

JOAQUIN VILLEGAS AND EMMA M. VILLEGAS, PETITIONERS, VS. RURAL BANK OF TANJAY, INC., RESPONDENT.

G.R. No. 161407. June 05, 2009

Ponente: NACHURA, J.

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NACHURA, J.:

This petition for review on certiorari under Rule 45 of the Rules of Court assails the Court of Appeals (CA) Decision[1] in CA-G.R. CV No. 40613 which affirmed with modification the Regional Trial Court (RTC) Decision in Civil Case No. 9570.[2]

The facts, as summarized by the CA, follow.

Sometime in June, 1982, [petitioners], spouses Joaquin and Emma Villegas, obtained an agricultural loan of P350,000.00 from [respondent] Rural Bank of Tanjay, Inc. The loan was secured by a real estate mortgage on [petitioners'] residential house and 5,229 - sq.m. lot situated in Barrio Bantayan, Dumaguete City and covered by TCT No. 12389.

For failure of [petitioners] to pay the loan upon maturity, the mortgage was extrajudicially foreclosed. At the foreclosure sale, [respondent], being the highest bidder, purchased the foreclosed properties for P367,596.16. Thereafter, the Sheriff executed in favor of [respondent] a certificate of sale, which was subsequently registered with the Registry of Deeds of Dumaguete City.

[Petitioners] failed to redeem the properties within the one-year redemption period.

In May, 1987, [respondent] and [petitioner] Joaquin Villegas, through his attorney-in-fact[,] Marilen Victoriano, entered into an agreement denominated as "Promise to Sell," whereby [respondent] promised to sell to [petitioners] the foreclosed properties for a total price of P713,312.72, payable within a period of five (5) years. The agreement reads in part:

PROMISE TO SELL

x x x x

WITNESSETH:

x x x x

2) That for and in consideration of SEVEN HUNDRED THIRTEEN THOUSAND AND THREE HUNDRED TWELVE & 72/100 PESOS (P713,312.72), the VENDOR do hereby promise to sell, transfer, and convey unto the VENDEE, their heirs, successors and assigns, all its rights, interests and participations over the above parcel of land with all the improvements thereon and a residential house.

3) That upon signing of this Promise To Sell, the VENDEE shall agree to make payment of P250,000.00 (Philippine Currency) and the balance of P463,312.72 payable in equal yearly installments plus interest based on the prevailing rate counting from the date of signing this Promise to Sell for a period of five (5) years.

x x x x

5) Provided further, that in case of a delay in any yearly installment for a period of ninety (90) days, this sale will become null and void and no further effect or validity; and provided further, that payments made shall be reimbursed (returned) to the VENDEE less interest on the account plus additional 15% liquidated damages and charges.

Upon the signing of the agreement, [petitioners] gave [respondent] the sum of P250,000.00 as down payment. [Petitioners], however, failed to pay the first yearly installment, prompting [respondent] to consolidate its ownership over the properties. Accordingly, TCT No. 12389 was cancelled and a new one, TCT No. 19042, (Exh. 14) was issued in [respondent's] name on November 8, 1989. Thereafter, [respondent] took possession of the properties. Hence, the action by [petitioners for declaration of nullity of loan and mortgage contracts, recovery of possession of real property, accounting and damages and, in the alternative, repurchase of real estate] commenced on January 15, 1990.

In resisting the complaint, [respondent] averred that [petitioners] have absolutely no cause of action against it, and that the complaint was filed only to force it to allow [petitioners] to reacquire the foreclosed properties under conditions unilaterally favorable to them.

x x x x

After trial on the merits, the [RTC] rendered a Decision dismissing the complaint, disposing as follows:

"In the light of the foregoing, it is considered opinion of this Court, that [petitioners] failed to prove by preponderance of evidence their case and therefore the herein complaint is ordered dismissed. [Petitioners] are ordered to pay [respondent] the sum of P3,000.00 as attorney's fees and to pay costs without pronouncement as to counterclaim.

SO ORDERED."[3]

On appeal by both parties, the CA affirmed with modification the RTC's ruling, thus:

WHEREFORE, the appealed Decision is hereby MODIFIED by (a) ORDERING [respondent] to reimburse [petitioners] their down payment of P250,000.00 and (b) DELETING the award of attorney's fees to [respondent].

SO ORDERED.[4]

Hence, this appeal by certiorari raising the following issues:

- (1) The Court of Appeals erred in not holding that the loan and mortgage contracts are null and void ab initio for being against public policy;
- (2) The Court of Appeals erred in not holding that, by reason of the fact that the loan and mortgage contracts are null and void ab initio for being against public policy, the doctrine of estoppel does not apply in this case;
- (3) The Court of Appeals erred in not finding that the addendum on the promissory notes containing an escalation clause is null and void ab initio for not being signed by petitioner Emma M. Villegas, wife of petitioner Joaquin Villegas, there being a showing that the companion real estate mortgage involves conjugal property. x x x.
- (4) The Court of Appeals erred in not finding that the addendum on the promissory notes containing an escalation clause is null and void ab initio for being so worded that the implementation thereof would deprive petitioners due process guaranteed by [the] constitution, the petitioners not having been notified beforehand of said implementation.[5]

Notwithstanding petitioners' formulation of the issues, the core issue for our resolution is whether petitioners may recover possession of the mortgaged properties.

The petition deserves scant consideration and ought to have been dismissed outright. Petitioners are precluded from seeking a declaration of nullity of the loan and mortgage contracts; they are likewise barred from recovering possession of the subject property.

Petitioners insist on the nullity of the loan and mortgage contracts. Unabashedly, petitioners admit that the loan (and mortgage) contracts were made to appear as several sugar crop loans not exceeding P50,000.00 each - even if they were not - just so the respondent rural bank could grant and approve the same pursuant to Republic Act (R.A.) No. 720, the Rural Banks Act. Petitioners boldly enumerate the following circumstances that show that these loans were obtained in clear contravention of R.A. No. 720:

(a)

The petitioners never planted sugar cane on any parcel of agricultural land;

(b)

The mortgaged real estate is residential, with a house, located in the heart of Dumaguete City, with an area of only one-half (1/2) hectare;

(c)

Petitioners never planted any sugar cane on this one-half (1/2) hectare parcel of land;

(d)

Petitioners were never required to execute any chattel mortgage on standing crops;

(e)

To make it appear that the petitioners were entitled to avail themselves of loan benefits under Republic Act No. 720, Rural Banks Act, respondent made them sign promissory notes for P350,000.00 in split amounts not exceeding P50,000.00 each.[6]

In short, petitioners aver that the sugar crop loans were merely simulated contracts and, therefore, without any force and effect.

Articles 1345 and 1346 of the Civil Code are the applicable laws, and they unmistakably provide:

Art. 1345. Simulation of a contract may be absolute or relative. The former takes place when the parties do not intend to be bound at all; the latter, when the parties conceal their true agreement.

Art. 1346. An absolutely simulated or fictitious contract is void. A relative simulation, when it does not prejudice a third person and is not intended for any purpose contrary to law, morals, good customs, public order or public policy binds the parties to their real agreement.

Given the factual antecedents of this case, it is obvious that the sugar crop loans were relatively simulated contracts and that both parties intended to be bound thereby. There are two juridical acts involved in relative simulation-- the ostensible act and the hidden act.[7] The ostensible act is the contract that the parties pretend to have executed while the hidden act is the true agreement between the parties.[8] To determine the enforceability of the actual agreement between the parties, we must discern whether the concealed or hidden act is lawful and the essential requisites of a valid contract are present.

In this case, the juridical act which binds the parties are the loan and mortgage contracts, i.e., petitioners' procurement of a loan from respondent. Although these loan and mortgage contracts were concealed and made to appear as sugar crop loans to make them fall within the purview of the Rural Banks Act, all the essential requisites of a contract^[9] were present. However, the purpose thereof is illicit, intended to circumvent the Rural Banks Act requirement in the procurement of loans.^[10] Consequently, while the parties intended to be bound thereby, the agreement is void and inexistent under Article 1409^[11] of the Civil Code.

In arguing that the loan and mortgage contracts are null and void, petitioners would impute all fault therefor to respondent. Yet, petitioners' averments evince an obvious knowledge and voluntariness on their part to enter into the simulated contracts. We find that fault for the nullity of the contract does not lie at respondent's feet alone, but at petitioners' as well. Accordingly, neither party can maintain an action against the other, as provided in Article 1412 of the Civil Code:

Art. 1412. If the act in which the unlawful or forbidden cause consists does not constitute a criminal offense, the following rules shall be observed:

(1) When the fault is on the part of both contracting parties, neither may recover what he has given by virtue of the contract, or demand the performance of the other's undertaking;

(2) When only one of the contracting parties is at fault, he cannot recover what he has given by reason of the contract, or ask for the fulfillment of what has been promised him. The other, who is not at fault, may demand the return of what he has given without any obligation to comply with his promise.

Petitioners did not come to court with clean hands. They admit that they never planted sugarcane on any property, much less on the mortgaged property. Yet, they eagerly accepted the proceeds of the simulated sugar crop loans. Petitioners readily participated in the ploy to circumvent the Rural Banks Act and offered no objection when their original loan of P350,000.00 was divided into small separate loans not exceeding P50,000.00 each. Clearly, both petitioners and respondent are in *pari delicto*, and neither should be accorded affirmative relief as against the other.

In *Tala Realty Services Corp. v. Banco Filipino Savings and Mortgage Bank*,^[12] we held that when the parties are in *pari delicto*, neither will obtain relief from the court, thus:

The Bank should not be allowed to dispute the sale of its lands to Tala nor should Tala be allowed to further collect rent from the Bank. The clean hands doctrine will not allow the creation or the use of a juridical relation such as a trust to subvert, directly or indirectly, the law. Neither the bank nor Tala came to court with clean hands; neither will obtain relief from the court as one who seeks equity and justice must come to court with clean hands. By not allowing Tala to collect from the Bank rent for the period during which the latter was arbitrarily closed, both Tala and the Bank will be left where they are, each paying the price for its deception.^[13]

Petitioners stubbornly insist that respondent cannot invoke the *pari delicto* doctrine, ostensibly because of our obiter in *Enrique T. Yuchengco, Inc., et al. v. Velayo*.^[14]

In *Yuchengco*, appellant sold 70% of the subscribed and outstanding capital stock of a Philippine corporation, duly licensed as a tourist operator, to appellees without the required prior notice and approval of the Department of Tourism (DOT). Consequently, the DOT cancelled the corporation's Local Tour Operator's License. In turn, appellees asked for a rescission of the sale and demanded the return of the purchase price.

We specifically ruled therein that the *pari delicto* doctrine is not applicable, because:

The obligation to secure prior Department of Tourism approval devolved upon the defendant (herein appellant)

for it was he as the owner vendor who had the duty to give clear title to the properties he was conveying. It was he alone who was charged with knowing about rules attendant to a sale of the assets or shares of his tourist-oriented organization. He should have known that under said rules and regulations, on pain of nullity, shares of stock in his company could not be transferred without prior approval from the Department of Tourism. The failure to secure this approval is attributable to him alone.[15]

Thus, we declared that even assuming both parties were guilty of the violation, it does not always follow that both parties, being in *pari delicto*, should be left where they are. We recognized as an exception a situation when courts must interfere and grant relief to one of the parties because public policy requires their intervention, even if it will result in a benefit derived by a plaintiff who is in equal guilt with defendant.[16]

In stark contrast to *Yuchengco*, the factual milieu of the present case does not compel us to grant relief to a party who is in *pari delicto*. The public policy requiring rural banks to give preference to bona fide small farmers in the grant of loans will not be served if a party, such as petitioners, who had equal participation and equal guilt in the circumvention of the Rural Banks Act, will be allowed to recover the subject property.

The following circumstances reveal the utter poverty of petitioners' arguments and militate against their bid to recover the subject property:

- As previously adverted to, petitioners readily and voluntarily accepted the proceeds of the loan, divided into small loans, without question.
- After failing to redeem the mortgaged subject property, thereby allowing respondent to consolidate title thereto,[17] petitioners then entered into a Promise to Sell and made a down payment of P250,000.00.
- Failing anew to comply with the terms of the Promise to Sell and pay the first yearly installment, only then did petitioners invoke the nullity of the loan and mortgage contracts.

In all, petitioners explicitly recognized respondent's ownership over the subject property and merely resorted to the void contract argument after they had failed to reacquire the property and a new title thereto in respondent's name was issued.

We are not unmindful of the fact that the Promise to Sell ultimately allows petitioners to recover the subject property which they were estopped from recovering under the void loan and mortgage contracts. However, the Promise to Sell, although it involves the same parties and subject matter, is a separate and independent contract from that of the void loan and mortgage contracts.

To reiterate, under the void loan and mortgage contracts, the parties, being in *pari delicto*, cannot recover what they each has given by virtue of the contract.[18] Neither can the parties demand performance of the contract. No remedy or affirmative relief can be afforded the parties because of their presumptive knowledge that the transaction was tainted with illegality.[19] The courts will not aid either party to an illegal agreement and will instead leave the parties where they find them.[20]

Consequently, the parties having no cause of action against the other based on a void contract, and possession and ownership of the subject property being ultimately vested in respondent, the latter can enter into a separate and distinct contract for its alienation. Petitioners recognized respondent's ownership of the subject property by entering into a Promise to Sell, which expressly designates respondent as the vendor and petitioners as the vendees. At this point, petitioners, originally co-owners and mortgagors of the subject property, unequivocally acquiesced to their new status as buyers thereof. In fact, the Promise to Sell makes no reference whatsoever to petitioners' previous ownership of the subject property and to the void loan and mortgage contracts.[21] On the whole, the Promise to Sell, an independent contract, did not purport to ratify the void loan and mortgage contracts.

By its very terms, the Promise to Sell simply intended to alienate to petitioners the subject property according to the terms and conditions contained therein. Article 1370 of the Civil Code reads:

Art. 1370. If the terms of a contract are clear and leave no doubt upon the intention of the contracting parties, the literal meaning of its stipulations shall control.

If the words appear to be contrary to the evident intention of the parties, the latter shall prevail over the former.

Thus, the terms and conditions of the Promise to Sell are controlling.

Paragraph 5 of the Promise to Sell provides:

5)

Provided further, that in case of a delay in any yearly installment for a period of ninety (90) days, this sale will become null and void [without] further effect or validity; and provided further, that payments made shall be reimbursed (returned to the VENDEE less interest on the account plus additional 15% liquidated damages and charges).[22]

As stipulated in the Promise to Sell, petitioners are entitled to reimbursement of the P250,000.00 down payment. We agree with the CA's holding on this score:

We note, however, that there is no basis for the imposition of interest and additional 15% liquidated damages and charges on the amount to be thus reimbursed. The "Promise to Sell" is separate and distinct from the loan and mortgage contracts earlier executed by the parties. Obviously, after the foreclosure, there is no more loan or account to speak of to justify the said imposition.[23]

Finally, contrary to petitioners' contention, the CA, in denying petitioners' appeal, did not commit an error; it did not ratify a void contract because void contracts cannot be ratified. The CA simply refused to grant the specific relief of recovering the subject property prayed for by petitioners. Nonetheless, it ordered respondent to reimburse petitioners for their down payment of P250,000.00 and disallowed respondent's claim for actual, moral and exemplary damages and attorney's fees.

WHEREFORE, premises considered, the petition is hereby DENIED. The Decision of the Court of Appeals in CA-G.R. CV No. 40613 is hereby AFFIRMED. Costs against petitioners.

SO ORDERED.

Ynares-Santiago, (Chairperson), Carpio, Corona, and Leonardo-De Castro, JJ., concur.

[*] Additional member in lieu of Associate Justice Conchita Carpio Morales per Special Order No. 646 dated May 15, 2009.

[**] Additional member per Raffle dated September 1, 2008.

*** Additional member in lieu of Associate Justice Minita V. Chico-Nazario per Special Order No. 651 dated May 29, 2009.

[1] Penned by Associate Justice Ruben T. Reyes (now a retired member of this Court), with Associate Justices Mariano M. Umali and Rebecca de Guia-Salvador, concurring; rollo, pp. 19-29.

[2] Penned by Judge Teofisto L. Calumpang, CA rollo, pp. 58-68.

[3] Rollo, pp. 20-23.

[4] Id. at 29.

[5] Petitioners' Memorandum, id. at 79.

[6] Rollo, pp. 76-77.

[7] See Tolentino, Civil Code of the Philippines (1991), Vol. IV, p. 516.

[8] Id.

[9] See CIVIL CODE, Art. 1318: There is no contract unless the following requisites concur:

- (1) Consent of the contracting parties;
- (2) Object certain which is the subject matter of the contract;
- (3) Cause of the obligation which is established.

[10] See Rural Banks Act, Secs. 5 and 6.

Sec. 5. Loans or advances extended by Rural Banks organized and operated under this Act, shall be primarily for the purpose of meeting the normal credit needs of farmers or farm families owning or cultivating land dedicated to agricultural production as well as the normal credit needs of cooperatives and merchants. In the granting of loans, the Rural Bank shall give credit preference to the application of farmers and merchants whose cash requirements are small.

Sec. 6. With the view to insuring balanced rural economic growth and expansion, Rural Banks, may within limits and conditions fixed by the Monetary Board, devote a portion of their loanable funds to meeting the normal credit needs of small business enterprise whose capital investment does not exceed fifty thousand pesos and of essential rural enterprises or industries other than those which are strictly agricultural in nature.

[11] Art. 1409. The following contracts are inexistent and void from the beginning:

- (1) Those whose cause, object or purpose is contrary to law, morals, good customs, public order or public policy;
- (2) Those which are absolutely simulated or fictitious;
- (3) Those whose cause or object did not exist at the time of the transaction;
- (4) Those whose object is outside the commerce of men;
- (5) Those which contemplate an impossible service;
- (6) Those where the intention of the parties relative to the principal object of the contract cannot be ascertained;
- (7) Those expressly prohibited or declared void by law.

These contracts cannot be ratified. Neither can the right to set up the defense of illegality be waived.

[12] 441 Phil. 1 (2002). (Citations omitted.)

[13] Tala Realty Services Corp. v. Banco Filipino Savings and Mortgage Bank, id. at 45.

[14] 200 Phil. 703 (1982).

[15] Yuchengco, Inc. v. Velayo, id. at 710-711.

[16] Id. at 711.

[17] After the lapse of the redemption period, the mortgagor is now considered to have lost interest in the

foreclosed property. See *Yulienco v. Court of Appeals*, 441 Phil. 397, 406 (2002).

[18] CIVIL CODE, Art. 1412, par. 1.

[19] *Top-Weld Manufacturing, Inc. v. ECED, S.A.*, G.R. No. L-44944, August 9, 1985, 138 SCRA 118, 131-132.

[20] *Id.* at 131.

[21] Paragraph 1 of the Promise to Sell provides:

1) That the Vendor is the present owner of the following properties:

a)

A parcel of land (Lot No. 8-A-5 of the subdivision plan (LRC) Psd-49727, being a portion of Lot No. 8-A (LRC) Psd-31929, L.R.C. Cad. Rec. No. 152) with the improvements thereon, situated in the Barrio of Bantayan, City of Dumaguete, Island of Negros. Bounded on the S., points 1 to 2 by Lot No. 8-A-3 of the subdivision plan; on the W., and N., points 3 to 4 by Lot No. 1593 of the Cadastral Survey of Dumaguete; and on the E., points 4 to 1 by Lot No. 8-A-4 of the subdivision plan. Containing an area of FIVE THOUSAND TWO HUNDRED TWENTY NINE (5,229) SQUARE METERS, more or less.

b)

A semi-concrete residential house with a ground floor area of 680 sq.m. of two (2) storey in height constructed of concrete hollow blocks under galvanized iron roof constructed on Lot No. 8-A-5 as per Transfer Certificate of Title No. 12389 situated in Rovera Extension, Bantayan, Dumaguete City belonging to the mortgagor is covered by this mortgage. For which they are responsible of the entire duration of this mortgage. Covered with fire insurance having a mortgage clause in favor of the bank.

all having been acquired under Sheriff's Certificate of Sale dated March 19, 1986. (Records, p. 6.)

[22] Records, pp. 6-7.

[23] Rollo, p. 26.

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