

PCI LEASING AND FINANCE, INC., PETITIONER, VS. TROJAN METAL INDUSTRIES INCORPORATED, WALFRIDO DIZON, ELIZABETH DIZON, AND JOHN DOE, RESPONDENTS.*G.R. No. 176381. December 15, 2010*

Ponente: CARPIO, J.

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This is a petition for review[1] with application for the immediate issuance of a temporary restraining order and writ of preliminary injunction assailing the 5 October 2006 Decision[2] and the 23 January 2007 Resolution[3] of the Court of Appeals in CA-G.R. CV No. 75855. The 5 October 2006 Decision set aside the 23 July 2002 Decision[4] of the Regional Trial Court (Branch 79) of Quezon City in Civil Case No. Q-99-37559, which granted petitioner's complaint for recovery of sum of money and personal property with prayer for the issuance of a writ of replevin. The 23 January 2007 Resolution denied petitioner's motion for reconsideration.

The Facts

Sometime in 1997, respondent Trojan Metal Industries, Inc. (TMI) came to petitioner PCI Leasing and Finance, Inc. (PCILF) to seek a loan. Instead of extending a loan, PCILF offered to buy various equipment TMI owned, namely: a Verson double action hydraulic press with cushion, a Hinohara powerpress 75-tons capacity, a USI-clearing powerpress 60-tons capacity, a Watanabe powerpress 60-tons capacity, a YMGP powerpress 30-tons capacity, a YMGP powerpress 15-tons capacity, a lathe machine, a vertical milling machine, and a radial drill. Hard-pressed for money, TMI agreed. PCILF and TMI immediately executed deeds of sale[5] evidencing TMI's sale to PCILF of the various equipment in consideration of the total amount of P 2,865,070.00.

PCILF and TMI then entered into a lease agreement,[6] dated 8 April 1997, whereby the latter leased from the former the various equipment it previously owned. Pursuant to the lease agreement, TMI issued postdated checks representing 24 monthly installments. The monthly rental for the Verson double action hydraulic press with cushion was in the amount of P62,328.00; for the Hinohara powerpress 75-tons capacity, the USI-clearing powerpress 60-tons capacity, the Watanabe powerpress 60-tons capacity, the YMGP powerpress 30-tons capacity, and the YMGP powerpress 15-tons capacity, the monthly rental was in the amount of P49,259.00; and for the lathe machine, the vertical milling machine, and the radial drill, the monthly rental was in the amount of P22,205.00.

The lease agreement required TMI to give PCILF a guaranty deposit of P1,030,350.00,[7] which would serve as security for the timely performance of TMI's obligations under the lease agreement, to be automatically forfeited should TMI return the leased equipment before the expiration of the lease agreement.

Further, spouses Walfrido and Elizabeth Dizon, as TMI's President and Vice-President, respectively executed in

favor of PCILF a Continuing Guaranty of Lease Obligations.[8] Under the continuing guaranty, the Dizon spouses agreed to immediately pay whatever obligations would be due PCILF in case TMI failed to meet its obligations under the lease agreement.

To obtain additional loan from another financing company,[9] TMI used the leased equipment as temporary collateral.[10] PCILF considered the second mortgage a violation of the lease agreement. At this time, TMI's partial payments had reached P1,717,091.00.[11] On 8 December 1998, PCILF sent TMI a demand letter[12] for the payment of the latter's outstanding obligation. PCILF's demand remained unheeded.

On 7 May 1999, PCILF filed in the Regional Trial Court (Branch 79) of Quezon City a complaint[13] against TMI, spouses Dizon, and John Doe (collectively referred to as "respondents" hereon) for recovery of sum of money and personal property with prayer for the issuance of a writ of replevin, docketed as Civil Case No. Q-99-37559.

On 7 September 1999, the RTC issued the writ of replevin[14] PCILF prayed for, directing the sheriff to take custody of the leased equipment. Not long after, PCILF sold the leased equipment to a third party and collected the proceeds amounting to P1,025,000.00.[15]

In their answer,[16] respondents claimed that the sale with lease agreement was a mere scheme to facilitate the financial lease between PCILF and TMI. Respondents explained that in a simulated financial lease, property of the debtor would be sold to the creditor to be repaid through rentals; at the end of the lease period, the property sold would revert back to the debtor. Respondents prayed that they be allowed to reform the lease agreement to show the true agreement between the parties, which was a loan secured by a chattel mortgage.

The Ruling of the RTC

In its 23 July 2002 Decision, the RTC granted the prayer of PCILF in its complaint. The RTC ruled that the lease agreement must be presumed valid as the law between the parties even if some of its provisions constituted unjust enrichment on the part of PCILF. The dispositive portion of its Decision reads:

WHEREFORE, judgment is hereby rendered in favor of the plaintiff-PCI Leasing and Finance, Inc. and against defendants Trojan Metal, Walfrido Dizon, and Elizabeth Dizon, as follows:

- Ordering the plaintiff to be entitled to the possession of herein machineries.
- Ordering the defendants to pay the remaining rental obligation in the amount of Php 888,434.48 plus legal interest from the date of filing of the complaint;
- Ordering defendant to pay an attorneys fees in the amount of Php 50,000.00;
- Ordering the defendant to pay the cost of suit.

SO ORDERED.[17]

Respondents appealed to the Court of Appeals alleging that the RTC erred in ruling that PCILF was entitled to the possession of TMI's equipment and that respondents still owed PCILF the balance of P888,423.48.

The Ruling of the Court of Appeals

The Court of Appeals ruled that the sale with lease agreement was in fact a loan secured by chattel mortgage. The Court of Appeals held that since PCILF sold the equipment to a third party for P1,025,000.00 and TMI paid PCILF a guaranty deposit of P1,030,000.00, PCILF had in its hands the sum of P2,055,250.00, as against TMI's remaining obligation of P888,423.48, or an excess of P1,166,826.52, which should be returned to TMI in

accordance with Section 14 of the Chattel Mortgage Law.

Thus, in its 5 October 2006 Decision, the Court of Appeals set aside the Decision of the RTC. The Court of Appeals entered a new one dismissing PCILF's complaint and directing PCILF to pay TMI, by way of refund, the amount of P1,166,826.52. The decretal part of its Decision reads:

WHEREFORE, premises considered, the July 23, 2002 Decision of the Regional Trial Court of Quezon City, Branch 79, in Civil Case No. Q-99-37559, is hereby REVERSED and SET ASIDE, and a new one entered DISMISSING the complaint and DIRECTING the plaintiff-appellee PCI Leasing and Finance, Inc. to PAY, by way of REFUND, to the defendant-appellant Trojan Metal Industries, Inc., the net amount of Php 1,166,826.52.

SO ORDERED.[18]

The Issues

The issues for resolution are (1) whether the sale with lease agreement the parties entered into was a financial lease or a loan secured by chattel mortgage; and (2) whether PCILF should pay TMI, by way of refund, the amount of P1,166,826.52.

The Court's Ruling

The petition lacks merit.

PCILF contends that the transaction between the parties was a sale and leaseback financing arrangement where the client sells movable property to a financing company, which then leases the same back to the client. PCILF insists the transaction is not financial leasing, which contemplates extension of credit to assist a buyer in acquiring movable property which the buyer can use and eventually own. PCILF claims that the sale and leaseback financing arrangement is not contrary to law, morals, good customs, public order, or public policy. PCILF stresses that the guaranty deposit should be forfeited in its favor, as provided in the lease agreement. PCILF points out that this case does not involve mere failure to pay rentals, it deals with a flagrant violation of the lease agreement.

Respondents counter that from the very beginning, transfer to PCILF of ownership over the subject equipment was never the intention of the parties. Respondents claim that under the lease agreement, the guaranty deposit would be forfeited if TMI returned the leased equipment to PCILF before the expiration of the lease agreement; thus, since TMI never returned the leased equipment voluntarily, but through a writ of replevin ordered by the RTC, the guaranty deposit should not be forfeited.

Since the lease agreement in this case was executed on 8 April 1997, Republic Act No. 5980 (RA 5980), otherwise known as the Financing Company Act, governs as to what constitutes financial leasing. Section 1, paragraph (j) of the New Rules and Regulations to Implement RA 5980[19] defines financial leasing as follows:

LEASING shall refer to financial leasing which is a mode of extending credit through a non-cancelable contract under which the lessor purchases or acquires at the instance of the lessee heavy equipment, motor vehicles, industrial machinery, appliances, business and office machines, and other movable property in consideration of the periodic payment by the lessee of a fixed amount of money sufficient to amortize at least 70% of the purchase price or acquisition cost, including any incidental expenses and a margin of profit, over the lease period. The contract shall extend over an obligatory period during which the lessee has the right to hold and use the leased property and shall bear the cost of repairs, maintenance, insurance, and preservation thereof, but with no obligation or option on the part of the lessee to purchase the leased property at the end of the lease contract.

The above definition of financial leasing gained statutory recognition with the enactment of Republic Act No. 8556 (RA 8556), otherwise known as the Financing Company Act of 1998.[20] Section 3(d) of RA 8556 defines financial leasing as:

a mode of extending credit through a non-cancelable lease contract under which the lessor purchases or acquires, at the instance of the lessee, machinery, equipment, motor vehicles, appliances, business and office machines, and other movable or immovable property in consideration of the periodic payment by the lessee of a fixed amount of money sufficient to amortize at least seventy (70%) of the purchase price or acquisition cost, including any incidental expenses and a margin of profit over an obligatory period of not less than two (2) years during which the lessee has the right to hold and use the leased property with the right to expense the lease rentals paid to the lessor and bears the cost of repairs, maintenance, insurance and preservation thereof, but with no obligation or option on his part to purchase the leased property from the owner-lessor at the end of the lease contract.

Thus, in a true financial leasing, whether under RA 5980 or RA 8556, a finance company purchases on behalf of a cash-strapped lessee the equipment the latter wants to buy but, due to financial limitations, is incapable of doing so. The finance company then leases the equipment to the lessee in exchange for the latter's periodic payment of a fixed amount of rental.

In this case, however, TMI already owned the subject equipment before it transacted with PCILF. Therefore, the transaction between the parties in this case cannot be deemed to be in the nature of a financial leasing as defined by law.

The facts in the instant case are analogous to those in *Cebu Contractors Consortium Co. v. Court of Appeals*.[21] There, Cebu Contractors Consortium Co. (CCCC) approached Makati Leasing and Finance Corporation (MLFC) to obtain a loan. MLFC agreed to extend financial assistance to CCCC but, instead of a loan with collateral, MLFC induced CCCC to adopt a sale and leaseback scheme. Under the scheme, several of CCCC's equipment were made to appear as sold to MLFC and then leased back to CCCC, which in turn paid lease rentals to MLFC. The rentals were treated as installment payments to repurchase the equipment.

The Court held in *Cebu Contractors Consortium Co. v. Court of Appeals*[22] that the transaction between CCCC and MLFC was not one of financial leasing as defined by law, but simply a loan secured by a chattel mortgage over CCCC's equipment. The Court went on to explain that where the client already owned the equipment but needed additional working capital and the finance company purchased such equipment with the intention of leasing it back to him, the lease agreement was simulated to disguise the true transaction that was a loan with security. In that instance, continued the Court, the intention of the parties was not to enable the client to acquire and use the equipment, but to extend to him a loan.

Similarly, in *Investors Finance Corporation v. Court of Appeals*,[23] a borrower came to Investors Finance Corporation (IFC) to secure a loan with his heavy equipment and machinery as collateral. The parties executed documents where IFC was made to appear as the owner of the equipment and the borrower as the lessee. As consideration for the lease, the borrower-lessee was to pay monthly amortizations over a period of 36 months. The parties executed a lease agreement covering various equipment described in the lease schedules attached to the lease agreement. As security, the borrower-lessee also executed a continuing guaranty.

The Court in *Investors Finance Corporation v. Court of Appeals*[24] held that the transaction between the parties was not a true financial leasing because the intention of the parties was not to enable the borrower-lessee to acquire and use the heavy equipment and machinery, which already belonged to him, but to extend to him a loan to use as capital for his construction and logging businesses. The Court held that the lease agreement was simulated to disguise the true transaction between the parties, which was a simple loan secured by heavy

equipment and machinery owned by the borrower-lessee. The Court differentiated between a true financial leasing and a loan with mortgage in the guise of a lease. The Court said that financial leasing contemplates the extension of credit to assist a buyer in acquiring movable property which he can use and eventually own. If the movable property already belonged to the borrower-lessee, the transaction between the parties, according to the Court, was a loan with mortgage in the guise of a lease.

In the present case, since the transaction between PCILF and TMI involved equipment already owned by TMI, it cannot be considered as one of financial leasing, as defined by law, but simply a loan secured by the various equipment owned by TMI.

Articles 1359 and 1362 of the Civil Code provide:

Art. 1359. When, there having been a meeting of the minds of the parties to a contract, their true intention is not expressed in the instrument purporting to embody the agreement, by reason of mistake, fraud, inequitable conduct, or accident, one of the parties may ask for the reformation of the instrument to the end that such true intention may be expressed.

Art. 1362. If one party was mistaken and the other acted fraudulently or inequitably in such a way that the instrument does not show their true intention, the former may ask for the reformation of the instrument.

Under Article 1144 of the Civil Code, the prescriptive period for actions based upon a written contract and for reformation of an instrument is ten years.[25] The right of action for reformation accrued from the date of execution of the lease agreement on 8 April 1997. TMI timely exercised its right of action when it filed an answer[26] on 14 February 2000 asking for the reformation of the lease agreement.

Hence, had the true transaction between the parties been expressed in a proper instrument, it would have been a simple loan secured by a chattel mortgage, instead of a simulated financial leasing. Thus, upon TMI's default, PCILF was entitled to seize the mortgaged equipment, not as owner but as creditor-mortgagee for the purpose of foreclosing the chattel mortgage. PCILF's sale to a third party of the mortgaged equipment and collection of the proceeds of the sale can be deemed in the exercise of its right to foreclose the chattel mortgage as creditor-mortgagee.

The Court of Appeals correctly ruled that the transaction between the parties was simply a loan secured by a chattel mortgage. However, in reckoning the amount of the principal obligation, the Court of Appeals should have taken into account the proceeds of the sale to PCILF less the guaranty deposit paid by TMI. After deducting payments made by TMI to PCILF, the balance plus applicable interest should then be applied against the aggregate cash already in PCILF's hands.

Records show that PCILF paid TMI P2,865,070.00[27] as consideration for acquiring the mortgaged equipment. In turn, TMI gave PCILF a guaranty deposit of P1,030,350.00.[28] Thus, the amount of the principal loan was P1,834,720.00, which was the net amount actually received by TMI (proceeds of the sale of the equipment to PCILF minus the guaranty deposit). Against the principal loan of P1,834,720.00 plus the applicable interest should be deducted loan payments, totaling P1,717,091.00.[29] Since PCILF sold the mortgaged equipment to a third party for P1,025,000.00,[30] the proceeds of the said sale should be applied to offset the remaining balance on the principal loan plus applicable interest.

However, the exact date of the sale of the mortgaged equipment, which is needed to compute the interest on the remaining balance of the principal loan, cannot be gleaned from the facts on record. We thus remand the case to the RTC for the computation of the total amount due from the date of demand on 8 December 1998 until the date of sale of the mortgaged equipment to a third party, which amount due shall be offset against the proceeds of the

sale.

In the absence of stipulation, the applicable interest due on the remaining balance of the loan is the legal rate of 12% per annum, computed from the date PCILF sent a demand letter to TMI on 8 December 1998. No interest can be charged prior to this date because TMI was not yet in default prior to 8 December 1998. The interest due shall also earn legal interest from the time it is judicially demanded, pursuant to Article 2212 of the Civil Code, which provides:

Art. 2212. Interest due shall earn legal interest from the time it is judicially demanded, although the obligation may be silent upon this point.

The foregoing provision has been incorporated in the comprehensive summary of existing rules on the computation of legal interest laid down by the Court in *Eastern Shipping Lines, Inc. v. Court of Appeals*,^[31] to wit:

- When an obligation is breached, and it consists in the payment of a sum of money, i.e., a loan or forbearance of money, the interest due should be that which may have been stipulated in writing. Furthermore, the interest due shall itself earn legal interest from the time it is judicially demanded. In the absence of stipulation, the rate of interest shall be 12% per annum to be computed from default, i.e., from judicial or extrajudicial demand under and subject to the provisions of Article 1169 of the Civil Code.
- When an obligation, not constituting a loan or forbearance of money, is breached, an interest on the amount of damages awarded may be imposed at the discretion of the court at the rate of 6% per annum. No interest, however, shall be adjudged on unliquidated claims or damages except when or until the demand can be established with reasonable certainty. Accordingly, where the demand is established with reasonable certainty, the interest shall begin to run from the time the claim is made judicially or extrajudicially (Art. 1169, Civil Code) but when such certainty cannot be so reasonably established at the time the demand is made, the interest shall begin to run only from the date the judgment of the court is made (at which time the quantification of damages may be deemed to have been reasonably ascertained). The actual base for the computation of legal interest shall, in any case, be on the amount finally adjudged.
- When the judgment of the court awarding a sum of money becomes final and executory, the rate of legal interest, whether the case falls under paragraph 1 or paragraph 2, above, shall be 12% per annum from such finality until its satisfaction, this interim period being deemed to be by then an equivalent to a forbearance of credit. (Emphasis supplied)

Applying the rules in the computation of interest, the remaining balance of the principal loan subject of the chattel mortgage must earn the legal interest of 12% per annum, which interest, as long as unpaid, also earns legal interest of 12% per annum, computed from the filing of the complaint on 7 May 1999.

In accordance with the rules laid down in *Eastern Shipping Lines, Inc. v. Court of Appeals*,^[32] we derive the following formula for the RTC's guidance:

TOTAL AMOUNT DUE = [principal - partial payments made] + [interest + interest on interest], where

Interest = remaining balance x 12% per annum x no. of years from due date (8 December 1998 when demand was made) until date of sale to a third party

Interest on interest = interest computed as of the filing of the complaint on 7 May 1999 x 12% x no. of years until date of sale to a third party

From the computed total amount should be deducted P1,025,000.00 representing the proceeds of the sale already in PCILF's hands. The difference represents overpayment by TMI, which the law requires PCILF to refund to

TMI.

Section 14 of Act No. 1508, otherwise known as the Chattel Mortgage Law, provides:

Section 14. Sale of property at public auction; officer's return; fees; disposition of proceeds. x x x The proceeds of such sale shall be applied to the payment, first, of the costs and expenses of keeping and sale, and then to the payment of the demand or obligation secured by such mortgage, and the residue shall be paid to persons holding subsequent mortgages in their order, and the balance, after paying the mortgages, shall be paid to the mortgagor or person holding under him on demand.

Section 14 of the Chattel Mortgage Law expressly entitles the debtor-mortgagor to the balance of the proceeds, upon satisfaction of the principal loan and costs. Prevailing jurisprudence^[33] also holds that the Chattel Mortgage Law bars the creditor-mortgagee from retaining the excess of the sale proceeds.

TMI's right to the refund accrued from the time PCILF received the proceeds of the sale of the mortgaged equipment. However, since TMI never made a counterclaim or demand for refund due on the resulting overpayment after offsetting the proceeds of the sale against the remaining balance on the principal loan plus applicable interest, no interest applies on the amount of refund due. Nonetheless, in accord with prevailing jurisprudence,^[34] the excess amount PCILF must refund to TMI is subject to interest at 12% per annum from finality of this Decision until fully paid.

WHEREFORE, we DENY the petition. We AFFIRM with MODIFICATION the 5 October 2006 Decision and the 23 January 2007 Resolution of the Court of Appeals in CA-G.R. CV No. 75855. Petitioner PCI Leasing and Finance, Inc. is hereby ORDERED to PAY respondent Trojan Metal Industries, Inc., by way of refund, the excess amount to be computed by the Regional Trial Court based on the formula specified above, with interest at 12% per annum from finality of this Decision until fully paid.

Costs against petitioner.

SO ORDERED.

Nachura, Peralta, Abad, and Mendoza, JJ., concur.

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

[2] Rollo, pp. 42-52. Penned by Associate Justice Vicente Q. Roxas, with Associate Justices Josefina Guevara-Salonga and Apolinario D. Bruselas, Jr., concurring.

[3] Id. at 53. Penned by Associate Justice Vicente Q. Roxas, with Associate Justices Josefina Guevara-Salonga and Apolinario D. Bruselas, Jr., concurring.

[4] CA rollo, pp. 67-72. Penned by Judge Demetrio B. Macapagal, Sr.

[5] Records, pp. 179-181.

[6] Id. at 10-14.

[7] Id. at 12-14. TSN dated 12 July 2001, p. 19.

[8] Id. at 17.

[9] Technology and Livelihood Resources Center.

[10] Records, pp. 279-280, 204-205; TSN dated 7 February 2002, p. 7.

[11] Id. at 157, 187.

[12] Id. at 15-16.

[13] Id. at 1-9.

[14] Id. at 75-76.

[15] TSN dated 17 August 2001, p. 15.

[16] Records, pp. 117-119.

[17] CA rollo, p. 72.

[18] Rollo, p. 52.

[19] Dated 16 October 1991.

[20] An Act Amending Republic Act No. 5980, otherwise known as the Financing Company Act.

[21] G.R. No. 107199, 22 July 2003, 407 SCRA 154.

[22] Id.

[23] G.R. No. 91334, 7 February 1991, 193 SCRA 701.

[24] Id.

[25] Civil Code, Art. 1144. The following actions must be brought within ten years from the time the right of action accrues:

1. Upon a written contract;

x x x x

[26] Records, pp. 117-119.

[27] Records, pp. 179-181.

[28] Id.

[29] Id. at 157, 187.

[30] TSN dated 17 August 2001, p. 15.

[31] G.R. No. 97412, 12 July 1994, 234 SCRA 78, 95-97.

[32] Id.

[33] PAMECA Wood Treatment Plant, Inc. v. CA, 369 Phil. 544 (1999).

[34] Cuyco v. Cuyco, G.R. No. 168736, 19 April 2006, 487 SCRA 693

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