

PHILIPPINE TRUST COMPANY, PLAINTIFF AND APPELLEE, VS. SMITH NAVIGATION COMPANY, DEFENDANT AND APPELLEE. RAMON L. VERZOSA ET AL., INTERVENORS. EL VARADERO DE MANILA, INTERVENOR A...

G.R. No. 44058. September 30, 1938

Ponente: VILLA-REAL, J.

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VILLA-REAL, J.:

This is a new hearing of the appeal taken by the intervenor El Varadero de Manila from the judgment of the Court of First Instance of Manila, the dispositive part of which reads as follows:

"For the foregoing considerations, judgment is rendered dismissing the complaint in intervention of the Varadero de Manila. The defendant Smith Navigation Company is ordered to pay to the plaintiff Philippine Trust Company, as 'trustee of an express trust,' the sum of P64,000 Philippine currency, with interest thereon at 12 per cent per annum from January 3, 1934, until fully paid, plus an additional sum equivalent to 10 per cent of the above-stated amount for costs, attorney's fees, expenses and liquidated damages. As soon as this judgment becomes final and executory and upon failure of the defendant to make such payment, the sheriff of the City of Manila is authorized to proceed in accordance with law to sell the two mortgaged vessels Ethel Conklin and Ethel Edwards separately at public auction, applying the proceeds thereof to the amount of this judgment, it being understood that the schooner Ethel Conklin, is subject to the preferred claim of the crew, intervenors herein, in the sum of P1,688.50, which claim should be paid with preference to that of the plaintiff. It is so ordered."

As ground for its appeal, the appellant assigns four alleged errors claimed by it to have been committed by the court a quo in its judgment in question, which will be discussed in the course of this decision.

When the case was called for hearing, the parties agreed upon the existence of the following pertinent facts: That the defendant Smith Navigation Company, on January 3, 1933, executed a document by virtue of which it constituted a mortgage on the schooner Ethel Conklin and the motorship Ethel Edwards, both of Manila registry, to secure the payment to the plaintiff Philippine Trust Company of said defendant's indebtedness in the sum of P66,000, with interest thereon at 12 per cent per annum from January 3, 1934, payable monthly on or before the 15th of every month from said date; that the mortgage in question has been registered in the Bureau of Customs; that it has been stipulated that in case of violation of any of the terms and conditions of said mortgage the entire amount unpaid would become due and payable and the mortgage could be foreclosed; that it has been agreed that in case of foreclosure of the mortgage the defendant would pay a sum equivalent to 10 per cent of all the sums due and unpaid for costs, attorney's fees, expenses and liquidated damages; that of the debt claimed by the Philippine Trust Company, there remains only the sum of P64,000, plus interest thereon at 12 per cent per annum due and unpaid from April 16, 1934; that the defendant Smith Navigation Company has failed to pay interest from April 16, 1934, to date; that the claim of the intervenor El Varadero de Manila for repairs made on the vessels amounts to P11,486.78; that such claim has not been registered either in the Bureau of Customs or in any other place; that

before causing such repairs to be made the defendant Smith Navigation Company did not inform the plaintiff Philippine Trust Company thereof; that said repairs were made on the vessels Ethel Conklin and Ethel Edwards from the month of June, 1933, to June, 1934 (Exhibits 1-V to 30-V of the El Varadero de Manila).

In addition to the above-stated facts, on the existence of which the parties have stipulated, the following have been established at the trial, some by a preponderance of evidence and others without discussion, to wit:

The intervenors Ramon L. Verzosa et al., who were the officer and crew of the motorship Ethel Conklin, rendered services as such from March 29, 1934, up to 2 o'clock In the afternoon of May 13th of said year when said motorship was tied up. The vessel in question thereafter made no other voyage because the intervenor-appellant El Varadero de Manila was made to repair it by order of the Bureau of Customs (Exhibit 3). From the month of May, 1934, the two vessels did not navigate again. The repairs for which El Varadero de Manila claims payment were made and finished in the month of June, 1933.

Wilson G. Smith, general manager of the defendant-appellee Smith Navigation Company, testifying as a witness, stated, among other things, that the mortgage creditor Philippine Trust Company had not been notified in writing of the repairs in question, as required by Exhibit A, because the current practice is that when the repairs are made by order of the Bureau of Customs said notice is not served, and because the witness had had a verbal agreement with Nolting and Ford, then president and vice-president, respectively, of the Philippine Trust Company, relative to said repairs.

Edward V. Ford, testifying in rebuttal, denied that Nolting and he had had such a verbal agreement, stating that he came to know of said repairs only when they had already been carried out, that is, some time prior to the filing of the action in the present case.

The parties recognize the preferred right of Ramon L. Verzosa et al., to collect their salaries earned during the last voyage of the schooner Ethel Conklin, for services rendered by them as officer and crew thereof.

The question to be decided in this new hearing is whether or not the credit of the intervenor and appellant, El Varadero de Manila, for repairs made on the two vessels, enjoy preference over that of the plaintiff and appellee, Philippine Trust Company, secured by a mortgage constituted on said vessels.

The pertinent parts of article 580 of the Code of Commerce read as follows:

"Art. 580. In all judicial sales of vessels for the payment of creditors, the said creditors shall have preference in the order stated:

* * * * *

"8. The part of the price which has not been paid the last vendor, the credits pending for the payment of material and work in the construction of the vessel, when it has not navigated, and those arising from the repair and equipment of the vessel and its provisioning with victuals and fuel during its last voyage.

"In order that the credits provided for in this subdivision may enjoy the preference they must appear by contracts recorded in the registry of vessels, or if they were contracted for the vessel while on a voyage and said vessel has not returned to the port of her registry, they must be made under the authority required for such cases and entered in the certificate of registry of the said vessel."

The above-quoted legal provision enumerates the credits that may compete for payment from the proceeds of the judicial sale of a vessel, prescribes the conditions that must be present therein and establishes the order of payment in case of concurrence of two or more credits enumerated as having the requisites prescribed by the above-quoted article. So that if any of the credits enumerated lack the conditions required, it would be barred from

the competition for payment and, therefore, would not enjoy the preference it would have if said conditions were present, thus making the pertinent provision of article 580 of the Code of Commerce inapplicable to it.

Although the credit under consideration of the intervenor El Varadero de Manila, for repairs made on the vessels sold at public auction, is among those enumerated in subsection 8 of said article 580 of the Code of Commerce, it cannot enter into the competition inasmuch as it does not appear by contract recorded in the registry of vessels prescribed by the second paragraph of the subsection in question. Consequently, the legal provision under discussion is not applicable thereto.

Now, then, are the provisions of said article 580 of the Code of Commerce applicable to the claim of the plaintiff Philippine Trust Company? The claim of said Philippine Trust Company is based on a pecuniary obligation contracted by Smith Navigation Company and secured by the mortgage constituted on the vessels Ethel Conklin and Ethel Edwards belonging to the latter. Credits secured by chattel mortgage are not among those enumerated in the above-cited article 580 of the Code of Commerce. Therefore, the provisions of said article are not applicable thereto and the benefits of preference afforded thereby do not extend to them, for which reason they can not enter in the competition for payment.

Inasmuch as the provisions of the above-quoted article 580 of the Code of Commerce are not applicable either to the claim for repairs of the intervenor El Varadero de Manila or to that of the plaintiff Philippine Trust Company, for payment of credit secured by chattel mortgage, which of the two credits enjoys preference over the other?

Every juridical relation, whether civil or commercial, is governed by some positive or common law, and article 6 of the Civil Code compels the courts to render judgment by applying the custom of the place when there is no statute applicable to the point in controversy, and in the absence of such custom, the general principles of law. Fortunately, however, there is no need of resorting to other sources of law and obligations outside the Civil Code and the Code of Commerce because article 2 of the latter Code provides that "commercial transactions, be they performed by merchants or not, whether they are specified in this Code or not, shall be governed by the provisions contained in the same; in the absence of such provisions, by the commercial customs generally observed in each place; and in the absence of both, by those of the common law. Commercial transactions shall be considered those enumerated in this Code and any others of similar character." Both the contract of loan entered into between the defendant-appellee Smith Navigation Company and the plaintiff-appellee Philippine Trust Company and secured by mortgage constituted on the vessels in question, and the contract of repair of said vessels entered into between the defendant-appellee Smith Navigation Company and the intervenor-appellant El Varadero de Manila, are commercial transactions and, as such, should be governed, first, by the provisions contained in the Code of Commerce; in the absence of such provisions, by the commercial customs generally observed in this place; and in the absence of both rules, by those of the common law, according to the above-quoted legal provision. As to which of the two credits resulting from the contracts in question should enjoy preference for payment from the proceeds of the judicial sale of said merchant vessels, we have not found any provision in the Code of Commerce or any commercial custom generally observed in the place, establishing preference between a credit secured by mortgage constituted on merchant vessels and a contract for the repair of said vessels not recorded in the registry of vessels. Therefore, we should resort to the common law, which in our case is the Civil Code (Decisions of the Supreme Court of Spain of April 28, 1899; December 29, 1898, and February 16, 1897; *G. Urrutia & Co. vs. Baco River Plantation Co.*, 26 Phil., 632; *Compañia General de Tabacos vs. Molina*, 5 Phil., 142, 146; *Vivante, Derecho Mercantil*, volume I, page 92, paragraph 7), as supplementary to the Code of Commerce, in accordance with the above-cited article 2, to find some provision establishing preference between one and the other.

Articles 1921 and 1922 of the Civil Code provide as follows:

"Art. 1921. Credits shall be classified for their graduation and payment in the order and manner specified in

this chapter.

"Art. 1922. With respect to determinate personal property of the debtor, the following are preferred:

"1. Credits for the construction, repair, preservation, or purchase price of personal property in the possession of the debtor, to the extent of the value of the same;

"2. Credits secured by a pledge in the possession of the creditor, with respect to the thing pledged and to the extent of its value."

It should be noted that article 1922 of the Civil Code gives preferential character to credits for the repair of personal property, while in the possession of the debtor, to the extent of the value of the same, but not to credits secured by mortgage on personal property, vessels being considered as such (article 585, Code of Commerce; *Philippine Refining Co. vs. Jarque*, 61 Phil., 229). The chattel mortgage is an institution created by a special act of the Philippine Commission (Act No. 1508). Its constitution is in the form of a conditional sale, similar to a sale with pacto de retro, inasmuch as both convey dominion, the only essential difference being that in the chattel mortgage failure on the part of the mortgagor to comply with his obligation to pay his debt gives rise to the execution of the thing mortgaged, while in the sale with pacto de retro failure on the part of the vendor to exercise his right to repurchase the thing sold consolidates the ownership thereof in the purchaser (*Rosales vs. Reyes and Ordoveza*, 25 Phil., 495; *Meyers vs. Thein*, 15 Phil., 303; *Bank of the Philippine Islands vs. Trinidad*, 42 Phil., 220; *Bachrach Motor Co. vs. Summers*, 42 Phil., 3). A chattel mortgage, in its legal effects, is but a mere security (section 3, Act No. 1508; *In re Du Tec Chuan*, 34 Phil., 488), and, as such, is inferior to the preferred liens established by the Civil Code (*Unson vs. Urquijo, Zuloaga & Escubi*, 50 Phil., 160; *Kabankalan Sugar Co. vs. Kubm*, 54 Phil., 645). Inasmuch as the credit secured by a chattel mortgage is not among those enumerated in the above-cited article 1922 of the Civil Code, as already stated, it can not compete with a credit for repairs so enumerated.

The question now arises whether or not after the sheriff had attached the vessels in question and sold them at public auction by virtue of a writ of execution of judgment, the credit of *El Varadero de Manila* for said repairs retains its character of a preferred lien for purposes of payment.

In the case of *International Banking Corporation vs. Corrales* (10 Phil., 435), this court has laid down the doctrine that "the possession of a receiver does not adversely affect prior existing liens and is not such a transfer of property as will deprive an intervenor, in a proper case, of the preferential right secured to him by article 1922 of the Civil Code."

Under the foregoing doctrine, the fact that the sheriff had attached the vessels in question by order of the court has not produced the effect of transferring possession of the same or the proceeds of the sale thereof, they being only in custodia legis for the benefit of the parties. Therefore, the credit of the intervenor-appellant *El Varadero de Manila* retains its character of a preferred lien for purposes of payment thereof from the proceeds of the sale.

It is contended by the plaintiff-appellee *Philippine Trust Company* that the chattel mortgage being a lien upon the personal property mortgaged, the credit secured thereby enjoys preference over a credit for repairs made on said personal property because the preferential right granted by law to the latter credit is not upon the property repaired and is not secured by the same.

This question has already been decided by this court in the cases of *Unson vs. Urquijo, Zuloaga & Escubi*, supra and *Kabankalan Sugar Co. vs. Rubin*, supra, wherein it laid down the doctrine that "By article 1922, paragraph No. 1, of the Civil Code and the decisions of this court, interpreting it, as well as by the Revised Civil Code of Louisiana and the decisions of the Supreme Court and the Circuit Court of Appeals of said State, the preference

granted the vendor to the personal property sold and in possession of the purchaser for the price thereof, is superior to any other real right or lien, such as mortgage and attachment." The same doctrine is applicable to the case of a credit for repairs on the ground that the work and material employed in the personal property repaired are incorporated into it, thereby increasing or, at least, conserving its value. What the repair man seeks, therefore, is, more than a security, a part of the thing itself, which part belongs to him.

In its motion for reconsideration and new hearing, the plaintiff and appellee Philippine Trust Company likewise raises the question whether or not, as some of the repairs were made in 1933, after which the repaired vessels made other voyages, having again been repaired in 1934, without putting to sea thereafter, the credits for repairs made in 1933 enjoy the same preference as the credits for repairs made in 1934.

The condition that the repairs be made on a vessel on its last voyage, so that the credit created thereby may have a preferential character, is imposed by article 580, subsection 8, of the Code of Commerce. It has been stated by this court that this legal provision is not applicable to the credit of El Varadero de Manila, having failed to comply with the condition that it appear by contract recorded in the registry of vessels, and that the provisions of the Civil Code, as a supplementary law, are applicable in accordance with the provision of article 2 of said Code of Commerce. Subsection 1 of said article 1922 of the Civil Code speaks of the credit for repair of personal property in general, neither making any distinction nor establishing any condition with respect to vessels. It is, therefore, sufficient that the repair has been made on a personal property, as a vessel, and that the same be in the possession of the debtor, the owner thereof, so that the credit created by such repair may enjoy preference, it being unimportant whether said vessel has navigated or not after the work thereon had been performed.

As to the question whether or not by reason of the failure of the defendant Smith Navigation Company to notify the plaintiff Philippine Trust Company of the necessity of making the repairs and of the order given by it to the intervenor El Varadero de Manila to make such repairs on the vessels in question, El Varadero de Manila is not entitled to collect the value of said repairs with, preference to the credit secured by the mortgage constituted on said vessels, the agreement entered into between the defendant Smith Navigation Company and the plaintiff Philippine Trust Company, whereby said defendant binds itself to notify said plaintiff of the necessity of making any repair on said vessels, is not binding on said intervenor El Varadero de Manila on the ground that it was not a party to said contract, notwithstanding the fact that the chattel mortgage, wherein said obligation was made to appear, is recorded in the register of transfers and liens of vessels of the Bureau of Customs. In the case of *Pacific Commercial Co. vs. Webb and Falcon* (51 Phil., 745), this court has laid down the doctrine that "the repair man is not a party to the terms and provisions in a chattel mortgage to the effect that the mortgagor cannot encumber the auto for subsequent repairs without the written consent of the mortgagee, and in the absence of personal knowledge of their existence, he is not legally bound by such provisions in the chattel mortgage."

In the case under consideration, it does not appear that the intervenor El Varadero de Manila had personal knowledge of the existence of such stipulation in the instrument of mortgage of the vessels Ethel Conklin and Ethel Edwards before the defendant and mortgagor Smith Navigation Company ordered their repair and said intervenor accepted said order.

Although the above-cited case involves an automobile, the mortgage of which is governed by Act No. 1508, otherwise known as the Chattel Mortgage Law, and not a vessel, the mortgage of which is governed by section 1171 of the Revised Administrative Code (*Arroyo vs. Yu de Sane*, 54 Phil., 511), the question at issue is the same and, therefore, the same principle is applicable.

Under the above-cited provisions of law and doctrine of this court, the intervenor El Varadero de Manila is not barred from collecting the amount of the repairs made by it with preference to the mortgage credit of the plaintiff

Philippine Trust Company (article 1922, subsection 1, Civil Code).

For the foregoing considerations, this court is of the opinion and so holds: (1) That the repairs made on merchant vessels by contract not recorded in the registry of vessels enjoy preference, not in accordance with article 580, subsection 8, of the Code of Commerce, but in accordance with article 1922, subsection 1, in connection with article 1921, of the Civil Code; (2) that the fact that a sheriff attaches said vessels and sells them at public auction by virtue of an execution, does not affect the preference of the repair man with respect to them or the proceeds thereof at the judicial sale, whether said repairs have been made during the last voyage or during a former one; and (3) that as the credit secured by a mortgage of vessels is not among those enumerated in article 1922 of the Civil Code, it cannot compete for payment with a credit for repairs thereon with respect to the proceeds of the sale thereof.

Wherefore, the appealed judgment is reversed in so far as it dismisses the complaint in intervention of El Varadero de Manila, and it is ordered that from the proceeds of the sale at public auction of the two vessels Ethel Conklin and Ethel Edwards the sheriff of the City of Manila, after having satisfied the claim of the other intervenors Ramon L. Verzosa et al., who constitute the officer and crew of the schooner Ethel Conklin, pay first to said intervenor El Varadero de Manila the sum of P11,486.78, with legal interest thereon from the date of the filing of the complaint in intervention, until fully paid, and lastly pay the plaintiff Philippine Trust Company in the manner provided¹ for in the appealed judgment, with costs to the plaintiff-appellee. So ordered.

Avanceña, C. J., Abad Santos, Imperial, and Diaz, JJ., concur.

DISSENTING

CONCEPCION, J.:

I regret to have to insist on my former dissenting opinion, with due respect to the majority opinion. There are before this court two credits disputing preference: The credit of the intervenor El Varadero de Manila for repairs made on the vessels Ethel Conklin and Ethel Edwards, and the credit of the plaintiff Philippine Trust Company secured by mortgage constituted on said vessels. Everything related to merchant vessels is governed by the provisions of Book III of the Code of Commerce, entitled "Maritime Commerce."

The part of article 580 of said Code, pertinent to this matter, reads as follows:

"Art. 580. In all judicial sales of vessels for the payment of creditors, the said creditors shall have preference in the order stated:

"8. The part of the price which has not been paid the last vendor, the credits pending for the payment of material and work in the construction of the vessel, when it has not navigated, and those arising from the repair and equipment of the vessel * * *.

"In order that the credits provided for in this subdivision may enjoy the preference they must appear by contracts recorded in the registry of vessels, * * *." (Underscoring mine.)

Now then: inasmuch as the credit of El Varadero de Manila does not appear by contract and is not recorded in the registry of vessels, this creditor can not claim right of preference. The majority, however, maintain that although the credit of El Varadero de Manila is among those included in subsection 8 of said article 580 of the Code of

Commerce it cannot compete with the other credits enumerated in said article because it does not appear by contract recorded in the registry of vessels. Therefore, the legal provision under consideration, according to them, is not applicable thereto. I dissent. I am of the opinion that it is applicable to the credit in question, not only when the latter enjoys preference for having complied with the conditions prescribed in said legal provision but also when the preference of said credit is not recognized precisely for noncompliance with the conditions prescribed therein.

With respect to the mortgage credit of the plaintiff Philippine Trust Company, the majority allege that neither is said credit included among those enumerated in said article 580 of the Code of Commerce and, upon the ground that none of the two credits in question falls under the provisions of said Code of Commerce, they have gone to seek solution of the litigation in the very vast field of the Civil Law. I cannot follow the majority in their quest.

I am of the opinion that, if the credit of El Varadero de Manila is merely an ordinary credit and enjoys no right of preference under the provisions of the Code of Commerce, which are the ones that govern this matter, no other law or Code can give it such right, because to hold otherwise would be to arrive at the absurdity of affirming that, with or without a written contract and with or without notation thereof in the registry, at any rate the credit of El Varadero de Manila is and shall be preferred in all cases. This would make a laughing stock of the provisions of the Code of Commerce. The registry of vessels would be a myth. The Code of Commerce, in requiring the credit to appear by contract and to be registered in the registry, attempts to protect all persons desiring to lend money upon a vessel, or attempting to purchase it. Had El Varadero de Manila recorded¹ its contract in the registry of vessels before commencing the repair works on the two vessels in question in June, 1933 (Exhibit 1), or immediately thereafter, the plaintiff Philippine Trust Company would have had knowledge of the lien existing on said vessels and, undoubtedly, it would not have granted the loan of P66,000 by accepting the mortgage constituted on said vessels on January 3, 1933. Under these circumstances, I do not see how the right of preference of the intervenor El Varadero de Manila, which has not sought the protection afforded by the Code, can be recognized, to the prejudice of the plaintiff Philippine Trust Company, which has complied with all the legal requisites for the purpose of safeguarding the efficacy of its security.

The plaintiff Philippine Trust Company has recorded its mortgage right on the vessels in the registry of vessels and under the law said mortgage is a security for the payment of its credit (section 3, Chattel Mortgage Law; *Bachrach Motor Co. vs. Summers*, 42 Phil., 3; *In re Du. Tec Chuan*, 34 Phil., 488, 490).

Wherefore, the vessels in question being specially assigned to the payment of the credit of the plaintiff, and on the other hand, as El Varadero de Manila has no lien on said vessels for not having complied with the provisions of the Code of Commerce, I vote for the preferred payment of the mortgage credit of the plaintiff.

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