

## THIRD DIVISION

[ G.R. No. 206806, June 25, 2014 ]

**ARCO PULP AND PAPER CO., INC. AND CANDIDA A. SANTOS,  
PETITIONERS, VS. DAN T. LIM, DOING BUSINESS UNDER THE  
NAME AND STYLE OF QUALITY PAPERS & PLASTIC PRODUCTS  
ENTERPRISES, RESPONDENT.**

### D E C I S I O N

**LEONEN, J.:**

Novation must be stated in clear and unequivocal terms to extinguish an obligation. It cannot be presumed and may be implied only if the old and new contracts are incompatible on every point.

Before us is a petition for review on certiorari<sup>[1]</sup> assailing the Court of Appeals' decision<sup>[2]</sup> in CA-G.R. CV No. 95709, which stemmed from a complaint<sup>[3]</sup> filed in the Regional Trial Court of Valenzuela City, Branch 171, for collection of sum of money.

The facts are as follows:

Dan T. Lim works in the business of supplying scrap papers, cartons, and other raw materials, under the name Quality Paper and Plastic Products, Enterprises, to factories engaged in the paper mill business.<sup>[4]</sup> From February 2007 to March 2007, he delivered scrap papers worth P7,220,968.31 to Arco Pulp and Paper Company, Inc. (Arco Pulp and Paper) through its Chief Executive Officer and President, Candida A. Santos.<sup>[5]</sup> The parties allegedly agreed that Arco Pulp and Paper would either pay Dan T. Lim the value of the raw materials or deliver to him their finished products of equivalent value.<sup>[6]</sup>

Dan T. Lim alleged that when he delivered the raw materials, Arco Pulp and Paper issued a post-dated check dated April 18, 2007<sup>[7]</sup> in the amount of P1,487,766.68 as partial payment, with the assurance that the check would not bounce.<sup>[8]</sup> When he deposited the check on April 18, 2007, it was dishonored for being drawn against a closed account.<sup>[9]</sup>

On the same day, Arco Pulp and Paper and a certain Eric Sy executed a memorandum of agreement<sup>[10]</sup> where Arco Pulp and Paper bound themselves to deliver their finished products to Megapack Container Corporation, owned by Eric Sy, for his account. According to the memorandum, the raw materials would be supplied by Dan T. Lim, through his company, Quality Paper and Plastic Products. The memorandum of agreement reads as follows:

Per meeting held at ARCO, April 18, 2007, it has been mutually agreed between Mrs. Candida A. Santos and Mr. Eric Sy that ARCO will deliver 600 tons Test Liner 150/175 GSM, full width 76 inches at the price of P18.50 per kg. to Megapack Container for Mr. Eric Sy's account. Schedule of deliveries are as follows:

. . . . .

It has been agreed further that the Local OCC materials to be used for the production of the above Test Liners will be supplied by Quality Paper & Plastic Products Ent., total of 600 Metric Tons at P6.50 per kg. (price subject to change per advance notice). Quantity of Local OCC delivery will be based on the quantity of Test Liner delivered to Megapack Container Corp. based on the above production schedule.<sup>[11]</sup>

On May 5, 2007, Dan T. Lim sent a letter<sup>[12]</sup> to Arco Pulp and Paper demanding payment of the amount of ₱7,220,968.31, but no payment was made to him.<sup>[13]</sup>

Dan T. Lim filed a complaint<sup>[14]</sup> for collection of sum of money with prayer for attachment with the Regional Trial Court, Branch 171, Valenzuela City, on May 28, 2007. Arco Pulp and Paper filed its answer<sup>[15]</sup> but failed to have its representatives attend the pre-trial hearing. Hence, the trial court allowed Dan T. Lim to present his evidence ex parte.<sup>[16]</sup>

On September 19, 2008, the trial court rendered a judgment in favor of Arco Pulp and Paper and dismissed the complaint, holding that when Arco Pulp and Paper and Eric Sy entered into the memorandum of agreement, novation took place, which extinguished Arco Pulp and Paper's obligation to Dan T. Lim.<sup>[17]</sup>

Dan T. Lim appealed<sup>[18]</sup> the judgment with the Court of Appeals. According to him, novation did not take place since the memorandum of agreement between Arco Pulp and Paper and Eric Sy was an exclusive and private agreement between them. He argued that if his name was mentioned in the contract, it was only for supplying the parties their required scrap papers, where his conformity through a separate contract was indispensable.<sup>[19]</sup>

On January 11, 2013, the Court of Appeals<sup>[20]</sup> rendered a decision<sup>[21]</sup> reversing and setting aside the judgment dated September 19, 2008 and ordering Arco Pulp and Paper to jointly and severally pay Dan T. Lim the amount of ₱7,220,968.31 with interest at 12% *per annum* from the time of demand; ₱50,000.00 moral damages; ₱50,000.00 exemplary damages; and ₱50,000.00 attorney's fees.<sup>[22]</sup>

The appellate court ruled that the facts and circumstances in this case clearly showed the existence of an alternative obligation.<sup>[23]</sup> It also ruled that Dan T. Lim was entitled to damages and attorney's fees due to the bad faith exhibited by Arco Pulp and Paper in not honoring its undertaking.<sup>[24]</sup>

Its motion for reconsideration<sup>[25]</sup> having been denied,<sup>[26]</sup> Arco Pulp and Paper and

its President and Chief Executive Officer, Candida A. Santos, bring this petition for review on certiorari.

On one hand, petitioners argue that the execution of the memorandum of agreement constituted a novation of the original obligation since Eric Sy became the new debtor of respondent. They also argue that there is no legal basis to hold petitioner Candida A. Santos personally liable for the transaction that petitioner corporation entered into with respondent. The Court of Appeals, they allege, also erred in awarding moral and exemplary damages and attorney's fees to respondent who did not show proof that he was entitled to damages. [27]

Respondent, on the other hand, argues that the Court of Appeals was correct in ruling that there was no proper novation in this case. He argues that the Court of Appeals was correct in ordering the payment of ₱7,220,968.31 with damages since the debt of petitioners remains unpaid.[28] He also argues that the Court of Appeals was correct in holding petitioners solidarily liable since petitioner Candida A. Santos was "the prime mover for such outstanding corporate liability." [29]

In their reply, petitioners reiterate that novation took place since there was nothing in the memorandum of agreement showing that the obligation was alternative. They also argue that when respondent allowed them to deliver the finished products to Eric Sy, the original obligation was novated. [30]

A rejoinder was submitted by respondent, but it was noted without action in view of A.M. No. 99-2-04-SC dated November 21, 2000. [31]

The issues to be resolved by this court are as follows:

1. Whether the obligation between the parties was extinguished by novation
2. Whether Candida A. Santos was solidarily liable with Arco Pulp and Paper Co., Inc.
3. Whether moral damages, exemplary damages, and attorney's fees can be awarded

The petition is denied.

### **The obligation between the parties was an alternative obligation**

The rule on alternative obligations is governed by Article 1199 of the Civil Code, which states:

Article 1199. A person alternatively bound by different prestations shall completely perform one of them.

The creditor cannot be compelled to receive part of one and part of the other undertaking.

"In an alternative obligation, there is more than one object, and the fulfillment of one is sufficient, determined by the choice of the debtor who generally has the right of election."<sup>[32]</sup> The right of election is extinguished when the party who may exercise that option categorically and unequivocally makes his or her choice known.<sup>[33]</sup> The choice of the debtor must also be communicated to the creditor who must receive notice of it since:

The object of this notice is to give the creditor . . . opportunity to express his consent, or to impugn the election made by the debtor, and only after said notice shall the election take legal effect when consented by the creditor, or if impugned by the latter, when declared proper by a competent court.<sup>[34]</sup>

According to the factual findings of the trial court and the appellate court, the original contract between the parties was for respondent to deliver scrap papers worth P7,220,968.31 to petitioner Arco Pulp and Paper. The payment for this delivery became petitioner Arco Pulp and Paper's obligation. By agreement, petitioner Arco Pulp and Paper, as the debtor, had the option to either (1) pay the price or (2) deliver the finished products of equivalent value to respondent.<sup>[35]</sup>

The appellate court, therefore, correctly identified the obligation between the parties as an alternative obligation, whereby petitioner Arco Pulp and Paper, after receiving the raw materials from respondent, would either pay him the price of the raw materials or, *in the alternative*, deliver to him the finished products of equivalent value.

When petitioner Arco Pulp and Paper tendered a check to respondent in partial payment for the scrap papers, they exercised their option to pay the price. Respondent's receipt of the check and his subsequent act of depositing it constituted his notice of petitioner Arco Pulp and Paper's option to pay.

This choice was also shown by the terms of the memorandum of agreement, which was executed on the same day. The memorandum declared in clear terms that the delivery of petitioner Arco Pulp and Paper's finished products would be to a third person, thereby extinguishing the option to deliver the finished products of equivalent value to respondent.

**The memorandum of agreement did not constitute a novation of the original contract**

The trial court erroneously ruled that the execution of the memorandum of agreement constituted a novation of the contract between the parties. When petitioner Arco Pulp and Paper opted instead to deliver the finished products to a third person, it did not novate the original obligation between the parties.

The rules on novation are outlined in the Civil Code, thus:

Article 1291. Obligations may be modified by:

- (1) Changing their object or principal conditions;
- (2) Substituting the person of the debtor;
- (3) Subrogating a third person in the rights of the creditor. (1203)

Article 1292. In order that an obligation may be extinguished by another which substitute the same, it is imperative that it be so declared in unequivocal terms, or that the old and the new obligations be on every point incompatible with each other. (1204)

Article 1293. Novation which consists in substituting a new debtor in the place of the original one, may be made even without the knowledge or against the will of the latter, but not without the consent of the creditor. Payment by the new debtor gives him the rights mentioned in Articles 1236 and 1237. (1205a)

Novation extinguishes an obligation between two parties when there is a substitution of objects or debtors or when there is subrogation of the creditor. It occurs only when the new contract declares so “in unequivocal terms” or that “the old and the new obligations be on every point incompatible with each other.”<sup>[36]</sup>

Novation was extensively discussed by this court in *Garcia v. Llamas*:<sup>[37]</sup>

**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 follows:

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

In general, there are two modes of substituting the person of the debtor: (1) *expromision* and (2) *delegacion*. In *expromision*, the initiative for the change does not come from — and may even be made without the knowledge of — the debtor, since it consists of a third person’s assumption of the obligation. As such, it logically requires the consent of the third person and the creditor. In *delegacion*, the debtor offers, and the creditor accepts, a third person who consents to the substitution and assumes the obligation; thus, the consent of these three persons are necessary. **Both modes of substitution by the debtor require the consent of the creditor.**