

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.

DECISION

PANGANIBAN, CJ:

Directors owe loyalty and fidelity to the corporation they serve and to its creditors. When these directors sit on the board 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-GR 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 P836,000. 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]

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 P21,745,707.36 (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 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 P16,123,918.02.^[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 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 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:

x x x x x x x x

"2. The price for the two (2) generator sets is PESOS: ONE MILLION FIVE HUNDRED FIFTY THOUSAND FIVE HUNDRED SEVENTY TWO ONLY (P1,550,572) x x x 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.

x x x x x x x x

"FURTHER RESOLVED, That the sales proceeds of PESOS: ONE MILLION FIVE HUNDRED FIFTY THOUSAND FIVE HUNDRED SEVENTY TWO ONLY (P1,550,572) shall be utilized to pay the liability of VISCO with the Development Bank of the Philippines."^[37]

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 a cash advance of P1,342,656.88 for the full settlement of VISCO's account with DBP.^[46] On June 29, 1976, FEBTC complied by issuing Check No. FE239249 for P1,342,656.88, 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 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-GR 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 P100,000. ^[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, 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 P25