

AZOLLA FARMS AND FRANCISCO R. YUSECO, PETITIONERS, VS. COURT OF APPEALS AND SAVINGS BANK OF MANILA, RESPONDENTS.

G.R. No. 138085. November 11, 2004

Ponente: AUSTRIA-MARTINEZ, J.

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AUSTRIA-MARTINEZ, J.:

This is an appeal by certiorari under Rule 45 of the Rules of Court seeking the reversal of the Decision dated February 19, 1999 rendered by the Court of Appeals[1] in CA-G.R. CV No. 53076, which reversed and set aside the decision of the trial court in Civil Case No. 83-20514, and the Resolution dated March 31, 1999, denying petitioners' motion for reconsideration.

Petitioner Francis R. Yuseco, Jr., is the Chairman, President and Chief Operating Officer of petitioner Azolla Farms International Philippines (Azolla Farms), a corporation duly organized under existing laws and engaged in the development, exploitation, production, manufacturing, promotion, marketing, and sale of natural, organic minerals, including its by-products, with the ultimate objective of utilizing said products for the promotion of food production.[2]

In 1982, Azolla Farms undertook to participate in the National Azolla Production Program wherein it will purchase all the Azolla produced by the Azolla beneficiaries in the amount not exceeding the peso value of all the inputs provided to them. The project also involves the then Ministry of Agriculture, the Kilusang Kabuhayan at Kaunlaran, and the Kiwanis. To finance its participation, petitioners applied for a loan with Credit Manila, Inc., which the latter endorsed to its sister company, respondent Savings Bank of Manila (Savings Bank). The Board of Directors of Azolla Farms, meanwhile, passed a board resolution on August 31, 1982, authorizing Yuseco to borrow from Savings Bank in an amount not exceeding P2,200,000.00.[3]

The loan having been approved, Yuseco executed a promissory note on September 13, 1982, promising to pay Savings Bank the sum of P1,400,000.00 on or before September 13, 1983.[4] The net proceeds of P1,225,443.31 was released to FNCB Finance, the mortgagee of a 548- square meter lot with residential house owned by Yuseco. With the release of the proceeds, FNCB Finance released the mortgage,[5] and in turn, the property was mortgaged to Savings Bank as collateral for the loan.[6] Yuseco and Francisco Bargas also executed an assignment of their shares of stock in Azolla Farms as additional security.[7] Yuseco then executed two other promissory notes on September 27, 1982[8] and January 4, 1983,[9] both for the amount of P300,000.00.

However, the Azolla Farms project collapsed. Blaming Savings Bank, petitioners Yuseco and Azolla Farms filed on October 3, 1983 with the Regional Trial Court of Manila (Branch 25), a complaint for damages. In essence, their complaint alleges that Savings Bank unjustifiably refused to promptly release the remaining P300,000.00 which impaired the timetable of the project and inevitably affected the viability of the project resulting in its collapse, and resulted in their failure to pay off the loan. Thus, petitioners pray for P1,000,000.00 as actual damages, among others.[10]

Respondent Savings Bank filed its Answer denying the allegations in the complaint. It contends that there was evidence that Yuseco was using the loan proceeds for expenses totally unrelated to the project and they decided to withhold the remaining amount until Yuseco gave the assurance that the diversion of the funds will be stopped. Respondent bank believed that the 90-day interval between the two tranches could not have impaired the operation of the project, and petitioners' subsequent receipt of the proceeds confirmed their agreement to the terms of the loan.

Trial ensued. After respondent, as defendant, rested its case, petitioners filed a Motion to Admit Amended Complaint alleging that the testimony of defense witness Jesus Venturina raised the issue of the invalidity of the promissory notes and the real estate mortgage.[11] Petitioners sought the amendment of the complaint to conform to the issues and evidence presented. Their Amended Complaint contains the following amendments:

That defendant bank acts in unilaterally reducing the agreed amount of FOUR MILLION PESOS (P4,000,000.00) to TWO MILLION PESOS (P2,000,000.00) and in unreasonably delay (sic) the release of THREE HUNDRED THOUSAND PESOS (P300,000.00) novated the promissory notes nos. 2491, 2510 and 2669 and also novated the real estate mortgage dated 6 September 1982 executed by plaintiff Francis R. Yuseco, Jr.;[12]

and in their prayer, petitioners seek that the promissory notes and real estate mortgage be declared novated, invalid and unenforceable. Petitioners also amended the actual damages sought, increasing it to P5,000,000.00.[13]

Respondent objected to petitioners' motion,[14] but the trial court nevertheless admitted the Amended Complaint.[15]

On June 17, 1994, the trial court rendered its decision annulling the promissory notes and real estate mortgage, and awarding damages to petitioners. The dispositive portion of the decision reads:

WHEREFORE, judgment is hereby rendered:

DECLARING --

- (a) the promissory notes and real estate mortgage executed by plaintiff Yuseco novated, if not unenforceable;
(b) any subsequent foreclosure or sale of the real estate property, without any binding effect;

ORDERING --

- (1) the defendants to return full, uninterrupted and complete possession and ownership of the subject real estate property to plaintiff Francis R. Yuseco, Jr.; (2) the defendant to pay plaintiffs: (a) P1,000,000.00 as actual damages; (b) P200,000.00, as moral damages for the personal sufferings, mental anguish, serious anxiety, social humiliation of plaintiff Yuseco; (c) P50,000.00, as reasonable attorney's fees; and (d) legal interest on the actual damages herein awarded from date of filing the Complaint until fully paid.

The Counterclaim interposed by the defendant in its Answer is hereby dismissed, for lack of merit.

Costs against the defendant. [16]

Aggrieved, respondent elevated the case to the Court of Appeals.

Finding merit in respondent's appeal, the Court of Appeals reversed and set aside the trial court's decision per its Decision dated February 19, 1999, the decretal portion of which reads:

WHEREFORE, premises considered, the decision of the trial court in Civil Case No. 83-20514 is hereby REVERSED and SET ASIDE and judgment is hereby entered declaring the promissory notes and real estate

mortgage executed in favor of defendant-appellant, as well as the extrajudicial foreclosure and sale of the mortgaged property, as valid and binding. Defendant-appellant is hereby ordered to pay plaintiff Azolla Farms International Philippines, Inc. the amount of fifty thousand pesos (P50,000.00) as nominal damages. No costs.

SO ORDERED.[17]

Hence, the herein petition filed before the Court, alleging that:

THE COURT OF APPEALS COMMITTED A REVERSIBLE ERROR WHEN IT REVERSED AND SET ASIDE THE DECISION OF THE COURT A QUO.[18]

Two issues are involved in this case: first, whether the trial court erred in admitting petitioners' amended complaint; and second, whether the trial court erred in nullifying the promissory notes, the real estate mortgage, and its extrajudicial foreclosure.

In their motion to amend complaint, petitioners allege that:

- During the direct examination of defendant bank's witness Jesus Venturina, he testified and identified various documents relating to the invalid and illegal foreclosure on plaintiff Francis R. Yuseco, Jr.'s real property subject of the real estate mortgage dated September 7, 1982 and marked and adopted as Exhibit N for the plaintiffs. Moreover, he testified and identified the promissory notes, marked and adopted as Exhibits L, M and Q for the plaintiffs evidencing the incomplete and invalid consideration of the said mortgage. As a result of the testimony thus given and the documents adduced during said hearing, the issue of the foreclosure on said property has been raised which, therefore, necessitates that the pleadings in this case, the complaint, be amended to conform to the issues raised and the evidence presented;[19]

The trial court granted the motion and admitted the Amended Complaint. The Court of Appeals, however, ruled that the trial court should not have admitted the Amended Complaint because it altered petitioners' cause of action. Apparently, the Court of Appeals treated petitioners' amendment of the complaint as one involving amendments after the case is set for hearing under Section 3, Rule 10 of the Rules of Court,[20] which is not however applicable to the present case.

The amendment of the complaint was made pursuant to Section 5, Rule 10 of the Rules of Court, governing amendment of pleadings to conform to evidence, to wit:

SEC. 5. Amendment to conform to or authorize presentation of evidence .—When issues not raised by the pleadings are tried by express or implied consent of the parties, they shall be treated in all respects, as if they had been raised in the pleadings. Such amendment of the pleadings as may be necessary to cause them to conform to the evidence and to raise these issues may be made upon motion of any party at any time, even after judgment; but failure so to amend does not affect the result of the trial of these issues. If evidence is objected to at the trial on the ground that it is not within the issues made by the pleadings, the court may allow the pleadings to be amended and shall do so freely when the presentation of the merits of the action will be subserved thereby and the objecting party fails to satisfy the court that the admission of such evidence would prejudice him in maintaining his action or defense upon the merits. The court may grant a continuance to enable the objecting party to meet such evidence.

In *Mercader vs. Development Bank of the Phils. (Cebu Branch)*,[21] the Court explained that the foregoing provision envisions two scenarios -- first, when evidence is introduced on an issue not alleged in the pleadings and no objection was interjected and second, when evidence is offered on an issue not alleged in the pleadings but this time an objection was interpolated. In cases where an objection is made, the court may nevertheless admit the evidence where the adverse party fails to satisfy the court that the admission of the evidence would prejudice him in maintaining his defense upon the merits, and the court may grant him a continuance to enable him to meet the

new situation created by the evidence.

As can be gleaned from the records, it was petitioners' belief that respondent's evidence justified the amendment of their complaint. The trial court agreed thereto and admitted the amended complaint. On this score, it should be noted that courts are given the discretion to allow amendments of pleadings to conform to the evidence presented during the trial. Thus, in *Bank of America, NT and SA vs. American Realty Corporation*,^[22] the Court stated:

There have been instances where the Court has held that even without the necessary amendment, the amount proved at the trial may be validly awarded, as in *Tuazon v. Bolanos* (95 Phil. 106), where we said that if the facts shown entitled plaintiff to relief other than that asked for, no amendment to the complaint was necessary, especially where defendant had himself raised the point on which recovery was based.^[23] The appellate court could treat the pleading as amended to conform to the evidence although the pleadings were actually not amended. Amendment is also unnecessary when only clerical error or non substantial matters are involved, as we held in *Bank of the Philippine Islands vs. Laguna* (48 Phil. 5). In *Co Tiamco vs. Diaz* (75 Phil. 672), we stressed that the rule on amendment need not be applied rigidly, particularly where no surprise or prejudice is caused the objecting party. And in the recent case of *National Power Corporation vs. Court of Appeals* (113 SCRA 556), we held that where there is a variance in the defendant's pleadings and the evidence adduced by it at the trial, the Court may treat the pleading as amended to conform with the evidence.^[24]

Verily, the trial court cannot be faulted for admitting the amended complaint as it had the discretion to do so.

However, whether the evidence introduced by respondent, indeed, supported the finding that the promissory notes, the real estate mortgage and the foreclosure sale, are invalid, is a different matter altogether.

As alleged by petitioners, the testimony of respondent's witness, Jesus Venturina, established the novation of the promissory notes and the real estate mortgage, and the illegality of the foreclosure of petitioner Yuseco's property.^[25] The trial court agreed with petitioners, ruling that there was a novation of the promissory notes and real estate mortgage, which rendered them unenforceable, to wit:

The promissory notes and real estate mortgage executed by plaintiff Yuseco appears to have been novated and, therefore, rendered to be unenforceable since there was a change in the parties (from Credit Manila, Inc. to Savings Bank of Manila) and, of course, in the amount of the loan applied for (from P5 Million to P2 Million) which, upon instruction of Mr. de Guzman -- was applied as follows:

...

It would, therefore, be improper (sic) to consider and treat the promissory notes and the real estate mortgage as relating to the separate loan of plaintiff Yuseco so made and pursued for the same purpose and nature, all inuring to a specific project -- the Azolla Project!^[26]

The Court of Appeals disagreed with the trial court and held that there was no novation, hence, the promissory notes and the real estate mortgage are valid and binding.

We agree with the appellate court.

Novation is the extinguishment of an obligation by the substitution or change of the obligation by a subsequent one which extinguishes or modifies the first, either by changing the object or principal conditions, or, by substituting another in place of the debtor, or by subrogating a third person in the rights of the creditor.^[27] In order for novation to take place, the concurrence of the following requisites is indispensable:^[28]

- there must be a previous valid obligation,
- there must be an agreement of the parties concerned to a new contract,

- there must be the extinguishment of the old contract, and
- there must be the validity of the new contract.

All these requisites are patently lacking in this case. In the first place, there is no new obligation that supposedly novated the promissory notes or the real estate mortgage, or a pre-existing obligation that was novated by the promissory notes and the real estate mortgage. In fact, there is only one agreement between the parties in this case, i.e., petitioners' P2,000,000.00 loan with respondent, as evidenced by the 3 promissory notes dated September 13 and 27, 1982, and January 4, 1983, and the real estate mortgage. As the Court of Appeals held:

... There was only one single loan agreement in the amount of P2 million between the parties as evidenced by the promissory notes and real estate mortgage - how can it be possibly claimed by plaintiffs that these notes and mortgage were "novated" when no previous notes or mortgage or loan agreement had been executed? What transpired was an application for loan was filed by plaintiffs with Credit Manila in an amount greater than the P2 million eventually granted. This loan application was endorsed to defendant Savings Bank of Manila, processed by the latter and eventually approved by it in the amount of P2 million.

It cannot be said that the loan application of plaintiffs or their initial representations with Credit Manila's Michael de Guzman was already in itself a binding original contract that was later "novated" by defendant. Plaintiff Yuseco being himself a banker, cannot pretend to have been unaware of banking procedures that normally recognize a "loan application" as just that, a mere application. Only upon the bank's approval of the loan application in the amount and under such terms it deems viable and acceptable, that a binding and effective loan agreement comes into existence. Without any such first or original "loan agreement" as approved in the amount and under specified terms by the bank, there can be nothing whatsoever that can be subsequently novated.[29]

Moreover, records show that petitioners were well aware of the conditions of the loan application. In its August 31, 1982 Board Resolution, the Board of Directors of Azolla Farms authorized Yuseco to "borrow from the SAVINGS BANK OF MANILA, Head Office, sums of money in an amount not exceeding P2,200,000.00." [30] The promissory notes signed by Yuseco were respondent Savings Bank's promissory notes, and the real estate mortgage was likewise respondent Savings Bank's standard real estate mortgage form. Obviously, this case is an attempt by petitioners to extricate themselves from their obligations; but they cannot be allowed to have their cake and eat it, too.

WHEREFORE, the petition is DENIED for lack of merit. The Court of Appeals' Decision dated February 19, 1999, together with its Resolution dated March 31, 1999, in CA-G.R. CV No. 53076, is AFFIRMED.

Costs against petitioners.

SO ORDERED.

Callejo, Sr., and Chico-Nazario, JJ., concur.
Puno, J., on official leave.
Tinga, J., on leave.

[1] Penned by Justice Martin S. Villarama, Jr. with Justices Angelina Sandoval Gutierrez (now a Member of this Court) and Romeo A. Brawner, concurring.

[2] Records, p. 2.

[3] Records, p. 261, Exhibit "K" for petitioners, Exhibit "5" for respondent.

- [4] Id., p. 270, Exhibits “Q” and “11.”
- [5] Id., p. 271, Exhibits “R” and “12.”
- [6] Id., p. 265, Exhibits “N” and “8.”
- [7] Id., p. 28, Annex “B.”
- [8] Id., p. 263, Exhibits “L” and “6.”
- [9] Id., p. 264, Exhibits “M” and “7.”
- [10] Id., pp. 2-7.
- [11] Id., pp. 284-285.
- [12] Id., p. 293.
- [13] Id., p. 295.
- [14] Id., pp. 298-301.
- [15] Id., p. 308.
- [16] Id., p. 337.
- [17] CA Rollo, p. 160.
- [18] Rollo, pp. 12-13.
- [19] Records, p. 284.
- [20] Citing *Gulang vs. Nadayag*, G.R. No. 82630, September 30, 1992, 214 SCRA 355.
- [21] G.R. No. 130699, May 12, 2000, 332 SCRA 82, 97.
- [22] G.R. No. 133876, December 29, 1999, 321 SCRA 659, 680.
- [23] Emphasis ours.
- [24] Citing *Talisay-Silay Milling Co., Inc. vs. Asociacion de Agricultores de Talisay-Silay, Inc.*, G.R. No. 91852, August 15, 1995, 247 SCRA 361.
- [25] Records, pp. 284 and 293.
- [26] Id., p. 336.
- [27] Article 1293, Civil Code; *California Bus Lines, Inc. vs. State Investment House, Inc.*, G.R. No. 147950, December 11, 2003, 418 SCRA 297, 308.
- [28] *Garcia vs. Llamas*, G.R. No. 154127, December 8, 2003, 417 SCRA 292, 301.
- [29] CA Rollo, pp. 156-157.
- [30] Records, p. 261; Emphasis ours.

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