Republic of the Philippines
Supreme Court
Manila

FIRST DIVISION

CESAR V. AREZA and LOLITA B. AREZA, Petitioners,	**G.R. No. 176697**
	Present:
	VELASCO, JR.,* *J.*, LEONARDO-DE CASTRO,** *Acting Chairperson,*
-versus-	BERSAMIN, PEREZ, and PERLAS-BERNABE, *JJ.*
EXPRESS SAVINGS BANK, INC. and MICHAEL POTENCIANO, Respondents.	Promulgated: SEP 10 2014

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DECISION

PEREZ, *J.*:

Before this Court is a Petition for Review on *Certiorari* under Rule 45 of the Rules of Court, which seeks to reverse the Decision[1] and Resolution[2] dated 29 June 2006 and 12 February 2007 of the Court of Appeals in CA-G.R. CV No. 83192. The Court of Appeals affirmed with modification the 22 April 2004 Resolution[3] of the Regional Trial Court (RTC) of Calamba, Laguna, Branch 92, in Civil Case No. B-5886.

The factual antecedents follow.

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* Per Special Order No. 1772 dated 28 August 2014.

** Per Special Order No. 1771 dated 28 August 2014.

1 Penned by Associate Justice Eliezer R. De Los Santos with Associate Justices Fernanda Lampas Peralta and Myrna Dimaranan Vidal, concurring. *Rollo*, pp. 36-49.

2 Id. at 50.

3 Penned by Pairing Judge Romeo C. De Leon. Records, pp. 215-218.

Petitioners Cesar V. Areza and Lolita B. Areza maintained two bank deposits with respondent Express Savings Bank's Biñan branch: 1) Savings Account No. 004-01-000185-5 and 2) Special Savings Account No. 004-02-000092-3.

They were engaged in the business of "buy and sell" of brand new and second-hand motor vehicles. On 2 May 2000, they received an order from a certain Gerry Mambuay (Mambuay) for the purchase of a second-hand Mitsubishi Pajero and a brand-new Honda CRV.

The buyer, Mambuay, paid petitioners with nine (9) Philippine Veterans Affairs Office (PVAO) checks payable to different payees and drawn against the Philippine Veterans Bank (drawee), each valued at Two Hundred Thousand Pesos (₱200,000.00) for a total of One Million Eight Hundred Thousand Pesos (₱1,800,000.00).

About this occasion, petitioners claimed that Michael Potenciano (Potenciano), the branch manager of respondent Express Savings Bank (the Bank) was present during the transaction and immediately offered the services of the Bank for the processing and eventual crediting of the said checks to petitioners' account.[4] On the other hand, Potenciano countered that he was prevailed upon to accept the checks by way of accommodation of petitioners who were valued clients of the Bank.[5]

On 3 May 2000, petitioners deposited the said checks in their savings account with the Bank. The Bank, in turn, deposited the checks with its depositary bank, Equitable-PCI Bank, in Biñan, Laguna. Equitable-PCI Bank presented the checks to the drawee, the Philippine Veterans Bank, which honored the checks.

On 6 May 2000, Potenciano informed petitioners that the checks they deposited with the Bank were honored. He allegedly warned petitioners that the clearing of the checks pertained only to the availability of funds and did not mean that the checks were not infirmed.[6] Thus, the entire amount of ₱1,800,000.00 was credited to petitioners' savings account. Based on this information, petitioners released the two cars to the buyer.

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4 Records, p. 2.
5 *Rollo*, p. 68.
6 Id.

Sometime in July 2000, the subject checks were returned by PVAO to the drawee on the ground that the amount on the face of the checks was altered from the original amount of ₱4,000.00 to ₱200,000.00. The drawee returned the checks to Equitable-PCI Bank by way of Special Clearing Receipts. In August 2000, the Bank was informed by Equitable-PCI Bank that the drawee dishonored the checks on the ground of material alterations. Equitable-PCI Bank initially filed a protest with the Philippine Clearing House. In February 2001, the latter ruled in favor of the drawee Philippine Veterans Bank. Equitable-PCI Bank, in turn, debited the deposit account of the Bank in the amount of ₱1,800,000.00.

The Bank insisted that they informed petitioners of said development in August 2000 by furnishing them copies of the documents given by its depositary bank.[7] On the other hand, petitioners maintained that the Bank never informed them of these developments.

On 9 March 2001, petitioners issued a check in the amount of ₱500,000.00. Said check was dishonored by the Bank for the reason "Deposit Under Hold." According to petitioners, the Bank unilaterally and unlawfully put their account with the Bank on hold. On 22 March 2001, petitioners' counsel sent a demand letter asking the Bank to honor their check. The Bank refused to heed their request and instead, closed the Special Savings Account of the petitioners with a balance of ₱1,179,659.69 and transferred said amount to their savings account. The Bank then withdrew the amount of ₱1,800,000.00 representing the returned checks from petitioners' savings account.

Acting on the alleged arbitrary and groundless dishonoring of their checks and the unlawful and unilateral withdrawal from their savings account, petitioners filed a Complaint for Sum of Money with Damages against the Bank and Potenciano with the RTC of Calamba.

On 15 January 2004, the RTC, through Judge Antonio S. Pozas, ruled in favor of petitioners. The dispositive portion of the Decision reads:

> WHEREFORE, the foregoing considered, the Court orders that judgment be rendered in favor of plaintiffs and against the defendants jointly and severally to pay plaintiffs as follows, to wit:
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> 1. ₱1,800,000.00 representing the amount unlawfully withdrawn by the defendants from the account of plaintiffs;

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7 Id.

2. ₱500,000.00 as moral damages; and
3. ₱300,000.00 as attorney's fees.[8]

The trial court reduced the issue to whether or not the rights of petitioners were violated by respondents when the deposits of the former were debited by respondents without any court order and without their knowledge and consent. According to the trial court, it is the depositary bank which should safeguard the right of the depositors over their money. Invoking Article 1977 of the Civil Code, the trial court stated that the depositary cannot make use of the thing deposited without the express permission of the depositor. The trial court also held that respondents should have observed the 24-hour clearing house rule that checks should be returned within 24-hours after discovery of the forgery but in no event beyond the period fixed by law for filing a legal action. In this case, petitioners deposited the checks in May 2000, and respondents notified them of the problems on the check three months later or in August 2000. In sum, the trial court characterized said acts of respondents as attended with bad faith when they debited the amount of ₱1,800,000.00 from the account of petitioners.

Respondents filed a motion for reconsideration while petitioners filed a motion for execution from the Decision of the RTC on the ground that respondents' motion for reconsideration did not conform with Section 5, Rule 16 of the Rules of Court; hence, it was a mere scrap of paper that did not toll the running of the period to appeal.

On 22 April 2004, the RTC, through Pairing Judge Romeo C. De Leon granted the motion for reconsideration, set aside the Pozas Decision, and dismissed the complaint. The trial court awarded respondents their counterclaim of moral and exemplary damages of ₱100,000.00 each.

The trial court first applied the principle of liberality when it disregarded the alleged absence of a notice of hearing in respondents' motion for reconsideration. On the merits, the trial court considered the relationship of the Bank and petitioners with respect to their savings account deposits as a contract of loan with the bank as the debtor and petitioners as creditors. As such, Article 1977 of the Civil Code prohibiting the depository from making use of the thing deposited without the express permission of the depositor is not applicable. Instead, the trial court applied Article 1980 which provides that fixed, savings and current deposits of money in banks and similar institutions shall be governed by the provisions governing simple

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[8] Records, p. 178.

loan. The trial court then opined that the Bank had all the right to set-off against petitioners' savings deposits the value of their nine checks that were returned.

On appeal, the Court of Appeals affirmed the ruling of the trial court but deleted the award of damages. The appellate court made the following ratiocination:

> Any argument as to the notice of hearing has been resolved when the pairing judge issued the order on February 24, 2004 setting the hearing on March 26, 2004. A perusal of the notice of hearing shows that request was addressed to the Clerk of Court and plaintiffs' counsel for hearing to be set on March 26, 2004.
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> The core issues in this case revolve on whether the appellee bank had the right to debit the amount of ₱1,800,000.00 from the appellants' accounts and whether the bank's act of debiting was done "without the plaintiffs' knowledge."
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> We find that the elements of legal compensation are all present in the case at bar. Hence, applying the case of the *Bank of the Philippine Islands v. Court of Appeals*, the obligors bound principally are at the same time creditors of each other. Appellee bank stands as a debtor of appellant, a depositor. At the same time, said bank is the creditor of the appellant with respect to the dishonored treasury warrant checks which amount were already credited to the account of appellants. When the appellants had withdrawn the amount of the checks they deposited and later on said checks were returned, they became indebted to the appellee bank for the corresponding amount.
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> It should be noted that [G]erry Mambuay was the appellants' walk-in buyer. As sellers, appellants ought to have exercised due diligence in assessing his credit or personal background. The 24-hour clearing house rule is not the one that governs in this case since the nine checks were discovered by the drawee bank to contain material alterations.
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> Appellants merely allege that they were not informed of any development on the checks returned. However, this Court believes that the bank and appellants had opportunities to communicate about the checks considering that several transactions occurred from the time of alleged return of the checks to the date of the debit.
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> However, this Court agrees with appellants that they should not pay moral and exemplary damages to each of the appellees for lack of basis. The appellants were not shown to have acted in bad faith.[9]

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9 *Rollo*, pp. 48-49.

Petitioners filed the present petition for review on *certiorari* raising both procedural and substantive issues, to wit:

> 1. Whether or not the Honorable Court of Appeals committed a reversible error of law and grave abuse of discretion in upholding the legality and/or propriety of the Motion for Reconsideration filed in violation of Section 5, Rule 15 of the Rules on Civil Procedure;
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> 2. Whether or not the Honorable Court of Appeals committed a grave abuse of discretion in declaring that the private respondents "had the right to debit the amount of ₱1,800,000.00 from the appellants' accounts" and the bank's act of debiting was done with the plaintiff's knowledge.[10]

Before proceeding to the substantive issue, we first resolve the procedural issue raised by petitioners.

Sections 5, Rule 15 of the Rules of Court states:

> Section 5. Notice of hearing. – The notice of hearing shall be addressed to all parties concerned, and shall specify the time and date of the hearing which must not be later than ten (10) days after the filing of the motion.

Petitioners claim that the notice of hearing was addressed to the Clerk of Court and not to the adverse party as the rules require. Petitioners add that the hearing on the motion for reconsideration was scheduled beyond 10 days from the date of filing.

As held in *Maturan v. Araula*,[11] the rule requiring that the notice be addressed to the adverse party has been substantially complied with when a copy of the motion for reconsideration was furnished to the counsel of the adverse party, coupled with the fact that the trial court acted on said notice of hearing and, as prayed for, issued an order[12] setting the hearing of the motion on 26 March 2004.

We would reiterate later that there is substantial compliance with the foregoing Rule if a copy of the said motion for reconsideration was furnished to the counsel of the adverse party.[13]

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10 Id. at 17.
11 197 Phil. 583 (1982).
12 Records, p. 190.
13 *Philippine National Bank v. Judge Paneda*, 544 Phil. 565, 579 (2007) citing *Un Giok v. Matusa*, 101 Phil. 727, 734 (1957).

Now to the substantive issues to which procedural imperfection must, in this case, give way.

The central issue is whether the Bank had the right to debit ₱1,800,000.00 from petitioners' accounts.

On 6 May 2000, the Bank informed petitioners that the subject checks had been honored. Thus, the amount of ₱1,800,000.00 was accordingly credited to petitioners' accounts, prompting them to release the purchased cars to the buyer.

Unknown to petitioners, the Bank deposited the checks in its depositary bank, Equitable-PCI Bank. Three months had passed when the Bank was informed by its depositary bank that the drawee had dishonored the checks on the ground of material alterations.

The return of the checks created a chain of debiting of accounts, the last loss eventually falling upon the savings account of petitioners with respondent bank. The trial court in its reconsidered decision and the appellate court were one in declaring that petitioners should bear the loss.

We reverse.

The fact that material alteration caused the eventual dishonor of the checks issued by PVAO is undisputed. In this case, before the alteration was discovered, the checks were already cleared by the drawee bank, the Philippine Veterans Bank. Three months had lapsed before the drawee dishonored the checks and returned them to Equitable-PCI Bank, the respondents' depositary bank. And it was not until 10 months later when petitioners' accounts were debited. A question thus arises: What are the liabilities of the drawee, the intermediary banks, and the petitioners for the altered checks?

LIABILITY OF THE DRAWEE

Section 63 of Act No. 2031 or the Negotiable Instruments Law provides that the acceptor, by accepting the instrument, engages that he will pay it according to the tenor of his acceptance. The acceptor is a drawee who accepts the bill. In *Philippine National Bank v. Court of Appeals*,[14] the

[14] 134 Phil. 829 (1968).

payment of the amount of a check implies not only acceptance but also compliance with the drawee's obligation.

In case the negotiable instrument is altered before acceptance, is the drawee liable for the original or the altered tenor of acceptance? There are two divergent intepretations proffered by legal analysts.[15] The first view is supported by the leading case of *National City Bank of Chicago v. Bank of the Republic.*[16] In said case, a certain Andrew Manning stole a draft and substituted his name for that of the original payee. He offered it as payment to a jeweler in exchange for certain jewelry. The jeweler deposited the draft to the defendant bank which collected the equivalent amount from the drawee. Upon learning of the alteration, the drawee sought to recover from the defendant bank the amount of the draft, as money paid by mistake. The court denied recovery on the ground that the drawee by accepting admitted the existence of the payee and his capacity to endorse.[17] Still, in *Wells*

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15 Agbayani, *Commentaries and Jurisprudence on the Commercial Law of the Philippines*, Vol. 1, 1992 edition, pp. 324-326. – x x x.

836. **Where original tenor isaltered before acceptance.** Suppose the bill is originally for ₱1,000. Before the drawee X accepts it, it is altered by the payee B to ₱4,000. Then X accepts it. How much is X liable to a holder in due course? Before the adoption of the Negotiable Instruments Law, at common law, an acceptor was liable according to the tenor of the bill. Since the adoption of the Negotiable Instruments Law, a diversity of opinion has arisen as to the effect of Section 62.

837. **View that altered tenor is tenor of acceptance.** According to one view, X ia liable for ₱4,000 not ₱1,000. The reason si that the tenor of X's acceptance is for ₱4,000. Since an acceptor, by Section 62 engages to pay the bill 'according to the tenor of his acceptance,' he must pay to the innocent payee or subsequent holder the amount called for by the time he accepted, even though larger than the original amount ordered by the drawer. Moreover, he would be a party who has himself assented to the alteration."

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839. **View that original tenor is tenor of acceptance.** A learned writer takes the opposite view and he is supported by some decisions. He suggests that the Illinois view overlooks other pertinent sections of the Negotiable Instruments Law and that Section 62 should be paraphrased to state that the liability of the acceptor depends upon the terms of his acceptance, that is, whether it is a general acceptance or a qualified acceptance or an acceptance for honor. He suggests that all three of these acceptance contracts are within the purview of the provision of Section 62 that the acceptor, by accepting the instrument, engages that the will pay it not according to the tenor of the bill since this would deny him the right to qualifty the acceptance or to accept for honor but according to the tenor of his acceptance.

840. **Effect of Section 124.** Under the first view, what is the effect of Section 124 which provides that a holder in due course can recover only the original tenor of the instrument? It seems that this refers to the original tenor of the instrument taken from the standpoint of the person principally liable, in the first illustration, from X's standpoint. In other words, the original tenor of the instrument is ₱4,000, which is the tenor of X's acceptance. If after his acceptance, a subsequent indorsee alters the bill to read ₱9,000, then X could be liable only for ₱4,000, the original tenor of his acceptance, even as to a holder in due course.

16 300 Ill. 103, 132 N.E. 832, 22 A.L.R. 1153.

17 Effect of Alteration of a Negotiable Instrument upon Drawee's Acceptance or Payment (March 1, 1922), Columbia Law Review, p. 260. https://archive.org/details/jstor-1112225. Columbia Law Review, Vol. 22, No. 3 (Mar., 1922), pp. 260-263.

Fargo Bank & Union Trust Co. v. Bank of Italy,[18] the court echoed the court's interpretation in *National City Bank of Chicago,* in this wise:

> We think the construction placed upon the section by the Illinois court is correct and that it was not the legislative intent that the obligation of the acceptor should be limited to the tenor of the instrument as drawn by the maker, as was the rule at common law, but that it should be enforceable in favor of a holder in due course against the acceptor according to its tenor at the time of its acceptance or certification.
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> The foregoing opinion and the Illinois decision which it follows give effect to the literal words of the Negotiable Instruments Law. As stated in the Illinois case: "The court must take the act as it is written and should give to the words their natural and common meaning . . . if the language of the act conflicts with statutes or decisions in force before its enactment the courts should not give the act a strained construction in order to make it harmonize with earlier statutes or decisions." The wording of the act suggests that a change in the common law was intended. A careful reading thereof, independent of any common-law influence, requires that the words "according to the tenor of his acceptance" be construed as referring to the instrument as it was at the time it came into the hands of the acceptor for acceptance, for he accepts no other instrument than the one presented to him — the altered form — and it alone he engages to pay. This conclusion is in harmony with the law of England and the continental countries. It makes for the usefulness and currency of negotiable paper without seriously endangering accepted banking practices, for banking institutions can readily protect themselves against liability on altered instruments either by qualifying their acceptance or certification or by relying on forgery insurance and special paper which will make alterations obvious. All of the arguments advanced against the conclusion herein announced seem highly technical in the face of the practical facts that the drawee bank has authenticated an instrument in a certain form, and that commercial policy favors the protection of anyone who, in due course, changes his position on the faith of that authentication.[19]

The second view is that the acceptor/drawee despite the tenor of his acceptance is liable only to the extent of the bill prior to alteration.[20] This view appears to be in consonance with Section 124 of the Negotiable Instruments Law which states that a material alteration avoids an instrument except as against an assenting party and subsequent indorsers, but a holder in due course may enforce payment according to its original tenor. Thus, when the drawee bank pays a materially altered check, it violates the terms of the check, as well as its duty to charge its client's account only for bona fide disbursements he had made. If the drawee did not pay according to the original tenor of the instrument, as directed by the drawer, then it has no

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18 214 Cal. 156; 4 P.2d 781; 1931 Cal. LEXIS 409.

19 Id.

20 Villanueva, Cesar, *Commercial Law Review*, 2003, p. 447.

right to claim reimbursement from the drawer, much less, the right to deduct the erroneous payment it made from the drawer's account which it was expected to treat with utmost fidelity.[21] The drawee, however, still has recourse to recover its loss. It may pass the liability back to the collecting bank which is what the drawee bank exactly did in this case. It debited the account of Equitable-PCI Bank for the altered amount of the checks.

LIABILITY OF DEPOSITARY BANK AND COLLECTING BANK

A depositary bank is the first bank to take an item even though it is also the payor bank, unless the item is presented for immediate payment over the counter.[22] It is also the bank to which a check is transferred for deposit in an account at such bank, even if the check is physically received and indorsed first by another bank.[23] A collecting bank is defined as any bank handling an item for collection except the bank on which the check is drawn.[24]

When petitioners deposited the check with the Bank, they were designating the latter as the collecting bank. This is in consonance with the rule that a negotiable instrument, such as a check, whether a manager's check or ordinary check, is not legal tender. As such, after receiving the deposit, under its own rules, the Bank shall credit the amount in petitioners' account or infuse value thereon only after the drawee bank shall have paid the amount of the check or the check has been cleared for deposit.[25]

The Bank and Equitable-PCI Bank are both depositary and collecting banks.

A depositary/collecting bank where a check is deposited, and which endorses the check upon presentment with the drawee bank, is an endorser. Under Section 66 of the Negotiable Instruments Law, an endorser warrants "that the instrument is genuine and in all respects what it purports to be; that he has good title to it; that all prior parties had capacity to contract; and that the instrument is at the time of his endorsement valid and subsisting." It has been repeatedly held that in check transactions, the depositary/collecting bank or last endorser generally suffers the loss because it has the duty to

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21 *Metropolitan Bank and Trust Co. v. Cabilzo*, 539 Phil. 316, 327-328 (2006).

22 U.C.C. – Article 4 – Bank Deposits and Collections (2002) › Part 1. General Provisions and Definitions › § 4-105.

23 12 USCS § 5002 (3) (B), Title 12. Banks and Banking; Chapter 50. Check Truncation.

24 Id.

25 *BPI v. Court of Appeals*, 383 Phil. 538, 553 (2000).

ascertain the genuineness of all prior endorsements considering that the act of presenting the check for payment to the drawee is an assertion that the party making the presentment has done its duty to ascertain the genuineness of the endorsements.[26] If any of the warranties made by the depositary/collecting bank turns out to be false, then the drawee bank may recover from it up to the amount of the check. [27]

The law imposes a duty of diligence on the collecting bank to scrutinize checks deposited with it for the purpose of determining their genuineness and regularity. The collecting bank being primarily engaged in banking holds itself out to the public as the expert and the law holds it to a high standard of conduct.[28]

As collecting banks, the Bank and Equitable-PCI Bank are both liable for the amount of the materially altered checks. Since Equitable-PCI Bank is not a party to this case and the Bank allowed its account with Equitable-PCI Bank to be debited, it has the option to seek recourse against the latter in another forum.

24-HOUR CLEARING RULE

Petitioners faulted the drawee bank for not following the 24-hour clearing period because it was only in August 2000 that the drawee bank notified Equitable-PCI that there were material alterations in the checks.

We do not subscribe to the position taken by petitioners that the drawee bank was at fault because it did not follow the 24-hour clearing period which provides that when a drawee bank fails to return a forged or altered check to the collecting bank within the 24-hour clearing period, the collecting bank is absolved from liability.

Section 21 of the Philippine Clearing House Rules and Regulations provides:

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26 *Metropolitan Bank and Trust Co. v. BA Finance Corporation*, G.R. No. 179952, 4 December 2009, 607 SCRA 620, 632; *Bank of America NT & SA v. Associated Citizens Bank*, G.R. No. 141001, 21 May 2009, 588 SCRA 51, 60-61; *Associated Bank v. Court of Appeals*, 322 Phil. 677, 699-700 (1996).

27 *Bank of America NT & SA v. Associated Citizens Bank*, id. at 61.

28 *Banco de Oro Savings and Mortgage Bank v. Equitable Banking Corporation*, 241 Phil. 187, 200 (1988).

> Sec. 21. *Special Return Items Beyond The Reglementary Clearing Period.* - Items which have been the subject of material alteration or items bearing forged endorsement when such endorsement is necessary for negotiation shall be returned by direct presentation or demand to the Presenting Bank and not through the regular clearing house facilities within the period prescribed by law for the filing of a legal action by the returning bank/branch, institution or entity sending the same.

Antonio Viray, in his book *Handbook on Bank Deposits*, elucidated:

> It is clear that the so-called "24-hour" rule has been modified. In the case of Hongkong & Shanghai vs. People's Bank reiterated in Metropolitan Bank and Trust Co. vs. FNCB, the Supreme Court strictly enforced the 24-hour rule under which the drawee bank forever loses the right to claim against presenting/collecting bank if the check is not returned at the next clearing day or within 24 hours. Apparently, the commercial banks felt strict enforcement of the 24-hour rule is too harsh and therefore made representations and obtained modification of the rule, which modification is now incorporated in the Manual of Regulations. Since the same commercial banks controlled the Philippine Clearing House Corporation, incorporating the amended rule in the PCHC Rules naturally followed.
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> As the rule now stands, the 24-hour rule is still in force, that is, any check which should be refused by the drawee bank in accordance with long standing and accepted banking practices shall be returned through the PCHC/local clearing office, as the case may be, not later than the next regular clearing (24-hour). The modification, however, is that items which have been the subject of material alteration or bearing forged endorsement may be returned even beyond 24 hours so long that the same is returned within the prescriptive period fixed by law. The consensus among lawyers is that the prescriptive period is ten (10) years because a check or the endorsement thereon is a written contract. Moreover, the item need not be returned through the clearing house but by direct presentation to the presenting bank.[29]

In short, the 24-hour clearing rule does not apply to altered checks.

LIABILITY OF PETITIONERS

The 2008 case of *Far East Bank & Trust Company v. Gold Palace Jewellery Co*.[30] is in point. A foreigner purchased several pieces of jewelry from Gold Palace Jewellery using a United Overseas Bank (Malaysia) issued draft addressed to the Land Bank of the Philippines (LBP). Gold Palace

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29 1988 Revised Edition, p. 169.

30 584 Phil. 579 (2008).

Jewellery deposited the draft in the company's account with Far East Bank. Far East Bank presented the draft for clearing to LBP. The latter cleared the same and Gold Palace Jewellery's account was credited with the amount stated in the draft. Consequently, Gold Palace Jewellery released the pieces of jewelries to the foreigner. Three weeks later, LBP informed Far East Bank that the amount in the foreign draft had been materially altered from ₱300,000.00 to ₱380,000.00. LBP returned the check to Far East Bank. Far East Bank refunded LBP the ₱380,000.00 paid by LBP. Far East Bank initially debited ₱168,053.36 from Gold Palace Jewellery's account and demanded the payment of the difference between the amount in the altered draft and the amount debited from Gold Palace Jewellery.

However, for the reasons already discussed above, our pronouncement in the *Far East Bank and Trust Company* case that "the drawee is liable on its payment of the check according to the tenor of the check at the time of payment, which was the raised amount"[31] is inapplicable to the factual milieu obtaining herein.

We only adopt said decision in so far as it adjudged liability on the part of the collecting bank, thus:

> Thus, considering that, in this case, Gold Palace is protected by Section 62 of the NIL, its collecting agent, Far East, should not have debited the money paid by the drawee bank from respondent company's account. When Gold Palace deposited the check with Far East, the latter, under the terms of the deposit and the provisions of the NIL, became an agent of the former for the collection of the amount in the draft. The subsequent payment by the drawee bank and the collection of the amount by the collecting bank closed the transaction insofar as the drawee and the holder of the check or his agent are concerned, converted the check into a mere voucher, and, as already discussed, foreclosed the recovery by the drawee of the amount paid. This closure of the transaction is a matter of course; otherwise, uncertainty in commercial transactions, delay and annoyance will arise if a bank at some future time will call on the payee for the return of the money paid to him on the check.
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> As the transaction in this case had been closed and the principal-agent relationship between the payee and the collecting bank had already ceased, the latter in returning the amount to the drawee bank was already acting on its own and should now be responsible for its own actions. x x x Likewise, Far East cannot invoke the warranty of the payee/depositor who indorsed the instrument for collection to shift the burden it brought upon itself. This is precisely because the said indorsement is only for purposes of collection which, under Section 36 of the NIL, is a restrictive indorsement. It did not in any way transfer the title of the instrument to the collecting bank. Far East did not own the draft, it merely presented it

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31 Id. at 588.

> for payment. Considering that the warranties of a general indorser as provided in Section 66 of the NIL are based upon a transfer of title and are available only to holders in due course, these warranties did not attach to the indorsement for deposit and collection made by Gold Palace to Far East. Without any legal right to do so, the collecting bank, therefore, could not debit respondent's account for the amount it refunded to the drawee bank.
>
> The foregoing considered, we affirm the ruling of the appellate court to the extent that Far East could not debit the account of Gold Palace, and for doing so, it must return what it had erroneously taken.[32]

Applying the foregoing ratiocination, the Bank cannot debit the savings account of petitioners. A depositary/collecting bank may resist or defend against a claim for breach of warranty if the drawer, the payee, or either the drawee bank or depositary bank was negligent and such negligence substantially contributed to the loss from alteration. In the instant case, no negligence can be attributed to petitioners. We lend credence to their claim that at the time of the sales transaction, the Bank's branch manager was present and even offered the Bank's services for the processing and eventual crediting of the checks. True to the branch manager's words, the checks were cleared three days later when deposited by petitioners and the entire amount of the checks was credited to their savings account.

ON LEGAL COMPENSATION

Petitioners insist that the Bank cannot be considered a creditor of the petitioners because it should have made a claim of the amount of ₱1,800,000.00 from Equitable-PCI Bank, its own depositary bank and the collecting bank in this case and not from them.

The Bank cannot set-off the amount it paid to Equitable-PCI Bank with petitioners' savings account. Under Art. 1278 of the New Civil Code, compensation shall take place when two persons, in their own right, are creditors and debtors of each other. And the requisites for legal compensation are:

> Art. 1279. In order that compensation may be proper, it is necessary:
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> (1) That each one of the obligors be bound principally, and that he be at the same time a principal creditor of the other;

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32 Id. at 591-592.

> (2) That both debts consist in a sum of money, or if the things due are consumable, they be of the same kind, and also of the same quality if the latter has been stated;
> (3) That the two debts be due;
> (4) That they be liquidated and demandable;
> (5) That over neither of them there be any retention or controversy, commenced by third persons and communicated in due time to the debtor.

It is well-settled that the relationship of the depositors and the Bank or similar institution is that of creditor-debtor. Article 1980 of the New Civil Code provides that fixed, savings and current deposits of money in banks and similar institutions shall be governed by the provisions concerning simple loans. The bank is the debtor and the depositor is the creditor. The depositor lends the bank money and the bank agrees to pay the depositor on demand. The savings deposit agreement between the bank and the depositor is the contract that determines the rights and obligations of the parties.[33]

But as previously discussed, petitioners are not liable for the deposit of the altered checks. The Bank, as the depositary and collecting bank ultimately bears the loss. Thus, there being no indebtedness to the Bank on the part of petitioners, legal compensation cannot take place.

DAMAGES

The Bank incurred a delay in informing petitioners of the checks' dishonor. The Bank was informed of the dishonor by Equitable-PCI Bank as early as August 2000 but it was only on 7 March 2001 when the Bank informed petitioners that it will debit from their account the altered amount. This delay is tantamount to negligence on the part of the collecting bank which would entitle petitioners to an award for damages under Article 1170 of the New Civil Code which reads:

> Art. 1170. Those who in the performance of their obligations are guilty of fraud, negligence, or delay, and those who in any manner contravene the tenor thereof, are liable for damages.

The damages in the form of actual or compensatory damages represent the amount debited by the Bank from petitioners' account.

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[33] *Central Bank of the Philippines v. Citytrust Banking Corporation*, G.R. No. 141835, 4 February 2009, 578 SCRA 27, 32.

We delete the award of moral damages. Contrary to the lower court's finding, there was no showing that the Bank acted fraudulently or in bad faith. It may have been remiss in its duty to diligently protect the account of its depositors but its honest but mistaken belief that petitioners' account should be debited is not tantamount to bad faith. We also delete the award of attorney's fees for it is not a sound public policy to place a premium on the right to litigate. No damages can be charged to those who exercise such precious right in good faith, even if done erroneously.[34]

To recap, the drawee bank, Philippine Veterans Bank in this case, is only liable to the extent of the check prior to alteration. Since Philippine Veterans Bank paid the altered amount of the check, it may pass the liability back as it did, to Equitable-PCI Bank, the collecting bank. The collecting banks, Equitable-PCI Bank and the Bank, are ultimately liable for the amount of the materially altered check. It cannot further pass the liability back to the petitioners absent any showing in the negligence on the part of the petitioners which substantially contributed to the loss from alteration.

Based on the foregoing, we affirm the *Pozas* decision only insofar as it ordered respondents to jointly and severally pay petitioners ₱1,800,000.00, representing the amount withdrawn from the latter's account. We do not conform with said ruling regarding the finding of bad faith on the part of respondents, as well as its failure to observe the 24-hour clearing rule.

WHEREFORE, the petition is **GRANTED**. The Decision and Resolution dated 29 June 2006 and 12 February 2007 respectively of the Court of Appeals in CA-G.R. CV No. 83192 are **REVERSED and SET ASIDE**. The 15 January 2004 Decision of the Regional Trial Court of Calamba City, Branch 92 in Civil Case No. B-5886 rendered by Judge Antonio S. Pozas is **REINSTATED** only insofar as it ordered respondents to jointly and severally pay petitioners ₱1,800,000.00 representing the amount withdrawn from the latter's account. The award of moral damages and attorney's fees are **DELETED**.

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[34] *Far East Bank and Trust Company v. Gold Palace Jewellery Co.*, supra note 30 at 593 citing *National Trucking and Forwarding Corp. v. Lorenzo Shipping Corp*., 491 Phil. 151, 158-159 (2005); *Pajuyo v. Court of Appeals*, G.R. No. 146364, 3 June 2004, 430 SCRA 492, 524; *Alonso v. Cebu Country Club, Inc*., 426 Phil. 61, 88 (2002); *Orosa v. Court of Appeals*, 386 Phil. 94, 105 (2000); *"J" Marketing Corporation v. Sia, Jr*., 349 Phil. 513, 517 (1998).

SO ORDERED.

JOSE PORTUGAL PEREZ
Associate Justice

WE CONCUR:

PRESBITERO J. VELASCO, JR.
Associate Justice

TERESITA J. LEONARDO-DE CASTRO
Associate Justice
Acting Chairperson

LUCAS P. BERSAMIN
Associate Justice

ESTELA M. PERLAS-BERNABE
Associate Justice

CERTIFICATION

Pursuant to Section 13, Article VIII of the Constitution, it is hereby certified that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court.

ANTONIO T. CARPIO
Acting Chief Justice