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FIRST DIVISION

[G.R. No. 118692. July 28, 2006]

COASTAL PACIFIC TRADING, INC., *petitioner, vs.* **SOUTHERN ROLLING MILLS, CO., INC. (now known as Visayan Integrated Steel Corporation), FAR EAST BANK & TRUST COMPANY, PHILIPPINE COMMERCIAL INDUSTRIAL[1] BANK, EQUITABLE BANKING CORPORATION, PRUDENTIAL BANK, BOARD OF TRUSTEES-CONSORTIUM OF BANKS-VISCO, UNITED COCONUT PLANTERS BANK, CITYTRUST BANKING CORPORATION, ASSOCIATED BANK, INSULAR BANK OF ASIA AND AMERICA, INTERNATIONAL CORPORATE BANK, COMMERCIAL BANK OF MANILA, BANK OF THE PHILIPPINE ISLANDS, NATIONAL STEEL CORPORATION, THE PROVINCIAL SHERIFF OF BOHOL, and DEPUTY SHERIFF JOVITO DIGAL,[2]** *respondents.*

SYLLABUS

1. REMEDIAL LAW; CIVIL PROCEDURE; JUDGMENT; *RES JUDICATA*; ELEMENTS. — The CA erred in applying *Southern Industrial projects v. United Coconut Planters Bank* as a bar by *res judicata* with respect to the present case. For this principle to apply, the following elements must concur: a) the former judgment was final; b) the court that rendered it had jurisdiction over the subject matter and the parties; c) the judgment was based on the merits; and d) between the first and the second actions, there is an identity of parties, subject matters, and causes of action.

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[1] Also referred to as "Philippine Commercial International Bank" in respondents' Memorandum (*rollo*, p. 223).

[2] The Petition impleaded the Court of Appeals (CA) as a respondent. Pursuant to Sec. 4 of Rule 45 of the Rules of Court, this Court has deleted the CA from the title of the case.

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2. **ID.; ID.; ID.; ID.; DOES NOT REQUIRE AN ABSOLUTE, BUT ONLY A SUBSTANTIAL, IDENTITY OF PARTIES.** — It is axiomatic that *res judicata* does not require an absolute, but only a substantial, identity of parties. There is a substantial identity when there is privity between the two parties or they are successors-in-interest by title subsequent to the commencement of the action, litigating for the same thing, under the same title, and in the same capacity. Petitioner was not acting in the same capacity as SIP when it filed Civil case No. 3383, which eventually became AC-GR CV No. 03719. It brought this latter action as a creditor under a processing agreement with VISCO; on the other hand, the latter was sued by SIP, based on an alleged breach of their management contact. Very clearly, their rights were entirely distinct and separate from each other. In no manner were these two creditors privies of each other.

3. **ID.; ID.; ID.; ID.; CAUSES OF ACTION, ELABORATED; NO IDENTITY OF CAUSES OF ACTION IN CASE AT BAR.** — The causes of action in the two Complaints were also different. Causes of action arise from violations of rights. A single right may be violated by several acts or omissions, in which case the plaintiff has only one cause of action. Likewise, a single act or omission may violate several rights at the same time, as when the act constitutes a violation of separate and distinct legal obligations. The violation of *each of these separate rights* is a separate cause of action in itself. Hence, although these causes of action arise from the same state of facts, they are distinct and independent and may be litigated separately; recovery on one is not a bar to subsequent actions on the others. In the present case, the right of SIP (arising from the management contract with VISCO) is totally distinct and separate from the right of Coastal (arising from its processing contract with VISCO). SIP and coastal are asserting rights from different legal obligations of the debtor corporation. Thus, VISCO's violation of those separate rights has given rise to separate causes of action.

4. **ID.; ID.; ID.; ID.; PERSONS DO NOT BECOME PRIVIES BY THE MERE FACT THAT THEY ARE NOT INTERESTED IN THE SAME QUESTION OR IN PROVING THE SAME SET OF FACTS, OR THAT ONE PERSON IS INTERESTED IN THE RESULT OF A LITIGATION INVOLVING THE OTHER.** — The confusion in the resolution of the issue of identity of parties occurred, because the two

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creditors were assailing the same transactions of VISCO on the same grounds. Since the two cases they filed presented similar legal issues, the appellate court held that its ruling in CA-GR CV No. 03719 was also applicable to the instant case. Common but palpable is this misconception of the doctrine of *res judicata*. Persons do not become privies by the mere fact that they are interested in the same question or in proving the same set of facts, or that one person is interested in the result of a litigation involving the other. Hence, several creditors of one debtor cannot be considered as identical parties for the purpose of assailing the acts of the debtor. They have distinct credits, rights, and interests, such that the failure of one to recover should not preclude the other creditors from also pursuing their legal remedies.

5. **CIVIL LAW; OBLIGATIONS AND CONTRACTS; CONTRACTS; RESCISSIBLE CONTRACTS; CONTRACTS THAT ARE OTHERWISE VALID BETWEEN THE CONTRACTING PARTIES MAY NONETHELESS BE SUBSEQUENTLY RESCINDED BY REASON OF INJURY TO THIRD PERSONS, LIKE CREDITORS.** — Coastal alleges that the assignment of mortgage, the extrajudicial foreclosure proceedings, and the sale of the properties of VISCO should all be rescinded on the ground that they were done to defraud the latter's creditors. The CA found no merit in petitioner's arguments. It ruled that the assignment conformed to the requirements of law; that the consideration for the assignment had allegedly been given by FEBTC; and that, hence, the Consortium had a right to foreclose on the mortgaged properties. By focusing on the innate validity of these Contracts, the CA totally overlooked the issue of fraud as a ground for rescission. Elementary is the principle that the validity of a contract does *not* preclude its rescission. Under Articles 1380 and 1381 (3) of the Civil Code, contracts that are otherwise valid between the contracting parties may nonetheless be subsequently rescinded by reason of injury to third persons, like creditors. In fact, rescission implies that there is a contract that, while initially valid, produces a lesion or pecuniary damage to someone. Thus, when the CA confined itself to the issue of the validity of these contracts, it did not at all address the heart of petitioner's cause of action: whether these transactions had been undertaken by the Consortium to defraud VISCO's other creditors.

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6. **ID.; ID.; ID.; ID.; FRAUD IS PRESENT WHEN THE DEBTOR KNOWS THAT ITS ACTIONS WOULD CAUSE INJURY.** — To be sure, there was undue advantage. The payment scheme devised by the Consortium continued the efficacy of the primary lien, this time in its favor, to the detriment of the other creditors. When one considers its knowledge that VISCO's assets might not be enough to meet its obligations to several creditors, the intention to defraud the other creditors is even more striking. Fraud is present when the debtor knows that its actions would cause injury.

7. **ID.; ID.; ID.; ID.; ASSIGNMENT OF MORTGAGE CONSIDERED A RESCISSIBLE CONTRACT WHERE THE SAME HAS BEEN UNDERTAKEN IN FRAUD OF CREDITORS; EFFECT OF RESCISSION.** — The assignment in favor of the Consortium was a rescissible contract for having been undertaken in fraud of creditors. Article 1385 of the Civil Code provides for the effect of rescission. x x x Indeed, mutual restitution is required in all cases involving rescission. But when it is no longer possible to return the object of the contract, an indemnity for damages operates as restitution. The important consideration is that the indemnity for damages should restore to the injured party what was lost.

8. **ID.; ID.; ID.; SALES; PURCHASERS WHEN DEEMED IN GOOD FAITH; CASE AT BAR.** — In the case at bar, it is no longer possible to order the return of VISCO's properties. They have already been sold to the NSC, which has not been shown to have acted in bad faith. The party alleging bad faith must establish it by competent proof. Sans that proof, purchasers are deemed to be in good faith, and their interest in the subject property must not be disturbed. Purchasers in good faith are those who buy the property of another without notice that some other person has a right to or interest in the property; and who pay the full and fair price for it at the time of the purchase, or before they get notice of some other person's claim of interest in the property. In the present case, petitioner failed to discharge its burden of proving bad faith on the part of NSC. There is insufficient evidence on record that the latter participated in the design to defraud VISCO's creditors. To NSC, petitioner imputes fraud from the sole fact that the former was allegedly aware that its vendor, the Consortium, has taken control over VISCO including, the corporation's assets. We cannot appreciate

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how knowledge of the takeover would necessarily implicate anyone in the Consortuim's fraudulent designs. Besides, NSC was not shown to be privy to the information that VISCO had no other assets to satisfy other creditor's respective claims.

9. **ID.; ID.; ID.; ID.; RIGHT OF AN INNOCENT PURCHASER FOR VALUE MUST BE RESPECTED AND PROTECTED, EVEN IF ITS VENDORS OBTAINED THEIR TITLE THROUGH FRAUD.** — The right of an innocent purchaser for value must be respected and protected, even if its vendors obtained their title through fraud. Pursuant to this principle, the remedy of the defrauded creditor is to sue for damages against those who caused or employed the fraud. Hence, petitioner is entitled to damages from the Consortium.

10. **ID.; DAMAGES; AWARD OF DAMAGES; CLAIMANT MUST SATISFACTORILY PROVE FACTUAL BASIS THEREOF, AND THAT THE DEFENDANT'S ACTS HAVE A CAUSAL CONNECTION TO THEM; CASE AT BAR.** — It is essential that for damages to be awarded, a claimant must satisfactorily prove during the trial that they have a factual basis, and that the defendant's acts have a causal connection to them. Thus, the question of damages should normally call for a remand of the case to the lower court for further proceedings. Considering, however, the length of time that petitioner's just claim has been thwarted, we find it in the best interest of substantial justice to decide the issue of damages now on the basis of the available records. A remand for further proceedings would only result in a needless delay. Going over the records of the case, we find that petitioner has a final and executory judgment in its favor in Civil case No. 21272. The judgment in that case reads as follows: x x x The foregoing is the judgment credit that petitioner cannot enforce VISCO because of Respondent Consortium's fraudulent disposition of the corporation's assets. In other words, the above amounts define the extent of the actual damage suffered by Coastal and the amount that respondent has to restore pursuant to Article 1385.

11. **ID.; ID.; EXEMPLARY DAMAGES; IMPOSED TO SERVE AS A WARNING TO OTHER CREDITORS NOT TO ABUSE THEIR RIGHTS.** — On the basis of the finding of fraud, the award of exemplary damages is in order, to serve as a warning to other creditors not to abuse their rights. Under Article 2229 of the Civil Code, exemplary or corrective damages are imposed

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by way of example or correction for the public good. By their nature, exemplary damages should be imposed in an amount sufficient and effective to deter possible future similar acts by respondent banks. The court finds the amount of ₱250,000 sufficient in the instant case.

12. **ID.; ID.; MORAL DAMAGES; CORPORATION NOT ENTITLED TO AN AWARD THEREOF; EXCEPTION; AWARD OF MORAL DAMAGES TO THE PETITIONER CORPORATION, UNWARRANTED.**— As a rule, a corporation is not entitled to moral damages because, not being a natural person, it cannot experience physical suffering or sentiments like wounded feelings, serious anxiety, mental anguish and moral shock. The only exception to this rule is when the corporation has a good reputation that is debased, resulting in its humiliation in the business realm. In the present case, the records do not show any evidence that the name or reputation of petitioner has been sullied as a result of the Consortium's fraudulent acts. Accordingly, moral damages are not warranted.

13. **COMMERCIAL LAW; CORPORATION LAW; CORPORATIONS; DIRECTORS WHO BECAME CORPORATE CREDITORS IN THEIR OWN RIGHT SHOULD NOT SECURE ANY UNDUE ADVANTAGE OVER OTHER CREDITORS.** — It will be recalled that Respondent Consortium took over management and control of VISCO by acquiring 90 percent of the latter's equity. Thus, out of the 10 directors of the corporation were all officials of the Consortium, which may thus be said to have effectively occupied and/or controlled the board. Significantly, nowhere in the records can we find any denial by respondent of this allegation by petitioner. As directors of VISCO, the officials of the Consortium were in a position of trust; thus, they owed it a duty of loyalty. This trust relationship sprang from the fact that they had control and guidance over its corporate affairs and property. Their duty was more stringent when it became insolvent that arose. Because they were deemed *trustees of the creditors* in those instances, they should have managed the corporation's assets with *strict regard* for the creditors' interests. When these directors became corporate creditors in their own right, they should not have permitted themselves to secure any undue advantage over the creditors. In the instant case, the Consortium miserably failed to observe its duty of fidelity towards VISCO and its creditors.

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14. ID.; ID.; ID.; ID.; CASE AT BAR. — Recall that as early as 1966, the Consortium, through its directors on the board of VISCO, had already assumed management and control over the latter. Hence, when VISCO recognized its outstanding liability to petitioner in 1970 and offered a Compromise Agreement, respondent banks were already at the helm of the debtor corporation. The members of the Consortium, therefore, cannot deny that they were aware of those claims against the corporation. Nonetheless, they did not adopt any measure to protect petitioner's credit. Quite the opposite, they even took steps to hide VISCO's unexpended funds. Garcia's 1972 letter to Samonte unmistakably reveals that they kept those funds in an account named "Board of Trustees VISCO Consortium of Banks." This fact alone shows an effort to hide, with the evident intent to keep, those funds for themselves. The letter even says that, for the protection of the Consortium, the name "VISCO" should be eliminated entirely, so that the account name would read "Board of Trustees Consortium of banks." Clearly, this particular move was found to be necessary to avoid a takeover by the government, which was also a creditor of VISCO. This express intent of the latter, under the direction and for the benefit of the Consortium, corroborated petitioner's contention that respondent banks had defrauded VISCO's creditors.

APPEARANCES OF COUNSEL

Crisanto L. Francisco for petitioner.

Ignacio C. Moneda II for respondents (Consortium of Banks) and *Sixto Marella, Jr.* for respondent Banks.

The Government Corporate Counsel for respondent National Steel Corporation.

D E C I S I O N

PANGANIBAN, *C.J.*:

Directors owe loyalty and fidelity to the corporation they serve and to its creditors. When these directors sit on the board

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as representatives of shareholders who are also major creditors, they cannot be allowed to use their offices to secure undue advantage for those shareholders, in fraud of other creditors who do not have a similar representation in the board of directors.

The Case

Before us is a Petition for Review[3] under Rule 45 of the Rules of Court, assailing the September 27, 1994 Decision[4] and the January 5, 1995 Resolution[5] of the Court of Appeals (CA) in CA-G.R. CV No. 39385. The challenged Decision disposed as follows:

"WHEREFORE, the decision of the Regional Trial Court is hereby AFFIRMED *in toto.*"[6]

The challenged Resolution denied reconsideration.

The Facts

Respondent Southern Rolling Mills Co., Inc. was organized in 1959 for the purpose of engaging in a steel processing business. It was later renamed Visayan Integrated Steel Corporation (VISCO).[7]

On December 11, 1961, VISCO obtained a loan from the Development Bank of the Philippines (DBP) in the amount of ₱836,000. This loan was secured by a duly recorded Real Estate Mortgage over VISCO's three (3) parcels of land, including all the machineries and equipment found there.[8]

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[3] *Rollo*, pp. 10-33.

[4] *Id.* at 35-54. Special Seventh Division. Penned by Justice Antonio M. Martinez (Division chair), with the concurrence of Justices Ramon Mabutas, Jr., and Delilah Vidallon-Magtolis (members).

[5] *Id.* at 56.

[6] Assailed CA Decision, p. 20; *rollo*, p. 54.

[7] *Id.* at 3; *id.* at 37.

[8] *Id.*

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On August 15, 1963, VISCO entered into a Loan Agreement[9] with respondent banks (later referred to as "Consortium"[10]) for the amount of US$5,776,186.71 or ₱21,745,707.36 (at the then prevailing exchange rate) to finance its importation of various raw materials. To secure the full and faithful performance of its obligation, VISCO executed on August 3, 1965, a second mortgage[11] over the same land, machineries and equipment in favor of respondent banks. This second mortgage remained unrecorded.[12]

VISCO eventually defaulted in the performance of its obligation to respondent banks. This prompted the Consortium to file on January 26, 1966, Civil Case No. 1841, which was a Petition for Foreclosure of Mortgage with Petition for Receivership.[13] This case was eventually dismissed for failure to prosecute.[14]

Afterwards, negotiations were conducted between VISCO and respondent banks for the conversion of the unpaid loan into equity in the corporation.[15] Vicente Garcia, vice-president of VISCO and of Far East Bank and Trust Company (FEBTC),[16] testified that sometime in 1966, the creditor banks were given management of and control over VISCO.[17] In time,[18] in order to

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[9] Records, Vol. I, pp. 77-84.

[10] Far East Bank and Trust Company (FEBTC), Philippine Commercial International Bank (PCIB) Equitable Banking Corporation (EBC), Prudential Bank and Trust Company (PBTC), United Coconut Planters Banks (UCPB), Bank of the Philippine Islands (BPI), Philippine Bank of Commerce, CityTrust Banking Corporation (CityTrust), Associated Bank, Insular Bank of Asia and America, Commercial Bank of Manila, and International Corporate Bank. Respondents' Memorandum, pp. 1-2; *rollo*, pp. 223-224.

[11] Records, Vol. I, pp. 85-99.

[12] Petition, p. 4; *rollo*, p. 13.

[13] Documentary Evidence of Coastal Pacific; records, pp. 74-86.

[14] RTC Decision, p. 9; CA *rollo*, p. 104.

[15] Respondents' Memorandum, p. 4; *rollo*, p. 226.

[16] IAC Decision, AC-G.R. CV No. 03719, p. 4; records, Vol. I, p. 136.

[17] RTC Decision, p. 8; CA *rollo*, p. 103.

[18] Particularly on January 29, 1970. SGV Audit Report (records, Vol. I, p. 176).

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reorganize it, its principal creditors agreed to group themselves into a creditors' consortium.[19] As a result of the reorganized corporate structure of VISCO, respondent banks acquired more than 90 percent of its equity. Notwithstanding this conversion, it remained indebted to the Consortium in the amount of ₱16,123,918.02. [20]

Meanwhile from 1964 to 1965, VISCO also entered into a processing agreement with Petitioner Coastal Pacific Trading, Inc. ("Coastal"). Pursuant to that agreement, petitioner, delivered 3,000 metric tons of hot rolled steel coils to VISCO for processing into block iron sheets. Contrary to their agreement, the latter was able to process and deliver to petitioner only 1,600 metric tons of those sheets. Hence, a total of 1,400 metric tons of hot rolled steel coils remained unaccounted for.[21] The fact that petitioner was among the major creditors of VISCO was recognized by the latter's vice-president, Vicente Garcia.[22] Indeed, on October 9, 1970, it forwarded to petitioner a proposal for a Compromise Agreement.[23] Subsequent developments indicate, however, that the parties did not arrive at a compromise.

Two years later, on October 20, 1972, Garcia wrote Arturo P. Samonte, representative of FEBTC[24] and director of VISCO,[25] a letter that reads as follows:

"In the light of recent development on IISMI and Elirol which were taken over by the government, I suggest that we take certain precautionary measures to protect the interests of the Consortium of Banks. One such step may be to insure the safety of the unexpended funds of VISCO from any contingencies in the future. As of now VISCO's account with the Far East Bank is in the name

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[19] Records, Vol. I, p. 176.

[20] CA Decision, p. 4; *rollo*, p. 38.

[21] Petitioner's Memorandum, p. 3; *rollo*, p. 260.

[22] RTC Decision, p. 9; CA *rollo*, p. 104.

[23] Documentary Evidence of Coastal Pacific; records, pp. 4-5.

[24] *Rollo*, p. 57.

[25] *Id.* at 61.

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of BOARD OF TRUSTEES VISCO CONSORTIUM OF BANKS. It may be better to eliminate the term VISCO and just call the account BOARD OF TRUSTEES CONSORTIUM OF BANKS."[26]

According to a notation on this letter, an FEBTC assistant cashier named Silverio duly complied with the above request.[27] Indeed, events would later reveal that the bank held a deposit account in the name of the "Board of Trustees-Consortium of Banks."[28]

On September 20, 1974, respondent banks held a luncheon meeting[29] in the FEBTC Boardroom to discuss how they would address the insistent demands of the DBP for VISCO to settle its obligations. Jose B. Fernandez, Jr., VISCO's then chairman and concurrent FEBTC President,[30] expressed his apprehension that either the DBP or the government would soon pursue extra-judicial foreclosure against VISCO.

In this regard, Fernandez informed the members of the Consortium that he had received letter-offers from two corporations that were interested in purchasing VISCO's generator sets.[31] After deliberating on the matter, the members decided to approve the sale of these two generator sets to Filmag (Phil.), Inc. It was also agreed that the proceeds of the sale would be used to pay VISCO's indebtedness to DBP and to secure the release of the first mortgage.[32] The Consortium agreed with Filmag on the following payment procedure:

"The payment procedure will be as follows: Filmag pays to VISCO; VISCO pays the Consortium; and then the Consortium pays the DBP

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[26] Annex "D" of the Petition; *rollo*, p. 66.

[27] Exhibit K-2 on Annex "D" of the Petition; *rollo*, p. 66.

[28] Documentary Evidence of Coastal Pacific; records, p. 34.

[29] Minutes of the Luncheon Meeting of the Creditors' Consortium for Visayan Integrated Steel Corporation held at the FEBTC Boardroom on Friday, September 20, 1974, pp. 1-4; *rollo*, pp. 57-60.

[30] IAC Decision, AC-G.R. CV No. 03719, p. 4; records, Vol. I, p. 136.

[31] *Supra* note 28, at 2; *rollo*, p. 58.

[32] *Id.* at 3; *id.* at 59.

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with the arrangement that the Consortium subrogates to the rights of the DBP as first mortgagee to the VISCO plant. The Consortium further agreed to call a meeting of the VISCO board of directors for the purpose of considering and formally approving the proposed sale of the 2 generators to Filmag."[33]

Accordingly, on October 4, 1974, the VISCO board of directors had a meeting in the FEBTC Boardroom.[34] The board was asked to decide how VISCO would settle its debt to DBP: whether by asking the Consortium to put up the necessary amount or by accepting Filmag's offer to purchase VISCO's generator sets.[35] The latter option was unanimously chosen[36] in a Resolution worded as follows:

"RESOLVED, That the offer of Filmag (Philippines) Inc. in their letters of December 14, 1973 and March 19, 1974 to purchase two (2) units of generator sets, including standard accessories, of VISCO is hereby accepted under the following terms and conditions:

xxx xxx xxx

"2. The price for the two (2) generator sets is PESOS: ONE MILLION FIVE HUNDRED FIFTY THOUSAND FIVE HUNDRED SEVENTY TWO ONLY (₱1,550,572) xxx and shall be payable upon signing of a letter-agreement and which shall be later formalized into a Deed of Sale. The amount, however, shall be held by the depositary bank of VISCO, Far East Bank and Trust Company, in escrow and shall be at VISCO's disposal upon the signing of Filmag of the receipt/s of delivery of the said two (2) generator sets.

xxx xxx xxx

"FURTHER RESOLVED, That the sales proceeds of PESOS: ONE MILLION FIVE HUNDRED FIFTY THOUSAND FIVE HUNDRED SEVENTY TWO ONLY (₱1,550,572) shall be utilized to pay the liability of VISCO with the Development Bank of the Philippines."[37]

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[33] *Id.*

[34] Minutes of the Special Board Meeting of Visayan Integrated Steel Corporation Held at the FEBTC Boardroom, Manila, on October 4, 1974, pp. 1-5; *rollo*, pp. 61-65.

[35] *Id.* at 3; *id.* at 63.

[36] *Id.*

[37] *Id.* at 3-5; *id.* at 63-65.

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The sale of the generator sets to Filmag took place and, according to the testimony of Garcia, the proceeds were deposited with FEBTC in a special account held in trust for the Consortium.[38]

A year after, on May 22, 1975, petitioner filed with the Pasig Regional Trial Court (RTC) a Complaint[39] for Recovery of Property and Damages with Preliminary Injunction and Attachment.[40] Petitioner's allegation was that VISCO had fraudulently misapplied or converted the finished steel sheets entrusted to it.[41] On June 3, 1975, Judge Pedro A. Revilla issued a Writ of Preliminary Attachment over its properties that were not exempt from execution.[42]

In compliance with the Writ, Sheriff Andres R. Bonifacio attempted to garnish the account of VISCO in FEBTC,[43] which denied holding that account. Instead, the bank admitted that what it had was a deposit account in the name of the Board of Trustees-Consortium of Banks, particularly Account No. 2479-1.[44] FEBTC reported to Sheriff Bonifacio that it had instructed its accounting department to hold the account, "subject to the prior liens or rights in favor of [FEBTC] and other entities."[45]

While petitioner's case was pending, VISCO's vice-president (Garcia) and director (Arturo Samonte) requested from FEBTC

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[38] CA *rollo*, p. 104.

[39] Exhibit "D", Documentary Evidence of Coastal Pacific; records, pp. 7-22.

[40] Docketed as Civil Case No. 21272 and entitled *Coastal Pacific Trading, Inc., v. Visayan Integrated Steel Corporation, Continental Bank and the Provincial Sheriff of Rizal.*

[41] Complaint, pp. 12-13; Documentary Evidence of Coastal Pacific; records, pp. 18-19.

[42] Exhibit "E-1", Documentary Evidence of Coastal Pacific; records, p. 26.

[43] Exhibit "E-2", *id.* at 29-30.

[44] Exhibit "E-5", *id.* at 34-35.

[45] Refer to Hector Villavecer's reply letters dated June 9, 1975 (records, Vol. I, p. 31) and June 30, 1975 (records, Vol. I, pp. 34-35).

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a cash advance of ₱1,342,656.88 for the full settlement of VISCO's account with DBP.[46] On June 29, 1976, FEBTC complied by issuing Check No. FE239249 for ₱1,342,656.88, payable to "[DBP] for [the] account of VISCO."[47] On even date, DBP executed a Deed of Assignment of Mortgage Rights Interest and Participation[48] in favor of Respondent Consortium of Banks. The deed stated that, in consideration of the payment made, all of DBP's rights under the mortgage agreement with VISCO were being transferred and conveyed to the Consortium.[49] Thus did the latter obtain DBP's recorded primary lien over the real and chattel properties of VISCO.

On September 23, 1980, the Consortium filed a Petition for Extra-Judicial Foreclosure with the Office of the Provincial Sheriff of Bohol.[50] The Notice of Extrajudicial Foreclosure of Mortgage, published in the *Bohol Newsweek* on October 10, 1980, announced that the auction sale was scheduled for November 11, 1980.[51]

On November 3, 1980, Southern Industrial Projects, Inc. (SIP), which was a judgment creditor[52] of VISCO, filed Civil Case No. 3383. It was a Complaint[53] for Declaration of Nullity of the Mortgage and Injunction to Restrain the Consortium from Proceeding with the Auction Sale. SIP argued that DBP had actually been paid by VISCO with the proceeds from the sale of the generator sets. Hence, the mortgage in favor of that bank had been extinguished by the payment and could not have

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[46] Documentary Evidence of Coastal Pacific; records, p. 175.

[47] *Id.* at 176.

[48] Records, Vol. I, pp. 100-105.

[49] *Id.* at 101.

[50] *Id.* at 111-118.

[51] *Id.* at 137.

[52] In Civil Case No. 3136, VISCO was sentenced to pay Southern Industrial Projects, Inc. the sum of ₱11,194,512.32 with interest from June 30, 1970. (Refer to IAC Decision dated June 14, 1985, p. 5; records, Vol. I, p. 137)

[53] Records, Vol. I, pp. 119-123.

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been assigned to the Consortium.[54] A temporary restraining order against the latter was thus successfully obtained; the provincial sheriff could not proceed with the auction sale of the mortgaged assets.[55] But SIP's victory was short-lived. On March 2, 1984, Civil Case No. 3383 was decided in favor of the Consortium[56] Judge Andrew S. Namocatcat ruled thus:

"The evidence of the plaintiff is only anchored on the fact that the deed of assignment executed by the DBP in favor of the defendant banks is an act which would defraud creditors. It is the thinking of the court that the payment of defendant banks to DBP of VISCO's loan and the execution of the DBP of the deed of assignment of credit and rights to the defendant banks is in accordance with Article 1302 and 1303 of the New Civil Code, and said transaction is not to defraud creditors because the defendant banks are also creditors of VISCO."[57]

On June 14, 1985, this Decision was affirmed by the Intermediate Appellate Court in CA-G.R. No. 03719.[58]

The auction sale of VISCO's mortgaged properties took place on March 19, 1985 and the Consortium emerged as the highest bidder.[59] The Certificate of Sale[60] in its favor was registered on May 22, 1985.[61]

On June 27, 1985, VISCO executed through Vicente Garcia, a Deed of Assignment of Right of Redemption[62] in favor of the National Steel Corporation, (NSC), in consideration of

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[54] *Id.* at 121.

[55] Respondents' Memorandum, p. 6; *rollo*, p. 228.

[56] Records, Vol. I, pp. 124-131.

[57] *Id.* at 131.

[58] *Id.* at 133-145.

[59] *Id.* at 25.

[60] *Id.* at 25-48.

[61] *Id.* at 4 and 48.

[62] *Id.* at 166-170.

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₱100,000.[63] On the same day, the Consortium sold the foreclosed real and personal properties of VISCO to the NSC.[64]

On August 16, 1985, petitioner filed against respondents Civil Case No. 3929, which was a Complaint for Annulment or Rescission of Sale, Damages with Preliminary Injunction.[65] Coastal alleged that, despite the Writ of Attachment issued in its favor in the still pending Civil Case No. 21272, the Consortium had sold the properties to NSC. Further, despite the attachment of the properties, the Consortium was allegedly able to sell and place them beyond the reach of VISCO's other creditors.[66] Thus imputing bad faith to respondent banks' actions, petitioner said that the sale was intended to defraud VISCO's other creditors.

Petitioner further contended that the assignment in favor of the Consortium was fraudulent, because DBP had been paid with the proceeds from the sale of the generator sets owned by VISCO, and not with the Consortium's own funds.[67] Petitioner offered as proof the minutes of the meeting[68] in which the transaction was decided. Respondent Consortium countered that the minutes would in fact readily disclose that the intention of its members was to apply the proceeds to a partial payment to DBP.[69] Respondent insisted that it used its own funds to pay the bank.[70]

On August 20, 1985, a temporary restraining order (TRO)[71] was issued by Judge Mercedes Gozo-Dadole against VISCO,

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[63] *Id.* at 184.

[64] Deed of Absolute Sale of Rights, Interests, and Participation over Personal Movable Properties (Records, Vol. I., pp. 146-155); and Deed of Absolute Sale of Rights, Interests, and Participation over Real Properties (records, Vol. I., pp. 156-165).

[65] Records, Vol. I, pp. 1-14.

[66] *Id.* at 11.

[67] Petitioner's Memorandum, pp. 11-12; *rollo*, pp. 268-269.

[68] Annex "B" of the Petition; *rollo*, pp. 57-60.

[69] Respondents' Consolidated Rejoinder, p. 3; *rollo*, p. 173.

[70] Respondents' Memorandum, p. 4; *rollo*, p. 226.

[71] Records, Vol. I, p. 18.

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enjoining it from proceeding with the removal or disposal of its properties; the execution and/or consummation of the foreclosure sale; and the sale of the foreclosed properties to NSC. On September 6, 1985, the trial court issued an Order requiring the Consortium to post a bond of ₱25 million in favor of Coastal for damages that petitioner may suffer from the lifting of the TRO. The bond filed was then approved by the RTC in its Order of September 13, 1985.[72]

On December 15, 1986, Civil Case No. 21272 was finally decided by Judge Nicolas P. Lapena, Jr., in favor of Coastal.[73] VISCO was ordered to pay petitioner the sum of ₱851,316.19 with interest at the legal rate, plus attorney's fees of ₱50,000.00 and costs.[74] Coastal filed a Motion for Execution,[75] but the judgment has remained unsatisfied to date.

On January 5, 1992, a Decision[76] on Civil Case No. 3929 was rendered as follows:

"WHEREFORE, this Court hereby renders judgment in favor of the defendants and against the plaintiff Coastal Pacific Trading, Inc. BY WAY OF THE MAIN COMPLAINT, to wit:

"1. Declaring the extrajudicial foreclosure sale conducted by the sheriff and the corresponding certificate of sale executed by the defendant sheriffs on March 15, 1985 relative to the real properties of the defendant SRM/VISCO of Cortes, Bohol, Philippines, which were registered in the Register of Deeds of Bohol, on May 22, 1985 and the Transfer of Assignment to the defendant National Steel Corporation of any or part of the foreclosed properties arising from the extrajudicial foreclosure sale as valid and legal;

"2. Ordering the plaintiff Coastal Pacific Trading Inc. to pay the defendant Consortium of Banks[,] Southern Rolling

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[72] Petitioner's Memorandum, p. 6; *rollo*, p. 263.

[73] Documentary Evidence of Coastal Pacific; records, pp. 150-158.

[74] *Id.* at 158.

[75] *Id.* at 159-161.

[76] CA *rollo*, pp. 96-108.

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Mills, Co., Inc., Far East Bank & Trust Company, Philippine Commercial Industrial Bank, Equitable Banking Corporation, Prudential Bank, Board of Trustees-Consortium of Banks-[VISCO], United Coconut Planters Bank,. City Trust Banking Corporation, Associated Bank, Insular Bank of Asia and America, International Corporate Bank, Commercial Bank of Manila, Bank of the Philippine Islands and the National Steel Corporation in the instant case the amount of FIVE HUNDRED THOUSAND PESOS (₱500,000.00) representing damages;

"3. Ordering the plaintiff The (sic) Coastal Pacific Trading Inc. to pay the defendants the amount of FIFTEEN THOUSAND PESOS (₱15,000.00) representing attorney's fees;

"4. Dismissing the Amended Complaint of the plaintiff;

"5. Ordering the plaintiff to pay the cost; AND

"BY WAY OF CROSS CLAIM INTERPOSED

"BY THE DEFENDANT National Steel Corporation against the Consortium of Banks and SRM/VISCO, the same is dismissed for lack of merit, without pronouncement as to cost."[77]

Insisting that the trial court erred in holding that it had failed to prove its case by preponderance of evidence, Coastal filed an appeal with the CA. Allegedly, the purported insufficiency of proof was based on the sole ground that petitioner did not file an objection when the properties were sold on execution. It contended that the court *a quo* had arrived at this erroneous conclusion by relying on inapplicable jurisprudence.[78]

Additionally, Coastal argued that the trial court had erred in not annulling the foreclosure proceedings and sale for being fictitious and done to defraud petitioner as VISCO's creditor. Supposedly, the DBP mortgage had already been extinguished by payment; thus, the bank could not have assigned the contract to the Consortium.[79]

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[77] RTC Decision, p. 13; CA *rollo*, p. 108.

[78] Appellant's Brief, pp. 11-13; CA *rollo*, pp. 58-60.

[79] *Id.* at 13-25; *id.* at 60-72.

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Petitioner also prayed for the annulment of the sale in favor of NSC on the ground that the latter was a party to the fraudulent foreclosure and, hence, not a buyer in good faith.[80]

Ruling of the Court of Appeals

At the outset, the CA stressed that the validity of the Consortium's mortgage, foreclosure, and assignments had already been upheld in CA-G.R. CV No. 03719, entitled *Southern Industrial Projects v. United Coconut Planters Bank*[81] Citing *Valencia v. RTC of Quezon City, Br. 90*[82] and *Vda. de Cruzo v. Carriaga,*[83] the CA explained that the absolute identity of parties was not necessary for the application of *res judicata.* All that was required was a shared identity of interests, as shown by the identity of reliefs sought by one person in a prior case and by another in a subsequent case.

While Coastal was not a party to *Southern Industrial Projects,* it should nevertheless be bound by that Decision, because it had raised substantially the same claim and cause of action as SIP, according to the appellate court. The CA held that the basic reliefs sought by Coastal and SIP were substantially the same: the nullification of the Deed of Assignment in favor of the Consortium, the foreclosure sale, and the subsequent sale to NSC. Because this identity of reliefs sought showed an identity of interests, the CA concluded that it need not rule on those issues.[84]

As to the issue that the DBP mortgage had been extinguished by payment, the CA quoted its earlier Decision in *Southern Industrial Projects*:

"The evidence shows that the proceeds of the sale of the two generating sets were applied by defendants-appellees in the payment

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[80] *Id.* at 40-46; *id.* at 87-93.

[81] IAC Decision, records, Vol. I, pp. 133-145.

[82] 184 SCRA 80, April 3, 1990.

[83] 174 SCRA 330, June 28, 1989.

[84] Assailed CA Decision, pp. 14-15; *rollo*, pp. 48-49.

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of the outstanding obligation of VISCO. It appears that said proceeds were deposited in the bank account of the consortium of creditors to avoid it being garnished by the creditors notwithstanding the set-off, VISCO was still indebted to the defendants-appellees.

"The evidence x x x shows that upon VISCO's request for [cash] advance, the Far East Banks (sic) and Trust Co., the manager of the consortium of creditors, issued FEBTC check No. 239249 on June 29, 1976 in the amount of ₱1,342,656.68 payable to the DBP to pay off its loan to the latter.

xxx xxx xxx

"x x x A public document celebrated with all the legal formalities under the safeguard of notarial certificate is evidence against a party, and a high degree [of] proof is necessary to overcome the legal presumption that the recital is true. The biased and interested testimony of one of the parties to such instrument who attempts to vary or repudiate what it purports to be, cannot overcome the evidentiary force of what is recited in the document."[85]

The appellate court also rejected petitioner's contention that the Consortium's Petition for Extrajudicial Foreclosure was already barred by the earlier resort to a judicial foreclosure. The CA clarified that in filing a Petition for Judicial Foreclosure, the Consortium had pursued its right as junior encumbrancer. On the other hand, the Consortium filed a Petition for Extrajudicial Foreclosure as a first encumbrancer by virtue of DBP's assignment in its favor.[86]

The CA also rejected petitioner's theory of extinguishment of obligation by merger. It observed that the merger could not have possibly taken place, because respondent banks and VISCO were not creditors and debtors in their own right.[87]

Petitioner's Motion for Reconsideration,[88] which was received by the CA on November 15, 1994,[89] was denied for lack of merit.

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[85] *Id.* at 15-16; *id.* at 49-50.

[86] *Id.* at 17; *id.* at 51.

[87] *Id.* at 17-18; *id.* at 51-52.

[88] CA *rollo*, pp. 170-178.

[89] *Id.* at 170.

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Hence, this Petition.[90]

Issues

Petitioner raises the following issues for our consideration:

"I

"Respondent Court of Appeals, seemingly to avoid the irrefutable evidence of fraud and collusion practised by [respondents] against [Petitioner] Coastal, erroneously sustained the trial court's holding that the present case is barred by *res judicata* because of the previous decision in the case of *Southern Industrial Projects, Inc., vs. United Coconut Planters Bank,* CA-G.R. No. 03719, considering that the elements that call for the application of this rule are not present in the case at bar, and the exceptions allowed by this Honorable Supreme Court are not applicable here for variance or distinction in facts and issues, x x x":[91]

"II

"Respondent Court of Appeals further erred in not annulling the Deed of Assignment of the DBP mortgage x x x, the extrajudicial foreclosure proceedings of the two mortgages x x x, and the separate sale of the land and machineries as real and personal properties by the foreclosing banks to NSC, as well as the assignment or waiver of SRM/Visco's legal right of redemption over the foreclosed properties, for being fraudulently executed through collusion among the [respondents] and in fraud of SRM/Visco's creditor, [Petitioner] Coastal, x x x";[92]

Stripped of nonessentials, the two issues may be restated as follows:

1. Whether the present action is barred by *res judicata*
2. Whether respondents disposed of VISCO's assets in fraud of the creditors

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[90] To resolve old cases, the Court created the Committee on Zero Backlog of Cases on January 26, 2006. Consequently, the Court resolved to prioritize the adjudication of long-pending cases by redistributing them among all the justices. This case was recently re-raffled and assigned to the undersigned *ponente* for study and report.

[91] Petitioner's Memorandum, p. 7; *rollo*, p. 264.

[92] *Id.* at 10; *id.* at 267.

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The Court's Ruling

The Petition is meritorious.

First Issue:
Res judicata

The CA cited *Valencia v. RTC of Quezon City*[93] to support the finding that SIP and Coastal were substantially the same parties. We distinguish.

In *Valencia*, the plaintiff-intervenor in the first case, Cariño, claimed Lot 4 based on an alleged purchase of Valencia's "squatter's rights" over the property. The trial court dismissed the claim and held that no such purchase ever took place.[94] It also held that, on the assumption that a sale had taken place, the sale was null and void for being contrary to the pertinent housing law. It also found that all current occupants of Lot 4 were illegal squatters; thus, it ordered their ejectment.

When this first case attained finality, Cariño's daughter, Catbagan, filed another suit against Valencia. Catbagan challenged the applicability of the ejectment Order issued to her; as an occupant of the lot, she was allegedly not a party to the first case. Her Petition was denied for lack of merit.[95]

The execution of the Decision in the first case was again forestalled when Llanes, Cariño's sister-in-law who was another occupant of Lot 4, filed another suit against the same respondent. Like Cariño, Llanes insisted on having purchased the subject lot from Valencia.[96] This Court ruled that the suit was barred by *res judicata*. There was a substantial identity of parties, because the right claimed by both Cariño and Llanes were based on each one's alleged purchase of Valencia's "squatter's rights."[97]

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[93] *Supra* at note 82.

[94] *Id.* at 85.

[95] *Id.* at 86-87.

[96] *Id.* at 87.

[97] *Id.* at 91.

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In the first case, sales of "squatter's rights" were already categorically declared null and void for being contrary to law. Thus, Llanes' admission that she had purchased Valencia's "squatter's rights" placed her in the same category as Cariño. The purchase could not be treated differently, because the final and executory Decision held that *all* purchases of "squatter's rights" (regardless of *who* the purchasers were) were null and void.[98]

Further, the earlier ruling held that "the present occupants are illegal squatters." That ruling included Llanes, who was admittedly one of the occupants.[99] Simply put, she and Valencia were considered identical parties for purposes of *res judicata,* because they were obviously litigating under the same void title and capacity as vendees of "squatter's rights" and as occupants of Lot 4.

Moreover, we held in *Valencia* that Llanes' suit was merely a clear attempt to prevent or delay the execution of the judgment in the first case, which had become final by reason of the three affirmances by this Court. The pattern to obstruct the execution of the first judgment was obvious: after Cariño lost the first case, her daughter filed a second one. When the daughter lost the second, the daughter-in-law filed a third case. It may be observed that the three successive plaintiffs were all occupants of the same property and belonged to the same family; this fact was also indicative of their privity.

Given this background, it becomes clear that the finding of a substantial identity of parties in *Valencia* was based on its peculiar factual circumstances, which are different from those in the present case.

Unlike Llanes, Coastal is not asserting a right that has been categorically declared null and void in a prior case. In fact, its right based on the processing agreement was upheld in Civil Case No. 21272. Clearly, Coastal cannot be treated in the same manner as Llanes.

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[98] *Id.* at 93.

[99] *Id.*

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The CA erred in applying *Southern Industrial Projects v. United Coconut Planters Bank*[100] as a bar by *res judicata* with respect to the present case. For this principle to apply, the following elements must concur: a) the former judgment was final; b) the court that rendered it had jurisdiction over the subject matter and the parties; c) the judgment was based on the merits; and, d) between the first and the second actions, there is an identity of parties, subject matters, and causes of action.[101]

It is axiomatic that *res judicata* does not require an absolute, but only a substantial, identity of parties. There is a substantial identity when there is privity between the two parties or they are successors-in-interest by title subsequent to the commencement of the action, litigating for the same thing, under the same title, and in the same capacity.[102] Petitioner was not acting in the same capacity as SIP when it filed Civil Case No. 3383, which eventually became AC-G.R. CV No. 03719. It brought this latter action as a creditor under a processing agreement with VISCO; on the other hand, the latter was sued by SIP, based on an alleged breach of their management contract. Very clearly, their rights were entirely distinct and separate from each other. In no manner were these two creditors privies of each other.

The causes of action in the two Complaints were also different. Causes of action arise from violations of rights. A single right may be violated by several acts or omissions, in which case the plaintiff has only one cause of action. Likewise, a single act or omission may violate several rights at the same time, as when the act constitutes a violation of separate and distinct legal obligations.[103] The violation of *each of these separate*

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[100] *Supra* note 81.

[101] *Aldovino v. National Labor Relations Commission,* 359 Phil. 54, November 16, 1998.

[102] *Taganas v. Emuslan,* 410 SCRA 237, September 2, 2003; *Cagayan de Oro Coliseum v. CA,* 320 SCRA 731, December 15, 1999.

[103] *Perez v. CA,* 464 SCRA 89, July 22, 2005.

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rights is a separate cause of action in itself.[104] Hence, although these causes of action arise from the same state of facts, they are distinct and independent and may be litigated separately; recovery on one is not a bar to subsequent actions on the others.[105]

In the present case, the right of SIP (arising from its management contract with VISCO) is totally distinct and separate from the right of Coastal (arising from its processing contract with VISCO). SIP and Coastal are asserting distinct rights arising from different legal obligations of the debtor corporation. Thus, VISCO's violation of those separate rights has given rise to separate causes of action.

The confusion in the resolution of the issue of identity of parties occurred, because the two creditors were assailing the same transactions of VISCO on the same grounds. Since the two cases they filed presented similar legal issues, the appellate court held that its ruling in AC-G.R. CV No. 03719 was also applicable to the instant case.

Common but palpable is this misconception of the doctrine of *res judicata*. Persons do not become privies by the mere fact that they are interested in the same question or in proving the same set of facts, or that one person is interested in the result of a litigation involving the other. Hence, several creditors of one debtor cannot be considered as identical parties for the purpose of assailing the acts of the debtor. They have distinct credits, rights, and interests, such that the failure of one to recover should not preclude the other creditors from also pursuing their legal remedies.

Further, petitioner, which was not a party to *Southern Industrial Projects* (their causes of action being separate and distinct), did not have the opportunity to be heard in that case, much less to present its own evidence. Thus, to bind petitioner to the Decision in that case would clearly violate its rights to

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[104] *Id.*

[105] See *The City of Bacolod v. San Miguel Brewery, Inc.*, 140 Phil. 363, October 30, 1969.

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due process. As a separate party, it has the right to have its arguments and evidence evaluated on their own merits.

Second Issue:

Fraud of Creditors

We now come to the heart of the Petition. Coastal alleges that the assignment of mortgage, the extrajudicial foreclosure proceedings, and the sale of the properties of VISCO should all be rescinded on the ground that they were done to defraud the latter's creditors.

The CA found no merit in petitioner's arguments. It ruled that the assignment conformed to the requirements of law; that the consideration for the assignment had allegedly been given by FEBTC; and that, hence, the Consortium had a right to foreclose on the mortgaged properties.

By focusing on the innate validity of these Contracts, the CA totally overlooked the issue of fraud as a ground for rescission. Elementary is the principle that the validity of a contract does *not* preclude its rescission. Under Articles 1380 and 1381 (3) of the Civil Code, contracts that are otherwise valid between the contracting parties may nonetheless be subsequently rescinded by reason of injury to third persons, like creditors.[106] In fact, rescission implies that there is a contract that, while initially valid, produces a lesion or pecuniary damage to someone.[107] Thus, when the CA confined itself to the issue of the validity of these contracts, it did not at all address the heart of petitioner's cause of action: whether these transactions had been undertaken by the Consortium to defraud VISCO's other creditors.

There is more than a preponderance of evidence showing the Consortium's deliberate plan to defraud VISCO's other creditors.

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[106] *Guzman, v. Bonnevie,* 206 SCRA 668, March 2, 1992.

[107] A. TOLENTINO, *COMMENTARIES AND JURISPRUDENCE ON THE CIVIL CODE OF THE PHILIPPINES* 571, Vol. IV (1991). See *Ong v. CA,* 310 SCRA 1, July 6, 1999.

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Consortium Banks as Directors

It will be recalled that Respondent Consortium took over management and control of VISCO by acquiring 90 percent of the latter's equity. Thus, 9 out of the 10 directors of the corporation were all officials of the Consortium,[108] which may thus be said to have effectively occupied and/or controlled the board. Significantly, nowhere in the records can we find any denial by respondent of this allegation by petitioner.[109]

As directors of VISCO, the officials of the Consortium were in a position of trust; thus, they owed it a duty of loyalty. This trust relationship sprang from the fact that they had control and guidance over its corporate affairs and property.[110] Their duty was more stringent when it became insolvent or without sufficient assets to meet its outstanding obligations that arose. Because they were deemed *trustees of the creditors* in those instances, they should have managed the corporation's assets with *strict regard* for the creditors' interests. When these directors became corporate creditors in their own right, they should not have permitted themselves to secure any undue advantage over other creditors.[111] In the instant case, the Consortium miserably failed to observe its duty of fidelity towards VISCO and its creditors.

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[108] The members of the board of directors were Jose B. Fernandez, Jr. (FEBTC), Arturo P. Samonte (FEBTC), Benjamin J. Aldaba (PBC), Ruperto M. Carpio, Jr. (EBC), Rene H. Peronilla (PCIB), Octavio D. Fule (PBTC), Primer B. Leonen (BPI), Caesar U. Querubin (FEBTC), Felicisimo Asoy (OBM), and Gregorio A. Concon. The vice-president and assistant corporate secretary was Vicente T. Garcia (FEBTC). Refer to Minutes dated October 4, 1974 (*rollo*, p. 61), in relation to Minutes of September 20, 1974 (*rollo*, p. 57).

[109] Petitioner's Memorandum, p. 4; *rollo*, p. 261. See *International Corporate Bank, Inc. v. CA,* 214 SCRA 364, September 30, 1992.

[110] *Prime White Cement Corporation v. IAC,* G.R. No. 68555, March 19, 1993, 220 SCRA 103.

[111] J. CAMPOS, JR. and M.C. CAMPOS, *THE CORPORATION CODE: COMMENTS, NOTES AND SELECTED CASES* 780, Vol. I (1990) citing *Mead v. McCullough,* 21 Phil. 95, December 26, 1911.

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Duty of the Consortium Banks
to VISCO's Creditors

Recall that as early as 1966, the Consortium, through its directors on the board of VISCO, had already assumed management and control over the latter. Hence, when VISCO recognized its outstanding liability to petitioner in 1970 and offered a Compromise Agreement,[112] respondent banks were already at the helm of the debtor corporation. The members of the Consortium, therefore, cannot deny that they were aware of those claims against the corporation. Nonetheless, they did not adopt any measure to protect petitioner's credit.

Quite the opposite, they even took steps to hide VISCO's unexpended funds. Garcia's 1972 letter to Samonte unmistakably reveals that they kept those funds in an account named "Board of Trustees VISCO Consortium of Banks." This fact alone shows an effort to hide, with the evident intent to keep, those funds for themselves. The letter even says that, for the protection of the Consortium, the name "VISCO" should be eliminated entirely, so that the account name would read "Board of Trustees Consortium of Banks." Clearly, this particular move was found to be necessary to avoid a takeover by the government, which was also a creditor of VISCO.[113] This express intent of the latter, under the direction and for the benefit of the Consortium, corroborated petitioner's contention that respondent banks had defrauded VISCO's creditors.

Assignment of Mortgage
in Favor of the Consortium Banks

The assignment of mortgage in favor of the Consortium also bears the earmarks of fraud. Initially, respondent banks had agreed that VISCO should sell two of its generator sets, so that the proceeds could be utilized to pay DBP. This plan was direct,

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[112] Documentary Evidence of Coastal Pacific; records, pp. 4-5.

[113] Minutes of the Luncheon Meeting of the Creditors' Consortium for Visayan Integrated Steel Corporation held at the FEBTC Boardroom on Friday, September 20, 1974, p. 2; *rollo*, p. 58.

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simple, and would extinguish the encumbrance in favor of the bank.

Then, quite surprisingly, the Consortium set down the following payment procedure: Filmag would pay VISCO; the latter would *pay the Consortium,* which would pay DBP; and the Consortium would then subrogate DBP to the latter's rights as first mortgagee. One is then led to ask: if the intention was to pay DBP; from the sales proceeds of the generator sets, why did the money have to pass through the Consortium?

The answer lies in the nature of respondent's mortgage. It will be recalled that this mortgage remained unrecorded and not legally binding on the other creditors.[114] Thus, if DBP had been directly paid by VISCO, the latter could have freed up its properties to the satisfaction of *all* its other creditors. This procedure would have been fair to all, but it was not followed by the Consortium.

Instead, the proceeds from the sale of the generator sets were first paid to respondent banks, which used the money to pay DBP. The last step in the payment procedure explains the reason for this preferred though roundabout manner of payment. This final step entitled the Consortium to obtain DBP's primary lien through an assignment by allowing it to pay VISCO's loan to the bank, without incurring additional expenses.

In the end, by collecting the money from VISCO, respondent banks recovered what they had ostensibly remitted to DBP. Moreover, the primary lien that respondent banks acquired allowed them, as unsecured creditors of VISCO, to foreclose on the assets of the corporation without regard to its inferior claims. It was a clever ruse that would have worked, were it not done by creditors who were duty-bound, as directors, not to take clever advantage of other creditors.

To be sure, there was undue advantage. The payment scheme devised by the Consortium continued the efficacy of the primary lien, this time in *its* favor, to the detriment of the other creditors.

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[114] See CIVIL CODE, Art. 2125.

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When one considers its knowledge that VISCO's assets might not be enough to meet its obligations to several creditors,[115] the intention to defraud the other creditors is even more striking. Fraud is present when the debtor knows that its actions would cause injury.[116]

The assignment in favor of the Consortium was a rescissible contract for having been undertaken in fraud of creditors.[117] Article 1385 of the Civil Code provides for the effect of rescission, as follows:

"Rescission creates the obligation to return the things which were the object of the contract, together with their fruits, and the price with its interest; consequently, it can be carried out only when he who demands rescission can return whatever he may be obliged to restore.

"Neither shall rescission take place when the things which are the object of the contract are legally in the possession of third persons who did not act in bad faith.

"In this case, indemnity for damages may be demanded from the person causing the loss."

Indeed, mutual restitution is required in all cases involving rescission. But when it is no longer possible to return the object of the contract, an indemnity for damages operates as restitution. The important consideration is that the indemnity for damages should restore to the injured party what was lost.

In the case at bar, it is no longer possible to order the return of VISCO's properties. They have already been sold to the NSC, which has not been shown to have acted in bad faith. The party alleging bad faith must establish it by competent proof. Sans that proof, purchasers are deemed to be in good faith, and their interest in the subject property must not be disturbed.

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[115] SGV Report to VISCO Board of Directors (records, Vol. I, pp. 171-178).

[116] A. TOLENTINO, *COMMENTARIES AND JURISPRUDENCE ON THE CIVIL CODE OF THE PHILIPPINES* 580, Vol. IV (1991).

[117] CIVIL CODE, Art. 1381(3).

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Purchasers in good faith are those who buy the property of another without notice that some other person has a right to or interest in the property; and who pay the full and fair price for it at the time of the purchase, or before they get notice of some other persons' claim of interest in the property.[118]

In the present case, petitioner failed to discharge its burden of proving bad faith on the part of NSC. There is insufficient evidence on record that the latter participated in the design to defraud VISCO's creditors. To NSC, petitioner imputes fraud from the sole fact that the former was allegedly aware that its vendor, the Consortium, had taken control over VISCO including the corporation's assets.[119] We cannot appreciate how knowledge of the takeover would necessarily implicate anyone in the Consortium's fraudulent designs. Besides, NSC was not shown to be privy to the information that VISCO had no other assets to satisfy other creditors' respective claims.

The right of an innocent purchaser for value must be respected and protected, even if its vendors obtained their title through fraud.[120] Pursuant to this principle, the remedy of the defrauded creditor is to sue for damages against those who caused or employed the fraud. Hence, petitioner is entitled to damages from the Consortium.

Award of Damages

It is essential that for damages to be awarded, a claimant must satisfactorily prove during the trial that they have a factual basis, and that the defendant's acts have a causal connection to them.[121] Thus, the question of damages should normally call for a remand of the case to the lower court for further proceedings. Considering, however, the length of time that petitioner's just claim has been thwarted, we find it in the best interest of

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[118] *Agricultural and Home Extension Development Group v. CA,* 213 SCRA 563, September 3, 1992; *Co v. CA,* 196 SCRA 705, May 6, 1991.

[119] Petitioner's Consolidated Reply, pp. 1-9; *rollo*, pp. 146-152.

[120] *Veloso v. CA,* 260 SCRA 593, August 21, 1996.

[121] *Air France v. CA,* 171 SCRA 399, March 21, 1989.

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substantial justice to decide the issue of damages now on the basis of the available records. A remand for further proceedings would only result in a needless delay.

Going over the records of the case, we find that petitioner has a final and executory judgment in its favor in Civil Case No. 21272. The judgment in that case reads as follows:

"WHEREFORE, judgment is hereby rendered in favor of the plaintiffs ordering defendant VISCO/SRM to pay the plaintiffs the sum of ₱851,316.19 with interest thereon at the legal rate from the filing of this complaint, plus attorney's fees of ₱50,000.00 and to pay the Costs."[122]

The foregoing is the judgment credit that petitioner cannot enforce against VISCO because of Respondent Consortium's fraudulent disposition of the corporation's assets. In other words, the above amounts define the extent of the actual damage suffered by Coastal and the amount that respondent has to restore pursuant to Article 1385.

On the basis of the finding of fraud, the award of exemplary damages is in order, to serve as a warning to other creditors not to abuse their rights. Under Article 2229 of the Civil Code, exemplary or corrective damages are imposed by way of example or correction for the public good. By their nature, exemplary damages should be imposed in an amount sufficient and effective to deter possible future similar acts by respondent banks. The court finds the amount of ₱250,000 sufficient in the instant case.

As a rule, a corporation is not entitled to moral damages because, not being a natural person, it cannot experience physical suffering or sentiments like wounded feelings, serious anxiety, mental anguish and moral shock.[123] The only exception to this rule is when the corporation has a good reputation that is debased, resulting in its humiliation in the business

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[122] Documentary Evidence of Coastal Pacific; records, p. 158.

[123] *Solid Homes, Inc. v. CA,* 275 SCRA 267, July 8, 1997.

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realm.[124] In the present case, the records do not show any evidence that the name or reputation of petitioner has been sullied as a result of the Consortium's fraudulent acts. Accordingly, moral damages are not warranted.

WHEREFORE, the Petition is ***GRANTED.*** The assailed Decision of the Court of Appeals dated September 27, 1994, and its Resolution dated January 5, 1995, are hereby ***REVERSED*** and ***SET ASIDE.*** Respondent Consortium of Banks is ordered to ***PAY*** Petitioner Coastal Pacific Trading, Inc., the sum adjudged by the Regional Trial Court of Pasig, Branch 167, in Civil Case No. 21272 entitled *Coastal Pacific Trading, Felix de la Costa, and Aurora del Banco v. Visayan Integrated Corporation,* to wit: "x x x the sum of ₱851,316.19 with interest thereon at the legal rate from the filing of [the] [C]omplaint, plus attorney's fees of ₱50,000 and x x x the costs." Respondent Consortium of Banks is further ordered to pay petitioner exemplary damages in the amount of ₱250,000.

SO ORDERED.

Ynares-Santiago, Austria-Martinez, Callejo, Sr., and *Chico-Nazario, JJ.,* concur.

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[124] *Simex International, Inc. v. CA,* 183 SCRA 360, March 19, 1990.