not have to file a separate action against petitioner since this would only result in multiplicity of suits. Furthermore, he points out that the order of attachment is an interlocutory order that may not be the subject of appeal.

Finally, respondent calls the attention of this Court to the sale by PNB of its shares in PNB MADECOR to the "Dy Group", which in turn assigned its majority interest to the "Atlanta Group". Respondent claims that the Dy Group set aside some P30 million for expenses to be incurred in litigating PNB MADECOR's pending cases, and asks that his "claim over this amount, arising from the instant case,"[9] be given preference in case the PNEI properties already garnished prove insufficient to satisfy his claim.

The first and third errors assigned by petitioner are obviously interrelated and must be resolved together.

Worth stressing, compensation is a mode of extinguishing to the concurrent amount the obligations of persons who in their own right and as principals are reciprocally debtors and creditors of each other.[10] Legal compensation takes place by operation of law when all the requisites are present,[11] as opposed to conventional compensation which takes place when the parties agree to compensate their mutual obligations even in the absence of some requisites.[12]

Legal compensation requires the concurrence of the following conditions:

(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.[13]

Petitioner insists that legal compensation had taken place such that no amount of money belonging to PNEI remains in its hands, and, consequently, there is nothing that could be garnished by respondent.

We find, however, that legal compensation could not have occurred because of the absence of one requisite in this case: that both debts must be due and demandable.

The CA observed:

> "Under the terms of the promissory note, failure on the part of NAREDECO (PNB MADECOR) to pay the

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> value of the instrument 'after due notice has been made by PNEI would entitle PNEI to collect an 18% [interest] per annum from date of notice of demand'."[14]

Petitioner makes a similar assertion in its petition, that

> "xxx It has been stipulated that the promissory note shall earn an interest of 18% per annum in case NAREDECO, after notice, fails to pay the amount stated therein."[15]

Petitioner's obligation to PNEI appears to be payable on demand, following the above observation made by the CA and the assertion made by petitioner. Petitioner is obligated to pay the amount stated in the promissory note upon receipt of a notice to pay from PNEI. If petitioner fails to pay after such notice, the obligation will earn an interest of 18 percent per annum.

Respondent alleges that PNEI had already demanded payment. The alleged demand letter reads in part:

> "We wish to inform you that as of August 31, 1984 your outstanding accounts amounted to P10,376,078.67, inclusive of interest.
>
> In accordance with our previous arrangement, we have conveyed in favor of the Philippine National Bank P7,884,921.10 of said receivables from you. With this conveyance, the unpaid balance of your account will be P2,491,157.57.[16]
>
> To forestall further accrual of interest, we request that you take up with PNB the implementation of said arrangement. xxx"[17]

We agree with petitioner that this letter was not one demanding payment, but one that merely informed petitioner of (1) the conveyance of a certain portion of its obligation to PNEI per a dacion en pago arrangement between PNEI and PNB, and (2) the unpaid balance of its obligation after deducting the amount conveyed to PNB. The import of this letter is not that PNEI was demanding payment, but that PNEI was advising petitioner to settle the matter of implementing the earlier arrangement with PNB.

Apart from the aforecited letter, no other demand letter appears on record, nor has any of the parties adverted to another demand letter.

Since petitioner's obligation to PNEI is payable on demand, and there being no demand made, it follows that the obligation is not yet due. Therefore, this obligation may not be subject to compensation for lack of a requisite under the law. Without compensation having taken place, petitioner remains obligated to PNEI to the extent stated in the promissory note. This obligation may undoubtedly be garnished in favor of respondent to satisfy PNEI's judgment debt.[18]

As to respondent's claim that legal compensation could not have taken place due to the existence of a controversy involving one of the mutual obligations, we find this matter no longer controlling. Said controversy was not seasonably communicated to petitioner as required under Article 1279 of the Civil Code.

The controversy, i.e., the action instituted by respondent against PNEI, must have been communicated to PNB MADECOR in due time to prevent compensation from taking place. By "in due time" should be meant the period before legal compensation was supposed to take place, considering that legal compensation operates so long as the requisites concur, even without any conscious intent on the part of the parties.[19] A controversy that is communicated to the parties after that time may no longer undo the compensation that had taken place by force of law, lest the law concerning legal compensation be for naught.

Petitioner had notice of the present controversy when it received the subpoena duces tecum issued by the trial court. The exact date when petitioner received the subpoena is not on record, but petitioner was allowed to submit

a position paper regarding said subpoena per order of the trial court dated March 27, 1995.[20] We assume that petitioner had notice of the pending litigation at least no later than this date. Now, was this date before that period when legal compensation would have occurred, assuming all other requisites to be present?

Clearly, it is not. PNB MADECOR's obligation to PNEI was contracted in 1982 and the alleged demand letter was sent by PNEI to petitioner on September 1984. On the other hand, PNEI's obligation to petitioner, the payment of monthly rentals, accrued during the period October 1990 to March 1994 and a demand to pay was sent in 1993. Assuming the other requisites to be present, legal compensation of the mutual obligations would have taken place on March 1994 at the latest. Obviously, this was before petitioner received notice of the pendency of this litigation in 1995. The controversy communicated to petitioner in 1995 could not have affected the legal compensation that would have taken place in 1994.

As regards respondent's averment that there was as yet no compensable debt when PNEI sent petitioner a demand letter on September 1984, since PNEI was not yet indebted to petitioner at that time, the law does not require that the parties' obligations be incurred at the same time. What the law requires only is that the obligations be due and demandable at the same time.

Coming now to the second assigned error, which we reserved as the last for our discussion, petitioner contends that it did not become a forced intervenor in the present case even after being served with a notice of garnishment. Petitioner argues that the correct procedure would have been for respondent to file a separate action against PNB MADECOR, per Section 43 of Rule 39 of the Rules of Court.[21] Petitioner insists it was denied its right to ventilate its claims in a separate, full-blown trial when the courts a quo ruled that the abovementioned rule was inapplicable to the present case.

On this score, we had occasion to rule as early as 1921 in Tayabas Land Co. v. Sharruf,[22] as follows:

> "...garnishment... consists in the citation of some stranger to the litigation, who is debtor to one of the parties to the action. By this means such debtor stranger becomes a forced intervenor; and the court, having acquired jurisdiction over his person by means of the citation, requires him to pay his debt, not to his former creditor, but to the new creditor, who is creditor in the main litigation. It is merely a case of involuntary novation by the substitution of one creditor for another. Upon principle the remedy is a species of attachment or execution for reaching any property pertaining to a judgment debtor which may be found owing to such debtor by a third person."

Again, in Perla Compania de Seguros, Inc. v. Ramolete,[23] we declared:

> "Through service of the writ of garnishment, the garnishee becomes a "virtual party" to, or a "forced intervenor" in, the case and the trial court thereby acquires jurisdiction to bind him to compliance with all orders and processes of the trial court with a view to the complete satisfaction of the judgment of the court."

Petitioner here became a forced intervenor by virtue of the notice of garnishment served upon him. It could have presented evidence on its behalf. The CA, in fact, noted that petitioner presented a statement of account purportedly showing that PNEI had not yet settled its obligation to petitioner.[24] That petitioner failed to present any more proof of its claim, as observed by the CA, is no longer the fault of the courts.

There is no need for the institution of a separate action under Rule 39, Section 43, contrary to petitioner's claim. This provision contemplates a situation where the person allegedly holding property of (or indebted to) the judgment debtor claims an adverse interest in the property (or denies the debt). In this case, petitioner expressly admits its obligation to PNEI.[25]

WHEREFORE, the petition is DENIED. The assailed decision and resolution of the Court of Appeals are

AFFIRMED. Costs against petitioner.

SO ORDERED.

Bellosillo, (Chairman), Mendoza, Buena, and De Leon, Jr., JJ., concur.

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[1] Rollo, pp. 28-42.

[2] Id. at 29.

[3] Ibid.

[4] Id. at 30-31.

[5] Id. at 31-32.

[6] CA Rollo, pp. 58-61.

[7] Rollo, pp. 11-12.

[8] Id. at 16, 124-125.

[9] Id. at 156.

[10] IV A.M. TOLENTINO, COMMENTARIES AND JURISPRUDENCE ON THE CIVIL CODE OF THE PHILIPPINES 366, 369 (1995). Stress supplied.

[11] CIVIL CODE, Article 1290.

[12] Supra, note 10 at 367.

[13] CIVIL CODE OF THE PHILIPPINES, Article 1279.

[14] Rollo, p. 37.

[15] Id. at 12.

[16] The second sentence of this paragraph was omitted in the CA decision but included in the petition. See rollo, p. 13.

[17] Rollo, p. 38.

[18] RULES OF COURT, Rule 39, Section 9 (c) provides:

> SEC. 9. Execution of judgments for money, how enforced. -- xxx
>
> (c) Garnishment of debts and credits. -- The officer may levy on debts due the judgment obligor and other credits, including bank deposits, financial interests, royalties, commissions and other personal property not capable of manual delivery in the possession or control of third parties. Levy shall be made by serving notice upon the person owing such debts or having in his possession or control such credits to which the judgment obligor is entitled. The garnishment shall cover only such amount as will satisfy the judgment and all lawful fees.
>
> xxx

[19] CIVIL CODE, Article 1290; Bank of the Philippine Islands v. Court of Appeals, 255 SCRA 571, 577 (1996).

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[20] Rollo, p. 30.

[21] SEC. 43. Proceedings when indebtedness denied or another person claims the property. -- If it appears that a person or corporation, alleged to have property of the judgment obligor or to be indebted to him, claims an interest in the property adverse to him or denies the debt, the court may authorize, by an order made to that effect, the judgment obligee to institute an action against such person or corporation for the recovery of such interest or debt, forbid a transfer or other disposition of such interest or debt within one hundred twenty (120) days from notice of the order, and may punish disobedience of such order as for contempt. Such order may be modified or vacated at any time by the court, which issued it, or by the court in which the action is brought, upon such terms as may be just.

[22] 41 Phil. 382, 387 (1921). This was reiterated in Bautista v. Barredo, 13 SCRA 744, 746 (1965).

[23] 203 SCRA 487, 492 (1991).

[24] Appended to its opposition to respondent’s omnibus motion before the trial court. Rollo, p. 36.

[25] Rollo, pp. 12, 234.

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