MINDANAO SAVINGS AND LOAN ASSOCIATION, INC., REPRESENTED BY ITS LIQUIDATOR, THE PHILIPPINE DEPOSIT INSURANCE CORPORATION, PETITIONER, VS. EDWARD WILLKOM; GILDA GO; REMEDIOS UY; ...

G.R. No. 178618. October 11, 2010

Ponente: NACHURA, J.

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NACHURA, J.:

This is a petition for review on certiorari under Rule 45 of the Rules of Court filed by Mindanao Savings and Loan Association, Inc. (MSLAI), represented by its liquidator, Philippine Deposit Insurance Corporation (PDIC), against respondents Edward R. Willkom (Willkom); Gilda Go (Go); Remedios Uy (Uy); Malayo Bantuas (sheriff Bantuas), in his capacity as sheriff of the Regional Trial Court (RTC), Branch 3 of Iligan City; and the Register of Deeds of Cagayan de Oro City. MSLAI seeks the reversal and setting aside of the Court of Appeals[1] (CA) Decision[2] dated March 21, 2007 and Resolution[3] dated June 1, 2007 in CA-G.R. CV No. 58337.

The controversy stemmed from the following facts:

The First Iligan Savings and Loan Association, Inc. (FISLAI) and the Davao Savings and Loan Association, Inc. (DSLAI) are entities duly registered with the Securities and Exchange Commission (SEC) under Registry Nos. 34869 and 32388, respectively, primarily engaged in the business of granting loans and receiving deposits from the general public, and treated as banks.[4]

Sometime in 1985, FISLAI and DSLAI entered into a merger, with DSLAI as the surviving corporation.[5] The articles of merger were not registered with the SEC due to incomplete documentation.[6] On August 12, 1985, DSLAI changed its corporate name to MSLAI by way of an amendment to Article 1 of its Articles of Incorporation, but the amendment was approved by the SEC only on April 3, 1987.[7]

Meanwhile, on May 26, 1986, the Board of Directors of FISLAI passed and approved Board Resolution No. 86-002, assigning its assets in favor of DSLAI which in turn assumed the former's liabilities.[8]

The business of MSLAI, however, failed. Hence, the Monetary Board of the Central Bank of the Philippines ordered its closure and placed it under receivership per Monetary Board Resolution No. 922 dated August 31, 1990. The Monetary Board found that MSLAI's financial condition was one of insolvency, and for it to continue in business would involve probable loss to its depositors and creditors. On May 24, 1991, the Monetary Board ordered the liquidation of MSLAI, with PDIC as its liquidator.[9]

It appears that prior to the closure of MSLAI, Uy filed with the RTC, Branch 3 of Iligan City, an action for collection of sum of money against FISLAI, docketed as Civil Case No. 111-697. On October 19, 1989, the RTC issued a summary decision in favor of Uy, directing defendants therein (which included FISLAI) to pay the former the sum of P136,801.70, plus interest until full payment, 25% as attorney's fees, and the costs of suit. The decision was modified by the CA by further ordering the third-party defendant therein to reimburse the payments

that would be made by the defendants. The decision became final and executory on February 21, 1992. A writ of execution was thereafter issued.[10]

On April 28, 1993, sheriff Bantuas levied on six (6) parcels of land owned by FISLAI located in Cagayan de Oro City, and the notice of sale was subsequently published. During the public auction on May 17, 1993, Willkom was the highest bidder. A certificate of sale was issued and eventually registered with the Register of Deeds of Cagayan de Oro City. Upon the expiration of the redemption period, sheriff Bantuas issued the sheriff's definite deed of sale. New certificates of title covering the subject properties were issued in favor of Willkom. On September 20, 1994, Willkom sold one of the subject parcels of land to Go.[11]

On June 14, 1995, MSLAI, represented by PDIC, filed before the RTC, Branch 41 of Cagayan de Oro City, a complaint for Annulment of Sheriff's Sale, Cancellation of Title and Reconveyance of Properties against respondents.[12] MSLAI alleged that the sale on execution of the subject properties was conducted without notice to it and PDIC; that PDIC only came to know about the sale for the first time in February 1995 while discharging its mandate of liquidating MSLAI's assets; that the execution of the RTC decision in Civil Case No. 111-697 was illegal and contrary to law and jurisprudence, not only because PDIC was not notified of the execution sale, but also because the assets of an institution placed under receivership or liquidation such as MSLAI should be deemed in custodia legis and should be exempt from any order of garnishment, levy, attachment, or execution.[13]

In answer, respondents averred that MSLAI had no cause of action against them or the right to recover the subject properties because MSLAI is a separate and distinct entity from FISLAI. They further contended that the "unofficial merger" between FISLAI and DSLAI (now MSLAI) did not take effect considering that the merging companies did not comply with the formalities and procedure for merger or consolidation as prescribed by the Corporation Code of the Philippines. Finally, they claimed that FISLAI is still a SEC registered corporation and could not have been absorbed by petitioner.[14]

On March 13, 1997, the RTC issued a resolution dismissing the case for lack of jurisdiction. The RTC declared that it could not annul the decision in Civil Case No. 111-697, having been rendered by a court of coordinate jurisdiction.[15]

On appeal, MSLAI failed to obtain a favorable decision when the CA affirmed the RTC resolution. The dispositive portion of the assailed CA Decision reads:

> WHEREFORE, premises considered, the instant appeal is DENIED. The decision assailed is AFFIRMED.
>
> We REFER Sheriff Malayo B. Bantuas' violation of the Supreme Court Administrative Circular No. 12 to the Office of the Court Administrator for appropriate action. The Division Clerk of Court is hereby DIRECTED to furnish the Office of the Court Administrator a copy of this decision.
>
> SO ORDERED.[16]

The appellate court sustained the dismissal of petitioner's complaint not because it had no jurisdiction over the case, as held by the RTC, but on a different ground. Citing Associated Bank v. CA,[17] the CA ruled that there was no merger between FISLAI and MSLAI (formerly DSLAI) for their failure to follow the procedure laid down by the Corporation Code for a valid merger or consolidation. The CA then concluded that the two corporations retained their separate personalities; consequently, the claim against FISLAI is warranted, and the subsequent sale of the levied properties at public auction is valid. The CA went on to say that even if there had been a de facto merger between FISLAI and MSLAI (formerly DSLAI), Willkom, having relied on the clean certificates of title, was an innocent purchaser for value, whose right is superior to that of MSLAI. Furthermore, the alleged

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assignment of assets and liabilities executed by FISLAI in favor of MSLAI was not binding on third parties because it was not registered. Finally, the CA said that the validity of the auction sale could not be invalidated by the fact that the sheriff had no authority to conduct the execution sale.[18]

Petitioner's motion for reconsideration was denied in a Resolution dated June 1, 2007. Hence, the instant petition anchored on the following grounds:

> THE HONORABLE COURT OF APPEALS, CAGAYAN DE ORO COMMITTED GRAVE AND REVERSIBLE ERROR WHEN:
>
> (1)
>
> IT PASSED UPON THE EXISTENCE AND STATUS OF DSLAI (now MSLAI) AS THE SURVIVING ENTITY IN THE MERGER BETWEEN DSLAI AND FISLAI AS A DEFENSE IN AN ACTION OTHER THAN IN A QUO WARRANTO PROCEEDING UPON THE INSTITUTION OF THE SOLICITOR GENERAL AS MANDATED UNDER SECTION 20 OF BATAS PAMBANSA BLG. 68.
>
> (2)
>
> IT REFUSED TO RECOGNIZE THE MERGER BETWEEN F[I]SLAI AND DSLAI WITH DSLAI AS THE SURVIVING CORPORATION.
>
> (3)
>
> IT HELD THAT THE PROPERTIES SUBJECT OF THE CASE ARE NOT IN CUSTODIA LEGIS AND THEREFORE, EXEMPT FROM GARNISHMENT, LEVY, ATTACHMENT OR EXECUTION.[19]

To resolve this petition, we must address two basic questions: (1) Was the merger between FISLAI and DSLAI (now MSLAI) valid and effective; and (2) Was there novation of the obligation by substituting the person of the debtor?

We answer both questions in the negative.

Ordinarily, in the merger of two or more existing corporations, one of the corporations survives and continues the combined business, while the rest are dissolved and all their rights, properties, and liabilities are acquired by the surviving corporation.[20] Although there is a dissolution of the absorbed or merged corporations, there is no winding up of their affairs or liquidation of their assets because the surviving corporation automatically acquires all their rights, privileges, and powers, as well as their liabilities.[21]

The merger, however, does not become effective upon the mere agreement of the constituent corporations.[22] Since a merger or consolidation involves fundamental changes in the corporation, as well as in the rights of stockholders and creditors, there must be an express provision of law authorizing them.[23]

The steps necessary to accomplish a merger or consolidation, as provided for in Sections 76,[24] 77,[25] 78,[26] and 79[27] of the Corporation Code, are:

> (1) The board of each corporation draws up a plan of merger or consolidation. Such plan must include any amendment, if necessary, to the articles of incorporation of the surviving corporation, or in case of consolidation, all the statements required in the articles of incorporation of a corporation.
>
> (2) Submission of plan to stockholders or members of each corporation for approval. A meeting must be called and at least two (2) weeks' notice must be sent to all stockholders or members, personally or by registered mail. A summary of the plan must be attached to the notice. Vote of two-thirds of the members or of stockholders representing two-thirds of the outstanding capital stock will be needed. Appraisal rights, when proper, must be

> respected.
>
> (3) Execution of the formal agreement, referred to as the articles of merger o[r] consolidation, by the corporate officers of each constituent corporation. These take the place of the articles of incorporation of the consolidated corporation, or amend the articles of incorporation of the surviving corporation.
>
> (4) Submission of said articles of merger or consolidation to the SEC for approval.
>
> (5) If necessary, the SEC shall set a hearing, notifying all corporations concerned at least two weeks before.
>
> (6) Issuance of certificate of merger or consolidation.[28]
>
> Clearly, the merger shall only be effective upon the issuance of a certificate of merger by the SEC, subject to its prior determination that the merger is not inconsistent with the Corporation Code or existing laws.[29] Where a party to the merger is a special corporation governed by its own charter, the Code particularly mandates that a favorable recommendation of the appropriate government agency should first be obtained.[30]

In this case, it is undisputed that the articles of merger between FISLAI and DSLAI were not registered with the SEC due to incomplete documentation. Consequently, the SEC did not issue the required certificate of merger. Even if it is true that the Monetary Board of the Central Bank of the Philippines recognized such merger, the fact remains that no certificate was issued by the SEC. Such merger is still incomplete without the certification.

The issuance of the certificate of merger is crucial because not only does it bear out SEC's approval but it also marks the moment when the consequences of a merger take place. By operation of law, upon the effectivity of the merger, the absorbed corporation ceases to exist but its rights and properties, as well as liabilities, shall be taken and deemed transferred to and vested in the surviving corporation.[31]

The same rule applies to consolidation which becomes effective not upon mere agreement of the members but only upon issuance of the certificate of consolidation by the SEC.[32] When the SEC, upon processing and examining the articles of consolidation, is satisfied that the consolidation of the corporations is not inconsistent with the provisions of the Corporation Code and existing laws, it issues a certificate of consolidation which makes the reorganization official.[33] The new consolidated corporation comes into existence and the constituent corporations are dissolved and cease to exist.[34]

There being no merger between FISLAI and DSLAI (now MSLAI), for third parties such as respondents, the two corporations shall not be considered as one but two separate corporations. A corporation is an artificial being created by operation of law. It possesses the right of succession and such powers, attributes, and properties expressly authorized by law or incident to its existence.[35] It has a personality separate and distinct from the persons composing it, as well as from any other legal entity to which it may be related.[36] Being separate entities, the property of one cannot be considered the property of the other.

Thus, in the instant case, as far as third parties are concerned, the assets of FISLAI remain as its assets and cannot be considered as belonging to DSLAI and MSLAI, notwithstanding the Deed of Assignment wherein FISLAI assigned its assets and properties to DSLAI, and the latter assumed all the liabilities of the former. As provided in Article 1625 of the Civil Code, "an assignment of credit, right or action shall produce no effect as against third persons, unless it appears in a public instrument, or the instrument is recorded in the Registry of Property in case the assignment involves real property." The certificates of title of the subject properties were clean and contained no annotation of the fact of assignment. Respondents cannot, therefore, be faulted for enforcing their claim against FISLAI on the properties registered under its name. Accordingly, MSLAI, as the successor-in-interest of DSLAI, has no legal standing to annul the execution sale over the properties of FISLAI. With more reason can it not cause the cancellation of the title to the subject properties of Willkom and Go.

Petitioner cannot also anchor its right to annul the execution sale on the principle of novation. While it is true that DSLAI (now MSLAI) assumed all the liabilities of FISLAI, such assumption did not result in novation as would release the latter from liability, thereby exempting its properties from execution. Novation is the extinguishment of an obligation by the substitution or change of the obligation by a subsequent one which extinguishes or modifies the first, either by changing the object or principal conditions, by substituting another in place of the debtor, or by subrogating a third person in the rights of the creditor.[37]

It is a rule that novation by substitution of debtor must always be made with the consent of the creditor.[38] Article 1293 of the Civil Code is explicit, thus:

> Art. 1293. Novation which consists in substituting a new debtor in the place of the original one, may be made even without the knowledge or against the will of the latter, but not without the consent of the creditor. Payment by the new debtor gives him the rights mentioned in Articles 1236 and 1237.

In this case, there was no showing that Uy, the creditor, gave her consent to the agreement that DSLAI (now MSLAI) would assume the liabilities of FISLAI. Such agreement cannot prejudice Uy. Thus, the assets that FISLAI transferred to DSLAI remained subject to execution to satisfy the judgment claim of Uy against FISLAI. The subsequent sale of the properties by Uy to Willkom, and of one of the properties by Willkom to Go, cannot, therefore, be questioned by MSLAI.

The consent of the creditor to a novation by change of debtor is as indispensable as the creditor's consent in conventional subrogation in order that a novation shall legally take place.[39] Since novation implies a waiver of the right which the creditor had before the novation, such waiver must be express.[40]

WHEREFORE, premises considered, the petition is DENIED. The Court of Appeals Decision dated March 21, 2007 and Resolution dated June 1, 2007 in CA-G.R. CV No. 58337 are AFFIRMED.

SO ORDERED.

Carpio, Nachura, Leonardo-De Castro,[*] Peralta, and Mendoza, JJ., concur.

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[*] Additional member in lieu of Associate Justice Roberto A. Abad per Special Order No. 905 dated October 5, 2010.

[1] Mindanao Station, Cagayan de Oro City.

[2] Penned by Associate Justice Teresita Dy-Liacco Flores, with Associate Justices Rodrigo F. Lim, Jr. and Jane Aurora C. Lantion, concurring; rollo, pp. 55-68a.

[3] Id. at 70-72a.

[4] Id. at 56.

[5] Id.

[6] Id.

[7] Id. at 56-57.

[8] Id. at 57.

[9] Id.

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[10] Id. at 57-58.

[11] Id. at 58-59.

[12] Id. at 59-60.

[13] Id. at 60.

[14] Id.

[15] Id. at 60a.

[16] Id. at 68a.

[17] 353 Phil. 702 (1998).

[18] Rollo, pp. 61-68.

[19] Id. at 34-35.

[20] Poliand Industrial Limited v. National Development Co., 505 Phil. 27, 50-51 (2005); Associated Bank v. CA, supra note 17, at 712.

[21] Associated Bank v. CA, supra , at 712.

[22] Poliand Industrial Limited v. National Development Co., supra note 20, at 51; PNB v. Andrada Electric & Engineering Company, 430 Phil. 882, 899 (2002); Associated Bank v. CA, supra, at 712.

[23] PNB v. Andrada Electric & Engineering Company, supra at 899.

[24] Sec. 76. Plan of merger or consolidation. - Two or more corporations may merge into a single corporation which shall be one of the constituent corporations or may consolidate into a new single corporation which shall be the consolidated corporation.

The board of directors or trustees of each corporation, party to the merger or consolidation, shall approve a plan of merger or consolidation setting forth the following:

- The names of the corporations proposing to merge or consolidate, hereinafter referred to as the constituent corporations;

- The terms of the merger or consolidation and the mode of carrying the same into effect;

- A statement of the changes, if any, in the articles of incorporation of the surviving corporation in case of merger; and, with respect to the consolidated corporation in case of consolidation, all the statements required to be set forth in the articles of incorporation for corporations organized under this Code; and

- Such other provisions with respect to the proposed merger or consolidation as are deemed necessary or desirable.

[25] Sec. 77. Stockholder's or member's approval. - Upon approval by majority vote of each of the board of directors or trustees of the constituent corporations of the plan of merger or consolidation, the same shall be submitted for approval by the stockholders or members of each of such corporations at separate corporate meetings duly called for the purpose. Notice of such meetings shall be given to all stockholders or members of the respective corporations, at least two (2) weeks prior to the date of the meeting, either personally or by registered mail. Said notice shall state the purpose of the meeting and shall include a copy or a summary of the plan of merger or consolidation. The affirmative vote of stockholders representing at least two-thirds (2/3) of the

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outstanding capital stock of each corporation in the case of stock corporations or at least two-thirds (2/3) of the members in the case of non-stock corporations shall be necessary for the approval of such plan. Any dissenting stockholder in stock corporations may exercise his appraisal right in accordance with the Code: Provided, That if after the approval by the stockholders of such plan, the board of directors decides to abandon the plan, the appraisal right shall be extinguished.

Any amendment to the plan of merger or consolidation may be made, provided such amendment is approved by majority vote of the respective boards of directors or trustees of all the constituent corporations and ratified by the affirmative vote of stockholders representing at least two-thirds (2/3) of the outstanding capital stock or of two-thirds (2/3) of the members of each of the constituent corporations. Such plan, together with any amendment, shall be considered as the agreement of merger or consolidation.

[26] Sec. 78. -Articles of merger or consolidation. - After the approval by the stockholders or members as required by the preceding section, articles of merger or articles of consolidation shall be executed by each of the constituent corporations, to be signed by the president or vice-president and certified by the secretary or assistant secretary of each corporation setting forth:

- The plan of the merger or the plan of consolidation;

- As to stock corporations, the number of shares outstanding, or in the case of non-stock corporations, the number of members; and

- As to each corporation, the number of shares or members voting for and against such plan, respectively.

[27] Sec. 79. Effectivity of merger or consolidation. - The articles of merger or of consolidation, signed and certified as herein above required, shall be submitted to the Securities and Exchange Commission in quadruplicate for its approval; Provided, That in the case of merger or consolidation of banks or banking institutions, building and loan associations, trust companies, insurance companies, public utilities, educational institutions and other special corporations governed by special laws, the favorable recommendation of the appropriate government agency shall first be obtained. If the Commission is satisfied that the merger or consolidation of the corporations concerned is not inconsistent with the provisions of this Code and existing laws, it shall issue a certificate of merger or of consolidation, at which time the merger or consolidation shall be effective.

If, upon investigation, the Securities and Exchange Commission has reason to believe that the proposed merger or consolidation is contrary to or inconsistent with the provisions of this Code or existing laws, it shall set a hearing to give the corporations concerned the opportunity to be heard. Written notice of the date, time and place of hearing shall be given to each constituent corporation at least two (2) weeks before said hearing. The Commission shall thereafter proceed as provided in this Code.

[28] The Corporation Code, Comments, Notes and Selected Cases by Jose Campos, Jr., Vol. II, pp. 446-447.

[29] Poliand Industrial Limited v. National Development Co., supra note 20, at 51.

[30] Id.

[31] Id. at 51-52.

[32] Lozano v. De los Santos, G.R. No. 125221, June 19, 1997, 274 SCRA 452, 458.

[33] Id.

[34] Id.

[35] PNB v. Andrada Electric & Engineering Company, supra note 22, at 894.

[36] Id.

[37] Phil. Savings Bank v. Sps. Mañalac, Jr., 496 Phil. 671, 686 (2005); Garcia v. Llamas, 462 Phil. 779, 788 (2003); Agro Conglomerates, Inc. v. Court of Appeals, 401 Phil. 644, 655 (2000).

[38] Chuidan v. Sandiganbayan, 402 Phil. 795, 819 (2001); Reyes v. Court of Appeals, G.R. No. 120817, November 4, 1996, 264 SCRA 35, 47.

[39] Reyes v. Court of Appeals, supra at 47.

[40] Garcia v. Llamas, supra note 37, at 791.

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