

SECOND DIVISION

[G.R. No. 118357, May 06, 1997]

**PHILIPPINE NATIONAL BANK, PETITIONER, VS. COURT OF
APPEALS AND INDUSTRIAL ENTERPRISES, INC., RESPONDENTS.
D E C I S I O N**

ROMERO, J.:

This is a petition for review on *certiorari* of the Decision^[1] of the Court of Appeals affirming in toto the November 27, 1992 decision^[2] of the Regional Trial Court of Makati, Branch 150 which disposed of Civil Case No. 8109, "Industrial Enterprises, Inc. v. Marinduque Mining and Industrial Corporation, Geronimo Velasco (in his capacity as the then Minister of Energy) and Philippine National Bank," an action for rescission of contract and damages, as follows:

"WHEREFORE, in the light of the foregoing, and as plaintiff Industrial Enterprises, Inc. was able to establish by preponderant evidence the allegations in its Complaint and causes of action against defendants Marinduque Mining and Industrial Corporation and Philippine National Bank, the Court finds both defendants civilly liable to plaintiff and, therefore, orders them to jointly and severally:

1. pay plaintiff the sum of P31.66 Million as of July 31, 1983, for the expenses invested by plaintiff in the property subject of this case, as computed by Sycip, Gorres, Velayo and Company and brought to current value per SGV formula, as agreed in the Memorandum of Agreement;
2. pay plaintiff the sum of P37,569,733.00, for the indemnification and rehabilitation cost, plus interest at the legal rate from March 31, 1991, until fully paid;
3. pay plaintiff the sum of P120 Million for unrealized profit for five (5) years from August, 1983, the date of defendant MMIC's takeover of the property, to October, 1988, when plaintiff was re-awarded the contract, plus interest at the legal rate, from the date of this decision, until fully paid;
4. pay plaintiff an amount not less than ten (10) percent of the losses it incurred and its unrealized profits as indicated in Numbers 1 to 3, for the injury done to plaintiff's business standing and commercial credit;
5. pay plaintiff an amount not less than five (5) percent of the above obligation as reimbursement to plaintiff for litigation expenses and attorney's fees; and
6. COST OF SUIT.

And finally, the extrajudicial foreclosure sale held on August 31, 1984, in Catbalogan, Samar, over the property of plaintiff, part of the Giporlos Coal Project, is hereby declared NULL and VOID.

SO ORDERED."

Marinduque Mining and Industrial Corporation (MMIC) was founded by Jesus S. Cabarrus in 1949.^[3] Four years later or in 1953, Cabarrus established J. Cabarrus, Inc. which subsequently was renamed Industrial Enterprises, Inc. (IEI). During the period when most of the facts relevant to this case transpired, Cabarrus and his family owned about 12% to 14% of the shares of stock in the MMIC^[4] where he was the President. He was also the President of IEI.

On July 27, 1979, IEI entered into a coal operating contract with the Bureau of Energy Development (BED), with Cabarrus and then Minister of Energy Geronimo Velasco as signatories.^[5] The contract was pursuant to the Coal Development Act of 1976 (P.D. No. 972, as amended) and covered 2,000 hectares of two (2) coal blocks in Barrio Carbon, Magsaysay, Eastern Samar.

While exploring this area, IEI found the adjacent areas, comprising of three (3) coal blocks, to be likewise coal potentials. Hence, upon confirmation by the BED that these three (3) adjacent coal blocks were in the free area, IEI filed an application for another coal operating contract on August 12, 1981. Simultaneously, IEI applied for the conversion of its July 27, 1979 coal operating contract from exploration to development/production. IEI also followed up its application on the three (3) newly-discovered coal blocks. All of these coal blocks were collectively known as the Giporlos Coal Project.

Sometime in April, 1982, Minister Velasco informed Cabarrus that IEI's application for exploration of the three (3) coal blocks had been disapproved and that, instead, the contract would be awarded to MMIC. Following Cabarrus' letter of May 4, 1982^[6] requesting that the rejection of IEI's application be made in writing, Minister Velasco wrote him a letter dated June 2, 1982,^[7] where Minister Velasco said:

"We appreciate your desire to increase Industrial Enterprises, Inc.'s (IEI) involvement in coal development. In line, however, with the objective of rationalizing the country's overall coal supply-demand balance, we believe that coal users who have the capability to go into coal production themselves should, as much as possible, be encouraged and given the preference to do so. This ensures maximum utilization of local coal and will be beneficial to coal producer/user in the long run. In your area of interest, therefore, we believe that the logical coal operator should be Marinduque Mining and Industrial Corporation (MMIC) which is now developing the Bagacay coal deposit in order to support MMIC's coal conversion program at the Nonoc Nickel Refinery. As a member of the board of MMIC, I am fully aware that this coal conversion program is critical to the profitability and the survival of the Nonoc Nickel Refinery. It is, therefore, imperative that MMIC secure its own coal supply.

Consistent with the above rationale, you are aware that MMIC Board has in fact taken concrete steps to consolidate the Giporlos and Bagacay coal

areas under MMIC and, for this purpose, has authorized Chairman Cesar C. Zalamea to create a committee (of which I was asked to be Chairman) to evaluate the Giporlos coal blocks of IEI to serve as basis for their acquisition by MMIC. As President of MMIC, you are likewise aware that the Board has recently hired the services of SGV to make an evaluation of the proper pricing for the IEI coal interest to be paid for by MMIC. With these developments indicating the imminent formal acquisition of Giporlos coal areas by MMIC, it would indeed be inconsistent now for us to award additional coal blocks in the same area to IEI. We believe that these additional coal areas, if at all, should be applied for and awarded direct to MMIC.

In view of the foregoing, please be advised that we are denying IEI's application, and we suggest instead that MMIC apply for the same blocks."

On March 28, 1983, Minister Velasco informed Cesar Zalamea, Chairman of the Board of the Development Bank of the Philippines (DBP) and of the MMIC, that IEI's application for the conversion of its coal operating contract for the Giporlos area from exploration to development/production had been put "under advisement in the light of the ongoing discussion for the transfer of IEI's rights and obligations" to MMIC.^[8]

Thereafter, MMIC and IEI, through Chairman Zalamea and President Cabarrus,^[9] respectively, entered into a Memorandum of Agreement (MOA) whereby IEI assigned to MMIC all its rights and interests under the July 27, 1979 coal operating contract. The MOA provided as follows:

"NOW, THEREFORE, the parties have agreed, as hereby they agree, one with the other, as follows:

1. That IEI, subject and conformably with the whereas clauses hereinabove stated, hereby assigns and transfers all its rights and interests on the Coal Operating Contract described in the first whereas clause; and MMIC shall in consideration of the above assignment and transfer —

(a) Undertake all the obligations required of IEI under said Coal Operating Contract;

(b) Reimburse all costs and expenses actually incurred as of 31 July 1983 by IEI on the coal property and brought up to current values, as shall be audited and confirmed by Sycip, Gorres and Velayo as of said date of 31 July 1983; and

(c) Pay to IEI the total sum equivalent to P4.17 per ton of proven and positive reserves of coal to be confirmed by an independent geologist who shall be designated and appointed by mutual agreement of the parties.

2. That the total sum due from MMIC to IEI under this agreement shall be paid upon the effectivity of this agreement in the following manner —

(a) An assumption by MMIC of the outstanding loan obligation (evidenced by Promissory Note No. 1516 for P3.3 Million and Promissory Note No. 11098 for P5.0 Million) of IEI to Manila Banking Corporation which as of 31 July 1983 stands at P8.3

Million.

(b) Payment in cash to IEI of the difference between the above amount of P8.3 Million and the sum total of subparagraphs (b) and (c) par. 1, above.

3. That this agreement shall only become binding and effective upon its approval by the BED, which approval shall be secured jointly by MMIC and IEI."

MMIC and IEI, again through Zalamea and Cabarrus, respectively, jointly informed the BED on August 10, 1983, that they had entered into the MOA "at the instance and suggestion of the Hon. Minister of Energy in one of the earlier meetings of the Board of Directors of MMIC."^[10] MMIC and IEI were informed of the approval of the MOA on August 29, 1983 by the then Acting BED Director Wenceslao R. de la Paz.^[11]

MMIC took over possession and control of the two (2) coal blocks even before the MOA was finalized. However, instead of continuing the exploration and development work actively pursued by IEI, MMIC completely stopped all works and dismissed the work force thereon, leaving only a caretaker crew.

Consequently, IEI made written demands to MMIC, pursuant to the MOA, for the reimbursement of all costs and expenses it had incurred on the project which, as of July 31, 1983, had amounted to P31.66 million as audited by the Sycip, Gorres and Velayo Company.

In view of MMIC's failure to comply with its obligations under the MOA, IEI filed a complaint against MMIC and Minister Velasco on August 7, 1984, for rescission of the MOA and damages, before the Regional Trial Court of Makati, Branch 137. Docketed as Civil Case No. 8109, the complaint alleged that MMIC acted in gross and evident bad faith in entering into the MOA when it had no intention at all to operate the two (2) coal blocks and of complying with any of its obligations under the said agreement. It likewise alleged that Minister Velasco was instrumental in causing the assignment of the coal operating contracts to MMIC when he did not act on complainant IEI's application for conversion of its coal operating contract from exploration to development/production and in rejecting its application for another coal operating contract for the exploration of additional three (3) coal blocks which he had reserved for MMIC.

Meanwhile, on July 13, 1981, for various credit accommodations secured from the Philippine National Bank (PNB), aggregating to four billion pesos (P4,000,000,000.00) excluding interest and charges as of November 30, 1980, as well as from the DBP, amounting to two billion pesos (P2,000,000,000.00), MMIC entered into a Mortgage Trust Agreement (MTA)^[12] whereby it constituted a mortgage *pari passu* of its assets in favor of PNB and DBP. These assets are described in the third "whereas clause" of the MTA as follows:

"(1) all the MORTGAGOR'S assets described and covered under the Deed of Real Estate and Chattel Mortgage executed by the MORTGAGOR in favor of PNB dated October 9, 1978, acknowledged before Notary Public of Manila, Lucas R. Vidad, as Doc. No. 1004, Page No. 94, Book No. VII, Series of 1978, as amended, which are made integral parts of this Agreement by way of reference; and

(2) additional assets of the MORTGAGOR described and identified in the list hereto attached as Annex 'A', including assets of whatever kind, nature or description, which the MORTGAGOR may hereafter acquire whether in substitution of, in replenishment, or in addition thereto, (the 'Mortgaged Properties')."^[13]

Under the MTA, the PNB was constituted and appointed as the trustee tasked with holding in trust the mortgaged properties "for the equal and ratable benefit of the Beneficiaries in proportion to the amount of the obligation of the MORTGAGOR to each of them" as provided therein.^[14] One of the conditions of the mortgage was that:

"x x x. Should the MORTGAGORS fail to deliver said properties, as aforesated, the TRUSTEE, through its duly authorized representative, is authorized to take possession of said properties and bring the same to the location of any of their respective offices or to any other place and the expenses of locating and bringing said properties to such place shall be for the account of the MORTGAGOR and shall form part of the sums secured by this mortgage; Provided, however, that the TRUSTEE shall have the option of selling said properties at any place where their respective offices shall be located or at any place where said properties may be found."^[15] (Underscoring supplied.)

The MTA also provided that:

"For the purpose of extra-judicial foreclosure, the MORTGAGOR hereby appoints the TRUSTEE, through its duly authorized representatives, its attorney-in-fact to sell the mortgaged properties in accordance with the provision of Act No. 3135, as amended, and/or Act No. 1508, as amended, and subject to the stipulations herein set forth, to sign all documents and perform any act requisite or necessary to accomplish said purpose and to appoint their representatives or substitutes as such attorneys-in-fact with all the powers herein conferred. In extra-judicial foreclosure under Act No. 3135, as amended, the auction sale shall take place in the City or Capital of the Province where the mortgaged properties are situated. In extra-judicial foreclosure under Act No. 1508, as amended, the auction sale shall take place in such City or Municipality as the TRUSTEE at its option, may elect by virtue of the provisions of the first paragraph of this Condition."^[16] (Underscoring supplied.)

The MTA was amended on April 27, 1984 with PNB Senior Vice President Gerardo Agulto, Jr. and MMIC Senior Vice President Jose Luis Javier as signatories.^[17] Premised on the fact that the mortgagor (MMIC) had "acquired additional personal and real properties, including, but not limited to, leasehold rights on mining claims, which pursuant to the terms of the Mortgage Trust Agreement are deemed covered by the mortgage as after-acquired assets," the MTA amended Sec. 2.01 thereof to read as follows:

"As security for the prompt and full payment by the MORTGAGOR of the Secured Obligations, the MORTGAGOR hereby establishes and constitutes in favor of the MORTGAGEES a first lien and mortgage of the first rank in