

## SECOND DIVISION

[ G.R. NO. 138703, June 30, 2006 ]

**DEVELOPMENT BANK OF THE PHILIPPINES<sup>[1]</sup> AND  
PRIVATIZATION AND MANAGEMENT OFFICE (FORMERLY ASSET  
PRIVATIZATION TRUST), PETITIONERS, VS. HON. COURT OF  
APPEALS, PHILIPPINE UNITED FOUNDRY AND MACHINERY  
CORP. AND PHILIPPINE IRON MANUFACTURING CO., INC.,  
RESPONDENTS.**

### DECISION

**AZCUNA, J.:**

This is a petition for review on certiorari under Rule 45 of the Rules of Court of the decision of the Court of Appeals (CA) dated May 7, 1999 in CA-G.R. CV No. 49239 entitled "Philippine United Foundry and Machinery Corp. and Philippine Iron Manufacturing Co., Inc. v. Development Bank of the Philippines and Asset Privatization Trust" which upheld the decision of the Regional Trial Court (RTC), Branch 98 of Quezon City in Civil Case No. Q-49650.

Sometime in March 1968, the Development Bank of the Philippines (DBP) granted to respondents Philippine United Foundry and Machineries Corporation and Philippine Iron Manufacturing Company, Inc. an industrial loan in the amount of P2,500,000 consisting of P500,000 in cash and P2,000,000 in DBP Progress Bonds. The loan was evidenced by a promissory note<sup>[2]</sup> dated June 26, 1968 and secured by a mortgage<sup>[3]</sup> executed by respondents over their present and future properties such as buildings, permanent improvements, various machineries and equipment for manufacture.

Subsequently, DBP granted to respondents another loan in the form of a five-year revolving guarantee amounting to P1,700,000 which was reflected in the amended mortgage contract<sup>[4]</sup> dated November 20, 1968. According to respondents, the loan guarantee was extended to them when they encountered difficulty in negotiating the DBP Progress Bonds. Respondents were only able to sell the bonds in 1972 or about five years from its issuance for an amount that was 25% less than its face value.<sup>[5]</sup>

On September 10, 1975, the outstanding accounts of respondents with DBP were restructured in view of their failure to pay. Thus, the outstanding principal balance of the loans and advances amounting to P4,655,992.35 were consolidated into a single account. The restructured loan was evidenced by a new promissory note<sup>[6]</sup> dated November 12, 1975 payable within seven years, with partial payments on the principal to be made beginning on the third year plus a 12% interest per annum payable every month. The following paragraph appears at the bottom portion of the note:

This promissory note represents the consolidation into one account of the outstanding principal balance of PHILIMCO and PHUMACO's account, and is prepared pursuant to Res. No. 228, dated September 10, 1975, approved by the Executive Committee pursuant to Bd. Res. No. 3577, s. of 1975. This note is secured by mortgages on the existing assets of the firms.<sup>[7]</sup>

On the other hand, all accrued interest and charges due amounting to P3,074,672.21 were denominated as "Notes Taken for Interests" and evidenced by a separate promissory note<sup>[8]</sup> dated November 12, 1975. The following annotation appears at the bottom portion of the note:

This promissory note represents all accrued interests and charges which are taken up as "NOTES TAKEN FOR INTEREST" due on the accounts of PHILIMCO and PHUMACO approved under Bd. Res. No. 3577, s. of 1975. This note is secured by (a) mortgage on the existing assets of the firm.<sup>[9]</sup>

Both notes provided for the following additional charges and penalties:

- (1) 12% interest per annum on unpaid amortizations<sup>[10]</sup>;
- (2) 10% penalty charge per annum on the total amortizations past due effective 30 days from the date respondents failed to comply with any of the terms stipulated in the notes<sup>[11]</sup>; and,
- (3) Bank advances for insurance premiums, taxes, rentals, litigation and acquired assets expenses, collection and other out-of-pocket expenses not covered by inspection and processing fees subject to the following charges<sup>[12]</sup>:
  - (a) One time service charge of ½% on the amount advanced to be included in the receivable account;
  - (b) Penalty charge of 8% per annum on past due advances; and
  - (c) Interest at 12% per annum.

Notwithstanding the restructuring, respondents were still unable to comply with the terms and conditions of the new promissory notes. As a result, respondents requested DBP to refinance the matured obligation. The request was granted by DBP, pursuant to which three foreign currency denominated loans sourced from DBP's own foreign borrowings were extended to respondents on various dates between 1980 and 1981.<sup>[13]</sup> These loans were secured by mortgages<sup>[14]</sup> on the properties of respondents and were evidenced by the following promissory notes:

	Face Value	Maturity Date	Interest Rate Per Annum
(1) Promissory Note <sup>[15]</sup> dated December 11, 1980	\$661,330	December 15, 1990	3% over DBP's borrowing rate <sup>[16]</sup>

(2) Promissory Note <sup>[17]</sup> dated June 5, 1981	\$666,666	June 23, 1991	3% over DBP's borrowing rate <sup>[18]</sup>
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(3) Promissory Note <sup>[19]</sup> dated December 16, 1981	\$486,472.37	December 31, 1982	4% over DBP's borrowing cost
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Apart from the interest, the promissory notes imposed additional charges and penalties if respondents defaulted on their payments. The notes dated December 11, 1980 and June 5, 1981 specifically provided for a 2% annual service fee computed on the outstanding principal balance of the loans as well as the following additional interest and penalty charges on the loan amortizations or portions in arrears:

(a) If in arrears for thirty (30) days or less:

- i. Additional interest at the basic loan interest rate per annum computed on total amortizations past due, irrespective of age.
- ii. No penalty charge

(b) If in arrears for more than thirty (30) days:

- i. Additional interest at the basic loan interest rate per annum computed on total amortizations past due, irrespective of age, plus,
- ii. Penalty charge of 16% per annum computed on amortizations or portions thereof in arrears for more than thirty (30) days counted from the date the amount in arrears becomes liable to this charge.<sup>[20]</sup>

Under these two notes, respondents also bound themselves to pay bank advances for insurance premiums, taxes, litigation and acquired assets expenses and other out-of-pocket expenses not covered by inspection and processing fees as follows:

(a) One-time service charge of 2% of the amount advanced, same to be included in the receivable account.

(b) Interest at 16% per annum.

(c) Penalty charge from date of advance at 16% per annum.

The note dated December 16, 1981, on the other hand, provided for the interest and penalty charges on loan amortizations or portions of it in arrears as follows:

(a) Additional interest at the basic loan interest per annum computed on total amortizations past due irrespective of age; plus

(b) Penalty charges of 8% per annum computed on total

amortizations in arrears, irrespective of age.<sup>[21]</sup>

Respondents were likewise bound to pay bank advances for insurance premiums, taxes, litigation and acquired assets expenses and other out-of-pocket expenses not covered by inspection and processing fees as follows:

- (a) One-time service charge of 2% of (the) amount advanced, same to be included and debited to the advances account;
- (b) Interest at the basic loan interest rate; and
- (c) Penalty charge from date of advance at 8% per annum.<sup>[22]</sup>

Sometime in October 1985, DBP initiated foreclosure proceedings upon its computation that respondents' loans were in arrears by P62,954,473.68.<sup>[23]</sup> According to DBP, this figure already took into account the intermittent payments made by respondents between 1968 and 1981 in the aggregate amount of P5,150,827.71.<sup>[24]</sup>

However, the foreclosure proceedings were suspended on twelve separate occasions from October 1985 to December 1986 upon the representations of respondents that a financial rehabilitation fund arising from a contract with the military was forthcoming. On December 23, 1986, before DBP could proceed with the foreclosure proceedings, respondents instituted the present suit for injunction.

On January 6, 1987, the complaint was amended to include the annulment of mortgage. On December 15, 1987, the complaint was amended a second time to implead the Asset Privatization Trust (APT) (now the Privatization and Management Office [PMO])<sup>[25]</sup> as a party defendant.

Respondents' cause of action arose from their claim that DBP was collecting from them an unconscionable if not unlawful or usurious obligation of P62,954,473.68 as of September 30, 1985, out of a mere P6,200,000 loan. Primarily, respondents contended that the amount claimed by DBP is erroneous since they have remitted to DBP approximately P5,300,000 to repay their original debt. Additionally, respondents assert that since the loans were procured for the Self-Reliant Defense Posture Program of the Armed Forces of the Philippines (AFP), the latter's breach of its commitment to purchase military armaments and equipment from respondents amounts to a failure of consideration that would justify the annulment of the mortgage on respondents' properties.<sup>[26]</sup>

On December 24, 1986, the RTC issued a temporary restraining order. A Writ of Preliminary Injunction was subsequently issued on May 4, 1987. After trial on the merits, the court rendered a decision in favor of respondents,<sup>[27]</sup> the dispositive portion of which reads:

WHEREFORE, in view of the foregoing consideration, judgment is hereby rendered in favor of the [respondents] and against the defendants [DBP and APT], ordering that:

- (1) The Writ of Preliminary Injunction already issued be made permanent;

(2) The [respondents] be made to pay the original loans in the aggregate amount of Six Million Two Hundred Thousand (P6,200,000) Pesos;

(3) The [respondents'] payment in the amount of Five Million Three Hundred Thirty-Five Thousand, Eight Hundred Twenty-seven Pesos and Seventy-one Centavos (P5,335,827.71) be applied to payment for interest and penalties; and

(4) No further interest and/or penalties on the aforementioned principal obligation of P6.2 million shall be imposed/charged upon the [respondents] for failure of the military establishment to honor their commitment to a valid and consummated contract with the former. Costs against the defendants.

SO ORDERED.

Both DBP and PMO appealed the decision to the CA. The CA, however, affirmed the decision of the RTC. Aggrieved, DBP filed with the CA a motion for a reconsideration<sup>[28]</sup> dated May 26, 1999, which motion has not been resolved by the CA to date. PMO, on the other hand, sought relief directly with the Court by filing this present petition upon the following grounds:

I. THE CA DISREGARDED THE BINDING AND OBLIGATORY FORCE OF CONTRACTS WHICH IS THE LAW BETWEEN THE PARTIES.

x x x

II. HE CA VIOLATED THE PRINCIPLE OF LAW THAT CONTRACTS TAKE EFFECT ONLY BETWEEN THE PARTIES AS IT LINKED RESPONDENTS' CONTRACTS WITH THE AFP WITH RESPONDENTS' LOANS WITH DBP.

x x x

III. THE CA ERRED IN PERMANENTLY ENJOINING THE DBP AND APT FROM FORECLOSING THE MORTGAGES ON RESPONDENTS' PROPERTIES THEREBY VIOLATING THE PROVISIONS OF P[RESIDENTIAL] D[ECREE NO.] 385 AND PROCLAMATION NO. 50.  
<sup>[29]</sup>

On the first issue, PMO asserts that the CA erred in declaring that the interest rate on the loans had been unilaterally increased by DBP despite the evidence on record (consisting of promissory notes and testimonies of witnesses for DBP) showing otherwise. PMO also claims that the CA failed to take into account the effect of the restructuring and refinancing of the loans granted by DBP upon the request of respondents.

Anent the second issue, PMO argues that the failure of the AFP to honor its commitment to respondents should have had no bearing on respondents' loan obligations to DBP as DBP was not a party to their contract. Hence, PMO contends that the CA ran afoul of the principle of relativity of contracts when it ruled that no