

PHILIPPINE NATIONAL BANK, PETITIONER, VS. MARCELINO BANATAO, ROSA BANATAO, VICTORINA B. CADANGAN, AVELINO BANATAO, ROSALINDA B. GUMABAY, EDNA B. CALUCAG, CATALINA BANATAO, ABDON...

G.R. No. 149221. April 07, 2009

Ponente: BRION, J.

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BRION, J.:

This petition for review on certiorari[1] brings into focus: (1) the effect of a compromise agreement entered into by some, but not all, of the parties to a litigation, and its effect on the non-participating litigants; and (2) the prohibition against the encumbrance, within the same periods prescribed by law, of lands granted under homestead patent.

The facts as culled from the records are outlined below.

On November 16, 1962, Banatao, et al. (plaintiffs-respondents) initiated an action docketed as Civil Case No. 1600 against Marciano Carag (one of the defendants-respondents) before the Regional Trial Court (RTC), Branch IV, Tuguegarao, Cagayan.[2] The action was for the recovery of real property (disputed property) situated at Malabac, Iguig, Cagayan. The disputed property was a new land formation on the banks of the Cagayan River -- an accretion to Lot 3192 of the Iguig Cadastre -- that the plaintiffs-respondents claimed as the owners of the adjoining Lot 3192. The defendants-respondents, on the other hand, were the occupants of the disputed property.

The records show that while the case was pending, the defendants-respondents (particularly the spouses Pedro Soriano and Paz Tagacay, the spouses Eugenio Soriano and Maria Cauilan, the spouses Benjamin Tagacay and Fausta Agustin, and Milagros B. Carag - wife of Marciano Carag) were able to secure homestead patents evidenced by Original Certificates of Title (OCTs) issued in their names, denominated as OCT Nos. 24800, 24801, 25217, and 25802, respectively.[3] The OCTs were issued in 1965 and 1966, and all bear the proviso that, in accordance with the Public Land Act, the patented homestead shall neither be alienated nor encumbered for five (5) years from the date of the issuance of the patent.[4]

Armed with their OCTs, the defendants-respondents separately applied for loans with the Philippine National Bank (PNB or the bank) secured by real estate mortgages on their respective titled portions of the disputed property. The bank approved the mortgages, relying solely on the OCTs which, at the time, did not contain any notice of lis pendens or annotation of liens and encumbrances. The PNB mortgages were annotated on the defendants-respondents' respective OCTs also in the years 1965 and 1966.[5]

On February 22, 1968, the trial court decided the case in favor of the plaintiffs-respondents and against defendant-respondent Carag, and ordered the return of the disputed property to the plaintiffs-respondents.[6] Carag appealed the trial court decision to the Court of Appeals (CA).

While the appeal was pending, the appellate court discovered that the disputed property had been subject of

homestead patents issued in the names of defendants-respondents Carag, et al. Hence, in its Resolution dated April 16, 1969, the Special Fourth Division of the CA set aside the February 22, 1968 decision of the RTC and ordered the remand of the records to the trial court for further proceedings.[7] The appellate court likewise ordered the necessary amendment of the complaint to implead the defendants-respondents who were deemed indispensable parties to the case.

The plaintiffs-respondents filed on October 14, 1970 the required amended complaint, impleading as party defendants Eugenio Soriano, Maria Cauilan, Pedro Soriano, Paz Tagacay, Benjamin Tagacay, Fausta Agustin, and Milagros B. Carag, as well as the bank.[8] The plaintiffs-respondents also added two (2) additional causes of action, or a total of three (3) causes of action, namely: (1) recovery of real property; (2) cancellation of the OCTs; and (3) annulment of real estate mortgage. The bank was made a party to the case in view of the suit for annulment of mortgage.

The records disclose that on March 29, 1973, while the case was pending before the trial court, the bank extrajudicially foreclosed the property covered by OCT No. 24800 issued to the spouses Pedro Soriano and Paz Tagacay. The bank was declared the highest bidder in the ensuing public auction. The spouses Soriano failed to redeem the foreclosed property, resulting in the consolidation of title in the bank's name; hence, the issuance on October 3, 1985 of TCT No. T-65664 in the name of the bank.[9]

On February 28, 1991, the plaintiffs-respondents and the defendants-respondents entered into a compromise agreement whereby ownership of virtually the northern half of the disputed property was ceded to the plaintiffs-respondents, while the remaining southern half was given to the defendants-respondents.[10] In the same compromise agreement, the defendants-respondents acknowledged their indebtedness to petitioner PNB and bound themselves to pay their respective obligations to the bank, including the interests accruing thereon. Petitioner PNB, however, was not a party to the compromise agreement which reads:

COMPROMISE AGREEMENT[11]

Plaintiffs and defendants, by counsels, enter into and submit the following compromise agreement:

x x x

(b)

That the defendant, PEDRO SORIANO, acknowledges the plaintiffs as the lawful owners of the NORTHERN PORTION of the land covered by Original Certificate of Title No. P-24800, with an area of 85,348 square meters more or less and is more particularly described in the technical description hereto attached as Annex "A" and forming part hereof;

(c)

That the defendant, BENJAMIN TAGACAY, acknowledges the plaintiffs to be the owners of the NORTHERN PORTION of the land covered by Original Certificate of Title No. P-25217, with an area of 98,790 square meters more or less and is more particularly described in the technical description hereto attached as Annex "B" and forming part hereof;

(d)

That the defendant, MILAGROS B. CARAG, acknowledges the plaintiffs to be the owners of the NORTHERN PORTION of the land covered by Original Certificate of Title No. P-24802, with an area of 58,378 square meters more or less and is more particularly described in the technical description attached hereto as Annex "C" and forming part hereof;

(e)

That the defendant Pedro Soriano acknowledges indebtedness to the Philippine National Bank and binds himself to pay his loan together with the interest and other charges;

(f)

That the defendant Benjamin Tagacay acknowledges indebtedness to the Philippine National Bank and binds himself to pay his loan together with the interest and other charges;

(g)

That the defendant Milagros B. Carag acknowledges indebtedness to the Philippine National Bank and binds himself to pay his loan together with the interest and other charges;

(h)

That the private defendants acknowledge the plaintiffs to be the owners and possessors of the motherland otherwise known as Lot 3192 and the area ceded to the plaintiffs by the private defendants;

(i)

That the parties hereto submit the foregoing compromise agreement as basis for the decision in the above-entitled case by the Honorable Court.

Tuguegarao, Cagayan, December 26, 1990.

On March 15, 1991, the trial court rendered its decision, approving and adopting in toto the compromise agreement, and ordering the participating parties to strictly comply with its terms.[12] The bank moved for reconsideration of the trial court's decision and for the setting aside of the compromise agreement. The trial court denied the motion in its Resolution of February 7, 1992, thus, compelled the bank to elevate the case to the CA.[13]

The appellate court dismissed the appeal in its decision of March 30, 2001, ruling that the bank is not an indispensable party to the compromise agreement that only settles the actions for: (1) recovery of property; and (2) cancellation of OCTs.[14] On the third cause of action for annulment of mortgage, the court held the bank is only a necessary party and "the issue could be dealt with in a separate and distinct action." The appellate court in the same decision proceeded to strike down the mortgages as void because the mortgagors (defendants-respondents), not being the absolute owners of the disputed parcels of land as agreed upon in the compromise agreement, did not have the right to constitute a mortgage on these properties.

The PNB sought reconsideration of the dismissal of its appeal, but the appellate court denied its motion in a Resolution dated July 27, 2001;[15] hence, this petition for review on certiorari.

The PNB raises the following legal issue:

WHETHER THE COMPROMISE AGREEMENT ENTERED INTO BY AND BETWEEN THE HEREIN PLAINTIFFS-RESPONDENTS AND DEFENDANTS-RESPONDENTS AND APPROVED BY THE TRIAL COURT LEGALLY BINDS PETITIONER PNB WHICH IS NOT A PARTY THERETO AND CONSTITUTES SUFFICIENT LEGAL BASIS TO NULLIFY PNB'S MORTGAGE LIEN ON THE REALTY IN QUESTION.

In attacking the compromise agreement between the plaintiffs-respondents and the defendants-respondents, the PNB argues that it is an indispensable, not merely a necessary, party to all three causes of action, namely, for (1) recovery of real property; (2) cancellation of the OCTs; and (3) annulment of mortgages. Arguing that the causes

of action are closely intertwined and intimately related, and that the compromise was entered into precisely to put an end to the case, the PNB submits that its consent to the compromise agreement is necessary to secure a final and complete determination of the claims and defenses of all the parties to the case.

The PNB further argues that when the appellate court approved in toto the trial court's judgment on the compromise agreement, it failed to consider that the bank was a mortgagee in good faith. The bank claims good faith on the position that the OCTs presented to it were all clean on their faces at the time the mortgages were applied for; that there were no notices of lis pendens or any annotation of liens or encumbrances on all of them; and that it had no knowledge, actual or constructive, of facts or circumstances to warrant further inquiry into the titles of the defendants-respondents.

THE COURT'S RULING

We resolve to dismiss the petition for the reasons discussed below.

The compromise agreement disposed of the first two causes of action filed by plaintiffs-respondents Banatao, et al. against defendants-respondents Carag, et al., namely, the actions for (1) recovery of real property; and (2) cancellation of the OCTs, thereby settling the question of ownership between them. The trial court approved the compromise agreement in toto. The appellate court, in turn, upheld the trial court, but it proceeded to discuss on the third cause of action (for annulment of mortgage), concluding that the mortgages were void because the mortgagors were not the absolute owners of the mortgaged properties. In the words of the appellate court:

The main cause of action here is the "Recovery of Realty and Reconveyance," the "Annulment of Mortgage" is only an ancillary cause of action. In the decision approving the compromise agreement it disposes and finally determined the "Recovery of Realty and Reconveyance."

The moment ownership of the disputed real property was clearly proven to be that of the [plaintiffs-respondents], the question of the validity of the mortgage made by the [defendants-respondents] with [petitioner PNB] could easily be determined.

x x x

The [defendants-respondents], not being the absolute owners and not having been authorized to mortgage the subject real property, could not validly mortgage the said real property with [petitioner PNB]. However, we are not unmindful of the [defendants-respondents'] liability to [the bank]. But such issue could be dealt with in a separate and distinct action. [Emphasis supplied.]

With the above ruling, the bank who was not a party to the agreement was therefore affected; it was a mortgagee of a part of the disputed property, and had in fact foreclosed the portion covered by OCT No. 24800.

It is basic in law that a compromise agreement, as a contract, is binding only upon the parties to the compromise, and not upon non-parties. This is the doctrine of relativity of contracts. Consistent with this principle, a judgment based entirely on a compromise agreement is binding only on the parties to the compromise the court approved, and not upon the parties who did not take part in the compromise agreement and in the proceedings leading to its submission and approval by the court. Otherwise stated, a court judgment made solely on the basis of a compromise agreement binds only the parties to the compromise, and cannot bind a party litigant who did not take part in the compromise agreement. In the case of *Castañeda v. Heirs of Maramba*, [16] we held that:

Judgment based on a compromise affects only participating litigants—A partial decision, stemming from an amicable settlement among two of several parties to an action, binds only the parties so participating in the settlement. This decision never becomes final with respect to the parties who did not take part in the settlement confirmed by the partial decision aforesaid. [Emphasis supplied.]

Following Castañeda, the judgment on compromise rendered by the trial court in this case, and later affirmed by the appellate court, is final with respect only to the plaintiffs-respondents and defendants-respondents, but not with respect to the PNB. Hence, the trial court's judgment on compromise which settles the issue of ownership over the properties in question is but a partial decision that does not completely decide the case and cannot bind the PNB.

In its assailed decision, the CA, while recognizing the liability of the defendants-respondents to the PNB, declared that the mortgagors, not being the absolute owners of the mortgaged properties as agreed upon in the compromise agreement, do not have the right to constitute the mortgage. This conclusion is legally incorrect as the CA capitalized on the ownership issue settled between the plaintiffs-respondents and the defendants-respondents in invalidating the PNB mortgages, without hearing the side of the PNB as mortgagee, and later, co-owner of the disputed property. As discussed above, the compromise agreement cannot bind the bank, a non-party to the agreement; necessarily, the ownership issue which was settled by the compromise agreement cannot be made applicable to the bank without hearing it.

Our own review of the records of the case shows that the appellate court was not without basis to properly dispose of all the causes of action, including the annulment of mortgage issue, had it fully scrutinized the records of the case. A glaring fact that escaped the scrutiny of both the trial and appellate courts, and which would have led them to the quick and correct disposition of the annulment issue (and of the entire case, given the compromise agreement), is the proviso against alienation or encumbrance of lands granted by homestead patent - a fact plainly evident upon a facial examination of the OCTs involved.

We conclude from our own examination of these OCTs that the mortgages cannot but be void ab initio. On the faces of all the OCTs—secured through homestead patents—are inscribed the following words that echo the mandatory provisions of law:

TO HAVE AND TO HOLD the said tract of land with the appurtenances thereunto x x x subject to the provisions of Sections 118, 121, 122 and 124 of Commonwealth Act No. 141, as amended, which provide that except in favor of the Government or any of its branches, units or institutions, THE LAND HEREBY ACQUIRED SHALL BE INALIENABLE AND SHALL NOT BE SUBJECT TO [E]NCUMBRANCE FOR A PERIOD OF FIVE (5) YEARS NEXT FOLLOWING THE DATE OF THIS PATENT, and shall not be liable for the satisfaction of any debt contracted prior to the expiration of that period; x x x.[17] [Emphasis supplied.]

This inscription reproduces Section 118[18] of the Public Land Act,[19] as amended, which contains a proscription against the alienation or encumbrance of homestead patents within five years from issue. The rationale for the prohibition, reiterated in a line of cases, first laid down in Pascua v. Talens[20] states that "x x x homestead laws were designed to distribute disposable agricultural lots of the State to land-destitute citizens for their home and cultivation. Pursuant to such benevolent intention the State prohibits the sale or encumbrance of the homestead (Section 116, now Section 118) within five years after the grant of the patent. x x x. It aims to preserve and keep in the family of the homesteader that portion of public land which the State had gratuitously given to him."

In the present case, the annotation of the mortgage liens occurred only months after the date of the issuance of the homestead patents. The pertinent facts as seen on the faces of the OCTs are illustrated below:

OCT No.	Mortgagors	Date of Homestead Patent	Date of Annotation / Inscription of Mortgage	Period from Date of Patent[21]
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P-24800	Pedro Soriano/ Paz Tagacay	28 Apr 1965	17 Sep 1965	5 Months
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P-24801 Eugenio Soriano/ Maria Cauilan 28 Apr 1965 27 Oct 1965 6 Months

P-24802 Milagros B. Carag/ Marciano Carag 28 Apr 1965 13 Oct 1965 6 Months

P-25217 Benjamin Tagacay/ Fausta Agustin 15 Feb 1966 25 Mar 1966 1 Month

This situation is similar to that of *Republic v. Heirs of Alejaga, Sr.*[22] where the respondent obtained a loan of P100,000.00 in 1981 from the PNB, secured by a real estate mortgage on the patented land. The 1981 encumbrance was contracted two years from date of issuance of the patent in 1979, for which reason the Court cited a violation of Section 118 of the Public Land Act which proscribes the alienation or encumbrance of the patented land within five years from the date of the patent, and which proscription clearly appears as a proviso in the OCT issued in the name of the respondent in the case. Consequently, the PNB mortgage was declared void.

The present case deserves exactly the same treatment, and the PNB cannot claim that it is a mortgagee in good faith. The proscription against alienation or encumbrance is unmistakable even on a cursory reading of the the OCTs. Thus, one who contracts with a homestead patentee is charged with knowledge of the law's proscriptive provision that must necessarily be read into the terms of any agreement involving the homestead. Under the circumstances, the PNB simply failed to observe the diligence required in the handling of its transactions and thus made the fatal error of approving the loans secured by mortgages of properties that cannot, in the first place, be mortgaged.

Both the defendants-respondents and the bank are to be faulted for the invalidity of the mortgages. We cannot, however, apply the doctrine of *pari delicto* in accordance with the ruling that the doctrine does not apply when the contract is prohibited by law.[23] A saving factor for the bank under the situation is that a mortgage is merely an accessory agreement and does not affect the principal contract of loan. The mortgages, while void, can still be considered as instruments evidencing the indebtedness of defendants-respondents to the PNB in a proper case for the collection of the defendants-respondents' loans.

Our conclusion on the nullity of mortgage issue renders it unnecessary to decide the question of whether the compromise agreement between the plaintiffs-respondents and the defendants-respondents should be set aside for its effect on the bank. With the mortgages invalidated, the PNB no longer has any interest that the compromise agreement can affect. In the absence of any other reason to impugn the lower court decisions approving the compromise agreement, we affirm the approval of the compromise agreement and the disposition of the case on the basis of compromise. Given our ruling on the invalidity of the mortgages, a remand of this issue is no longer necessary. The parties' liabilities to PNB on the loans they obtained are not issues before us for disposition, and are for the parties to act upon as matters outside the coverage of this case.

WHEREFORE, we hereby DECLARE the mortgages constituted on OCT Nos. 24800, 24801, 25217 and 25802 VOID and, for this reason, we DISMISS the petition. We AFFIRM the approval of the compromise agreement by the Court of Appeals and the disposition of the case on the basis of compromise. The order to remand the case to the Regional Trial Court, Branch IV, Tuguegarao, Cagayan, for further proceedings is therefore REVERSED.

Costs against petitioner PNB.

SO ORDERED.

Quisumbing, (Chairperson), Carpio Morales, Tinga, and Velasco, Jr., JJ., concur.

[1] Under Rule 45 of the Rules of Court.

- [2] Records, Vol. I, pp. 1-4.
- [3] Under Commonwealth Act No. 141 or CA No. 141, effective November 7, 1936.
- [4] CA No. 141, Section 118.
- [5] Exhibits "8," "9," "10," and "11," Record of Exhibits, pp. 55-57, 58-59, 60-62, and 63-64, respectively.
- [6] Records, Vol. I, pp. 180-202.
- [7] Id., Vol II, pp. 238-240.
- [8] Id., pp. 246-255.
- [9] Memorandum of PNB, rollo, p.101.
- [10] Records, Vol. IV, pp. 877-878.
- [11] Ibid.
- [12] Records, Vol. IV, pp. 879-880.
- [13] Id., pp. 906-909, penned by Associate Justice Andres B. Reyes, Jr., with Associate Justice B.A. Adefuin-De la Cruz (retired) and Associate Justice Josefina Guevarra-Salonga, concurring.
- [14] Rollo, pp. 26-37.
- [15] Id., p. 40.
- [16] G.R. No. L-25569, December 28, 1971, 42 SCRA 634.
- [17] Exhibits "8", "9", "10" and "11," Record of Exhibits, pp. 55-57,58-59,60-62, and 63-64, respectively.
- [18] SECTION 118. Except in favor of the Government or any of its branches, units, or institutions, or legally constituted banking corporations lands acquired under free patent or homestead provisions shall not be subject to encumbrance or alienation from the date of the approval of the application and for a term of five years from and after the date of issuance of the patent or grant, nor shall they become liable to the satisfaction of any debt contracted prior to the expiration of said period, but the improvements or crops on the land may be mortgaged or pledged to qualified persons, associations, or corporations.
- No alienation, transfer, or conveyance of any homestead after five years and before twenty-five years after issuance of title shall be valid without the approval of the Secretary of Agriculture and Natural Resources, which approval shall not be denied except on constitutional and legal grounds. [Emphasis supplied.]
- [19] Supra note 3.
- [20] 80 Phil. 792 (1948).
- [21] Approximation in months, from date of entry of homestead patent to date of annotation of the mortgage.
- [22] G.R. No. 146030, December 3, 2002, 393 SCRA 361.
- [23] Philippine National Bank v. De los Reyes, G.R. Nos. 46898-99, November 28, 1989, 179 SCRA 619.

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