



Republic of the Philippines
Supreme Court
Manila

THIRD DIVISION

PREMIERE DEVELOPMENT
BANK,*

G.R. No. 185110

Present:

Petitioner,

CAGUIOA, J., Chairperson,
INTING,
GAERLAN
DIMAAMPAO, and
SINGH, JJ.

- versus -

SPOUSES ENGRACIO T.
CASTAÑEDA** AND LOURDES
E. CASTAÑEDA,**

Promulgated:

Respondents.

August 19, 2024

MistDeBatt

X ----- X

DECISION

CAGUIOA, J.:

This is a case of first impression on the issue of application of payment involving a person who is both a principal debtor of a personal loan and a surety of corporate loans of the same creditor.

Before the Court is a petition for review on *certiorari*¹ under Rule 45 of the Rules of Court, assailing the Court of Appeals (CA) Decision² dated June 25, 2008 in CA-G.R. CV No. 84578, which affirmed with modification the Decision³ dated January 31, 2005 of the Regional Trial Court, Branch 149, Makati City (RTC) in Civil Case No. 01-029, and Resolution⁴ promulgated

* Presently known as Security Bank Savings Corporation, *rollo*, p. 370, Premier Development Bank's Explanation dated January 22, 2014.
** "Engracio T. Castaneda" and "Engracio Castaneda" in some parts of the records.
*** "Lourdes E. Castaneda," "Lourdes Castaneda," "Lourdes Castañeda" in some parts of the records.
¹ *Rollo*, pp. 3-39.
² *Id.* at 40-54. Penned by Associate Justice Ramon M. Bato, Jr. and concurred in by Associate Justices Jose L. Sabio, Jr. and Jose C. Reyes, Jr.
³ *Id.* at 60-69. Penned by Presiding Judge Cesar O. Untalan.
⁴ *Id.* at 55-59. Penned by Associate Justice Ramon M. Bato, Jr. and concurred in by Associate Justices Jose C. Reyes, Jr. and Isaias P. Dicedican.

on October 20, 2008 which denied petitioner Premiere Development Bank's (PDB) Motion for Reconsideration⁵ dated July 14, 2008 (MR).

The Antecedents

The facts are not disputed.

The respondents, Spouses Engracio T. Castañeda (Engracio) and Lourdes E. Castañeda (Lourdes) (collectively, Spouses Castañeda), had an outstanding loan obligation with PDB in the amount of PHP 2.6 million under Promissory Note No. (PN) 717-X⁶ (Subject Loan). The maturity date of the Subject Loan was on September 10, 2000. As collateral, Engracio assigned and pledged to PDB a proprietary share in Manila Polo Club (MPC) identified as Proprietary Membership Certificate No. 170 (MPC Certificate No. 170) which was registered under the name of his brother, Constancio T. Castañeda, Jr.⁷ (Constancio).

Engracio and Constancio were officers of two corporations. Engracio was the president of Casent Realty and Development Corporation (Casent Realty) and vice-president of Central Surety and Insurance Company, Inc., (Central Surety). Constancio was the president of Central Surety.

These corporations had separate loans with PDB. Casent Realty had a loan of PHP 40 million under PN 235-Z⁸ while Central Surety had two loans of PHP 40,898,000 under PN 376-X⁹ and PHP 6 million under PN 714-Y.¹⁰ These loans were also secured by separate pledge and real estate mortgage contracts (REM).¹¹

Prior to the maturity of the Subject Loan, the parties started renegotiating for its renewal. However, the parties could not agree on the amount of partial payment that Spouses Castañeda should pay on the principal amount;¹² thus, the Subject Loan became due on September 10, 2000. On September 20, 2000, Spouses Castañeda delivered to PDB a Bank of Commerce (BC) check¹³ worth PHP 2.6 million in payment of the Subject Loan.

Meanwhile, Central Surety's loan of PHP 6 million under PN 714-Y had become due on August 14, 2000. PDB sent Central Surety a demand letter

⁵ *Id.* at 161–179.

⁶ RTC records, pp. 173–174.

⁷ “Constancio T. Castaneda, Jr.,” “Constancio E. Castañeda” and “Constancio E. Castaneda” in some parts of the records.

⁸ RTC records, pp. 353 and 353-a.

⁹ *Id.* at 354 and 354-a.

¹⁰ *Id.* at 355 and 355-a.

¹¹ *See id.* at 355-a, PN 714-Y, Deed of Assignment of Wack-Wack Golf and Country Club Inc., Membership Certificate No. 217; *see id.* at 354-a, PN 376-X, Condominium Certificate of Title No. 8804, Makati City; *see id.* at 353-a, PN 235-Z, Real Estate Mortgage over Transfer of Certificate of Title No. 136244, Makati, Metro Manila.

¹² *Rollo*, p. 7, Petition dated November 11, 2008.

¹³ RTC records, p. 16.



for payment of the same. Thus, on September 20, 2000, Central Surety also sent to PDB a BC check worth PHP 6 million in full payment of its loan under PN 714-Y.

Initially, PDB refused to accept the check payment of Spouses Castañeda for their personal loan and returned the same to them. On September 29, 2000, Spouses Castañeda, through counsel, sent a letter¹⁴ to PDB, tendering the check with warning that PDB's continued refusal to accept the same would result in consignment of the check with the court.

In a letter¹⁵ dated October 13, 2000, PDB replied to Spouses Castañeda's counsel saying that it could not accept the check as full payment of the Subject Loan as it was insufficient and instead made an application of payments. The letter stated:

13 October 2000

ATTY. EPIFANIO E. CUA
2/F Universalre Condominium
106 Paseo de Roxas
Legaspi Village, Makati City

Dear Atty. Cua:

Thank you for your two (2) letters both dated 29 September 2000 on behalf of your clients with the enclosed check nos. 0008114 and 0008115 for the total of P8,600,000.00.

As previously relayed to your client, Premiere Bank cannot accept the two (2) checks as full settlement of the obligation under Account Nos. PN # 714-Y and PN # 717-X, as the amount is insufficient.

In accordance with the terms and conditions of the Promissory Notes executed by your clients in favor of Premiere Development Bank, we have applied the two (2) checks to the due obligations of your clients as follows:

1) Account No.: COM 235-Z	P1,044,939.45
2) Account No.: IND 717-X	P1,459,693.15
3) Account No.: COM 367-Z¹⁶	P4,476,200.18
4) Account No.: COM 714-Y	<u>P1,619,167.22</u>
TOTAL:	<u>P8,600,000.00</u>

....

We shall appreciate the settlement in full of the accounts of your client or necessary arrangements for settlement thereof be made as soon as possible to put the accounts on up to-date status.

¹⁴ *Id.* at 18.

¹⁵ *Id.* at 19-20.

¹⁶ *Id.* at 343 and 343-a., PN 367-Z. PN 376-X was availed of through a renewal of Central Surety's prior loan, then covered by PN 367-Z earlier executed on August 30, 1999.



Thank you.

Very truly yours,

[(sgd.)]

MS. ELSA M. SAPAPO

Manager

Loans Accounting and
Control Department¹⁷

(Emphasis in the original)

Thus, what PDB did was to add the check payments of Spouses Castañeda and Central Surety and applied the total amount of PHP 8.6 million to the 4 separate loans. The table below summarizes the debtors, loans, due dates, and the application of payment made by PDB:

Account	Account Holder/ Debtor	Due Date	Amount Applied
1) Account No. IND PN ¹⁸ 717-X (PHP 2.6 million)	Spouses Castañeda (Subject Loan)	September 10, 2000	PHP 1,459,693.15
2) Account No. COM PN ¹⁹ 235-Z (PHP 40 million)	Casent Realty	December 28, 2009	PHP 1,044,939.45
3) Account No. COM PN ²⁰ 376-X (PHP 40,898,000.00)	Central Surety	October 10, 2001	PHP 4,476,200.18
4) Account No. IND PN ²¹ 714-Y (PHP 6 million)	Central Surety	August 14, 2000	PHP 1,619,167.22
Total			PHP 8,600,000.00

Spouses Castañeda then filed a complaint²² for specific performance with damages before the RTC for the proper and correct application of the payment to the Subject Loan.

PDB justified the application of payment to the outstanding loans of the corporations on the ground that Engracio is the president and vice-president, respectively, of Casent Realty and Central Surety. PDB further alleged that Engracio had bound himself solidarily as co-borrower, mortgagor, and obligor of the corporations' loans.

¹⁷ *Id.* at 19–20.

¹⁸ Executed September 10, 1999.

¹⁹ Executed December 28, 1994.

²⁰ Executed October 10, 2000.

²¹ Executed August 20, 1999.

²² RTC records, pp. 30–35.



PDB relied on the following provision in the Subject Loan which was signed by both Spouses Castañeda:

In case, I/We have several obligations with the Bank, I/We hereby empower the Bank to apply without [notice] and in any manner it sees fit, any or all of my/our deposits and payments to any of my/our obligations whether due or not. Any such application of deposits or payments shall be conclusive and binding upon me/us.²³

PN 235-Z, PN 376-X, and PN 714-Y, which were the commercial loans taken by Casent Realty and Central Surety, also contain the same proviso. PN 235-Z was signed by Engracio in his capacity as president, while PN 376-X and PN 714-Y were signed by Engracio and his brother Constancio, in their capacity as officers of the corporations.

In this regard, the records reveal that Constancio and Spouses Castañeda had signed two similarly worded Continuing Guaranty/Comprehensive Surety Agreements²⁴ (Surety Agreement) for Casent Realty's loan of PHP 40 million covered by PN 235-Z, and for Central Surety's loan of PHP 40,898,000.00, covered by PN 376-X. The Surety Agreement provides:

Upon any fault, you may proceed directly against the undersigned on this guaranty without first proceeding against the principal debtor and without exhausting the property of the principal debtor.²⁵

Central Surety had also filed a separate complaint against PDB for damages and release of collateral with regard to the PHP 6 million check that it issued for its corporate loan under PN 714-Y. This separate case was eventually decided by the Court in *Premiere Dev't Bank v. Central Surety & Insurance Co., Inc.*²⁶ (*Central Surety*) where it was held that PDB was correct in applying the PHP 6 million check paid by Central Surety to its two loans under PN 714-Y and PN 376-X. As will be further explained, however, the Court did not make any pronouncement as to whether the application of payments made by PDB was also correct for the loans of Spouses Castañeda and of Casent Realty.

The Ruling of the RTC

On January 31, 2005, the RTC rendered Decision in favor of Spouses Castañeda and disposed as follows:

²³ *Id.* at 174.

²⁴ *Id.* at 333-336, 388-391.

²⁵ *Id.* at 335, 390.

²⁶ *Rollo*, pp. 325-357. Penned by Associate Justice Antonio Eduardo B. Nachura and concurred in by Chairperson and Associate Justice Consuelo Ynares-Santiago and Associate Justices Ma. Alicia Austria-Martinez, Minita V. Chico-Nazario and Teresita J. Leonardo-De Castro; *See also* 598 Phil. 827 (2009) [Per J. Nachura, Third Division].



WHEREFORE, premises considered, this court finds the complaint in favor of the plaintiffs against the defendant Bank. It hereby orders the defendant Bank to apply the Php 2.6 million check payment to the subject loan of plaintiffs in the sum of Php 2.6 million covered by Promissory Note No. 717-X; and it hereby further orders the defendant bank to release unto the plaintiffs the Manila Polo Club, Inc., Proprietary Membership Certificate No. 170, registered in the name of Constancio [T.] Castañeda.

Moreover, this court hereby orders the defendant Bank to reimburse plaintiffs the sum of Philippine Pesos: ONE HUNDRED TWENTY-EIGHT THOUSAND TWO HUNDRED EIGHTY AND TWO CENTAVOS (Php 128,280.02) and to pay plaintiffs the sum of Php 250,000.00 representing attorney's fee (sic) plus cost of suit.

SO ORDERED. ²⁷ (Emphasis in the original)

The RTC also held that the increase of the interest rate made by PDB from 16.30% to 26% was invalid as it was made at the sole discretion of PDB.

The Ruling of the CA

The CA affirmed the Decision of the RTC with modification only as to the amount of attorney's fees, which was reduced to PHP 50,000.00 in its Decision promulgated on June 25, 2008.

The CA held that the right to specify to which amount the various obligations to the same creditor is to be satisfied rests with the debtor, as provided under Article 1252 of the New Civil Code. The CA also held that for a valid application of payment under Article 1252, the debts must be of the same kind and must be owed by the same debtor. The CA noted that the Subject Loan in this case is owed by Spouses Castañeda in their personal capacity while the loans to which the payment were also applied are owed by the corporations. The CA ruled that the debts of the former are not the debts of the latter and reiterated the doctrine that a corporation has a separate and distinct personality from that of its officers and stockholders.²⁸

Undaunted, PDB filed an MR alleging that Spouses Castañeda had waived their right under Article 1252 to choose how to apply payment as they had stipulated in the Subject Loan that the right to choose application pertained to PDB.²⁹

In its Resolution of the MR, the CA held that notwithstanding the waiver by Spouses Castañeda of their right to specify which among their obligations are to be first satisfied, Spouses Castañeda's are not the debtors in

²⁷ *Id.* at 69.

²⁸ *Id.* at 50, CA Decision.

²⁹ *Id.* at 162-163.



the obligations of the corporations as the latter have juridical personalities separate and distinct from their officers and stockholders.³⁰

The Petition

PDB alleges that the CA committed reversible error in affirming the RTC Decision. It argues that the right to choose which debt to apply payment belongs to it because the case falls under the exception on application of payment provided for in Article 1252. Assuming arguendo that the check should be applied to the Subject Loan, the collateral, MPC Certificate No. 170, should not be released in view of the cross-default and cross-guarantee provisions in the deed of assignment with pledge and the REM covering Central Surety's loan.

Issues

PDB assigns the following errors to the CA:

I

WHETHER OR NOT THE HONORABLE [CA] COMMITTED REVERSIBLE AND PALPABLE ERROR WHEN IT FAILED TO CORRECTLY APPLY THE EXCEPTION PROVIDED FOR IN ARTICLE 1252 OF THE NEW CIVIL CODE ON APPLICATION OF PAYMENT IN THE PRESENT CASE

II

WHETHER OR NOT THE STIPULATION IN THE PROMISSORY NOTE EXECUTED BY THE RESPONDENTS IN FAVOR OF PETITIONER BANK IS AN EXCEPTION TO THE GENERAL RULE CONTEMPLATED BY ARTICLE 1252 OF THE NEW CIVIL CODE

III

EVEN ASSUMING EX GRATIA THAT THE SUBJECT P2.6 MILLION PAYMENT COULD BE APPLIED TO THE SUBJECT LOAN, STILL THE SUBJECT COLLATERAL COULD NOT BE RELEASED IN VIEW OF THE CROSS-DEFAULT AND CROSS-GUARANTEENEE PROVISIONS OF THE DEED OF ASSIGNMENT WITH PLEDGE AND THE [REM] CONTRACTS EXECUTED BETWEEN THE PARTIES³¹ (Emphasis and underscoring in the original)

In simple terms, the issue is whether or not a portion of the PHP 2.6 million check given by Spouses Castañeda as complete payment for their loan

³⁰ *Id.* at 56.

³¹ *Id.* at 14, Petition dated November 11, 2008.

under PN 717-X and its collateral pledge MPC Certificate No. 170, can be applied by PDB to the corporate loans of Casent Realty and Central Surety.

The Ruling of the Court

Article 1252 is not applicable when debtors are different persons; corporations have separate and distinct personalities from their officers/stockholders.

Article 1252 of the New Civil Code provides:

He who has various debts of the same kind in favor of one and the same creditor, may declare at the time of making the payment, to which of them the same must be applied. Unless the parties so stipulate, or when the application of payment is made by the party for whose benefit the term has been constituted, application shall not be made as to debts which are not yet due.

If the debtor accepts from the creditor a receipt in which an application of the payment is made, the former cannot complain of the same, unless there is a cause for invalidating the contract. (1172a)

However, the Court finds that Article 1252 does not apply in this case since the PNs executed in favor of PDB have different debtors.

In *Magdalena Estates, Inc. v. Rodriquez*,³² the Court held that the rules contained in Article 1252 of the Civil Code apply to a person owing several debts of the same kind to a single creditor.³³ In order for the provision to apply, there must be **a single debtor** with several debts due to a single creditor.³⁴

Here, PDB would want to treat Spouses Castañeda, Central Surety, and Casent Realty as one person as regards their separate loans. In fact, not only did PDB apply the PHP 2.6 million check payment of Spouses Castañeda to the corporate loans of Central Surety and Casent Realty; PDB co-mingled the payments for the PHP 2.6 million personal debt and PHP 6 million corporate debt and distributed the total PHP 8.6 million payment among the four separate debts. In effect, an aliquot portion of Central Surety's payment of PHP 6 million was also applied to Spouses Castañeda's personal loan of PHP 2.6 million. However, this cannot be done because the terms of the PNs clearly indicate whether the debts are personal to Spouses Castañeda or are owed by the corporations. In this regard, it should be added that, contrary to what PDB

³² 125 Phil. 151 (1966) [Per J. Regala, *En Banc*].

³³ *Id.* at 156.

³⁴ *Pepsi Cola Products Philippines, Inc. v. Premiere General Distributors, Inc.*, G.R. No. 233763, March 6, 2023 [Notice, First Division]



has asserted, the PNs do not show that Engracio had bound himself solidarily as co-borrower and obligor of the corporations' loans.

As correctly held by the CA, the obligations of the corporations Casent Realty and Central Surety are not the obligations of Spouses Castañeda. It is *indeed* a basic doctrine in corporation law that corporations have separate and distinct personality from their officers and stockholders. Thus, the payment made by Spouses Castañeda for their personal loan cannot be applied to the corporate loans of Central Surety and Casent Realty. This also applies in the reverse situation to the loan obligations of Central Surety and Casent Realty in that the payment of their corporate loans cannot be applied to the personal debts of Spouses Castañeda.

Simply put, there could be no valid application of payment in this case as Casent Realty and Central Surety have separate and distinct personalities from Engracio and the Spouses Castañeda; hence, each cannot be held liable for the other's obligations.

As previously held in the case of *Francisco v. Mallen, Jr.*,³⁵ citing *Santos v. NLRC*.³⁶

“A corporation is a juridical entity with legal personality separate and distinct from those acting for and in its behalf and, in general, from the people comprising it. The rule is that obligations incurred by the corporation, acting through its directors, officers and employees, are its sole liabilities.”³⁷

It is settled that a corporation is clothed with a personality separate and distinct from that of the persons composing it. It may not generally be held liable for the personal indebtedness of its stockholders or those of the entities connected with it. Conversely, an officer or stockholder cannot be made to answer for corporate obligations even if he or she should be its president.³⁸

Furthermore, even if the Court were to understand PDB's position as an attempt to pierce the veil of corporate fiction, this position is still unwarranted.

For reasons of public policy and in the interest of justice, the corporate veil will justifiably be impaired only when it was used as a shield for fraud, illegality or inequity committed against third persons.³⁹ Here, there was no showing of any fraud or illegality of any kind. There was no inequity as PDB could have simply applied the PHP 6 million to the corporate loans of Central

³⁵ 645 Phil. 369 (2010) [Per J. Carpio, Second Division].

³⁶ 325 Phil. 145 (1996) [Per J. Vitug, First Division].

³⁷ *Francisco v. Mallen, Jr.*, *supra* note 35, at 374, citing *Santos v. NLRC*, *id* at 156.

³⁸ *Laperal Development Corp. v. Court of Appeals*, 295 Phil. 298, 303 (1993) [Per J. Cruz, First Division].

³⁹ *PNB v. Hydro Resources Contractors Corp.*, 706 Phil. 297, 308-309 (2013) [Per J. Leonardo-De Castro, First Division].

Surety and accepted the PHP 2.6 million of Spouses Castañeda as full payment for their separate personal loan.

On the other hand, with respect to the waiver executed by Spouses Castañeda in the Subject Loan, the Court finds that PDB's invocation of the same to be misplaced.

At the outset, the Court clarifies that the exception in Article 1252 of the New Civil Code, specifically, the phrase, "[u]nless the parties so stipulate," refers to the application of payments to debts which are not yet due. It does not refer to the debtor's right to specify to which debt should his or her payment be applied, which PDB herein invokes to justify its application of the stipulation on the promissory note.

Nonetheless, the Court recognizes the right of the parties to contract and to agree to stipulations in relation to the application of payment. Thus, contrary to PDB's allegations, the waiver is not rendered inutile and a useless decorative provision on the promissory note as it is considered a contract between the parties.

At any rate, the waiver cannot be applied to the Subject Loan. To recall, the waiver provision states:

In case, I/We have several obligations with the Bank, I/We hereby empower the Bank to apply without [notice] and in any manner it sees fit, any or all of my/our deposits and payments to any of my/our obligations whether due or not. Any such application of deposits or payments shall be conclusive and binding upon me/us.⁴⁰ (Emphasis supplied)

Clearly, the obligations being referred to in said proviso refers to the obligations of the borrower and of no one else. It refers to **several obligations of the same borrower**. As such, payments can be validly applied only to obligations of the same debtor but not to obligations of other persons or entities. Consequently, the waiver does not apply to obligations that properly are for the account of the corporations and not for Spouses Castañeda. Stated simply, this provision only authorizes application of payment if Spouses Castañeda had other outstanding obligations with PDB obtained in their personal capacity.

Even assuming that it may validly invoke the provisions of the waiver, PDB is mandated to exercise its rights under the same in good faith.

Even assuming arguendo that the waiver executed by Spouses Castañeda is applicable to the corporate loans or to any other obligation of

⁴⁰ RTC records, p. 174.



either Engracio or Lourdes with PDB in whatever capacity, PDB is still bound to act in good faith in applying the payments of Spouses Castañeda.

Article 1159 of the New Civil Code provides that: “[o]bligations arising from contracts have the force of law between the contracting parties and should be complied with in good faith.” Article 1315 of the New Civil Code is likewise clear:

Contracts are perfected by mere consent, and from that moment the parties are bound not only to the fulfillment of what has been expressly stipulated but also to all the consequences which, according to their nature, may be in keeping with good faith, usage and law. (1258)

Thus, the application of the provisions of the waiver, as mandated by these articles, should be in keeping with not only the law, but also good faith. PDB should not apply the waiver in a way that would prejudice the rights of Spouses Castañeda; otherwise, the exercise of PDB’s right under the waiver would be tantamount to bad faith.

Corollary thereto, while PDB may exercise its right to apply payment to the other obligations of Spouses Castañeda, the same must be done in good faith and only if it would not disadvantage Spouses Castañeda, especially if the debtor has multiple loans with the bank and not all of these loans are due and demandable as of the time of payment.

To illustrate, at the time of Spouses Castañeda’s payment on September 20, 2000, Central Surety’s loan of PHP 40,898,000.00, covered by PN 376-X was not yet due for another year or until October 10, 2001. Casent Realty’s loan of PHP 40 million covered by PN 235-Z was not due until December 28, 2009 or a total of nine years. On the other hand, the personal loan of PHP 2.6 million, covered by the Subject Loan, was already due and demandable.

“Keeping in good faith” therefore required PDB to apply the payment of Spouses Castañeda to the Subject Loan to result in its full satisfaction, instead of distributing it to other loans that are not yet due and demandable. “Keeping in good faith” would also be PDB applying the payment of Spouses Castañeda to the Subject Loan to result in its full satisfaction and applying any excess of the payment to their other obligations.

And the contrary—that is, insisting on applying the payment to loans that are not yet due and demandable, while allowing the Subject Loan to remain delinquent and continue to accumulate interest and other charges, even if the payment is sufficient to fully satisfy the latter—is NOT “keeping in good faith.”

To rule otherwise would create the absurd and unfair situation where Spouses Castañeda’s PHP 2.6 million loan would remain delinquent until all the debts of the Central Surety and Casent Realty would be fully paid. In effect, the personal loan of Spouses Castañeda would be held hostage until



such time that the corporate loans of Central Surety and Casent Realty would be extinguished as PDB would have full discretion to apply Spouses Castañeda's loan payments to the corporate loans rather than to their personal loan. Interest payments and charges for the PHP 2.6 million personal loan would continue to accumulate, to the disadvantage and prejudice of Spouses Castañeda. Effectively, the period of Spouses Castañeda's loan, which was already due and payable on September 10, 2000, would be extended until the extinguishment of Casent Realty's loan, which had the longest period. The Court cannot countenance such an inequitable situation.

The Surety Agreement did not make Spouses Castañeda principal co-debtors in the corporate debts.

As earlier stated, the records reveal that Spouses Castañeda had executed a Surety Agreement for Central Surety's loan of PHP 40,898,000.00 loan under PN 376-X. However, PDB cannot justify its application of payment thereon because Central Surety's loan under PN 376-X was not yet due at the time the PHP 2.6 million BC check payment was made on September 20, 2000. The due date of PN 376-X was on October 10, 2001. Thus, the direct and solidary obligation of Spouses Castañeda as sureties of Central Surety had not yet been triggered at the time they tendered the PHP 2.6 million BC check. The same is true for the loan of Casent Realty under PN 235-Z as its due date was on December 28, 2009.

Neither can the Surety Agreement be used to justify the application of payment of Spouses Castañeda's PHP 2.6 million BC check payment to the separate loan of PHP 6 million, covered by PN 714-Y, which had become due on August 14, 2000. This is so because the Surety Agreement contains a proviso which caps the sureties' liability to an amount that "shall not exceed at any one time[,] the aggregate principal sum of FORTY MILLION EIGHT HUNDRED NINETY[-]EIGHT THOUSAND PESOS (P40,898,000.00)."⁴¹ This indicates a clear intent of the parties to specifically limit the liability of Spouses Castañeda, as sureties, to up to PHP 40,898,000.00 only; meaning, they could no longer be considered as sureties to the PHP 6 million peso loan covered by PN 714-Y so long as the PHP 40,898,000.00 debt remained pending and unpaid. Indeed, it is settled that the application of a surety agreement cannot be extended by implication beyond its specified limits.⁴²

Article 2047 of the New Civil Code provides:

By guaranty a person, called the guarantor, binds himself to the creditor to fulfill the obligation of the principal debtor in case the latter should fail to do so.

⁴¹ *Id.* at 388, Continuing Guaranty/Comprehensive Surety Agreement. (Emphasis supplied)

⁴² *Diño v. Court of Appeals*, 290 Phil. 405, 420 (1992) [Per J. Davide, Jr., Third Division].

If a person binds himself solidarily with the principal debtor, the provisions of Section 4, Chapter 3, Title I of this Book shall be observed. In such case the contract is called a suretyship. (1822a) (Emphasis supplied)

In *Philippine Charter Insurance Corp. v. Central Colleges of the Philippines*,⁴³ the Court explained the nature of a surety obligation:

x x x. The surety's obligation is not an original and direct one for the performance of his own act, but merely accessory or collateral to the obligation contracted by the principal. Nevertheless, although the contract of a surety is in essence secondary only to a valid principal obligation, his liability to the creditor or promisee of the principal is said to be **direct, primary and absolute**; in other words, he is directly and equally bound with the principal.

Suretyship, in essence, contains two types of relationship — the principal relationship between the obligee and the obligor, and the accessory surety relationship between the principal and the surety. In this arrangement, the obligee accepts the surety's solidary undertaking to pay if the obligor does not pay. **Such acceptance, however, does not change in any material way the obligee's relationship with the principal obligor. Neither does it make the surety an active party to the principal obligee-obligor relationship. Thus, the acceptance does not give the surety the right to intervene in the principal contract. The surety's role arises only upon the obligor's default, at which time, it can be directly held liable by the obligee for payment as a solidary obligor.**⁴⁴ (Emphasis in the original; citations omitted)

Thus, in a contract of suretyship, the creditor may proceed directly against the surety when the debt becomes due because the surety binds himself or herself solidarily with the principal debtor. The surety is considered in law as the same party as the principal debtor in relation to the debt and the surety's liability is limited up to the amount which was specified in the loan or surety agreement. Moreover, to emphasize, the surety's liability arises **only upon the obligor's default**.⁴⁵

The surety and the principal do not become one and the same person to the extent that the surety's payments for his or her separate personal obligations may be applied directly to the loans for which he or she is a mere surety.

As applied in this case, PDB cannot apply Spouses Castañeda's payment of their personal loan to Central Surety's corporate loans despite the former being sureties of the latter. Spouses Castañeda and Central Surety are separate and distinct persons; their relationship as surety and principal does not negate this fact.

⁴³ 682 Phil. 507 (2012) [Per J. Mendoza, Third Division].

⁴⁴ *Id.* at 523.

⁴⁵ *Id.*



The Subject Loan is a personal loan of Spouses Castañeda and is thus more onerous to them.

Over and above the foregoing, even assuming arguendo that Spouses Castañeda could be held liable for the corporate loans, the BC check payment of PHP 2.6 million should have still been applied exclusively to their personal loan as it was more onerous to them as principal debtors.

Article 1254 of the New Civil Code provides:

When the payment cannot be applied in accordance with the preceding rules, or if application cannot be inferred from other circumstances, the debt which is most onerous to the debtor, among those due, shall be deemed to have been satisfied.

If the debts are of the same nature and burden, the payment shall be applied to all of them proportionately. (1174a)

In *Commonwealth of the Phil. v. Far Eastern Surety*⁴⁶ (*Commonwealth*), the Court, interpreted Article 1174 of the Old Civil Code, the precursor of Article 1254.

Article 1174 provided:

“When the payment cannot be applied in accordance with the preceding rules, that which, among the matured debts, is the most burdensome to the debtor shall be deemed paid.

“If such debts should be equally burdensome, the payment shall be applied to all of them *pro rata*.”⁴⁷ (Emphasis in the original, citation omitted)

In interpreting the above provision, the Court held in *Commonwealth*:

Manresa, commenting on article 1174, says that *when a person has two debts, one as sole debtor and another as solidary co-debtor his more onerous obligation to which first payments are to be applied is the debt as sole debtor*. (Cod. Civil, Vol. VIII, 4th Ed., p. 290). That view is exactly what this Court followed in *Hongkong and [Shanghai] Banking Corporation vs. Aldanese* (48 Phil., 990) on which the trial judge relied correctly. No difference is perceivable between this litigation and the *Aldanese* case. In both the problem of application of payments is involved.

This Court has held:

“Where in a bond the debtor and surety have bound themselves solidarily, but limiting the liability of the surety to a lesser amount than that due from the principal debtor, any such payment as the latter may have made on account of

⁴⁶ 83 Phil. 305 (1949) [Per J. Bengzon, First Division].

⁴⁷ *Id.* at 307.

such obligation must be applied first to the unsecured portion of the debt, for, as regards the principal debtor, the obligation is more onerous as to the amount not secured.” (Hongkong & Shanghai Banking Corporation vs. Aldanese, 48 Phil., 990.)

No valid reason has been demonstrated to justify [departure] from the above ruling.⁴⁸ (Emphasis supplied)

Thus, considering that the Subject Loan is a personal loan of Spouses Castañeda, the same is considered as more onerous to them and the payment should have been applied exclusively to the Subject Loan to settle the same in full.

The cross-guarantee and cross-default provisions do not apply; MPC pledge invalid.

PDB argues that the pledge of MPC Certificate No. 170 should not be released due to the “cross-guarantee or cross-default provisions.”⁴⁹

However, the provisions invoked by PDB are found in the Deed of Assignment with Pledge of the Certificate of Membership in Wack-Wack Golf and Country Club, Inc., as quoted by PDB in its Petition⁵⁰ and the REM⁵¹ executed by Central Surety and Casent Realty for their corporate loans, and **NOT** in the Deed of Assignment⁵² of the MPC Certificate No. 170 which is the subject of this case.

Furthermore, as correctly found by the RTC, MPC Certificate No. 170 is registered under the name of Constancio and not Engracio. This therefore makes the pledge invalid because, under Article 2085(2) of the New Civil Code, it is essential that the pledgor be the absolute owner of the thing pledged. While there was a mention in the Deed of Assignment that Constancio had assigned the MPC Certificate No. 170 to Engracio, this document was not presented and offered during trial. Thus, there is no need to speak of the pledge as it was never valid in the first place for lacking an essential element.

PDB’s argument that it might suffer deficiency if any form of settlement or payment is not equally or proportionally applied to the loans of Spouses Castañeda, Casent Realty, and Central Surety as PDB “globally treated” these as interrelated loans⁵³ is of no moment. To the Court, the unsound banking practice lies in PDB’s admission that all the loan accounts of Spouses Castañeda, Casent Realty, and Central Surety, despite having been

⁴⁸ *Id.* at 307–308.

⁴⁹ *Rollo*, p. 27, Petition dated November 11, 2008.

⁵⁰ *Id.* at 28–29.

⁵¹ *Id.* at 241–244, Dated January 15, 1998.

⁵² RTC records, p. 9–10.

⁵³ *Rollo*, p. 27, Petition dated November 11, 2008.



acquired by different persons, were given “one and indivisible credit worthiness evaluation”⁵⁴ by PDB, and that it “never individually or separately evaluated the credit worthiness of each of the respondents, Casent Realty and Central Surety.”⁵⁵ PDB cannot now insist on its position to remedy its predicament, whether real or perceived.

The oppressiveness of the application of payment made by PDB becomes more apparent when the cross-default provision is misapplied in the instance where the payment to fully satisfy a due and demandable obligation is spread out to other obligations which are not yet due, the consequence of which will make all the obligations then becoming due and demandable because a default now exists in the unpaid due and demandable obligation. This misapplication cannot be tolerated by the Court to the detriment of the borrower who in good faith is simply complying with the borrower’s obligation to pay a due and demandable obligation to prevent default and its dire consequences.

The Court’s ruling in Central Surety

In its Reply⁵⁶ to the Comment⁵⁷ of Spouses Castañeda, PDB cites the Decision of the Court in *Central Surety*⁵⁸ PDB posits that as *Central Surety* was decided in its favor, this subject case should also be similarly resolved in PDB’s favor. PDB’s position is misguided.

In *Central Surety*, the issue was the application of payment made by PDB to the loan obligations of said corporation. As shown in the table above, Central Surety also had loans with PDB worth PHP 6 million and PHP 40,898,000.00 which were covered by PN 714-Y and PN 376-X, respectively. Central Surety issued a check dated September 22, 2000 in the amount of PHP 6 million and payable to PDB for its debt under PN 714-Y. Central Surety wanted to have the payment applied exclusively to the PHP 6 million debt under PN 714-Y. PDB did not do this and instead added the PHP 6 million to the PHP 2.6 million (paid by Spouses Castañeda) and then applied the total amount of PHP 8.6 million as payment for PN 714-Y, PN 235-Z, PN 376-X, and PN 717-X.

The Court held that the application of payment of Central Surety’s check worth PHP 6 million was valid insofar as the application of payment to the loans of Central Surety covered by PN 376-X and PN 714-Y are concerned, for the reason that said PNs provided that the right to apply payment pertains to the creditor.

⁵⁴ *Id.*

⁵⁵ *Id.* at 28.

⁵⁶ *Id.* at 310–323.

⁵⁷ *Id.* at 267–292.

⁵⁸ *Supra* note 26.



The Court also upheld PDB's right to withhold release of the pledge over the Certificate of Membership in Wack-Wack Golf and Country Club, Inc., as the Deed of Assignment with Pledge over the same provided that it secured not just the particular loan obligation but also the other outstanding loans of Central Surety.

Indeed, the Court's ruling in the Central Surety case is consistent with the ruling here in this case—that application of payments made by the creditor is valid if agreed upon by the parties and applied to loans **of the same debtor**. The ruling in the Central Surety case did not declare that the application of payments to the personal loan of Spouses Castañeda and to Casent Realty was valid. The Decision confined itself only to the debt of Central Surety. To be sure, even the Decision itself contained the following pronouncement:

At the outset, we qualify that this case deals only with the extinguishment of Central Surety's P6,000,000.00 loan secured by the Wack Wack Membership pledge. We do not dispose herein the matter of the P2,600,000.00 loan [of Spouses Castañeda] covered by PN No. 717-X subject of BC Check No. 08115.⁵⁹

Damages and attorney's fees

The RTC and CA did not award moral and exemplary damages to Spouses Castañeda and only awarded them attorney's fees. The RTC held that there was no fraud or gross negligence on the part of PDB but only simple negligence.⁶⁰ The CA also ruled that there was no bad faith or malice in the act of PDB as it could be considered an honest mistake in the interpretation of the provision in the promissory note.⁶¹ On this score, the Court deviates from the findings of the RTC and CA.

Under Article 2220⁶² of the New Civil Code, moral damages may be recovered in breaches of contract where a party acted in bad faith. The Court views PDB's continued insistence on its egregiously wrong position to be a clear act of bad faith that has compelled Spouses Castañeda to unnecessarily undergo the travails of trial and the time-consuming appeal process that, to date, totals already 23 very long years.

The legal doctrine that a corporation is a juridical entity clothed with a separate and distinct personality from its directors and stockholders is so basic that the position taken by PDB cannot be considered an honest mistake on a difficult provision of law. Corollary to this, the Subject Loan clearly indicates that it is a personal loan of Spouses Castañeda. To make matters worse, PDB's assertion that Engracio had bound himself solidarily as a co-borrower with PDB has absolutely no basis whatsoever.

⁵⁹ *Id.* at 842.

⁶⁰ *Rollo*, p. 68, RTC Decision.

⁶¹ *Id.* at 52, CA Decision.

⁶² **ART. 2220.** Willful injury to property may be a legal ground for awarding moral damages if the court should find that, under the circumstances, such damages are justly due. The same rule applies to breaches of contract where the defendant acted fraudulently or in bad faith.



The General Banking Law of 2000 provides that the State recognizes the fiduciary nature of banking that requires high standards of integrity and performance.⁶³ This duty exists not only with regard to deposits but also as to other business dealings and services of the bank. PDB not only failed to exercise the highest degree of diligence in the instant case, it has, in fact, by its intransigence in maintaining a fundamentally wrong position, forced Spouses Castañeda to incur the more burdensome obligation of having to litigate for 23 years. In its unreasonable refusal to apply the PHP 2.6 million BC check as full payment to the Subject Loan, PDB's bad faith scheme is made manifest. **The bad faith of PDB becomes more manifest and oppressive when one considers that the corporate loans of Central Surety⁶⁴ and Casent Realty⁶⁵ were sufficiently secured by separate real estate mortgages and pledges.** Creditors cannot be allowed to unreasonably refuse payment, to the prejudice of debtors who run the risk of incurring higher interest fees and other charges.

In unjustly refusing to accept the PHP 2.6 million BC check as full payment of the Subject Loan and applying portions thereof to the loan obligations of the corporations, PDB clearly caused damage and prejudice to Spouses Castañeda. Engracio's testimony that due to the non-extinguishment of their loan obligation despite full payment, he and Lourdes had suffered sleepless nights, wounded feelings, mental anguish, and serious anxiety⁶⁶ resonates resoundingly. Thus, the Court believes that they should be awarded moral damages in the amount of PHP 2,000,000.00.

The law allows the grant of exemplary damages by way of example or correction for the public good.⁶⁷ In contracts and quasi-contracts, the court may award exemplary damages if the defendant acted in a wanton, fraudulent, reckless, oppressive, or malevolent manner.⁶⁸

The highest degree of diligence is required of banks in dealing with its clients, considering that the banking business is imbued with public interest.⁶⁹ As stated earlier, PDB did not act merely with negligence but with evident bad faith. This justifies the award of exemplary damages of PHP 2,000,000.00. This should deter banks from committing similar dubious practices.

The RTC awarded attorney's fees to Spouses Castañeda of PHP 250,000.00 because they were compelled to litigate and incur expenses to

⁶³ Republic Act No. 8791 (2000), sec. 2.

⁶⁴ See RTC records, p. 355-a, PN 714-Y, Deed of Assignment of Wack-Wack Golf and Country Club, Inc., Membership Certificate No. 217; see RTC records, p. 354-a, PN 376-X, Condominium Certificate of Title No. 8804, Makati City.

⁶⁵ See *id.* at 353-a, PN 235-Z, Real Estate Mortgage over Transfer Certificate of Title No. 136244, Makati, Metro Manila.

⁶⁶ *Id.* at 198, Affidavit of Engracio dated October 2003.

⁶⁷ NEW CIVIL CODE, art. 2229.

⁶⁸ NEW CIVIL CODE, art. 2232.

⁶⁹ *Philippine Savings Bank v. Chowking Food Corp.*, 579 Phil. 589, 596-597 (2008) [Per J. Reyes, R.T., Third Division].



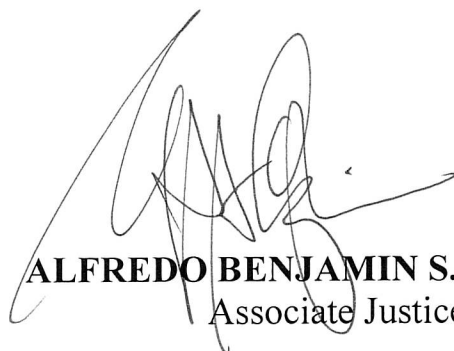
protect their interest. The CA affirmed the award of attorney's fees but reduced the amount to PHP 50,000.00 only.

Under Article 2208 of the New Civil Code, attorney's fees may be awarded when exemplary damages are awarded and when the defendant acted in gross and evident bad faith in refusing to satisfy the plaintiff's plainly valid, just, and demandable claim. Accordingly, the Court sustains the award of attorney's fees awarded by the CA.

In sum, the CA did not commit any reversible error in affirming the RTC's ruling which ordered PDB to fully apply the BC check worth PHP 2.6 million paid by Spouses Castañeda to their loan under PN 717-X and to release the MPC Certificate No. 170, registered in the name of Constancio. No further interests, charges, or fees can thus be imposed upon Spouses Castañeda.

ACCORDINGLY, in view of the foregoing, the Petition is **DENIED** for lack of merit. The Court of Appeals Decision dated June 25, 2008 and Resolution dated October 20, 2008 in CA-G.R. CV No. 84578 are **AFFIRMED** with **MODIFICATION** in that the Court further **ORDERS** petitioner Premiere Development Bank to pay respondents Spouses Engracio T. Castañeda and Lourdes E. Castañeda moral damages in the amount of PHP 2,000,000.00 and exemplary damages in the amount of PHP 2,000,000.00. The Court of Appeals' award of attorney's fees in the amount of PHP 50,000.00 is affirmed.

SO ORDERED.

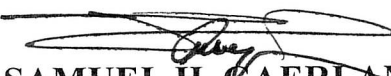


ALFREDO BENJAMIN S. CAGUIOA
Associate Justice

WE CONCUR:



HENRI JEAN PAUL B. INTING
Associate Justice



SAMUEL H. GAERLAN
Associate Justice



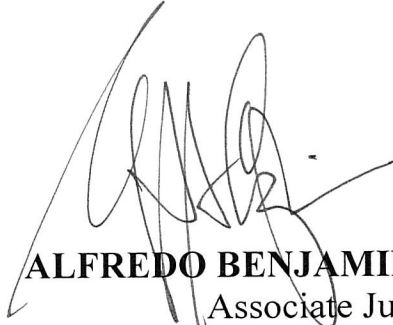
JAPAR B. DIMAAMPAO
Associate Justice



MARIA FILOMENA D. SINGH
Associate Justice

ATTESTATION

I attest that the conclusions in the above Decision had been reached in consultation before the case was assigned to the writer of the opinion of the Court's division.



ALFREDO BENJAMIN S. CAGUIOA
Associate Justice
Chairperson, Third Division

CERTIFICATION

Pursuant to Article VIII, Section 13, of the Constitution and the Division Chairperson's Attestation, I certify that the conclusions in the above Decision had been reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.


ALEXANDER G. GESMUNDO
Chief Justice

