

## FIRST DIVISION

[ G.R. No. 159622, July 30, 2004 ]

**LANDL & COMPANY (PHIL.) INC., PERCIVAL G. LLABAN AND  
MANUEL P. LUCENTE, PETITIONERS, VS. METROPOLITAN BANK &  
TRUST COMPANY, RESPONDENT.**

### D E C I S I O N

**YNARES-SANTIAGO, J.:**

At issue in this petition for review on *certiorari* is whether or not, in a trust receipt transaction, an entruster which had taken actual and juridical possession of the goods covered by the trust receipt may subsequently avail of the right to demand from the entrustee the deficiency of the amount covered by the trust receipt.

As correctly appreciated by the Court of Appeals, the undisputed facts of this case are as follows:

Respondent Metropolitan Bank and Trust Company (Metrobank) filed a complaint for sum of money against Landl and Company (Phil.) Inc. (Landl) and its directors, Percival G. Llaban and Manuel P. Lucente before the Regional Trial Court of Cebu City, Branch 19, docketed as Civil Case No. CEB-4895.

Respondent alleged that petitioner corporation is engaged in the business of selling imported welding rods and alloys. On June 17, 1983, it opened Commercial Letter of Credit No. 4998 with respondent bank, in the amount of US\$19,606.77, which was equivalent to P218,733.92 in Philippine currency at the time the transaction was consummated. The letter of credit was opened to purchase various welding rods and electrodes from Perma Alloys, Inc., New York, U.S.A., as evidenced by a Pro-Forma Invoice dated March 10, 1983. Petitioner corporation put up a marginal deposit of P50,414.00 from the proceeds of a separate clean loan.

As an additional security, and as a condition for the approval of petitioner corporation's application for the opening of the commercial letter of credit, respondent bank required petitioners Percival G. Llaban and Manuel P. Lucente to execute a Continuing Suretyship Agreement to the extent of P400,000.00, excluding interest, in favor of respondent bank. Petitioner Lucente also executed a Deed of Assignment in the amount of P35,000.00 in favor of respondent bank to cover the amount of petitioner corporation's obligation to the bank. Upon compliance with these requisites, respondent bank opened an irrevocable letter of credit for the petitioner corporation.

To secure the indebtedness of petitioner corporation, respondent bank required the execution of a Trust Receipt in an amount equivalent to the letter of credit, on the condition that petitioner corporation would hold the goods in trust for respondent bank, with the right to sell the goods and the obligation to turn over to respondent

bank the proceeds of the sale, if any. If the goods remained unsold, petitioner corporation had the further obligation to return them to respondent bank on or before November 23, 1983.

Upon arrival of the goods in the Philippines, petitioner corporation took possession and custody thereof.

On November 23, 1983, the maturity date of the trust receipt, petitioner corporation defaulted in the payment of its obligation to respondent bank and failed to turn over the goods to the latter. On July 24, 1984, respondent bank demanded that petitioners, as entrustees, turn over the goods subject of the trust receipt. On September 24, 1984, petitioners turned over the subject goods to the respondent bank.

On July 31, 1985, in the presence of representatives of the petitioners and respondent bank, the goods were sold at public auction. The goods were sold for P30,000.00 to respondent bank as the highest bidder.

The proceeds of the auction sale were insufficient to completely satisfy petitioners' outstanding obligation to respondent bank, notwithstanding the application of the time deposit account of petitioner Lucente. Accordingly, respondent bank demanded that petitioners pay the remaining balance of their obligation. After petitioners failed to do so, respondent bank instituted the instant case to collect the said deficiency.

On March 31, 1997, after trial on the merits, the trial court rendered a decision, the dispositive portion of which reads:

WHEREFORE, foregoing premises considered, Judgment is hereby rendered in favor of the plaintiff and against the defendant by (1) ordering the defendant to pay jointly and severally to the plaintiff the sum of P292,172.23 representing the defendant's obligation, as of April 17, 1986; (2) to pay the interest at the rate of 19% per annum to be reckoned from April 18, 1986 until [the] obligation is fully paid; (3) to pay service charge at the rate of 2% per annum starting April 18, 1986; (4) to pay the sum equivalent to 10% per annum of the total amount due collectible by way of Attorney's Fees; (5) to pay Litigation Expenses of P3,000.00 and to pay the cost of the suit; and (6) to pay penalty charge of 12% per annum.

SO ORDERED.<sup>[1]</sup>

Petitioners appealed to the Court of Appeals, raising the issues of: (1) whether or not respondent bank has the right to recover any deficiency after it has retained possession of and subsequently effected a public auction sale of the goods covered by the trust receipt; (2) whether or not respondent bank is entitled to the amount of P3,000.00 as and for litigation expenses and costs of the suit; and (3) whether or not respondent bank is entitled to the award of attorney's fees.

On February 13, 2003, the Court of Appeals rendered a decision affirming *in toto* the decision of the trial court.<sup>[2]</sup>

Hence, this petition for review on the following assignment of errors:

**I.**

THE HONORABLE COURT OF APPEALS GROSSLY ERRED IN AFFIRMING THE TRIAL COURT'S RULING THAT RESPONDENT HAD THE RIGHT TO CLAIM THE DEFICIENCY FROM PETITIONERS NOTWITHSTANDING THE FACT THAT THE GOODS COVERED BY THE TRUST RECEIPT WERE FULLY TURNED OVER TO RESPONDENT.

**II.**

THE HONORABLE COURT OF APPEALS GROSSLY ERRED IN AFFIRMING THE TRIAL COURT'S PATENTLY ERRONEOUS AWARD OF PRINCIPAL OBLIGATION, INTEREST, ATTORNEY'S FEES, AND PENALTY AGAINST THE PETITIONERS.<sup>[3]</sup>

The instant petition is partly meritorious.

The resolution of the first assigned error hinges on the proper interpretation of Section 7 of Presidential Decree No. 115, or the Trust Receipts Law, which reads:

Sec. 7. *Rights of the entruster.* - The entruster shall be entitled to the proceeds from the sale of the goods, documents or instruments released under a trust receipt to the trustee to the extent of the amount owing to the entruster or as appears in the trust receipt, or to the return of the goods, documents or instruments in case of non-sale, and to the enforcement of all other rights conferred on him in the trust receipt provided such are not contrary to the provisions of this Decree.

The entruster may cancel the trust and take possession of the goods, documents or instruments subject of the trust or of the proceeds realized therefrom at any time upon default or failure of the trustee to comply with any of the terms and conditions of the trust receipt or any other agreement between the entruster and the trustee, and the entruster in possession of the goods, documents or instruments may, on or after default, give notice to the trustee of the intention to sell, and may, not less than five days after serving or sending of such notice, sell the goods, documents or instruments at public or private sale, and the entruster may, at a public sale, become a purchaser. The proceeds of any such sale, whether public or private, shall be applied (a) to the payment of the expenses thereof; (b) to the payment of the expenses of re-taking, keeping and storing the goods, documents or instruments; (c) to the satisfaction of the trustee's indebtedness to the entruster. The trustee shall receive any surplus but shall be liable to the entruster for any deficiency. Notice of sale shall be deemed sufficiently given if in writing, and either personally served on the trustee or sent by post-paid ordinary mail to the trustee's last known business address.

There is no question that petitioners failed to pay their outstanding obligation to respondent bank. They contend, however, that when the trustee fails to settle his principal loan, the entruster may choose between two separate and alternative

remedies: (1) the return of the goods covered by the trust receipt, in which case, the entruster now acquires the ownership of the goods which the trustee failed to sell; or (2) cancel the trust and take possession of the goods, for the purpose of selling the same at a private sale or at public auction. Petitioners assert that, under this second remedy, the entruster does not acquire ownership of the goods, in which case he is entitled to the deficiency. Petitioners argue that these two remedies are so distinct that the availing of one necessarily bars the availing of the other. Thus, when respondent bank availed of the remedy of demanding the return of the goods, the actual return of all the unsold goods completely extinguished petitioners' liability.<sup>[4]</sup>

Petitioners' argument is bereft of merit.

A trust receipt is inextricably linked with the primary agreement between the parties. Time and again, we have emphasized that a trust receipt agreement is merely a collateral agreement, the purpose of which is to serve as security for a loan. Thus, in *Abad v. Court of Appeals*,<sup>[5]</sup> we ruled:

A letter of credit-trust receipt arrangement is endowed with its own distinctive features and characteristics. Under that set-up, a bank extends a loan covered by the letter of credit, with the trust receipt as security for the loan. In other words, the transaction involves a loan feature represented by the letter of credit, and a security feature which is in the covering trust receipt. x x x.

A trust receipt, therefore, is a security agreement, pursuant to which a bank acquires a "security interest" in the goods. It secures an indebtedness and there can be no such thing as security interest that secures no obligation.<sup>[6]</sup>

The Trust Receipts Law was enacted to safeguard commercial transactions and to offer an additional layer of security to the lending bank. Trust receipts are indispensable contracts in international and domestic business transactions. The prevalent use of trust receipts, the danger of their misuse and/or misappropriation of the goods or proceeds realized from the sale of goods, documents or instruments held in trust for entruster banks, and the need for regulation of trust receipt transactions to safeguard the rights and enforce the obligations of the parties involved are the main thrusts of the Trust Receipts Law.<sup>[7]</sup>

The second paragraph of Section 7 provides a statutory remedy available to an entruster in the event of default or failure of the trustee to comply with any of the terms and conditions of the trust receipt or any other agreement between the entruster and the trustee. More specifically, the entruster "may cancel the trust and take possession of the goods, documents or instruments subject of the trust or of the proceeds realized therefrom at any time". The law further provides that "the entruster in possession of the goods, documents or instruments may, on or after default, give notice to the trustee of the intention to sell, and may, not less than five days after serving or sending of such notice, sell the goods, documents or instruments at public or private sale, and the entruster may, at a public sale, become a purchaser. The proceeds of any such sale, whether public or private, shall be applied (a) to the payment of the expenses thereof; (b) to the payment of the expenses of re-taking, keeping and storing the goods, documents or instruments;

(c) to the satisfaction of the entrustee's indebtedness to the entruster. The entrustee shall receive any surplus but shall be liable to the entruster for any deficiency."

The trust receipt between respondent bank and petitioner corporation contains the following relevant clauses:

The BANK/ENTRUSTER may, at any time, and only at its option, cancel this trust and take possession of the goods/documents/instruments subject hereof or of the proceeds realized therefrom wherever they may then be found, upon default or failure of the ENTRUSTEE to comply with any of the terms and conditions of this Trust Receipt or of any other agreement between the BANK/ENTRUSTER and the ENTRUSTEE; and the BANK/ENTRUSTER having taken repossession of the goods/documents/instruments object hereof may, on or after default, give at least five (5) days' previous notice to the ENTRUSTEE of its intention to sell the goods/documents/instruments at public or private sale, at which public sale, it may become a purchaser; Provided, that the proceeds of any such sale, whether public or private, shall be applied: (a) to the payment of the expenses thereof; (b) to the payment of the expenses of retaking, keeping and storing the goods/documents/instruments; (c) to the satisfaction of all of the ENTRUSTEE's indebtedness to the BANK/ENTRUSTER; and Provided, further, that the ENTRUSTEE shall receive any surplus thereof but shall, in any case, be liable to the BANK/ENTRUSTER for any deficiency. x x x

No act or omission on the part of the BANK/ENTRUSTER shall be deemed and considered a waiver of any of its rights hereunder or under any related letters of credit, drafts or other documents unless such waiver is expressly made in writing over the signature of the BANK/ENTRUSTER.<sup>[8]</sup>

The afore-cited stipulations in the trust receipt are a near-exact reproduction of the second paragraph of Section 7 of the Trust Receipts Law. The right of repossession and subsequent sale at public auction which were availed of by respondent bank were rights available upon default, and which were conferred by statute and reinforced by the contract between the parties.

The initial repossession by the bank of the goods subject of the trust receipt did not result in the full satisfaction of the petitioners' loan obligation. Petitioners are apparently laboring under the mistaken impression that the full turn-over of the goods suffices to divest them of their obligation to repay the principal amount of their loan obligation. This is definitely not the case. In *Philippine National Bank v. Hon. Gregorio G. Pineda and Tayabas Cement Company, Inc.*,<sup>[9]</sup> we had occasion to rule:

PNB's possession of the subject machinery and equipment being precisely as a form of security for the advances given to TCC under the Letter of Credit, said possession by itself cannot be considered payment of the loan secured thereby. Payment would legally result only after PNB had foreclosed on said securities, sold the same and applied the proceeds thereof to TCC's loan obligation. Mere possession does not amount to foreclosure for foreclosure denotes the procedure adopted by the