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SECOND DIVISION

[G.R. No. 176381, December 15, 2010]

PCI LEASING AND FINANCE, INC., PETITIONER, VS. TROJAN METAL INDUSTRIES INCORPORATED, WALFRIDO DIZON, ELIZABETH DIZON, AND JOHN DOE, RESPONDENTS.

D E C I S I O N

CARPIO, J.:

The Case

This is a petition for review[1] with application for the immediate issuance of a temporary restraining order and writ of preliminary injunction assailing the 5 October 2006 Decision[2] and the 23 January 2007 Resolution[3] of the Court of Appeals in CA-G.R. CV No. 75855. The 5 October 2006 Decision set aside the 23 July 2002 Decision[4] of the Regional Trial Court (Branch 79) of Quezon City in Civil Case No. Q-99-37559, which granted petitioner's complaint for recovery of sum of money and personal property with prayer for the issuance of a writ of replevin. The 23 January 2007 Resolution denied petitioner's motion for reconsideration.

The Facts

Sometime in 1997, respondent Trojan Metal Industries, Inc. (TMI) came to petitioner PCI Leasing and Finance, Inc. (PCILF) to seek a loan. Instead of extending a loan, PCILF offered to buy various equipment TMI owned, namely: a Verson double action hydraulic press with cushion, a Hinohara powerpress 75-tons capacity, a USI-clearing powerpress 60-tons capacity, a Watanabe powerpress 60-tons capacity, a YMGP powerpress 30-tons capacity, a YMGP powerpress 15-tons capacity, a lathe machine, a vertical milling machine, and a radial drill. Hard-pressed for money, TMI agreed. PCILF and TMI immediately executed deeds of sale[5] evidencing TMI's sale to PCILF of the various equipment in consideration of the total amount of P 2,865,070.00.

PCILF and TMI then entered into a lease agreement,[6] dated 8 April 1997, whereby the latter leased from the former the various equipment it previously owned. Pursuant to the lease agreement, TMI issued postdated checks representing 24 monthly installments. The monthly rental for the Verson double action hydraulic press with cushion was in the amount of P62,328.00; for the Hinohara powerpress 75-tons capacity, the USI-clearing powerpress 60-tons capacity, the Watanabe powerpress 60-tons capacity, the YMGP powerpress 30-tons capacity, and the YMGP powerpress 15-tons capacity, the monthly rental was in the amount of P49,259.00; and for the lathe machine, the vertical milling machine, and the radial drill, the monthly rental was in the amount of P22,205.00.

The lease agreement required TMI to give PCILF a guaranty deposit of P1,030,350.00,[7] which would serve as security for the timely performance of TMI's obligations under the lease agreement, to be automatically forfeited should TMI return the leased equipment before the expiration of the lease agreement.

Further, spouses Walfrido and Elizabeth Dizon, as TMI's President and Vice-President, respectively executed in favor of PCILF a Continuing Guaranty of Lease Obligations.[8] Under the continuing guaranty, the Dizon spouses agreed to immediately pay whatever obligations would be due PCILF in case TMI failed to meet its obligations under the lease agreement.

To obtain additional loan from another financing company,[9] TMI used the leased equipment as temporary collateral.[10] PCILF considered the second mortgage a violation of the lease agreement. At this time, TMI's partial payments had reached P1,717,091.00.[11] On 8 December 1998, PCILF sent TMI a demand letter[12] for the payment of the latter's outstanding obligation. PCILF's demand remained unheeded.

On 7 May 1999, PCILF filed in the Regional Trial Court (Branch 79) of Quezon City a complaint[13] against TMI, spouses Dizon, and John Doe (collectively referred to as "respondents" hereon) for recovery of sum of money and personal property with prayer for the issuance of a writ of replevin, docketed as Civil Case No. Q-99-37559.

On 7 September 1999, the RTC issued the writ of replevin[14] PCILF prayed for, directing the sheriff to take custody of the leased equipment. Not long after, PCILF sold the leased equipment to a third party and collected the proceeds amounting to P1,025,000.00.[15]

In their answer,[16] respondents claimed that the sale with lease agreement was a mere scheme to facilitate the financial lease between PCILF and TMI. Respondents explained that in a simulated financial lease, property of the debtor would be sold to the creditor to be repaid through rentals; at the end of the lease period, the property sold would revert back to the debtor. Respondents prayed that they be allowed to reform the lease agreement to show the true agreement between the parties, which was a loan secured by a chattel mortgage.

The Ruling of the RTC

In its 23 July 2002 Decision, the RTC granted the prayer of PCILF in its complaint. The RTC ruled that the lease agreement must be presumed valid as the law between the parties even if some of its provisions constituted unjust enrichment on the part of PCILF. The dispositive portion of its Decision reads:

> WHEREFORE, judgment is hereby rendered in favor of the plaintiff-PCI Leasing and Finance, Inc. and against defendants Trojan Metal, Walfrido Dizon, and Elizabeth Dizon, as follows:

1. Ordering the plaintiff to be entitled to the possession of herein machineries.
2. Ordering the defendants to pay the remaining rental obligation in the amount of Php 888,434.48 plus legal interest from the date of filing of the complaint;
3. Ordering defendant to pay an attorneys fees in the amount of Php 50,000.00;
4. Ordering the defendant to pay the cost of suit.

SO ORDERED.[17]

Respondents appealed to the Court of Appeals alleging that the RTC erred in ruling that PCILF was entitled to the possession of TMI's equipment and that respondents still owed PCILF the balance of P888,423.48.

The Ruling of the Court of Appeals

The Court of Appeals ruled that the sale with lease agreement was in fact a loan secured by chattel mortgage. The Court of Appeals held that since PCILF sold the equipment to a third party for P1,025,000.00 and TMI paid PCILF a guaranty deposit of P1,030,000.00, PCILF had in its hands the sum of P2,055,250.00, as against TMI's remaining obligation of P888,423.48, or an excess of P1,166,826.52, which should be returned to TMI in accordance with Section 14 of the Chattel Mortgage Law.

Thus, in its 5 October 2006 Decision, the Court of Appeals set aside the Decision of the RTC. The Court of Appeals entered a new one dismissing PCILF's complaint and directing PCILF to pay TMI, by way of refund, the amount of P1,166,826.52. The decretal part of its Decision reads:

> WHEREFORE, premises considered, the July 23, 2002 Decision of the Regional Trial Court of Quezon City, Branch 79, in Civil Case No. Q-99-37559, is hereby REVERSED and SET ASIDE, and a new one entered DISMISSING the complaint and DIRECTING the plaintiff-appellee PCI Leasing and Finance, Inc. to PAY, by way of REFUND, to the defendant-appellant Trojan Metal Industries, Inc., the net amount of Php 1,166,826.52.
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> SO ORDERED.[18]

The Issues

The issues for resolution are (1) whether the sale with lease agreement the parties entered into was a financial lease or a loan secured by chattel mortgage; and (2) whether PCILF should pay TMI, by way of refund, the amount of P1,166,826.52.

The Court's Ruling

The petition lacks merit.

PCILF contends that the transaction between the parties was a sale and leaseback financing arrangement where the client sells movable property to a financing company, which then leases the same back to the client. PCILF insists the transaction is not financial leasing, which contemplates extension of credit to assist a buyer in acquiring movable property which the buyer can use and eventually own. PCILF claims that the sale and leaseback financing arrangement is not contrary to law, morals, good customs, public order, or public policy. PCILF stresses that the guaranty deposit should be forfeited in its favor, as provided in the lease agreement. PCILF points out that this case does not involve mere failure to pay rentals, it deals with a flagrant violation of the lease agreement.

Respondents counter that from the very beginning, transfer to PCILF of ownership over the subject equipment was never the intention of the parties. Respondents claim that under the lease agreement, the guaranty deposit would be forfeited if TMI returned the leased equipment to PCILF before the expiration of the lease agreement; thus, since TMI never returned the leased equipment voluntarily, but through a writ of replevin ordered by the RTC, the guaranty deposit should not be forfeited.

Since the lease agreement in this case was executed on 8 April 1997, Republic Act No. 5980 (RA 5980), otherwise known as the Financing Company Act, governs as to what constitutes financial leasing. Section 1, paragraph (j) of the New Rules and Regulations to Implement RA 5980[19] defines financial leasing as follows:

> LEASING shall refer to financial leasing which is a mode of extending credit through a non-cancelable contract under which the lessor purchases or acquires at the instance of the lessee heavy equipment, motor vehicles, industrial machinery, appliances, business and office machines, and other movable property in consideration of the periodic payment by the lessee of a fixed amount of money sufficient to amortize at least 70% of the purchase price or acquisition cost, including any incidental expenses and a margin of profit, over the lease period. The contract shall extend over an obligatory period during which the lessee has the right to hold and use the leased property and shall bear the cost of repairs, maintenance, insurance, and preservation thereof, but with no obligation or option on the part of the lessee to purchase the leased property at the end of the lease contract.

The above definition of financial leasing gained statutory recognition with the enactment of Republic Act No. 8556 (RA 8556), otherwise known as the Financing Company Act of 1998.[20] Section 3(d) of RA 8556 defines financial leasing as:

> a mode of extending credit through a non-cancelable lease contract under which the lessor purchases or acquires, at the instance of the lessee, machinery, equipment, motor vehicles, appliances, business and office machines, and other movable or immovable property in consideration of the periodic payment by the lessee of a fixed amount of money sufficient to amortize at least seventy (70%) of the purchase price or acquisition cost, including any incidental expenses and a margin

> of profit over an obligatory period of not less than two (2) years during which the lessee has the right to hold and use the leased property with the right to expense the lease rentals paid to the lessor and bears the cost of repairs, maintenance, insurance and preservation thereof, but with no obligation or option on his part to purchase the leased property from the owner-lessor at the end of the lease contract.

Thus, in a true financial leasing, whether under RA 5980 or RA 8556, a finance company purchases on behalf of a cash-strapped lessee the equipment the latter wants to buy but, due to financial limitations, is incapable of doing so. The finance company then leases the equipment to the lessee in exchange for the latter's periodic payment of a fixed amount of rental.

In this case, however, TMI already owned the subject equipment before it transacted with PCILF. Therefore, the transaction between the parties in this case cannot be deemed to be in the nature of a financial leasing as defined by law.

The facts in the instant case are analogous to those in *Cebu Contractors Consortium Co. v. Court of Appeals.*[21] There, Cebu Contractors Consortium Co. (CCCC) approached Makati Leasing and Finance Corporation (MLFC) to obtain a loan. MLFC agreed to extend financial assistance to CCCC but, instead of a loan with collateral, MLFC induced CCCC to adopt a sale and leaseback scheme. Under the scheme, several of CCCC's equipment were made to appear as sold to MLFC and then leased back to CCCC, which in turn paid lease rentals to MLFC. The rentals were treated as installment payments to repurchase the equipment.

The Court held in *Cebu Contractors Consortium Co. v. Court of Appeals*[22] that the transaction between CCCC and MLFC was not one of financial leasing as defined by law, but simply a loan secured by a chattel mortgage over CCCC's equipment. The Court went on to explain that where the client already owned the equipment but needed additional working capital and the finance company purchased such equipment with the intention of leasing it back to him, the lease agreement was simulated to disguise the true transaction that was a loan with security. In that instance, continued the Court, the intention of the parties was not to enable the client to acquire and use the equipment, but to extend to him a loan.

Similarly, in *Investors Finance Corporation v. Court of Appeals*,[23] a borrower came to Investors Finance Corporation (IFC) to secure a loan with his heavy equipment and machinery as collateral. The parties executed documents where IFC was made to appear as the owner of the equipment and the borrower as the lessee. As consideration for the lease, the borrower-lessee was to pay monthly amortizations over a period of 36 months. The parties executed a lease agreement covering various equipment described in the lease schedules attached to the lease agreement. As security, the borrower-lessee also executed a continuing guaranty.

The Court in *Investors Finance Corporation v. Court of Appeals*[24] held that the transaction between the parties was not a true financial leasing because the intention of the parties was not to enable the borrower-lessee to acquire and use the heavy equipment and machinery, which already belonged to him, but to extend to him a loan to use as capital for his construction and logging businesses. The