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THIRD DIVISION

[G.R. No. 143772, November 22, 2005]

DEVELOPMENT BANK OF THE PHILIPPINES, PETITIONER, VS. PRUDENTIAL BANK, RESPONDENT.

D E C I S I O N

CORONA, J.:

Development Bank of the Philippines (DBP) assails in this petition for review on certiorari under Rule 45 of the Rules of Court the December 14, 1999 decision[1] and the June 8, 2000 resolution of the Court of Appeals in CA-G.R. CV No. 45783. The challenged decision dismissed DBP's appeal and affirmed the February 12, 1991 decision of the Regional Trial Court of Makati, Branch 137 in Civil Case No. 88-931 *in toto,* while the impugned resolution denied DBP's motion for reconsideration for being *pro forma.*

In 1973, Lirag Textile Mills, Inc. (Litex) opened an irrevocable commercial letter of credit with respondent Prudential Bank for US$498,000. This was in connection with its importation of 5,000 spindles for spinning machinery with drawing frame, simplex fly frame, ring spinning frame and various accessories, spare parts and tool gauge. These were released to Litex under covering "trust receipts" it executed in favor of Prudential Bank. Litex installed and used the items in its textile mill located in Montalban, Rizal.

On October 10, 1980, DBP granted a foreign currency loan in the amount of US$4,807,551 to Litex. To secure the loan, Litex executed real estate and chattel mortgages on its plant site in Montalban, Rizal, including the buildings and other improvements, machineries and equipments there. Among the machineries and equipments mortgaged in favor of DBP were the articles covered by the "trust receipts."

Sometime in June 1982, Prudential Bank learned about DBP's plan for the overall rehabilitation of Litex. In a July 14, 1982 letter, Prudential Bank notified DBP of its claim over the various items covered by the "trust receipts" which had been installed and used by Litex in the textile mill. Prudential Bank informed DBP that it was the absolute and juridical owner of the said items and they were thus not part of the mortgaged assets that could be legally ceded to DBP.

For the failure of Litex to pay its obligation, DBP extra-judicially foreclosed on the real estate and chattel mortgages, including the articles claimed by Prudential Bank. During the foreclosure sale held on April 19, 1983, DBP acquired the foreclosed properties as the highest bidder.

Subsequently, DBP caused to be published in the September 2, 1984 issue of the Times Journal an invitation to bid in the public sale to be held on September 10,

1984. It called on interested parties to submit bids for the sale of the textile mill formerly owned by Litex, the land on which it was built, as well as the machineries and equipments therein. Learning of the intended public auction, Prudential Bank wrote a letter dated September 6, 1984 to DBP reasserting its claim over the items covered by "trust receipts" in its name and advising DBP not to include them in the auction. It also demanded the turn-over of the articles or alternatively, the payment of their value.

An exchange of correspondences ensued between Prudential Bank and DBP. In reply to Prudential Bank's September 6, 1984 letter, DBP requested documents to enable it to evaluate Prudential Bank's claim. On September 28, 1994, Prudential Bank provided DBP the requested documents. Two months later, Prudential Bank followed up the status of its claim. In a letter dated December 3, 1984, DBP informed Prudential Bank that its claim had been referred to DBP's legal department and instructed Prudential Bank to get in touch with its chief legal counsel. There being no concrete action on DBP's part, Prudential Bank, in a letter dated July 30, 1985, made a final demand on DBP for the turn-over of the contested articles or the payment of their value. Without the knowledge of Prudential Bank, however, DBP sold the Litex textile mill, as well as the machineries and equipments therein, to Lyon Textile Mills, Inc. (Lyon) on June 8, 1987.

Since its demands remained unheeded, Prudential Bank filed a complaint for a sum of money with damages against DBP with the Regional Trial Court of Makati, Branch 137, on May 24, 1988. The complaint was docketed as Civil Case No. 88-931.

On February 12, 1991, the trial court decided[2] in favor of Prudential Bank. Applying the provisions of PD 115, otherwise known as the "Trust Receipts Law," it ruled:

> When PRUDENTIAL BANK released possession of the subject properties, over which it holds absolute title to LITEX upon the latter's execution of the trust receipts, the latter was bound to hold said properties in trust for the former, and (a) to sell or otherwise dispose of the same and to turn over to PRUDENTIAL BANK the amount still owing; or (b) to return the goods if unsold. Since LITEX was allowed to sell the properties being claimed by PRUDENTIAL BANK, all the more was it authorized to mortgage the same, provided of course LITEX turns over to PRUDENTIAL BANK all amounts owing. When DBP, well aware of the status of the properties, acquired the same in the public auction, it was bound by the terms of the trust receipts of which LITEX was the entrustee. Simply stated, DBP held no better right than LITEX, and is thus bound to turn over whatever amount was due PRUDENTIAL BANK. Being a trustee *ex maleficio* of PRUDENTIAL BANK, DBP is necessarily liable therefor. In fact, DBP may well be considered as an agent of LITEX when the former sold the properties being claimed by PRUDENTIAL BANK, with the corresponding responsibility to turn over the proceeds of the same to PRUDENTIAL BANK.[3] (Citations omitted)

The dispositive portion of the decision read:

> WHEREFORE, judgment is hereby rendered ordering defendant DEVELOPMENT BANK OF THE PHILIPPINES to pay plaintiff PRUDENTIAL

> BANK:
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> a) P3,261,834.00, as actual damages, with interest thereon computed from 10 August 1985 until the entire amount shall have been fully paid;
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> b) P50,000.00 as exemplary damages; and
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> c) 10% of the total amount due as and for attorney's fees.
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> SO ORDERED.

Aggrieved, DBP filed an appeal with the Court of Appeals. However, the appellate court dismissed the appeal and affirmed the decision of the trial court *in toto*. It applied the provisions of PD 115 and held that ownership over the contested articles belonged to Prudential Bank as entrustor, not to Litex. Consequently, even if Litex mortgaged the items to DBP and the latter foreclosed on such mortgage, DBP was duty-bound to turn over the proceeds to Prudential Bank, being the party that advanced the payment for them.

On DBP's argument that the disputed articles were not proper objects of a trust receipt agreement, the Court of Appeals ruled that the items were part of the trust agreement entered into by and between Prudential Bank and Litex. Since the agreement was not contrary to law, morals, public policy, customs and good order, it was binding on the parties.

Moreover, the appellate court found that DBP was not a mortgagee in good faith. It also upheld the finding of the trial court that DBP was a trustee *ex maleficio* of Prudential Bank over the articles covered by the "trust receipts."

DBP filed a motion for reconsideration but the appellate court denied it for being *pro forma*. Hence, this petition.

Trust receipt transactions are governed by the provisions of PD 115 which defines such a transaction as follows:

> Section 4. *What constitutes a trust receipt transaction.* – A trust receipt transaction, within the meaning of this Decree, is any transaction by and between a person referred to in this Decree as the entruster, and another person referred to in this Decree as entrustee, whereby the entruster, who owns or holds absolute title or security interests over certain specified goods, documents or instruments, releases the same to the possession of the entrustee upon the latter's execution and delivery to the entruster of a signed document called a "trust receipt" wherein the entrustee binds himself to hold the designated goods, documents or instruments in trust for the entruster and to sell or otherwise dispose of the goods, documents or instruments with the obligation to turn over to the entruster the proceeds thereof to the extent of the amount owing to the entruster or as appears in the trust receipt or the goods, documents or instruments themselves if they are unsold or not otherwise disposed of, in accordance with the terms and conditions specified in the trust receipt, or for other purposes substantially equivalent to any of the following:

1. In the case of goods or documents, (a) to sell the goods or procure their sale; or (b) to manufacture or process the goods with the purpose of ultimate sale: Provided, That, in the case of goods delivered under trust receipt for the purpose of manufacturing or processing before its ultimate sale, the entruster shall retain its title over the goods whether in its original or processed form until the entrustee has complied fully with his obligation under the trust receipt; or (c) to load, unload, ship or tranship or otherwise deal with them in a manner preliminary or necessary to their sale; or
2. In the case of instruments, (a) to sell or procure their sale or exchange; or (b) to deliver them to a principal; or (c) to effect the consummation of some transactions involving delivery to a depository or register; or (d) to effect their presentation, collection or renewal.

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In a trust receipt transaction, the goods are released by the entruster (who owns or holds absolute title or security interests over the said goods) to the entrustee on the latter's execution and delivery to the entruster of a trust receipt. The trust receipt evidences the absolute title or security interest of the entruster over the goods. As a consequence of the release of the goods and the execution of the trust receipt, a two-fold obligation is imposed on the entrustee, namely: (1) to hold the designated goods, documents or instruments in trust for the purpose of selling or otherwise disposing of them and (2) to turn over to the entruster either the proceeds thereof to the extent of the amount owing to the entruster or as appears in the trust receipt, or the goods, documents or instruments themselves if they are unsold or not otherwise disposed of, in accordance with the terms and conditions specified in the trust receipt. In the case of goods, they may also be released for other purposes substantially equivalent to (a) their sale or the procurement of their sale; or (b) their manufacture or processing with the purpose of ultimate sale, in which case the entruster retains his title over the said goods whether in their original or processed form until the entrustee has complied fully with his obligation under the trust receipt; or (c) the loading, unloading, shipment or transshipment or otherwise dealing with them in a manner preliminary or necessary to their sale.[4] Thus, in a trust receipt transaction, the release of the goods to the entrustee, on his execution of a trust receipt, is essentially for the purpose of their sale or is necessarily connected with their ultimate or subsequent sale.

Here, Litex was not engaged in the business of selling spinning machinery, its accessories and spare parts but in manufacturing and producing textile and various kinds of fabric. The articles were not released to Litex to be sold. Nor was the transfer of possession intended to be a preliminary step for the said goods to be ultimately or subsequently sold. Instead, the contemporaneous and subsequent acts of both Litex and Prudential Bank showed that the imported articles were released to Litex to be installed in its textile mill and used in its business. DBP itself was aware of this. To support its assertion that the contested articles were excluded from goods that could be covered by a trust receipt, it contended: