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FIRST DIVISION

[G.R. NO. 161135, April 08, 2005]

SWAGMAN HOTELS AND TRAVEL, INC., PETITIONER, VS. HON. COURT OF APPEALS, AND NEAL B. CHRISTIAN, RESPONDENTS.

DECISION

DAVIDE, JR., C.J.:

May a complaint that lacks a cause of action at the time it was filed be cured by the accrual of a cause of action during the pendency of the case? This is the basic issue raised in this petition for the Court's consideration.

Sometime in 1996 and 1997, petitioner Swagman Hotels and Travel, Inc., through Atty. Leonor L. Infante and Rodney David Hegerty, its president and vice-president, respectively, obtained from private respondent Neal B. Christian loans evidenced by three promissory notes dated 7 August 1996, 14 March 1997, and 14 July 1997. Each of the promissory notes is in the amount of US$50,000 payable after three years from its date with an interest of 15% per annum payable every three months.[1] In a letter dated 16 December 1998, Christian informed the petitioner corporation that he was terminating the loans and demanded from the latter payment in the total amount of US$150,000 plus unpaid interests in the total amount of US$13,500.[2]

On 2 February 1999, private respondent Christian filed with the Regional Trial Court of Baguio City, Branch 59, a complaint for a sum of money and damages against the petitioner corporation, Hegerty, and Atty. Infante. The complaint alleged as follows: On 7 August 1996, 14 March 1997, and 14 July 1997, the petitioner, as well as its president and vice-president obtained loans from him in the total amount of US$150,000 payable after three years, with an interest of 15% per annum payable quarterly or every three months. For a while, they paid an interest of 15% per annum every three months in accordance with the three promissory notes. However, starting January 1998 until December 1998, they paid him only an interest of 6% per annum, instead of 15% per annum, in violation of the terms of the three promissory notes. Thus, Christian prayed that the trial court order them to pay him jointly and solidarily the amount of US$150,000 representing the total amount of the loans; US$13,500 representing unpaid interests from January 1998 until December 1998; P100,000 for moral damages; P50,000 for attorney's fees; and the cost of the suit.[3]

The petitioner corporation, together with its president and vice-president, filed an Answer raising as defenses lack of cause of action and novation of the principal obligations. According to them, Christian had no cause of action because the three promissory notes were not yet due and demandable. In December 1997, since the petitioner corporation was experiencing huge losses due to the Asian financial crisis, Christian agreed (a) to waive the interest of 15% per annum, and (b) accept

payments of the principal loans in installment basis, the amount and period of which would depend on the state of business of the petitioner corporation. Thus, the petitioner paid Christian capital repayment in the amount of US$750 per month from January 1998 until the time the complaint was filed in February 1999. The petitioner and its co-defendants then prayed that the complaint be dismissed and that Christian be ordered to pay P1 million as moral damages; P500,000 as exemplary damages; and P100,000 as attorney's fees.[4]

In due course and after hearing, the trial court rendered a decision[5] on 5 May 2000 declaring the first two promissory notes dated 7 August 1996 and 14 March 1997 as already due and demandable and that the interest on the loans had been reduced by the parties from 15% to 6% per annum. It then ordered the petitioner corporation to pay Christian the amount of $100,000 representing the principal obligation covered by the promissory notes dated 7 August 1996 and 14 March 1997, "plus interest of 6% per month thereon until fully paid, with all interest payments already paid by the defendant to the plaintiff to be deducted therefrom."

The trial court ratiocinated in this wise:

> (1) There was no novation of defendant's obligation to the plaintiff. Under Article 1292 of the Civil Code, there is an implied novation only if the old and the new obligation be on every point incompatible with one another.
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> The test of incompatibility between the two obligations or contracts, according to an imminent author, is whether they can stand together, each one having an independent existence. If they cannot, they are incompatible, and the subsequent obligation novates the first (Tolentino, Civil Code of the Philippines, Vol. IV, 1991 ed., p. 384). Otherwise, the old obligation will continue to subsist subject to the modifications agreed upon by the parties. Thus, it has been written that accidental modifications in an existing obligation do not extinguish it by novation. Mere modifications of the debt agreed upon between the parties do not constitute novation. When the changes refer to secondary agreement and not to the object or principal conditions of the contract, there is no novation; such changes will produce modifications of incidental facts, but will not extinguish the original obligation. Thus, the acceptance of partial payments or a partial remission does not involve novation (*id*., p. 387). Neither does the reduction of the amount of an obligation amount to a novation because it only means a partial remission or condonation of the same debt.
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> In the instant case, the Court is of the view that the parties merely intended to change the rate of interest from 15% per annum to 6% per annum when the defendant started paying $750 per month which payments were all accepted by the plaintiff from January 1998 onward. The payment of the principal obligation, however, remains unaffected which means that the defendant should still pay the plaintiff $50,000 on August 9, 1999, March 14, 2000 and July 14, 2000.
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> (2) When the instant case was filed on February 2, 1999, none of the promissory notes was due and demandable. As of this date however, the first and the second promissory notes have already matured. Hence,

payment is already due.

Under Section 5 of Rule 10 of the 1997 Rules of Civil Procedure, a complaint which states no cause of action may be cured by evidence presented without objection. Thus, even if the plaintiff had no cause of action at the time he filed the instant complaint, as defendants' obligation are not yet due and demandable then, he may nevertheless recover on the first two promissory notes in view of the introduction of evidence showing that the obligations covered by the two promissory notes are now due and demandable.

(3) Individual defendants Rodney Hegerty and Atty. Leonor L. Infante can not be held personally liable for the obligations contracted by the defendant corporation it being clear that they merely acted in representation of the defendant corporation in their capacity as General Manager and President, respectively, when they signed the promissory notes as evidenced by Board Resolution No. 1(94) passed by the Board of Directors of the defendant corporation (Exhibit "4").[6]

In its decision[7] of 5 September 2003, the Court of Appeals denied petitioner's appeal and affirmed *in toto* the decision of the trial court, holding as follows:

In the case at bench, there is no incompatibility because the changes referred to by appellant Swagman consist only in the manner of payment. . . .

Appellant Swagman's interpretation that the three (3) promissory notes have been novated by reason of appellee Christian's acceptance of the monthly payments of US$750.00 as capital repayments continuously even after the filing of the instant case is a little bit strained considering the stiff requirements of the law on novation that the intention to novate must appear by express agreement of the parties, or by their acts that are too clear and unequivocal to be mistaken. Under the circumstances, the more reasonable interpretation of the act of the appellee Christian in receiving the monthly payments of US$750.00 is that appellee Christian merely allowed appellant Swagman to pay whatever amount the latter is capable of. This interpretation is supported by the letter of demand dated December 16, 1998 wherein appellee Christian demanded from appellant Swagman to return the principal loan in the amount of US$150,000 plus unpaid interest in the amount of US$13,500.00. . .

Appellant Swagman, likewise, contends that, at the time of the filing of the complaint, appellee Christian ha[d] no cause of action because none of the promissory notes was due and demandable.

Again, We are not persuaded.

. . .

In the case at bench, while it is true that appellant Swagman raised in its Answer the issue of prematurity in the filing of the complaint, appellant Swagman nonetheless failed to object to appellee Christian's presentation of evidence to the effect that the promissory notes have become due and

demandable.

> The afore-quoted rule allows a complaint which states no cause of action to be cured either by evidence presented without objection or, in the event of an objection sustained by the court, by an amendment of the complaint with leave of court (Herrera, Remedial Law, Vol. VII, 1997 ed., p. 108).[8]

Its motion for reconsideration having been denied by the Court of Appeals in its Resolution of 4 December 2003,[9] the petitioner came to this Court raising the following issues:

> I. WHERE THE DECISION OF THE TRIAL COURT DROPPING TWO DEFENDANTS HAS BECOME FINAL AND EXECUTORY, MAY THE RESPONDENT COURT OF APPEALS STILL STUBBORNLY CONSIDER THEM AS APPELLANTS WHEN THEY DID NOT APPEAL?
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> II. WHERE THERE IS NO CAUSE OF ACTION, IS THE DECISION OF THE LOWER COURT VALID?
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> III. MAY THE RESPONDENT COURT OF APPEALS VALIDLY AFFIRM A DECISION OF THE LOWER COURT WHICH IS INVALID DUE TO LACK OF CAUSE OF ACTION?
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> IV. WHERE THERE IS A VALID NOVATION, MAY THE ORIGINAL TERMS OF CONTRACT WHICH HAS BEEN NOVATED STILL PREVAIL?[10]

The petitioner harps on the absence of a cause of action at the time the private respondent's complaint was filed with the trial court. In connection with this, the petitioner raises the issue of novation by arguing that its obligations under the three promissory notes were novated by the renegotiation that happened in December 1997 wherein the private respondent agreed to waive the interest in each of the three promissory notes and to accept US$750 per month as installment payment for the principal loans in the total amount of US$150,000. Lastly, the petitioner questions the act of the Court of Appeals in considering Hegerty and Infante as appellants when they no longer appealed because the trial court had already absolved them of the liability of the petitioner corporation.

On the other hand, the private respondent asserts that this petition is "a mere ploy to continue delaying the payment of a just obligation." Anent the fact that Hegerty and Atty. Infante were considered by the Court of Appeals as appellants, the private respondent finds it immaterial because they are not affected by the assailed decision anyway.

Cause of action, as defined in Section 2, Rule 2 of the 1997 Rules of Civil Procedure, is the act or omission by which a party violates the right of another. Its essential elements are as follows:

> 1. A right in favor of the plaintiff by whatever means and under whatever law it arises or is created;

2. An obligation on the part of the named defendant to respect or not to violate such right; and

3. Act or omission on the part of such defendant in violation of the right of the plaintiff or constituting a breach of the obligation of the defendant to the plaintiff for which the latter may maintain an action for recovery of damages or other appropriate relief.[11]

It is, thus, only upon the occurrence of the last element that a cause of action arises, giving the plaintiff the right to maintain an action in court for recovery of damages or other appropriate relief.

It is undisputed that the three promissory notes were for the amount of P50,000 each and uniformly provided for (1) a term of three years; (2) an interest of 15 % per annum, payable quarterly; and (3) the repayment of the principal loans after three years from their respective dates. However, both the Court of Appeals and the trial court found that a renegotiation of the three promissory notes indeed happened in December 1997 between the private respondent and the petitioner resulting in the reduction -- not waiver -- of the interest from 15% to 6% per annum, which from then on was payable monthly, instead of quarterly. The term of the principal loans remained unchanged in that they were still due three years from the respective dates of the promissory notes. Thus, at the time the complaint was filed with the trial court on 2 February 1999, none of the three promissory notes was due yet; although, two of the promissory notes with the due dates of 7 August 1999 and 14 March 2000 matured during the pendency of the case with the trial court. Both courts also found that the petitioner had been religiously paying the private respondent US$750 per month from January 1998 and even during the pendency of the case before the trial court and that the private respondent had accepted all these monthly payments.

With these findings of facts, it has become glaringly obvious that when the complaint for a sum of money and damages was filed with the trial court on 2 February 1999, no cause of action has as yet existed because the petitioner had not committed any act in violation of the terms of the three promissory notes as modified by the renegotiation in December 1997. Without a cause of action, the private respondent had no right to maintain an action in court, and the trial court should have therefore dismissed his complaint.

Despite its finding that the petitioner corporation did not violate the modified terms of the three promissory notes and that the payment of the principal loans were not yet due when the complaint was filed, the trial court did not dismiss the complaint, citing Section 5, Rule 10 of the 1997 Rules of Civil Procedure, which reads:

> Section 5. *Amendment to conform to or authorize presentation of evidence*. - When issues not raised by the pleadings are tried with the express or implied consent of the parties, they shall be treated in all respects as if they had been raised in the pleadings. Such amendment of the pleadings as may be necessary to cause them to conform to the evidence and to raise these issues may be made upon motion of any party at any time, even after judgment; but failure to amend does not affect the result of the trial of these issues. If evidence is objected to at the trial on the ground that it is not within the issues made by the