

SWAGMAN HOTELS AND TRAVEL, INC., PETITIONER, VS. HON. COURT OF APPEALS, AND NEAL B. CHRISTIAN, RESPONDENTS.*G.R. NO. 161135. April 08, 2005*

Ponente: DAVIDE, JR., C.J.

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May a complaint that lacks a cause of action at the time it was filed be cured by the accrual of a cause of action during the pendency of the case? This is the basic issue raised in this petition for the Court's consideration.

Sometime in 1996 and 1997, petitioner Swagman Hotels and Travel, Inc., through Atty. Leonor L. Infante and Rodney David Hegerty, its president and vice-president, respectively, obtained from private respondent Neal B. Christian loans evidenced by three promissory notes dated 7 August 1996, 14 March 1997, and 14 July 1997. Each of the promissory notes is in the amount of US\$50,000 payable after three years from its date with an interest of 15% per annum payable every three months.[1] In a letter dated 16 December 1998, Christian informed the petitioner corporation that he was terminating the loans and demanded from the latter payment in the total amount of US\$150,000 plus unpaid interests in the total amount of US\$13,500.[2]

On 2 February 1999, private respondent Christian filed with the Regional Trial Court of Baguio City, Branch 59, a complaint for a sum of money and damages against the petitioner corporation, Hegerty, and Atty. Infante. The complaint alleged as follows: On 7 August 1996, 14 March 1997, and 14 July 1997, the petitioner, as well as its president and vice-president obtained loans from him in the total amount of US\$150,000 payable after three years, with an interest of 15% per annum payable quarterly or every three months. For a while, they paid an interest of 15% per annum every three months in accordance with the three promissory notes. However, starting January 1998 until December 1998, they paid him only an interest of 6% per annum, instead of 15% per annum, in violation of the terms of the three promissory notes. Thus, Christian prayed that the trial court order them to pay him jointly and solidarily the amount of US\$150,000 representing the total amount of the loans; US\$13,500 representing unpaid interests from January 1998 until December 1998; P100,000 for moral damages; P50,000 for attorney's fees; and the cost of the suit.[3]

The petitioner corporation, together with its president and vice-president, filed an Answer raising as defenses lack of cause of action and novation of the principal obligations. According to them, Christian had no cause of action because the three promissory notes were not yet due and demandable. In December 1997, since the petitioner corporation was experiencing huge losses due to the Asian financial crisis, Christian agreed (a) to waive the interest of 15% per annum, and (b) accept payments of the principal loans in installment basis, the amount and period of which would depend on the state of business of the petitioner corporation. Thus, the petitioner paid Christian capital repayment in the amount of US\$750 per month from January 1998 until the time the complaint was filed in February 1999. The petitioner and its co-defendants then prayed that the complaint be dismissed and that Christian be ordered to pay P1 million as moral damages; P500,000 as exemplary damages; and P100,000 as attorney's fees.[4]

In due course and after hearing, the trial court rendered a decision[5] on 5 May 2000 declaring the first two promissory notes dated 7 August 1996 and 14 March 1997 as already due and demandable and that the interest on the loans had been reduced by the parties from 15% to 6% per annum. It then ordered the petitioner corporation to pay Christian the amount of \$100,000 representing the principal obligation covered by the promissory notes dated 7 August 1996 and 14 March 1997, "plus interest of 6% per month thereon until fully paid, with all interest payments already paid by the defendant to the plaintiff to be deducted therefrom."

The trial court ratiocinated in this wise:

(1) There was no novation of defendant's obligation to the plaintiff. Under Article 1292 of the Civil Code, there is an implied novation only if the old and the new obligation be on every point incompatible with one another.

The test of incompatibility between the two obligations or contracts, according to an imminent author, is whether they can stand together, each one having an independent existence. If they cannot, they are incompatible, and the subsequent obligation novates the first (Tolentino, Civil Code of the Philippines, Vol. IV, 1991 ed., p. 384). Otherwise, the old obligation will continue to subsist subject to the modifications agreed upon by the parties. Thus, it has been written that accidental modifications in an existing obligation do not extinguish it by novation. Mere modifications of the debt agreed upon between the parties do not constitute novation. When the changes refer to secondary agreement and not to the object or principal conditions of the contract, there is no novation; such changes will produce modifications of incidental facts, but will not extinguish the original obligation. Thus, the acceptance of partial payments or a partial remission does not involve novation (*id.*, p. 387). Neither does the reduction of the amount of an obligation amount to a novation because it only means a partial remission or condonation of the same debt.

In the instant case, the Court is of the view that the parties merely intended to change the rate of interest from 15% per annum to 6% per annum when the defendant started paying \$750 per month which payments were all accepted by the plaintiff from January 1998 onward. The payment of the principal obligation, however, remains unaffected which means that the defendant should still pay the plaintiff \$50,000 on August 9, 1999, March 14, 2000 and July 14, 2000.

(2) When the instant case was filed on February 2, 1999, none of the promissory notes was due and demandable. As of this date however, the first and the second promissory notes have already matured. Hence, payment is already due.

Under Section 5 of Rule 10 of the 1997 Rules of Civil Procedure, a complaint which states no cause of action may be cured by evidence presented without objection. Thus, even if the plaintiff had no cause of action at the time he filed the instant complaint, as defendants' obligation are not yet due and demandable then, he may nevertheless recover on the first two promissory notes in view of the introduction of evidence showing that the obligations covered by the two promissory notes are now due and demandable.

(3) Individual defendants Rodney Hegerty and Atty. Leonor L. Infante can not be held personally liable for the obligations contracted by the defendant corporation it being clear that they merely acted in representation of the defendant corporation in their capacity as General Manager and President, respectively, when they signed the promissory notes as evidenced by Board Resolution No. 1(94) passed by the Board of Directors of the defendant corporation (Exhibit "4").[6]

In its decision[7] of 5 September 2003, the Court of Appeals denied petitioner's appeal and affirmed in toto the decision of the trial court, holding as follows:

In the case at bench, there is no incompatibility because the changes referred to by appellant Swagman consist only in the manner of payment. . . .

Appellant Swagman's interpretation that the three (3) promissory notes have been novated by reason of

appellee Christian's acceptance of the monthly payments of US\$750.00 as capital repayments continuously even after the filing of the instant case is a little bit strained considering the stiff requirements of the law on novation that the intention to novate must appear by express agreement of the parties, or by their acts that are too clear and unequivocal to be mistaken. Under the circumstances, the more reasonable interpretation of the act of the appellee Christian in receiving the monthly payments of US\$750.00 is that appellee Christian merely allowed appellant Swagman to pay whatever amount the latter is capable of. This interpretation is supported by the letter of demand dated December 16, 1998 wherein appellee Christian demanded from appellant Swagman to return the principal loan in the amount of US\$150,000 plus unpaid interest in the amount of US\$13,500.00. .

Appellant Swagman, likewise, contends that, at the time of the filing of the complaint, appellee Christian ha[d] no cause of action because none of the promissory notes was due and demandable.

Again, We are not persuaded.

...

In the case at bench, while it is true that appellant Swagman raised in its Answer the issue of prematurity in the filing of the complaint, appellant Swagman nonetheless failed to object to appellee Christian's presentation of evidence to the effect that the promissory notes have become due and demandable.

The afore-quoted rule allows a complaint which states no cause of action to be cured either by evidence presented without objection or, in the event of an objection sustained by the court, by an amendment of the complaint with leave of court (Herrera, Remedial Law, Vol. VII, 1997 ed., p. 108).[8]

Its motion for reconsideration having been denied by the Court of Appeals in its Resolution of 4 December 2003,[9] the petitioner came to this Court raising the following issues:

- WHERE THE DECISION OF THE TRIAL COURT DROPPING TWO DEFENDANTS HAS BECOME FINAL AND EXECUTORY, MAY THE RESPONDENT COURT OF APPEALS STILL STUBBORNLY CONSIDER THEM AS APPELLANTS WHEN THEY DID NOT APPEAL?
- WHERE THERE IS NO CAUSE OF ACTION, IS THE DECISION OF THE LOWER COURT VALID?
- MAY THE RESPONDENT COURT OF APPEALS VALIDLY AFFIRM A DECISION OF THE LOWER COURT WHICH IS INVALID DUE TO LACK OF CAUSE OF ACTION?
- WHERE THERE IS A VALID NOVATION, MAY THE ORIGINAL TERMS OF CONTRACT WHICH HAS BEEN NOVATED STILL PREVAIL?[10]

The petitioner harps on the absence of a cause of action at the time the private respondent's complaint was filed with the trial court. In connection with this, the petitioner raises the issue of novation by arguing that its obligations under the three promissory notes were novated by the renegotiation that happened in December 1997 wherein the private respondent agreed to waive the interest in each of the three promissory notes and to accept US\$750 per month as installment payment for the principal loans in the total amount of US\$150,000. Lastly, the petitioner questions the act of the Court of Appeals in considering Hegerty and Infante as appellants when they no longer appealed because the trial court had already absolved them of the liability of the petitioner corporation.

On the other hand, the private respondent asserts that this petition is "a mere ploy to continue delaying the payment of a just obligation." Anent the fact that Hegerty and Atty. Infante were considered by the Court of Appeals as appellants, the private respondent finds it immaterial because they are not affected by the assailed decision anyway.

Cause of action, as defined in Section 2, Rule 2 of the 1997 Rules of Civil Procedure, is the act or omission by

which a party violates the right of another. Its essential elements are as follows:

- A right in favor of the plaintiff by whatever means and under whatever law it arises or is created;
- An obligation on the part of the named defendant to respect or not to violate such right; and
- Act or omission on the part of such defendant in violation of the right of the plaintiff or constituting a breach of the obligation of the defendant to the plaintiff for which the latter may maintain an action for recovery of damages or other appropriate relief.[11]

It is, thus, only upon the occurrence of the last element that a cause of action arises, giving the plaintiff the right to maintain an action in court for recovery of damages or other appropriate relief.

It is undisputed that the three promissory notes were for the amount of P50,000 each and uniformly provided for (1) a term of three years; (2) an interest of 15 % per annum, payable quarterly; and (3) the repayment of the principal loans after three years from their respective dates. However, both the Court of Appeals and the trial court found that a renegotiation of the three promissory notes indeed happened in December 1997 between the private respondent and the petitioner resulting in the reduction -- not waiver -- of the interest from 15% to 6% per annum, which from then on was payable monthly, instead of quarterly. The term of the principal loans remained unchanged in that they were still due three years from the respective dates of the promissory notes. Thus, at the time the complaint was filed with the trial court on 2 February 1999, none of the three promissory notes was due yet; although, two of the promissory notes with the due dates of 7 August 1999 and 14 March 2000 matured during the pendency of the case with the trial court. Both courts also found that the petitioner had been religiously paying the private respondent US\$750 per month from January 1998 and even during the pendency of the case before the trial court and that the private respondent had accepted all these monthly payments.

With these findings of facts, it has become glaringly obvious that when the complaint for a sum of money and damages was filed with the trial court on 2 February 1999, no cause of action has as yet existed because the petitioner had not committed any act in violation of the terms of the three promissory notes as modified by the renegotiation in December 1997. Without a cause of action, the private respondent had no right to maintain an action in court, and the trial court should have therefore dismissed his complaint.

Despite its finding that the petitioner corporation did not violate the modified terms of the three promissory notes and that the payment of the principal loans were not yet due when the complaint was filed, the trial court did not dismiss the complaint, citing Section 5, Rule 10 of the 1997 Rules of Civil Procedure, which reads:

Section 5. Amendment to conform to or authorize presentation of evidence. - When issues not raised by the pleadings are tried with the 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 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 with liberality if the presentation of the merits of the action and the ends of substantial justice will be subserved thereby. The court may grant a continuance to enable the amendment to be made.

According to the trial court, and sustained by the Court of Appeals, this Section allows a complaint that does not state a cause of action to be cured by evidence presented without objection during the trial. Thus, it ruled that even if the private respondent had no cause of action when he filed the complaint for a sum of money and damages because none of the three promissory notes was due yet, he could nevertheless recover on the first two promissory notes dated 7 August 1996 and 14 March 1997, which became due during the pendency of the case in view of the

introduction of evidence of their maturity during the trial.

Such interpretation of Section 5, Rule 10 of the 1997 Rules of Civil Procedure is erroneous.

Amendments of pleadings are allowed under Rule 10 of the 1997 Rules of Civil Procedure in order that the actual merits of a case may be determined in the most expeditious and inexpensive manner without regard to technicalities, and that all other matters included in the case may be determined in a single proceeding, thereby avoiding multiplicity of suits.[12] Section 5 thereof applies to situations wherein evidence not within the issues raised in the pleadings is presented by the parties during the trial, and to conform to such evidence the pleadings are subsequently amended on motion of a party. Thus, a complaint which fails to state a cause of action may be cured by evidence presented during the trial.

However, the curing effect under Section 5 is applicable only if a cause of action in fact exists at the time the complaint is filed, but the complaint is defective for failure to allege the essential facts. For example, if a complaint failed to allege the fulfillment of a condition precedent upon which the cause of action depends, evidence showing that such condition had already been fulfilled when the complaint was filed may be presented during the trial, and the complaint may accordingly be amended thereafter.[13] Thus, in *Roces v. Jalandoni*, [14] this Court upheld the trial court in taking cognizance of an otherwise defective complaint which was later cured by the testimony of the plaintiff during the trial. In that case, there was in fact a cause of action and the only problem was the insufficiency of the allegations in the complaint. This ruling was reiterated in *Pascua v. Court of Appeals*. [15]

It thus follows that a complaint whose cause of action has not yet accrued cannot be cured or remedied by an amended or supplemental pleading alleging the existence or accrual of a cause of action while the case is pending.[16] Such an action is prematurely brought and is, therefore, a groundless suit, which should be dismissed by the court upon proper motion seasonably filed by the defendant. The underlying reason for this rule is that a person should not be summoned before the public tribunals to answer for complaints which are immature. As this Court eloquently said in *Surigao Mine Exploration Co., Inc. v. Harris*: [17]

It is a rule of law to which there is, perhaps, no exception, either at law or in equity, that to recover at all there must be some cause of action at the commencement of the suit. As observed by counsel for appellees, there are reasons of public policy why there should be no needless haste in bringing up litigation, and why people who are in no default and against whom there is yet no cause of action should not be summoned before the public tribunals to answer complaints which are groundless. We say groundless because if the action is immature, it should not be entertained, and an action prematurely brought is a groundless suit.

It is true that an amended complaint and the answer thereto take the place of the originals which are thereby regarded as abandoned (*Reynes vs. Compañía General de Tabacos* [1912], 21 Phil. 416; *Ruyman and Farris vs. Director of Lands* [1916], 34 Phil., 428) and that "the complaint and answer having been superseded by the amended complaint and answer thereto, and the answer to the original complaint not having been presented in evidence as an exhibit, the trial court was not authorized to take it into account." (*Bastida vs. Menzi & Co.* [1933], 58 Phil., 188.) But in none of these cases or in any other case have we held that if a right of action did not exist when the original complaint was filed, one could be created by filing an amended complaint. In some jurisdictions in the United States what was termed an "imperfect cause of action" could be perfected by suitable amendment (*Brown vs. Galena Mining & Smelting Co.*, 32 Kan., 528; *Hooper vs. City of Atlanta*, 26 Ga. App., 221) and this is virtually permitted in *Banzon and Rosauero vs. Sellner* ([1933], 58 Phil., 453); *Asiatic Petroleum [sic] Co. vs. Veloso* ([1935], 62 Phil., 683); and recently in *Ramos vs. Gibbon* (38 Off. Gaz., 241). That, however, which is no cause of action whatsoever cannot by amendment or supplemental pleading be converted into a cause of action: *Nihil de re accrescit ei qui nihil in re quando jus accresceret habet*.

We are therefore of the opinion, and so hold, that unless the plaintiff has a valid and subsisting cause of action

at the time his action is commenced, the defect cannot be cured or remedied by the acquisition or accrual of one while the action is pending, and a supplemental complaint or an amendment setting up such after-accrued cause of action is not permissible. (Emphasis ours).

Hence, contrary to the holding of the trial court and the Court of Appeals, the defect of lack of cause of action at the commencement of this suit cannot be cured by the accrual of a cause of action during the pendency of this case arising from the alleged maturity of two of the promissory notes on 7 August 1999 and 14 March 2000.

Anent the issue of novation, this Court observes that the petitioner corporation argues the existence of novation based on its own version of what transpired during the renegotiation of the three promissory notes in December 1997. By using its own version of facts, the petitioner is, in a way, questioning the findings of facts of the trial court and the Court of Appeals.

As a rule, the findings of fact of the trial court and the Court of Appeals are final and conclusive and cannot be reviewed on appeal to the Supreme Court^[18] as long as they are borne out by the record or are based on substantial evidence.^[19] The Supreme Court is not a trier of facts, its jurisdiction being limited to reviewing only errors of law that may have been committed by the lower courts. Among the exceptions is when the finding of fact of the trial court or the Court of Appeals is not supported by the evidence on record or is based on a misapprehension of facts. Such exception obtains in the present case.^[20]

This Court finds to be contrary to the evidence on record the finding of both the trial court and the Court of Appeals that the renegotiation in December 1997 resulted in the reduction of the interest from 15% to 6% per annum and that the monthly payments of US\$750 made by the petitioner were for the reduced interests.

It is worthy to note that the cash voucher dated January 1998^[21] states that the payment of US\$750 represents "INVESTMENT PAYMENT." All the succeeding cash vouchers describe the payments from February 1998 to September 1999 as "CAPITAL REPAYMENT."^[22] All these cash vouchers served as receipts evidencing private respondent's acknowledgment of the payments made by the petitioner: two of which were signed by the private respondent himself and all the others were signed by his representatives. The private respondent even identified and confirmed the existence of these receipts during the hearing. ^[23] Significantly, cognizant of these receipts, the private respondent applied these payments to the three consolidated principal loans in the summary of payments he submitted to the court.^[24]

Under Article 1253 of the Civil Code, if the debt produces interest, payment of the principal shall not be deemed to have been made until the interest has been covered. In this case, the private respondent would not have signed the receipts describing the payments made by the petitioner as "capital repayment" if the obligation to pay the interest was still subsisting. The receipts, as well as private respondent's summary of payments, lend credence to petitioner's claim that the payments were for the principal loans and that the interests on the three consolidated loans were waived by the private respondent during the undisputed renegotiation of the loans on account of the business reverses suffered by the petitioner at the time.

There was therefore a novation of the terms of the three promissory notes in that the interest was waived and the principal was payable in monthly installments of US\$750. Alterations of the terms and conditions of the obligation would generally result only in modificatory novation unless such terms and conditions are considered to be the essence of the obligation itself.^[25] The resulting novation in this case was, therefore, of the modificatory type, not the extinctive type, since the obligation to pay a sum of money remains in force.

Thus, since the petitioner did not renege on its obligation to pay the monthly installments conformably with their new agreement and even continued paying during the pendency of the case, the private respondent had no cause of action to file the complaint. It is only upon petitioner's default in the payment of the monthly amortizations that

a cause of action would arise and give the private respondent a right to maintain an action against the petitioner.

Lastly, the petitioner contends that the Court of Appeals obstinately included its President Infante and Vice-President Hegerty as appellants even if they did not appeal the trial court's decision since they were found to be not personally liable for the obligation of the petitioner. Indeed, the Court of Appeals erred in referring to them as defendants-appellants; nevertheless, that error is no cause for alarm because its ruling was clear that the petitioner corporation was the one solely liable for its obligation. In fact, the Court of Appeals affirmed in toto the decision of the trial court, which means that it also upheld the latter's ruling that Hegerty and Infante were not personally liable for the pecuniary obligations of the petitioner to the private respondent.

In sum, based on our disquisition on the lack of cause of action when the complaint for sum of money and damages was filed by the private respondent, the petition in the case at bar is impressed with merit.

WHEREFORE, the petition is hereby GRANTED. The Decision of 5 September 2003 of the Court of Appeals in CA-G.R. CV No. 68109, which affirmed the Decision of 5 May 2000 of the Regional Trial Court of Baguio, Branch 59, granting in part private respondent's complaint for sum of money and damages, and its Resolution of 4 December 2003, which denied petitioner's motion for reconsideration are hereby REVERSED and SET ASIDE. The complaint docketed as Civil Case No. 4282-R is hereby DISMISSED for lack of cause of action.

No costs.

SO ORDERED.

Quisumbing, Ynares-Santiago, Carpio, and Azcuna, JJ., concur.

[1] Rollo, 33, 56.

[2] Exhibit "D," Original Records (OR), 9.

[3] Rollo, 54.

[4] Rollo, 72.

[5] Id., 56-59. Per Judge Abraham B. Borreta.

[6] Rollo, 57-58.

[7] Rollo, 33-39. Per Associate Justice B.A. Adefuin-De la Cruz, J., with Associate Justices Eliezer R. de los Santos and Jose C. Mendoza concurring.

[8] Rollo, 37-39.

[9] Id., 40.

[10] Rollo, 10.

[11] *Cole v. Vda. de Gregorio*, 202 Phil. 226, 231 (1982); *Magat v. Medialdea*, 206 Phil. 341, 348 (1983); *Baliwag Transit, Inc. v. Ople*, G.R. No. 57642, 16 March 1989, 171 SCRA 250, 258; *Dulay v. Court of Appeals*, G.R. No. 108017, 3 April 1995, 243 SCRA 220; *Leberman Realty Corp. v. Typingco*, G.R. No. 126647, 29 July 1998, 293 SCRA 316, 328.

[12] 1 OSCAR HERRERA, REMEDIAL LAW 580 (2000).

[13] 1 JOSE FERIA & MARIA CONCEPCION NOCHE, CIVIL PROCEDURE ANNOTATED 332 (2001).

[14] 12 Phil. 599 (1909).

[15] G.R. Nos. 76851 & 78431, 19 March 1990, 183 SCRA 262, 266.

[16] Limpangco v. Mercado, 10 Phil. 508 (1908).

[17] 68 Phil. 113, 121-122 (1939).

[18] Amigo v. Teves, 96 Phil. 252 (1954).

[19] Alsua-Betts v. Court of Appeals, Nos. L-46430-31, 30 July 1979, 92 SCRA 332.

[20] Navarro v. Court of Appeals, G.R. No. 100257, 8 June 1992, 209 SCRA 612, 623; McKee v. Intermediate Appellate Court, G.R. No. 68102, 16 July 1992, 211 SCRA 517, 537.

[21] Exhibit "3," OR, 90.

[22] Exh. "3-A" to "3-T," OR, 90-105.

[23] TSN, 12 October 1999,5.

[24] Exh. "G," OR, 84.

[25] III JOSE C. VITUG, CIVIL LAW 96-97 (2003) citing Tiu v. Habana, 45 Phil. 407 (1924) and Young v. Court of Appeals, 196 SCRA 795.

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