Republic of the Philippines
Supreme Court
Manila

THIRD DIVISION

PARADIGM DEVELOPMENT CORPORATION OF THE PHILIPPINES, Petitioner,	**G.R. No. 191174**
	Present:
- versus -	VELASCO, JR., *J.*, *Chairperson*, BERSAMIN, REYES, CAGUIOA,* and TIJAM, *JJ.*
BANK OF THE PHILIPPINE ISLANDS, Respondent.	Promulgated: June 7, 2017

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DECISION

REYES, *J.*:

This is a Petition for Review on *Certiorari*[1] filed under Rule 45 of the Rules of Court assailing the Decision[2] dated November 25, 2009 and Resolution[3] dated February 2, 2010 of the Court of Appeals (CA) in CA-G.R. CV No. 89755, which granted respondent Bank of the Philippine Islands' (BPI) appeal and accordingly dismissed the complaint filed by petitioner Paradigm Development Corporation of the Philippines (PDCP).

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* Additional Member per Raffle dated March 27, 2017 *vice* Associate Justice Francis H. Jardeleza.

1 *Rollo*, pp. 8-35.

2 Penned by Associate Justice Romeo F. Barza, with Associate Justices Remedios A. Salazar-Fernando and Isaias P. Dicdican concurring; id. at 37-74.

3 Id. at 76-77.

The Facts

Sometime in February 1996, Sengkon Trading (Sengkon), a sole proprietorship owned by Anita Go, obtained a loan from Far East Bank and Trust Company (FEBTC) under a credit facility denominated as Omnibus Line in the amount of ₱100 Million on several sub-facilities with their particular sub-limits denominated as follows: (i) Discounting Line for ₱20 Million; (ii) Letter of Credit/Trust Receipt (LC-TR) Line for ₱60 Million; and (iii) Bills Purchased Line for ₱8 Million. This was embodied in the document denominated as "Agreement for Renewal of Omnibus Line."[4]

On April 19, 1996, FEBTC again granted Sengkon another credit facility, denominated as Credit Line, in the amount of ₱60 Million as contained in the "Agreement for Credit Line." Two real estate mortgage (REM) contracts were executed by PDCP President Anthony L. Go (Go) to partially secure Sengkon's obligations under this Credit Line. One REM, acknowledged on April 22, 1996, was constituted over Transfer Certificate of Title (TCT) No. RT-55259 (354583) and secured the amount of ₱8 Million. The other REM, acknowledged on December 19, 1997, was constituted over TCT Nos. RT-58281, RT-54993 (348989) and RT-55260 (352956) and secured the amount of ₱42,400,000.00.[5]

In a letter dated September 18, 1997, FEBTC informed Sengkon regarding the renewal, increase and conversion of its ₱100 Million Omnibus Line to ₱150 Million LC-TR Line and ₱20 Million Discounting Line, the renewal of the ₱60 Million Credit Line and ₱8 Million Bills Purchased Line.[6]

In the same letter, FEBTC also approved the request of Sengkon to change the account name from SENGKON TRADING to SENGKON TRADING, INC. (STI).[7]

Eventually, Sengkon defaulted in the payment of its loan obligations.[8] Thus, in a letter dated September 8, 1999, FEBTC demanded payment from PDCP of alleged Credit Line and Trust Receipt availments with a principal balance of ₱244,277,199.68 plus interest and other charges which Sengkon failed to pay. PDCP responded by requesting for segregation of Sengkon's obligations under the Credit Line and for the pertinent statement of account and supporting documents.[9]

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4 RTC records, p. 696.
5 *Rollo*, pp. 39-40.
6 RTC records, p. 697.
7 Id. at 698.
8 *Rollo*, p. 40.
9 RTC records, p. 699.

Negotiations were then held and PDCP proposed to pay approximately ₱50 Million, allegedly corresponding to the obligations secured by its property, for the release of its properties but FEBTC pressed for a comprehensive repayment scheme for the entirety of Sengkon's obligations.[10]

Meanwhile, the negotiations were put on hold because BPI acquired FEBTC and assumed the rights and obligations of the latter.[11]

When negotiations for the payment of Sengkon's outstanding obligations, however, fell, FEBTC, on April 5, 2000, initiated foreclosure proceedings against the mortgaged properties of PDCP before the Regional Trial Court (RTC) of Quezon City.[12] In its Bid for the mortgaged properties, FEBTC's counsel stated that:

> On behalf of our client, [FEBTC], we hereby submit its Bid for the Real Properties including all improvements existing thereon covered by [TCT] Nos. RT – 55259 (354583), 58281, RT – 54993 (348989) and RT- 55260 (352956) which are the subject of the Auction Sale scheduled on June, 20, 2000 in the amount of:
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> **SEVENTY[-]SIX MILLION FIVE HUNDRED THOUSAND PESOS ONLY (₱76,500,000.00), Philippine Currency.**
>
> Please note that the aforesaid Bid is only in **PARTIAL SETTLEMENT** of the obligation of [PDCP], x x x.[13]

Upon verification with the Registry of Deeds, PDCP discovered that FEBTC extra-judicially foreclosed on June 20, 2000 the first and second mortgage without notice to it as mortgagor and sold the mortgaged properties to FEBTC as the lone bidder.[14] Thereafter, on August 8, 2000, the corresponding Certificate of Sale was registered.[15]

Consequently, on July 19, 2001, PDCP filed a Complaint for Annulment of Mortgage, Foreclosure, Certificate of Sale and Damages[16] with the RTC of Quezon City, against BPI, successor-in-interest of FEBTC, alleging that the REMs and their foreclosure were null and void.[17]

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10 Id.
11 Id.
12 *Rollo*, pp. 40-41.
13 RTC records, p. 65.
14 Id. at 699.
15 Id. at 700.
16 Id. at 1-9.
17 Id. at 5.

In its Amended Complaint,[18] PDCP alleged that FEBTC assured it that the mortgaged properties will only secure the Credit Line sub-facility of the Omnibus Line. With this understanding, PDCP President Go allegedly agreed to sign on two separate dates a pro-forma and blank REM, securing the amount of ₱42.4 Million and ₱8 Million, respectively. PDCP, however, claimed that it had no intent to be bound under the second REM, which was not intended to be a separate contract, but only a means to reduce registration expenses.[19]

Moreover, PDCP averred that sometime in September 1997, FEBTC allegedly requested it to sign a document which would effectively extend the liability of the properties covered by the mortgage beyond the Credit Line. Because of its refusal to sign said document, it surmised that this must have been the reason why, as it later discovered, FEBTC registered not only the first but also the second REM, contrary to the parties' agreement.[20]

In asking for the nullity of the REMs and the foreclosure proceeding, PDCP alleged:

> a.) THAT although the [REM] of April 22, 1996 for Php 8.0 Million was not a separate security but was merely intended to reduce registration expenses, FEBTC, [BPI's] predecessor-in-interest, fraudulently and in violation of the original intent and agreement of the parties, made it appear that said [REM] of April 22, 1996 was separate and distinct from that of December 18, 1997 and caused the registration of both mortgages with separate considerations totaling Php 50.4 Million;
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> b.) THAT the subject [REMs] were foreclosed to answer not only for obligations incurred under SENGKON's Credit Line but also for other obligations of SENGKON and other companies which were not secured by said mortgages;
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> c.) THAT no notice was given to or received by [PDCP] of the projected foreclosure x x x since the notice of said foreclosure was sent by defendant SHERIFF to an address (333 EDSA, Quezon City) other than [PDCP's] known address as stated in the [REMs] themselves (333 EDSA Caloocan City) x x x;
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> d.) THAT, contrary to the then prevailing Supreme Court Circular AM 99-10-05-0 x x x, only one (1) bidder was present and participated at the foreclosure sale[; and]

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18 Id. at 289-299.
19 Id. at 291-293.
20 Id. at 293.

e.) THAT, without the knowledge and consent of [PDCP], obligation of SENGKON has been transferred to STI[,] a juridical personality separate and distinct from SENGKON, a single proprietorship. This substitution of SENGKON as debtor by STI x x x effectively novated the obligation of [PDCP] to FEBTC. x x x.[21] (Underlining ours)

Ruling of the RTC

On April 16, 2007, the RTC rendered its Decision[22] nullifying the REMs and the foreclosure proceedings. It also awarded damages to PDCP. The dispositive portion of the decision reads:

WHEREFORE, premises considered the Court renders judgment in favor of [PDCP] and against defendants [BPI], Sheriff and the Register of Deeds of Quezon City in the following manner:

1) Declaring null and void and of no further force and effect the following:

(a) the [REMs] (Annexes "F" and "F-1" hereof);
(b) the foreclosure thereof;
(c) the Certificate of Sale; and
(d) the entries relating to said [REMs] and Certificate of Sale annotated on TCT Nos. 58281, RT-54993 (348989), RT-55260 (352956) and RT-55259 (354583) covering the mortgaged properties;

2) Ordering defendant Registrar of Deeds to cancel all the annotations of the [REMs] and the Certificate of Sale on the above stated TCTs covering the mortgaged properties and otherwise to clear said TCTs of any liens and encumbrances annotated thereon relating to the invalid [REMs] aforesaid;

3) Ordering defendant [BPI] to return to [PDCP] the owner's duplicate copies of the TCTs covering the mortgaged properties free from any and all liens and encumbrances; and,

4) Ordering the defendant BPI to pay [PDCP] the following sums:

(a) Php 150,000.00 as attorney's fees; and,
(b) Php 50,000.00 as litigation expenses.

The Writ of Preliminary Injunction is hereby made FINAL and PERMANENT.

Costs against defendant [BPI].

SO ORDERED.[23]

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21 Id. at 294-295.
22 Rendered by Judge Rogelio M. Pizarro; id. at 695-706.
23 Id. at 705-706.

The RTC observed that the availments under the Credit Line, secured by PDCP's properties, may be made only within one year, or from April 19, 1996 to April 30, 1997. While BPI claimed that the period of said credit line was extended up to July 31, 1997, PDCP was not notified of the extension and thus could not have consented to the extension. Anyhow, said the RTC, "no evidence had been adduced to show that Sengkon availed of any loan under the credit line up to July 31, 1997." Thus, in the absence of any monetary obligation that needed to be secured, the REM cannot be said to subsist.[24]

Further, the RTC agreed with PDCP that novation took place in this case, which resulted in discharging the latter from its obligations as third-party mortgagor. In addition, it also nullified the foreclosure proceedings because the original copies of the promissory notes (PNs), which were the basis of FEBTC's Petition for Extrajudicial Foreclosure of Mortgage, were not presented in court and no notice of the extrajudicial foreclosure sale was given to PDCP.[25]

Lastly, the RTC ruled that the shorter period of redemption under Republic Act No. 8791[26] cannot apply to PDCP considering that the REMs were executed prior to the effectivity of said law. As such, the longer period of redemption under Act No. 3135[27] applies.[28]

Aggrieved, BPI appealed to the CA.[29]

Ruling of the CA

In its Decision[30] dated November 25, 2009, the CA reversed the RTC's ruling on all points. The CA found PDCP's contentions incredible for the following reasons: (i) the fact that PDCP surrendered the titles to the mortgaged properties to FEBTC only shows that PDCP intended to mortgage all of these properties; (ii) if it were true that FEBTC assured PDCP that it would be registering only one of the two REMs in order to reduce registration expenses, then each of the two REMs should have covered the four properties but it was not. On the contrary, the four properties were spread out with one REM covering one of the four

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24 Id. at 701.
25 Id. at 702-704.
26 The General Banking Law of 2000. Approved on May 23, 2000.
27 AN ACT TO REGULATE THE SALE OF PROPERTY UNDER SPECIAL POWERS INSERTED IN OR ANNEXED TO REAL-ESTATE MORTGAGES. Approved on March 26, 1924.
28 RTC records, pp. 704-705.
29 Id. at 707A-708.
30 *Rollo*, pp. 37-74.

properties and the other REMs covering the remaining three properties; and (iii) PDCP never complained to FEBTC regarding the registration of the two REMs even after it discovered the same.[31]

Also, the CA ruled that novation could not have taken place from FEBTC's mere act of approving Sengkon's request to change account name from Sengkon to STI.[32]

Moreover, it held that the fact that FEBTC failed to submit the original copies of the PNs that formed the basis of its Petition for Extrajudicial Foreclosure of Mortgage cannot affect the validity of foreclosure because the validity of the obligations represented in those PNs was never denied by Sengkon nor by PDCP.[33]

The CA added that even if the obligations of Sengkon in credit facilities (other than the Credit Line) were included, since the REMs contain a dragnet clause, these other obligations were still covered by PDCP's REMs.[34] Lastly, the CA ruled that the failure to send a notice of extrajudicial foreclosure sale to PDCP did not affect the validity of the foreclosure sale because personal notice to the mortgagor is not even generally required.[35]

Hence, this present petition, where PDCP presented the following arguments:

I. THE FINDINGS IN THE CA DECISION WHICH DEVIATED ON ALMOST ALL POINTS FROM THOSE OF THE RTC ARE NOT IN ACCORD WITH THE RULES ON THE ASSESSMENT OF THE CREDIBILITY AND WEIGHT OF THE EVIDENCE;

II. THE VALIDITY OF THE REMs, AS UPHELD BY THE CA, IS VITIATED BY THE FACT THAT BPI'S PREDECESSOR-IN-INTEREST VIOLATED THE TRUE INTENT AND AGREEMENT OF THE PARTIES THERETO;

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31 Id. at 51-53.
32 Id. at 54-56.
33 Id. at 60.
34 Id. at 61-65.
35 Id. at 65-66.

III. THE CA DECISION'S REJECTION OF PDCP'S NOVATION THEORY BASED ON THE ABSENCE OF AN EXPRESS RELEASE OF THE OLD DEBTOR AND THE SUBSTITUTION IN ITS PLACE OF A NEW DEBTOR IS MISPLACED AND ERRONEOUS;

IV. THE FORECLOSURE OF THE REMs WAS VITIATED NOT ONLY BY THE INADMISSIBILITY OF THE PNs UPON WHICH IT IS BASED BUT ALSO BECAUSE IT VIOLATED THE THERETO APPLICABLE RULES; and

V. THE APPLICATION BY THE CA OF THE SHORTENED PERIOD OF REDEMPTION IN THIS CASE VIOLATED THE NON-IMPAIRMENT AND EQUAL PROTECTION CLAUSES OF THE CONSTITUTION.[36]

Ruling of the Court

The Court finds the petition meritorious.

The registration of the REMs, even if contrary to the supposed intent of the parties, did not affect the validity of the mortgage contracts

According to PDCP, when FEBTC registered both REMs, even if the intent was only to register one, the validity of both REMs was vitiated by lack of consent. PDCP claims that said intent is supported by the fact that the REMs were constituted merely as "partial security" for Sengkon's obligations and therefore there was really no intent to be bound under both – but only in one – REM.

The Court cannot see its way clear through PDCP's argument. To begin with, the registration of the REM contract is not essential to its validity. Article 2085 of the Civil Code provides:

> Art. 2085. The following requisites are essential to the contracts of pledge and mortgage:
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> (1) That they be constituted to secure the fulfillment of a principal obligation;

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36 Id. at 17-18.

> (2) That the pledgor or mortgagor be the absolute owner of the thing pledged or mortgaged;
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> (3) That the persons constituting the pledge or mortgage have the free disposal of their property, and in the absence thereof, that they be legally authorized for the purpose.
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> Third persons who are not parties to the principal obligation may secure the latter by pledging or mortgaging their own property.

In relation thereto, Article 2125 of the Civil Code reads:

> Article 2125. In addition to the requisites stated in Article 2085, it is indispensable, in order that a mortgage may be validly constituted, that the document in which it appears be recorded in the Registry of Property. **If the instrument is not recorded, the mortgage is nevertheless binding between the parties.**
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> x x x x (Emphasis ours)

In *Mobil Oil Philippines, Inc. v. Diocares, et al.*,[37] the trial court refused to order the foreclosure of the mortgaged properties on the ground that while an unregistered REM contract created a personal obligation between the parties, the same did not validly establish a REM. In reversing the trial court, the Court said:

> The lower court predicated its inability to order the foreclosure in view of the categorical nature of the opening sentence of [Article 2125] that it is indispensable, "in order that a mortgage may be validly constituted, that the document in which it appears be recorded in the Registry of Property." Not[e] that it ignored the succeeding sentence: "If the instrument is not recorded, the mortgage is nevertheless binding between the parties." Its conclusion, however, is that what was thus created was merely "a personal obligation but did not establish a [REM]."
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> Such a conclusion does not commend itself for approval. The codal provision is clear and explicit. Even if the instrument were not recorded, "the mortgage is nevertheless binding between the parties." The law cannot be any clearer. Effect must be given to it as written. The mortgage subsists; the parties are bound. **As between them, the mere fact that there is as yet no compliance with the requirement that it be recorded cannot be a bar to foreclosure.**
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> x x x x

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37 140 Phil. 171 (1969).

> Moreover to rule as the lower court did would be to show less than fealty to the purpose that animated the legislators in giving expression to their will that the failure of the instrument to be recorded does not result in the mortgage being any the less "binding between the parties." In the language of the Report of the Code Commission: "In Article [2125] an additional provision is made that if the instrument of mortgage is not recorded, the mortgage, is nevertheless binding between the parties." We are not free to adopt then an interpretation, even assuming that the codal provision lacks the forthrightness and clarity that this particular norm does and therefore requires construction, that would frustrate or nullify such legislative objective.[38] (Citation omitted and emphasis and underlining ours)

Hence, even assuming that the parties indeed agreed to register only one of the two REMs, the subsequent registration of both REMs did not affect an already validly executed REM if there was no other basis for the declaration of its nullity. That the REMs were intended merely as "partial security" does not make PDCP's argument more plausible because as aptly observed by the CA, the PDCP's act of surrendering all the titles to the properties to FEBTC clearly establishes PDCP's intent to mortgage all of the four properties in favor of FEBTC to secure Sengkon's obligation under the Credit Line. The Court notes that the principal debtor, Sengkon, has several obligations under its Omnibus Line corresponding to the several credit sub-facilities made available to it by FEBTC. As found by the trial court, PDCP intended to be bound only for Sengkon's availments under the Credit Line sub-facility and not for just any of Sengkon's availments. Hence, it is in this sense that the phrase "partial security" should be logically understood.

In this regard, PDCP argued that what its President signed is a pro-forma REM whose important details were still left in blank at the time of its execution. But notably, nowhere in PDCP's Amended Complaint did it anchor its cause of action for the nullity of the REMs on this ground. While it indeed alleged this circumstance, PDCP's Amended Complaint is essentially premised on the supposed fraud employed on it by FEBTC consisting of the latter's assurances that the REMs it already signed would not be registered. In *Solidbank Corporation v. Mindanao Ferroalloy Corporation*,[39] the Court discussed the nature of fraud that would annul or avoid a contract, thus:

> Fraud refers to all kinds of deception – whether through insidious machination, manipulation, concealment or misrepresentation – that would lead an ordinarily prudent person into error after taking the circumstances into account. In contracts, a fraud known as *dolo causante* or causal fraud is basically a deception used by one party prior to or simultaneous with the

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38 Id. at 175-177.

39 502 Phil. 651 (2005).

> contract, in order to secure the consent of the other. Needless to say, the deceit employed must be serious. In contradistinction, only some particular or accident of the obligation is referred to by incidental fraud or *dolo incidente*, or that which is not serious in character and without which the other party would have entered into the contract anyway.[40] (Citations omitted)

Under Article 1344 of the Civil Code, the fraud must be serious to annul or avoid a contract and render it voidable. This fraud or deception must be so material that had it not been present, the defrauded party would not have entered into the contract.

In the present case, even if FEBTC represented that it will not register one of the REMs, PDCP cannot disown the REMs it executed after FEBTC reneged on its alleged promise. As earlier stated, with or without the registration of the REMs, as between the parties thereto, the same is valid and PDCP is already bound thereby. The signature of PDCP's President coupled with its act of surrendering the titles to the four properties to FEBTC is proof that no fraud existed in the execution of the contract. Arguably at most, FEBTC's act of registering the mortgage only amounted to *dolo incidente* which is not the kind of fraud that avoids a contract.

No novation took place

The Court likewise agrees with the CA that no novation took place in the present case. Novation is a mode of extinguishing an obligation by changing its objects or principal obligations, by substituting a new debtor in place of the old one, or by subrogating a third person to the rights of the creditor. Article 1293 of the Civil Code defines novation as "consists in substituting a new debtor in the place of the original one, [which] may be made even without the knowledge or against the will of the latter, but not without the consent of the creditor." However, while the consent of the creditor need not be expressed but may be inferred from the creditor's clear and unmistakable acts,[41] to change the person of the debtor, the former debtor must be **expressly released** from the obligation, and the third person or ***new debtor must assume the former's place in the contractual relation.***[42]

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40 Id. at 669.

41 *Bank of the Philippine Islands v. Domingo*, G.R. No. 169407, March 25, 2015, 754 SCRA 245, 263.

42 *S.C. Megaworld Construction and Development Corporation v. Engr. Parada*, 717 Phil. 752, 764 (2013).

Thus, in *Ajax Marketing and Development Corporation v. CA*,[43] the Court had already ruled that:

> The well-settled rule is that novation is never presumed. Novation will not be allowed unless it is clearly shown by express agreement, or by acts of equal import. Thus, to effect an objective novation it is imperative that the new obligation expressly declare that the old obligation is thereby extinguished, or that the new obligation be on every point incompatible with the new one. In the same vein, to effect a subjective novation by a change in the person of the debtor **it is necessary that the old debtor be released expressly from the obligation, and the third person or new debtor assumes his place in the relation**. There is no novation without such release as the third person who has assumed the debtor's obligation becomes merely a co-debtor or surety.[44] (Emphasis ours)

In the present case, PDCP failed to prove by preponderance of evidence that Sengkon was already expressly released from the obligation and that STI assumed the former's obligation. Again, as correctly pointed out by the CA, the Deed of Assumption of Line/Loan with Mortgage (Deed of Assumption) which was supposed to embody STI's assumption of all the obligations of Sengkon under the line, including but not necessarily limited to the repayment of all the outstanding availments thereon, as well as all applicable interests and other charges, was not signed by the parties.

Contrary to PDCP's claim, the CA's rejection of its claim of novation is not based on the absence of the mortgagor's conformity to the Deed of Assumption. The CA's rejection is based on the fact that the non-execution of the Deed of Assumption by Sengkon, STI and FEBTC rendered the existence of novation doubtful because of lack of clear proof that Sengkon is being **expressly released** from its obligation; that STI was already assuming Sengkon's former place in the contractual relation; and that FEBTC is giving its conformity to this arrangement. While FEBTC indeed approved Sengkon's request for the "change in account name" from Sengkon to STI, such mere change in account name alone does not meet the required degree of certainty to establish novation absent any other circumstance to bolster said conclusion.

The trial court's finding that Sengkon did not avail under the Credit Line taints the foreclosure of the mortgage

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43 318 Phil. 268 (1995).

44 Id. at 274-275.

PDCP also claims that the foreclosure of the mortgage was invalid because the PNs that formed the basis of FEBTC's Petition for Extrajudicial Foreclosure of Mortgage were inadmissible in evidence. Rejecting this argument, the CA ruled that the admissibility of the PNs is a non-issue in this case because in questioning the validity of the REMs and the foreclosure proceedings, PDCP did not actually assail the validity or existence of said PNs; what it raised as an issue was whether the foreclosure covered obligations other than Sengkon's availment under the Credit Line. As the CA puts it:

> [W]hat should have been the focal and critical question to be answered on the issue of whether the subject [REMs] were validly foreclosed should have been **whether the [REMs] executed by [PDCP] covered the obligations of [Sengkon] as represented in those [PNs] or, stated in another way, were the [PNs] used by defendant BPI in its foreclosure proceedings over [PDCP's] mortgages availments by [Sengkon] under its Credit Line?**
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> An examination of the subject [PNs] *vis-à-vis* the Agreement for Credit Line would yield an affirmative answer.
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> In the case at bar, a close look at the Agreement for Credit Line would reveal that the said credit facility for Php60 Million was granted in favor of [Sengkon] for the purpose of "Additional Working Capital" and that it would be "available by way of short term [PN]." In the same manner, an examination of [PNs] PN Nos. 2-002-028618, 2-002-029436 and 2-002-029437 would reveal that the said [PNs] were availed of by [Sengkon] for the purpose of "Additional Working Capital."[45] (Citations omitted and emphasis in the original)

The Court cannot agree with the CA. In order to determine whether the obligations sought to be satisfied by the foreclosure proceedings were only Sengkon's availments under the Credit Line, the court necessarily needs to refer to the PNs themselves, as what the CA in fact did. Thus, it is actually the contents of these PNs that are in issue and the trial court did not err in applying the best evidence rule.

But even if the Court disregards the best evidence rule, the circumstances in this case militate against the CA's conclusion. The trial court made a factual finding that Sengkon's availment under the Credit Line, which is the one secured by PDCP's properties, may be made only within one year, or from April 19, 1996 to April 30, 1997. While FEBTC claimed that the period of said credit line was extended up to July 31, 1997, PDCP was not notified of the extension. At any rate, the RTC found that "no evidence had been adduced to show that Sengkon availed of any loan under the credit line up to July 31, 1997," which was the period of the extension.

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45 *Rollo*, pp. 61-62.

Notably, while PDCP demanded from FEBTC for the segregation of Sengkon's availments under the Credit Line, FEBTC failed to heed PDCP's valid request and instead demanded for a comprehensive payment of Sengkon's entire obligation, unmindful of the fact of PDCP's status as a mere third-party mortgagor and not a principal debtor. As a third-party mortgagor, the limitation on its liability pertains not only to the properties it mortgaged but also to the obligations specifically secured thereby. It is well settled that while a REM may exceptionally secure future loans or advancements, these future debts must be specifically described in the mortgage contract. An obligation is not secured by a mortgage unless it comes fairly within the terms of the mortgage contract.[46]

In this case, there was simply no evidence to support the conclusion that the PNs were in fact availments under the Credit Line secured by PDCP's properties. The PNs that were used by FEBTC in its Petition for Extrajudicial Foreclosure of Mortgage were all executed beyond the extended duration of Sengkon's Credit Line (or until July 1997). While FEBTC wrote a letter[47] dated September 18, 1997, which is a few days short of the date of the earliest PN (September 23, 1997), addressed to STI, approving the renewal of the debtor's Credit Line subject to the condition that the Line "shall be partially secured" by the PDCP's mortgaged properties, it is worthy to note that this letter did not bear the conforme of the debtor, lending credence to the trial court's observation. In this light, FEBTC's failure to heed PDCP's request for the segregation of the amounts secured by its properties assumes critical significance. The lack of proof that the availments subject of the foreclosure proceedings were within the coverage of PDCP's REMs explains FEBTC's omission.

Despite the foregoing, however, particularly the variance between the duration of Sengkon's Credit Line and the dates appearing on the face of the PNs, the CA upheld the validity of the foreclosure based merely on the similarity in the purpose for which the Credit Line was granted and the purpose for which the PNs were executed.

On the implied premise that what is material is only the identity of the debtor whose obligation the mortgagor secures, the CA cited *Prudential Bank v. Alviar*[48] and applied the dragnet clause in PDCP's REMs. According to the CA, since the REMs contain a dragnet clause, then PDCP's properties can be made to answer even if the PNs supporting the Petition for

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46 *Traders Royal Bank v. Spouses Castañares*, 651 Phil. 236, 247 (2010).

47 RTC records, pp. 316-319.

48 502 Phil. 595 (2005).

Extrajudicial Foreclosure of Mortgage refer to Sengkon's obligations in its other credit facilities.[49]

The CA unfortunately misapplied the ruling in *Prudential Bank*. In that case, the Court's discussion on the application of the blanket mortgage clause or dragnet clause was not as much as critically important as the Court's novel application of the doctrine of reliance on security test.

A dragnet clause is a stipulation in a REM contract that extends the coverage of a mortgage to advances or loans other than those already obtained or specified in the contract. Where there are several advances, however, a mortgage containing a dragnet clause will not be extended to cover future advances, unless the document evidencing the subsequent advance refers to the mortgage as providing security therefor or unless there are clear and supportive evidence to the contrary.[50] This is especially true in this case where the advances were not only several but were covered by different sub-facilities. Thus, in *Prudential Bank*, the Court stated:

> In the case at bar, the subsequent loans obtained by respondents were secured by other securities, thus: PN BD#76/C-345, executed by Don Alviar was secured by a "hold-out" on his foreign currency savings account, while PN BD#76/C-430, executed by respondents for Donalco Trading, Inc., was secured by "Clean-Phase out TOD CA 3923" and eventually by a deed of assignment on two [PNs] executed by Bancom Realty Corporation with Deed of Guarantee in favor of A.U. Valencia and Co., and by a chattel mortgage on various heavy and transportation equipment. The matter of PN BD#76/C-430 has already been discussed. Thus, the critical issue is whether the "blanket mortgage" clause applies even to subsequent advancements for which other securities were intended, or particularly, to PN BD#76/C-345.
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> Under American jurisprudence, two schools of thought have emerged on this question. One school advocates that a "dragnet clause" so worded as to be broad enough to cover all other debts in addition to the one specifically secured will be construed to cover a different debt, although such other debt is secured by another mortgage. The contrary thinking maintains that a mortgage with such a clause will not secure a note that expresses on its face that it is otherwise secured as to its entirety, at least to anything other than a deficiency after exhausting the security specified therein, such deficiency being an indebtedness within the meaning of the mortgage, in the absence of a special contract excluding it from the arrangement.
>
> The latter school represents the better position. The parties having conformed to the "blanket mortgage clause" or "dragnet clause," it is reasonable to conclude that they also agreed to an implied understanding that subsequent loans need not be secured by other securities, as the

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49 *Rollo*, pp. 63-65.

50 *Asiatrust Development Bank v. Tuble*, 691 Phil. 732, 746 (2012).

> subsequent loans will be secured by the first mortgage. In other words, the sufficiency of the first security is a corollary component of the "dragnet clause." But of course, there is no prohibition, as in the mortgage contract in issue, against contractually requiring other securities for the subsequent loans. Thus, when the mortgagor takes another loan for which another security was given it could not be inferred that such loan was made in reliance solely on the original security with the "dragnet clause," but rather, on the new security given. This is the "reliance on the security test."
>
> Hence, based on the "reliance on the security test," the California court in the cited case made an inquiry whether the second loan was made in reliance on the original security containing a "dragnet clause." Accordingly, finding a different security was taken for the second loan no intent that the parties relied on the security of the first loan could be inferred, so it was held. The rationale involved, the court said, was that the "dragnet clause" in the first security instrument constituted a continuing offer by the borrower to secure further loans under the security of the first security instrument, and that when the lender accepted a different security he did not accept the offer.
>
> x x x x
>
> Indeed, in some instances, it has been held that **in the absence of clear, supportive evidence of a contrary intention, a mortgage containing a "dragnet clause" will not be extended to cover future advances unless the document evidencing the subsequent advance refers to the mortgage as providing security therefor**.[51] (Citations omitted and emphasis and underlining ours)

In the present case, PDCP's REMs indeed contain a blanket mortgage clause in the following language:

> That, for and in consideration of credit accommodations obtained from the [FEBTC], and to secure the payment of the same and those that may hereafter be obtained, the principal of all of which is hereby fixed at x x x PESOS x x x, Philippine Currency, as well as those that the [FEBTC] may extend to the [PDCP], including interest and expenses or any other obligation owing to the [FEBTC], whether direct or indirect, principal or secondary, as appears in the accounts, books and records of the [FEBTC] x x x.[52]

Nonetheless, the parties do not dispute that what the REMs secured were only Sengkon's availments under the Credit Line and not all of Sengkon's availments under other sub-facilities which are also secured by other collaterals.[53] Since the liability of PDCP's properties was not unqualified, the PNs, used as basis of the Petition for Extrajudicial

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51 *Prudential Bank v. Alviar*, supra note 48, at 607-609.

52 RTC records, pp. 451 and 456.

53 Id. at 346.

Foreclosure of Mortgage should sufficiently indicate that it is within the terms of PDCP's limited liability. In this case, the PNs failed to make any reference to PDCP's availments, if any, under its Credit Line. In fact, it did not even mention Sengkon's securities under the Credit Line. Notably, the Disclosure Statements, which were "certified correct" by FEBTC's authorized representative, Ma. Luisa C. Ellescas, and which accompanied the PNs, failed to disclose whether the loan secured thereby was actually secured or not.

Thus, even if the Court brushes aside the Best Evidence Rule, the foregoing observations clearly support the trial court's observation that FEBTC's foreclosure did not actually cover the specific obligations secured by PDCP's properties.

FEBTC's failure to send personal notice to the mortgagor is fatal to the validity of the foreclosure proceedings

Indeed, FEBTC's failure to comply with its contractual obligation to send notice to PDCP of the foreclosure sale is fatal to the validity of the foreclosure proceedings. In *Metropolitan Bank v. Wong*,[54] the Court ruled that while as a rule, personal notice to the mortgagor is not required, such notice may be subject of a contractual stipulation, the breach of which is sufficient to nullify the foreclosure sale, thus:

> In resolving the first query, we resort to the fundamental principle that a contract is the law between the parties and, that absent any showing that its provisions are wholly or in part contrary to law, morals, good customs, public order, or public policy, it shall be enforced to the letter by the courts. Section 3, Act No. 3135 reads:
>
> x x x x
>
> The Act only requires (*1*) the posting of notices of sale in three public places, and (*2*) the publication of the same in a newspaper of general circulation. Personal notice to the mortgagor is not necessary. *Nevertheless*, the parties to the mortgage contract are not precluded from exacting additional requirements. In this case, petitioner and respondent in entering into a contract of [REM], agreed *inter alia*:
>
> > "all correspondence relative to this mortgage, including demand letters, summonses, subpoenas, or notifications of any judicial or extra-judicial action shall be sent to the MORTGAGOR at 40-42 Aldeguer St. Iloilo City,

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54 412 Phil. 207 (2001).

> or at the address that may hereafter be given in writing by the MORTGAGOR to the MORTGAGEE."
>
> Precisely, the purpose of the foregoing stipulation is to apprise respondent of any action which petitioner might take on the subject property, thus according him the opportunity to safeguard his rights. When petitioner failed to send the notice of foreclosure sale to respondent, he committed a contractual breach sufficient to render the foreclosure sale on November 23, 1981 null and void.[55] (Citation omitted and italics in the original)

In trivializing FEBTC's failure to send personal notice to PDCP however, the CA, citing *Philippine National Bank v. Nepomuceno Productions, Inc.*,[56] ruled that since the principal object of a notice of sale is not so much to notify the mortgagor but to inform the public in general of the particularities of the foreclosure, then personal notice to the mortgagor may be disregarded.[57] The cited case, however, is inapplicable because that case did not in fact involve stipulations on personal notice to mortgagor nor the sending of notice to a wrong address. The issue involved in that case is whether the parties to the mortgage can validly waive the statutory requirements of posting and publication and not whether the bank can ignore a contractual stipulation for personal notice. Neither is *PNB v. Spouses Rabat*[58] likewise cited by the CA applicable because the trial court therein found that the mortgage contract did not in fact require that personal service of notice of foreclosure sale be given to the mortgagors. The CA's cavalier disregard of the mortgagor's contractual right to notice of the foreclosure sale runs contrary to jurisprudence. In *Wong*,[59] the Court already had the occasion to observe:

> It is bad enough that the mortgagor has no choice but to yield his property in a foreclosure proceeding. It is infinitely worse, if prior thereto, he was denied of his basic right to be informed of the impending loss of his property. x x x.[60]

While the CA acknowledged that there was indeed a contractual stipulation for notice to PDCP as mortgagor, it considered the absence of a particular address in the space provided therefor in the mortgage contract as merely evincing an expression of "general intent" between the parties and that this cannot prevail against their "specific intent" that Act No. 3135 be

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55 Id. at 216-217.
56 442 Phil. 655 (2002).
57 *Rollo*, pp. 65-66.
58 398 Phil. 654 (2000).
59 Supra note 54.
60 Id. at 212.

the controlling law between them, citing *Cortes v. Intermediate Appellate Court.*[61]

The Court cannot agree with the CA. To begin with, the value of the doctrine enunciated in *Cortes* has long been considered questionable by this Court. Thus, in *Global Holiday Ownership Corporation v. Metropolitan Bank and Trust Company*,[62] the Court held:

> But what is stated in *Cortes* no longer applies in light of the Court's rulings in *Wong* and all the subsequent cases, which have been consistent. *Cortes* has never been cited in subsequent rulings of the Court, nor has the doctrine therein ever been reiterated. Its doctrinal value has been diminished by the policy enunciated in *Wong* and the subsequent cases; that is, that in addition to Section 3 of Act 3135, the *parties may stipulate that personal notice of foreclosure proceedings may be required. Act 3135 remains the controlling law, but the parties may agree, in addition to posting and publication, to include personal notice to the mortgagor, the non-observance of which renders the foreclosure proceedings null and void*, since the foreclosure proceedings become an illegal attempt by the mortgagee to appropriate the property for itself.
>
> Thus, we restate: the *general rule* is that personal notice to the mortgagor in extrajudicial foreclosure proceedings is not necessary, and posting and publication will suffice. Sec. 3 of Act 3135 governing extra-judicial foreclosure of [REMs], as amended by Act 4118, requires only posting of the notice of sale in three public places and the publication of that notice in a newspaper of general circulation. The *exception* is when the parties stipulate that personal notice is additionally required to be given the mortgagor. Failure to abide by the general rule, or its exception, renders the foreclosure proceedings null and void.[63] (Citation omitted, italics ours, and emphasis and underlining in the original deleted)

In fact, the 2002 case of *Nepomuceno Productions*,[64] cited by the CA, already made it clear that while personal notice to the mortgagor in extrajudicial foreclosure proceedings is not necessary, this holds true only if the parties did not stipulate therefor. Stated differently, personal notice is necessary if the parties so agreed in their mortgage contract. In the present case, the parties provided in their REMs that:

> 12. All correspondence relative to this mortgage, including demand letters, summonses, subpoenas, or notifications of any judicial or extrajudicial action shall be sent to the [PDCP] at _____

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61 256 Phil. 979 (1989).
62 607 Phil. 850 (2009).
63 Id. at 864.
64 Supra note 56.

> or at the address that may hereafter be given in writing by the [PDCP] to the [FEBTC]. x x x.[65]

This provision clearly establishes the agreement between the parties that personal notice is required before FEBTC may proceed with the foreclosure of the property and thus, FEBTC's act of proceeding with the foreclosure despite the absence of personal notice to the mortgagor was its own lookout.

That the portion on the mortgagor's address was left in blank cannot be simply swept under the rug as "an expression of general intent" that cannot prevail of the parties' specific intent not to require personal notice. Apart from the fact that this reasoning is based on a questionable doctrine, the CA's ruling completely ignored the fact that the mortgage contract containing said stipulation was a standard contract prepared by FEBTC itself. If the latter did not intend to require personal notice, on top of the statutory requirements of posting and publication, then said provision should not have at all been included in the mortgage contract. In other words, the REMs in this case are contracts of adhesion, and in case of doubt, the doubt should be resolved against the party who prepared it.[66]

Accordingly, the CA should have considered the "doubt" created by the blank space in the mortgage contract against FEBTC and not in its favor. Nonetheless, even if the Court ignores this particular rule of interpretation, the fact that FEBTC caused the sending of a notice, albeit at a wrong address, to PDCP is itself a clear proof that the parties did intend to impose a contractual requirement of personal notice, FEBTC's undisputed breach of which sufficiently nullifies the foreclosure proceeding.

With the foregoing, the Court finds it unnecessary to discuss PDCP's argument based on the alleged violation of its constitutional right against impairment of obligations and contract.

WHEREFORE, premises considered, the petition is **GRANTED**. The Decision dated November 25, 2009 and Resolution dated February 2, 2010 of the Court of Appeals in CA-G.R. CV No. 89755 are hereby **ANNULLED** and **SET ASIDE**. The Decision dated April 16, 2007 of the Regional Trial Court of Quezon City, Branch 222, in Civil Case No. Q01-44630 is **REINSTATED** and **AFFIRMED**.

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65 RTC records, pp. 452 and 457.

66 *South Pachem Development, Inc. v. CA*, 488 Phil. 87, 98 (2004).

SO ORDERED.

BIENVENIDO L. REYES
Associate Justice

WE CONCUR:

PRESBITERO J. VELASCO, JR.
Associate Justice
Chairperson

LUCAS P. BERSAMIN
Associate Justice

ALFREDO BENJAMIN S. CAGUIOA
Associate Justice

NOEL GIMENEZ TIJAM
Associate Justice

A T T E S T A T I O N

I attest that the conclusions in the above Decision had been reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

PRESBITERO J. VELASCO, JR.
Associate Justice
Chairperson

CERTIFICATION

Pursuant to Section 13, Article VIII of the Constitution and the Division Chairperson's Attestation, I certify that the conclusions in the above Decision had been reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

MARIA LOURDES P. A. SERENO
Chief Justice

CERTIFIED TRUE COPY
WILFREDO V. LAPITAN
Division Clerk of Court
Third Division
JUL 26 2017