Republic of the Philippines
Supreme Court
Manila

SECOND DIVISION

SPOUSES EDUARDO and LYDIA SILOS, *Petitioners,*	**G.R. No. 181045**
	Present:
- versus -	CARPIO, *Chairperson,* LEONARDO-DE CASTRO,* DEL CASTILLO, PEREZ, *and* PERLAS-BERNABE, *JJ.*
PHILIPPINE NATIONAL BANK, *Respondent.*	Promulgated: JUL 02 2014

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DECISION

DEL CASTILLO, *J.*:

In loan agreements, it cannot be denied that the rate of interest is a principal condition, if not the most important component. Thus, any modification thereof must be mutually agreed upon; otherwise, it has no binding effect. Moreover, the Court cannot consider a stipulation granting a party the option to prepay the loan if said party is not agreeable to the arbitrary interest rates imposed. Premium may not be placed upon a stipulation in a contract which grants one party the right to choose whether to continue with or withdraw from the agreement if it discovers that what the other party has been doing all along is improper or illegal.

This Petition for Review on *Certiorari*[1] questions the May 8, 2007 Decision[2] of the Court of Appeals (CA) in CA-G.R. CV No. 79650, which affirmed with modifications the February 28, 2003 Decision[3] and the June 4, 2003 Order[4] of the Regional Trial Court (RTC), Branch 6 of Kalibo, Aklan in Civil Case No. 5975.

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* Per Raffle dated June 9, 2014.

1 *Rollo*, pp. 9-45.

2 Id. at 47-64; penned by Associate Justice Francisco P. Acosta and concurred in by Executive Justice Arsenio J. Magpale and Associate Justice Agustin S. Dizon.

3 Records, pp. 361-367; penned by Judge Niovady M. Marin.

4 *Rollo*, pp. 72-73.

Factual Antecedents

Spouses Eduardo and Lydia Silos (petitioners) have been in business for about two decades of operating a department store and buying and selling of ready-to-wear apparel. Respondent Philippine National Bank (PNB) is a banking corporation organized and existing under Philippine laws.

To secure a one-year revolving credit line of ₱150,000.00 obtained from PNB, petitioners constituted in August 1987 a **Real Estate Mortgage**[5] over a 370-square meter lot in Kalibo, Aklan covered by Transfer Certificate of Title No. (TCT) T-14250. In July 1988, the credit line was increased to ₱1.8 million and the mortgage was correspondingly increased to ₱1.8 million.[6] And in July 1989, a **Supplement** to the Existing Real Estate Mortgage[7] was executed to cover the same credit line, which was increased to ₱2.5 million, and additional security was given in the form of a 134-square meter lot covered by TCT T-16208. In addition, petitioners issued **eight Promissory Notes**[8] and signed a **Credit Agreement**.[9] This July 1989 Credit Agreement contained a stipulation on interest which provides as follows:

> 1.03. Interest. (a) **The Loan shall be subject to interest at the rate of 19.5% *per annum***. Interest shall be payable in advance every one hundred twenty days at the rate prevailing at the time of the renewal.
>
> (b) **The Borrower agrees that the Bank may modify the interest rate in the Loan depending on whatever policy the Bank may adopt in the future**, including without limitation, the shifting from the floating interest rate system to the fixed interest rate system, or vice versa. Where the Bank has imposed on the Loan interest at a rate *per annum*, which is equal to the Bank's spread over the current floating interest rate, **the Borrower hereby agrees that the Bank may, without need of notice to the Borrower, increase or decrease its spread over the floating interest rate at any time depending on whatever policy it may adopt in the future**.[10] (Emphases supplied)

The eight Promissory Notes, on the other hand, contained a stipulation granting PNB the right to increase or reduce interest rates "*within the limits allowed by law or by the Monetary Board*."[11] The Real Estate Mortgage agreement provided the same right to increase or reduce interest rates "*at any time depending on whatever policy PNB may adopt in the future*."[12]

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5 Records, p. 94.
6 See Whereas Clause of Supplement to Existing Real Estate Mortgage, id. at 10.
7 Id. at 10-11.
8 *Rollo*, p. 148.
9 Records, pp. 47-54.
10 Id. at 47.
11 Id. at 192.
12 Id. at 74, dorsal portion.

Petitioners religiously paid interest on the notes at the following rates:

1. 1st Promissory Note dated July 24, 1989 – 19.5%;
2. 2nd Promissory Note dated November 22, 1989 – 23%;
3. 3rd Promissory Note dated March 21, 1990 – 22%;
4. 4th Promissory Note dated July 19, 1990 – 24%;
5. 5th Promissory Note dated December 17, 1990 – 28%;
6. 6th Promissory Note dated February 14, 1991 – 32%;
7. 7th Promissory Note dated March 1, 1991 – 30%; and
8. 8th Promissory Note dated July 11, 1991 – 24%.[13]

In August 1991, an **Amendment to Credit Agreement**[14] was executed by the parties, with the following stipulation regarding interest:

> 1.03. Interest on Line Availments. (a) **The Borrowers agree to pay interest on each Availment** from date of each Availment up to but not including the date of full payment thereof **at the rate *per annum* which is determined by the Bank to be prime rate plus applicable spread in effect as of the date of each Availment**.[15] (Emphases supplied)

Under this Amendment to Credit Agreement, petitioners issued in favor of PNB the following **18 Promissory Notes**, which petitioners settled – except the last (the note covering the principal) – at the following interest rates:

1. 9th Promissory Note dated November 8, 1991 – 26%;
2. 10th Promissory Note dated March 19, 1992 – 25%;
3. 11th Promissory Note dated July 11, 1992 – 23%;
4. 12th Promissory Note dated November 10, 1992 – 21%;
5. 13th Promissory Note dated March 15, 1993 – 21%;
6. 14th Promissory Note dated July 12, 1993 – 17.5%;
7. 15th Promissory Note dated November 17, 1993 – 21%;
8. 16th Promissory Note dated March 28, 1994 – 21%;
9. 17th Promissory Note dated July 13, 1994 – 21%;
10. 18th Promissory Note dated November 16, 1994 – 16%;
11. 19th Promissory Note dated April 10, 1995 – 21%;
12. 20th Promissory Note dated July 19, 1995 – 18.5%;
13. 21st Promissory Note dated December 18, 1995 – 18.75%;
14. 22nd Promissory Note dated April 22, 1996 – 18.5%;
15. 23rd Promissory Note dated July 22, 1996 – 18.5%;
16. 24th Promissory Note dated November 25, 1996 – 18%;
17. 25th Promissory Note dated May 30, 1997 – 17.5%; and

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13 Id. at 192-199.
14 Id. at 55-58.
15 Id. at 56.

18. 26th Promissory Note **(PN 9707237)** dated July 30, 1997 – 25%.[16]

The 9th up to the 17th promissory notes provide for the payment of interest at the "*rate the Bank may at any time without notice, raise within the limits allowed by law x x x.*"[17] On the other hand, the 18th up to the 26th promissory notes – including PN 9707237, which is the 26th promissory note – carried the following provision:

> x x x For this purpose, I/We agree that **the rate of interest herein stipulated may be increased or decreased for the subsequent Interest Periods, with prior notice to the Borrower in the event of changes in interest rate prescribed by law or the Monetary Board of the Central Bank of the Philippines, or in the Bank's overall cost of funds. I/We hereby agree that in the event I/we are not agreeable to the interest rate fixed for any Interest Period, I/we shall have the option to prepay the loan or credit facility without penalty within ten (10) calendar days from the Interest Setting Date**.[18] (Emphasis supplied)

Respondent regularly renewed the line from 1990 up to 1997, and petitioners made good on the promissory notes, religiously paying the interests without objection or fail. But in 1997, petitioners faltered when the interest rates soared due to the Asian financial crisis. Petitioners' sole outstanding promissory note for ₱2.5 million – PN 9707237 executed in July 1997 and due 120 days later or on October 28, 1997 – became past due, and despite repeated demands, petitioners failed to make good on the note.

Incidentally, PN 9707237 provided for the penalty equivalent to 24% *per annum* in case of default, as follows:

> Without need for notice or demand, failure to pay this note or any installment thereon, when due, shall constitute default and in such cases or in case of garnishment, receivership or bankruptcy or suit of any kind filed against me/us by the Bank, the outstanding principal of this note, at the option of the Bank and without prior notice of demand, shall immediately become due and payable and shall be **subject to a penalty charge of twenty four percent (24%) *per annum* based on the defaulted principal amount**. x x x[19] (Emphasis supplied)

PNB prepared a Statement of Account[20] as of October 12, 1998, detailing the amount due and demandable from petitioners in the total amount of ₱3,620,541.60, broken down as follows:

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16 Id. at 174-191.
17 Id. at 191.
18 Id. at 174.
19 Id.
20 Id. at 12.

Principal	₱ 2,500,000.00
Interest	538,874.94
Penalties	581,666.66
Total	₱ 3,620,541.60

Despite demand, petitioners failed to pay the foregoing amount. Thus, PNB foreclosed on the mortgage, and on January 14, 1999, TCTs T-14250 and T-16208 were sold to it at auction for the amount of ₱4,324,172.96.[21] The sheriff's certificate of sale was registered on March 11, 1999.

More than a year later, or on March 24, 2000, petitioners filed Civil Case No. 5975, seeking annulment of the foreclosure sale and an accounting of the PNB credit. Petitioners theorized that after the first promissory note where they agreed to pay 19.5% interest, the succeeding stipulations for the payment of interest in their loan agreements with PNB – which allegedly left to the latter the sole will to determine the interest rate – became null and void. Petitioners added that because the interest rates were fixed by respondent without their prior consent or agreement, these rates are void, and as a result, petitioners should only be made liable for interest at the legal rate of 12%. They claimed further that they overpaid interests on the credit, and concluded that due to this overpayment of steep interest charges, their debt should now be deemed paid, and the foreclosure and sale of TCTs T-14250 and T-16208 became unnecessary and wrongful. As for the imposed penalty of ₱581,666.66, petitioners alleged that since the Real Estate Mortgage and the Supplement thereto did not include penalties as part of the secured amount, the same should be excluded from the foreclosure amount or bid price, even if such penalties are provided for in the final Promissory Note, or PN 9707237.[22]

In addition, petitioners sought to be reimbursed an alleged overpayment of ₱848,285.00 made during the period August 21, 1991 to March 5, 1998, resulting from respondent's imposition of the alleged illegal and steep interest rates. They also prayed to be awarded ₱200,000.00 by way of attorney's fees.[23]

In its Answer,[24] PNB denied that it unilaterally imposed or fixed interest rates; that petitioners agreed that without prior notice, PNB may modify interest rates depending on future policy adopted by it; and that the imposition of penalties was agreed upon in the Credit Agreement. It added that the imposition of penalties is supported by the all-inclusive clause in the Real Estate Mortgage agreement which provides that the mortgage shall stand as security for any and all other obligations of whatever kind and nature owing to respondent, which thus

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21 Id. at 13.
22 Id. at 68-70.
23 Id. at 71.
24 Id. at 37-43.

includes penalties imposed upon default or non-payment of the principal and interest on due date.

On pre-trial, the parties mutually agreed to the following material facts, among others:

a) That since 1991 up to 1998, petitioners had paid PNB the total amount of ₱3,484,287.00;[25] and

b) That PNB sent, and petitioners received, a March 10, 2000 demand letter.[26]

During trial, petitioner Lydia Silos (Lydia) testified that the Credit Agreement, the Amendment to Credit Agreement, Real Estate Mortgage and the Supplement thereto were all prepared by respondent PNB and were presented to her and her husband Eduardo only for signature; that she was told by PNB that the latter alone would determine the interest rate; that as to the Amendment to Credit Agreement, she was told that PNB would fill up the interest rate portion thereof; that at the time the parties executed the said Credit Agreement, she was not informed about the applicable spread that PNB would impose on her account; that the interest rate portion of all Promissory Notes she and Eduardo issued were always left in blank when they executed them, with respondent's mere assurance that it would be the one to enter or indicate thereon the prevailing interest rate at the time of availment; and that they agreed to such arrangement. She further testified that the two Real Estate Mortgage agreements she signed did not stipulate the payment of penalties; that she and Eduardo consulted with a lawyer, and were told that PNB's actions were improper, and so on March 20, 2000, they wrote to the latter seeking a recomputation of their outstanding obligation; and when PNB did not oblige, they instituted Civil Case No. 5975.[27]

On cross-examination, Lydia testified that she has been in business for 20 years; that she also borrowed from other individuals and another bank; that it was only with banks that she was asked to sign loan documents with no indicated interest rate; that she did not bother to read the terms of the loan documents which she signed; and that she received several PNB statements of account detailing their outstanding obligations, but she did not complain; that she assumed instead that what was written therein is correct.[28]

For his part, PNB Kalibo Branch Manager Diosdado Aspa, Jr. (Aspa), the sole witness for respondent, stated on cross-examination that as a practice, the

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25 Id. at 165.
26 Id. at 149.
27 *Rollo*, pp. 51-52.
28 Id. at 52.

determination of the prime rates of interest was the responsibility solely of PNB's Treasury Department which is based in Manila; that these prime rates were simply communicated to all PNB branches for implementation; that there are a multitude of considerations which determine the interest rate, such as the cost of money, foreign currency values, PNB's spread, bank administrative costs, profitability, and the practice in the banking industry; that in every repricing of each loan availment, the borrower has the right to question the rates, but that this was not done by the petitioners; and that anything that is not found in the Promissory Note may be supplemented by the Credit Agreement.[29]

Ruling of the Regional Trial Court

On February 28, 2003, the trial court rendered judgment dismissing Civil Case No. 5975.[30] It ruled that:

1. While the Credit Agreement allows PNB to unilaterally increase its spread over the floating interest rate at any time depending on whatever policy it may adopt in the future, it likewise allows for the decrease at any time of the same. Thus, such stipulation authorizing both the increase and decrease of interest rates as may be applicable is valid,[31] as was held in *Consolidated Bank and Trust Corporation (SOLIDBANK) v. Court of Appeals*;[32]

2. Banks are allowed to stipulate that interest rates on loans need not be fixed and instead be made dependent on prevailing rates upon which to peg such variable interest rates;[33]

3. The Promissory Note, as the principal contract evidencing petitioners' loan, prevails over the Credit Agreement and the Real Estate Mortgage.

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29 Id. at 52-53.

30 Records, pp. 361-367; penned by Judge Niovady M. Marin.

31 Id. at 365-366.

32 408 Phil. 803, 811-812 (2001). The Court therein held:

> While it may be acceptable, for practical reasons given the fluctuating economic conditions, for banks to stipulate that interest rates on a loan not be fixed and instead be made dependent upon prevailing market conditions, there should always be a reference rate upon which to peg such variable interest rates. An example of such a valid variable interest rate was found in *Polotan, Sr. v. Court of Appeals*. In that case, the contractual provision stating that "if there occurs any change in the prevailing market rates, the new interest rate shall be the guiding rate in computing the interest due on the outstanding obligation without need of serving notice to the Cardholder other than the required posting on the monthly statement served to the Cardholder" was considered valid. The aforequoted provision was upheld notwithstanding that it may partake of the nature of an escalation clause, **because at the same time it provides for the decrease in the interest rate in case the prevailing market rates dictate its reduction**. In other words, unlike the stipulation subject of the instant case, the interest rate involved in the *Polotan* case is designed to be based on the prevailing market rate. On the other hand, a stipulation ostensibly signifying an agreement to "any increase or decrease in the interest rate," without more, cannot be accepted by this Court as valid for it leaves solely to the creditor the determination of what interest rate to charge against an outstanding loan. (Emphasis supplied)

33 Records, p. 365.

As such, the rate of interest, penalties and attorney's fees stipulated in the Promissory Note prevail over those mentioned in the Credit Agreement and the Real Estate Mortgage agreements;[34]

4. Roughly, PNB's computation of the total amount of petitioners' obligation is correct;[35]

5. Because the loan was admittedly due and demandable, the foreclosure was regularly made;[36]

6. By the admission of petitioners during pre-trial, all payments made to PNB were properly applied to the principal, interest and penalties.[37]

The dispositive portion of the trial court's Decision reads:

> IN VIEW OF THE FOREGOING, judgment is hereby rendered in favor of the respondent and against the petitioners by DISMISSING the latter's petition.
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> Costs against the petitioners.
>
> SO ORDERED.[38]

Petitioners moved for reconsideration. In an Order[39] dated June 4, 2003, the trial court granted only a modification in the award of attorney's fees, reducing the same from 10% to 1%. Thus, PNB was ordered to refund to petitioner the excess in attorney's fees in the amount of ₱356,589.90, *viz*:

> WHEREFORE, judgment is hereby rendered upholding the validity of the interest rate charged by the respondent as well as the extra-judicial foreclosure proceedings and the Certificate of Sale. However, respondent is directed to refund to the petitioner the amount of ₱356,589.90 representing the excess interest charged against the latter.
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> No pronouncement as to costs.
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> SO ORDERED.[40]

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34 Id. at 366.
35 Id.
36 Id.
37 Id. at 367.
38 Id.
39 *Rollo*, pp. 72-73.
40 Id. at 73

Ruling of the Court of Appeals

Petitioners appealed to the CA, which issued the questioned Decision with the following decretal portion:

> WHEREFORE, in view of the foregoing, the instant appeal is PARTLY GRANTED. The modified Decision of the Regional Trial Court per Order dated June 4, 2003 is hereby AFFIRMED with MODIFICATIONS, to wit:
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> 1. [T]hat the interest rate to be applied after the expiration of the first 30-day interest period for PN. No. 9707237 should be 12% *per annum*;
>
> 2. [T]hat the attorney's fees of 10% is valid and binding; and
>
> 3. [T]hat [PNB] is hereby ordered to reimburse [petitioners] the excess in the bid price of ₱377,505.99 which is the difference between the total amount due [PNB] and the amount of its bid price.
>
> SO ORDERED.[41]

On the other hand, respondent did not appeal the June 4, 2003 Order of the trial court which reduced its award of attorney's fees. It simply raised the issue in its appellee's brief in the CA, and included a prayer for the reversal of said Order.

In effect, the CA limited petitioners' appeal to the following issues:

1) Whether x x x the interest rates on petitioners' outstanding obligation were unilaterally and arbitrarily imposed by PNB;

2) Whether x x x the penalty charges were secured by the real estate mortgage; and

3) Whether x x x the extrajudicial foreclosure and sale are valid.[42]

The CA noted that, based on receipts presented by petitioners during trial, the latter dutifully paid a total of ₱3,027,324.60 in interest for the period August 7, 1991 to August 6, 1997, over and above the ₱2.5 million principal obligation. And this is exclusive of payments for insurance premiums, documentary stamp taxes, and penalty. All the while, petitioners did not complain nor object to the imposition of interest; they in fact paid the same religiously and without fail for seven years. The appellate court ruled that petitioners are thus estopped from questioning the same.

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41 Id. at 63-64.
42 Id. at 55.

The CA nevertheless noted that for the period July 30, 1997 to August 14, 1997, PNB wrongly applied an interest rate of 25.72% instead of the agreed 25%; thus it overcharged petitioners, and the latter paid, an excess of ₱736.56 in interest.

On the issue of penalties, the CA ruled that the express tenor of the Real Estate Mortgage agreements contemplated the inclusion of the PN 9707237-stipulated 24% penalty in the amount to be secured by the mortgaged property, thus –

> For and in consideration of certain loans, overdrafts and other credit accommodations obtained from the MORTGAGEE and to secure the payment of the same and **those others that the MORTGAGEE may extend to the MORTGAGOR, including interest and expenses, and other obligations owing by the MORTGAGOR to the MORTGAGEE, whether direct or indirect, principal or secondary**, as appearing in the accounts, books and records of the MORTGAGEE, the MORTGAGOR does hereby transfer and convey by way of mortgage unto the MORTGAGEE x x x[43] (Emphasis supplied)

The CA believes that the 24% penalty is covered by the phrase "*and other obligations owing by the mortgagor to the mortgagee*" and should thus be added to the amount secured by the mortgages.[44]

The CA then proceeded to declare valid the foreclosure and sale of properties covered by TCTs T-14250 and T-16208, which came as a necessary result of petitioners' failure to pay the outstanding obligation upon demand.[45] The CA saw fit to increase the trial court's award of 1% to 10%, finding the latter rate to be reasonable and citing the Real Estate Mortgage agreement which authorized the collection of the higher rate.[46]

Finally, the CA ruled that petitioners are entitled to ₱377,505.09 surplus, which is the difference between PNB's bid price of ₱4,324,172.96 and petitioners' total computed obligation as of January 14, 1999, or the date of the auction sale, in the amount of ₱3,946,667.87.[47]

Hence, the present Petition.

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43 Records, p. 74.
44 *Rollo*, p. 61.
45 Id. at 61-62.
46 Id. at 62.
47 Id. at 63.

Issues

The following issues are raised in this Petition:

I

A. THE COURT OF APPEALS AS WELL AS THE LOWER COURT ERRED IN NOT NULLIFYING THE INTEREST RATE PROVISION IN THE CREDIT AGREEMENT DATED JULY 24, 1989 X X X AND IN THE AMENDMENT TO CREDIT AGREEMENT DATED AUGUST 21, 1991 X X X WHICH LEFT TO THE SOLE UNILATERAL DETERMINATION OF THE RESPONDENT PNB THE ORIGINAL FIXING OF INTEREST RATE AND ITS INCREASE, WHICH AGREEMENT IS CONTRARY TO LAW, ART. 1308 OF THE [NEW CIVIL CODE], AS ENUNCIATED IN PONCIANO ALMEIDA V. COURT OF APPEALS, G.R. [NO.] 113412, APRIL 17, 1996, AND CONTRARY TO PUBLIC POLICY AND PUBLIC INTEREST, AND IN APPLYING THE PRINCIPLE OF ESTOPPEL ARISING FROM THE ALLEGED DELAYED COMPLAINT OF PETITIONER[S], AND [THEIR] PAYMENT OF THE INTEREST CHARGED.

B. CONSEQUENTLY, THE COURT OF APPEALS AND THE LOWER COURT ERRED IN NOT DECLARING THAT PNB IS NOT AT ALL ENTITLED TO ANY INTEREST EXCEPT THE LEGAL RATE FROM DATE OF DEMAND, AND IN NOT APPLYING THE EXCESS OVER THE LEGAL RATE OF THE ADMITTED PAYMENTS MADE BY PETITIONER[S] FROM 1991-1998 IN THE ADMITTED TOTAL AMOUNT OF ₱3,484,287.00, TO PAYMENT OF THE PRINCIPAL OF ₱2,500,000.[00] LEAVING AN OVERPAYMENT OF ₱984,287.00 REFUNDABLE BY RESPONDENT TO PETITIONER[S] WITH INTEREST OF 12% *PER ANNUM*.

II

THE COURT OF APPEALS AND THE LOWER COURT ERRED IN HOLDING THAT PENALTIES ARE INCLUDED IN THE SECURED AMOUNT, SUBJECT TO FORECLOSURE, WHEN NO PENALTIES ARE MENTIONED [NOR] PROVIDED FOR IN THE REAL ESTATE MORTGAGE AS A SECURED AMOUNT AND THEREFORE THE AMOUNT OF PENALTIES SHOULD HAVE BEEN EXCLUDED FROM [THE] FORECLOSURE AMOUNT.

III

THE COURT OF APPEALS ERRED IN REVERSING THE RULING OF THE LOWER COURT, WHICH REDUCED THE ATTORNEY'S FEES OF 10% OF THE TOTAL INDEBTEDNESS CHARGED IN THE X X X EXTRAJUDICIAL FORECLOSURE TO ONLY 1%, AND [AWARDING] 10% ATTORNEY'S FEES.[48]

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[48] Id. at 23-24.

Petitioners' Arguments

Petitioners insist that the interest rate provision in the Credit Agreement and the Amendment to Credit Agreement should be declared null and void, for they relegated to PNB the sole power to fix interest rates based on arbitrary criteria or factors such as bank policy, profitability, cost of money, foreign currency values, and bank administrative costs; spaces for interest rates in the two Credit Agreements and the promissory notes were left blank for PNB to unilaterally fill, and their consent or agreement to the interest rates imposed thereafter was not obtained; the interest rate, which consists of the prime rate plus the bank spread, is determined not by agreement of the parties but by PNB's Treasury Department in Manila. Petitioners conclude that by this method of fixing the interest rates, the principle of mutuality of contracts is violated, and public policy as well as Circular 905[49] of the then Central Bank had been breached.

Petitioners question the CA's application of the principle of estoppel, saying that no estoppel can proceed from an illegal act. Though they failed to timely question the imposition of the alleged illegal interest rates and continued to pay the loan on the basis of these rates, they cannot be deemed to have acquiesced, and hence could recover what they erroneously paid.[50]

Petitioners argue that if the interest rates were nullified, then their obligation to PNB is deemed extinguished as of July 1997; moreover, it would appear that they even made an overpayment to the bank in the amount of ₱984,287.00.

Next, petitioners suggest that since the Real Estate Mortgage agreements did not include nor specify, as part of the secured amount, the penalty of 24% authorized in PN 9707237, such amount of ₱581,666.66 could not be made answerable by or collected from the mortgages covering TCTs T-14250 and T-16208. Claiming support from *Philippine Bank of Communications [PBCom] v. Court of Appeals*,[51] petitioners insist that the phrase "*and other obligations owing by the mortgagor to the mortgagee*"[52] in the mortgage agreements cannot embrace the ₱581,666.66 penalty, because, as held in the *PBCom* case, "[a] penalty charge does not belong to the species of obligations enumerated in the mortgage, hence, the said contract cannot be understood to secure the penalty";[53] while the mortgages are the accessory contracts, what items are secured may only be determined from the provisions of the mortgage contracts, and not from the Credit Agreement or the promissory notes.

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49 Which removed the ceiling on interest rates for secured and unsecured loans, regardless of maturity (Section 1), but required that the rate of interest on a floating rate loan during each interest period shall be stated on the basis of a reference rate plus a margin as may be agreed upon by the parties (Section 7).

50 *Rollo*, p. 167, citing *United Coconut Planters Bank v. Spouses Beluso*, 557 Phil. 326 (2007).

51 323 Phil. 297 (1996).

52 Records, p. 74.

53 *Philippine Bank of Communications v. Court of Appeals*, supra note 50 at 313.

Finally, petitioners submit that the trial court's award of 1% attorney's fees should be maintained, given that in foreclosures, a lawyer's work consists merely in the preparation and filing of the petition, and involves minimal study.[54] To allow the imposition of a staggering ₱396,211.00 for such work would be contrary to equity. Petitioners state that the purpose of attorney's fees in cases of this nature "is not to give respondent a larger compensation for the loan than the law already allows, but to protect it against any future loss or damage by being compelled to retain counsel x x x to institute judicial proceedings for the collection of its credit."[55] And because the instant case involves a simple extrajudicial foreclosure, attorney's fees may be equitably tempered.

Respondent's Arguments

For its part, respondent disputes petitioners' claim that interest rates were unilaterally fixed by it, taking relief in the CA pronouncement that petitioners are deemed estopped by their failure to question the imposed rates and their continued payment thereof without opposition. It adds that because the Credit Agreement and promissory notes contained both an escalation clause and a de-escalation clause, it may not be said that the bank violated the principle of mutuality. Besides, the increase or decrease in interest rates have been mutually agreed upon by the parties, as shown by petitioners' continuous payment without protest. Respondent adds that the alleged unilateral imposition of interest rates is not a proper subject for review by the Court because the issue was never raised in the lower court.

As for petitioners' claim that interest rates imposed by it are null and void for the reasons that 1) the Credit Agreements and the promissory notes were signed in blank; 2) interest rates were at short periods; 3) no interest rates could be charged where no agreement on interest rates was made in writing; 4) PNB fixed interest rates on the basis of arbitrary policies and standards left to its choosing; and 5) interest rates based on prime rate plus applicable spread are indeterminate and arbitrary – PNB counters:

> a. That Credit Agreements and promissory notes were signed by petitioner[s] in blank – Respondent claims that this issue was never raised in the lower court. Besides, documentary evidence prevails over testimonial evidence; Lydia Silos' testimony in this regard is self-serving, unsupported and uncorroborated, and for being the lone evidence on this issue. The fact remains that these documents are in proper form, presumed regular, and endure, against arbitrary claims by Silos – who is an experienced business person – that she signed questionable loan documents

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54 Citing *Mambulao Lumber Co. v. Philippine National Bank*, 130 Phil. 366, 380-381 (1968).

55 Citing *New Sampaguita Builders Construction, Inc. v. Philippine National Bank*, 479 Phil. 483, 510 (2004).

whose provisions for interest rates were left blank, and yet she continued to pay the interests without protest for a number of years.[56]

b. That interest rates were at short periods – Respondent argues that the law which governs and prohibits changes in interest rates made more than once every twelve months has been removed[57] with the issuance of Presidential Decree No. 858.[58]

c. That no interest rates could be charged where no agreement on interest rates was made in writing in violation of Article 1956 of the Civil Code, which provides that no interest shall be due unless it has been expressly stipulated in writing – Respondent insists that the stipulated 25% *per annum* as embodied in PN 9707237 should be imposed during the interim, or the period after the loan became due and while it remains unpaid, and not the legal interest of 12% as claimed by petitioners.[59]

d. That PNB fixed interest rates on the basis of arbitrary policies and standards left to its choosing – According to respondent, interest rates were fixed taking into consideration increases or decreases as provided by law or by the Monetary Board, the bank's overall costs of funds, and upon agreement of the parties.[60]

e. That interest rates based on prime rate plus applicable spread are indeterminate and arbitrary – On this score, respondent submits there are various factors that influence interest rates, from political events to economic developments, etc.; the cost of money, profitability and foreign currency transactions may not be discounted.[61]

On the issue of penalties, respondent reiterates the trial court's finding that during pre-trial, petitioners admitted that the Statement of Account as of October 12, 1998 – which detailed and included penalty charges as part of the total outstanding obligation owing to the bank – was correct. Respondent justifies the imposition and collection of a penalty as a normal banking practice, and the standard rate *per annum* for all commercial banks, at the time, was 24%.

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56 *Rollo*, pp. 100, 102.
57 Id. at 103.
58 Amending Further Act Numbered Two Thousand Six Hundred Fifty-Five, As Amended, Otherwise Known As The "Usury Law".
59 *Rollo*, pp. 103-104.
60 Id. at 104-105.
61 Id. at 106-107.

Respondent adds that the purpose of the penalty or a penal clause for that matter is to ensure the performance of the obligation and substitute for damages and the payment of interest in the event of non-compliance.[62] And the promissory note – being the principal agreement as opposed to the mortgage, which is a mere accessory – should prevail. This being the case, its inclusion as part of the secured amount in the mortgage agreements is valid and necessary.

Regarding the foreclosure of the mortgages, respondent accuses petitioners of pre-empting consolidation of its ownership over TCTs T-14250 and T-16208; that petitioners filed Civil Case No. 5975 ostensibly to question the foreclosure and sale of properties covered by TCTs T-14250 and T-16208 in a desperate move to retain ownership over these properties, because they failed to timely redeem them.

Respondent directs the attention of the Court to its petition in G.R. No. 181046,[63] where the propriety of the CA's ruling on the following issues is squarely raised:

1. That the interest rate to be applied after the expiration of the first 30-day interest period for PN 9707237 should be 12% *per annum*; and

2. That PNB should reimburse petitioners the excess in the bid price of ₱377,505.99 which is the difference between the total amount due to PNB and the amount of its bid price.

Our Ruling

The Court grants the Petition.

Before anything else, it must be said that it is not the function of the Court to re-examine or re-evaluate evidence adduced by the parties in the proceedings below. The rule admits of certain well-recognized exceptions, though, as when the lower courts' findings are not supported by the evidence on record or are based on a misapprehension of facts, or when certain relevant and undisputed facts were manifestly overlooked that, if properly considered, would justify a different conclusion. This case falls within such exceptions.

The Court notes that on March 5, 2008, a Resolution was issued by the Court's First Division denying respondent's petition in G.R. No. 181046, due to

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62 Citing Article 1226 of the Civil Code and Paras, Civil Code of the Philippines Annotated (Commentaries) Vol. IV, 1989 12th edition, p. 298.

63 *Philippine National Bank*, petitioner, versus *Spouses Eduardo and Lydia Silos*, respondents.

late filing, failure to attach the required affidavit of service of the petition on the trial court and the petitioners, and submission of a defective verification and certification of non-forum shopping. On June 25, 2008, the Court issued another Resolution denying with finality respondent's motion for reconsideration of the March 5, 2008 Resolution. And on August 15, 2008, entry of judgment was made. This thus settles the issues, as above-stated, covering a) the interest rate – or 12% *per annum* – that applies upon expiration of the first 30 days interest period provided under PN 9707237, and b) the CA's decree that PNB should reimburse petitioner the excess in the bid price of ₱377,505.09.

It appears that respondent's practice, more than once proscribed by the Court, has been carried over once more to the petitioners. In a number of decided cases, the Court struck down provisions in credit documents issued by PNB to, or required of, its borrowers which allow the bank to increase or decrease interest rates "*within the limits allowed by law at any time depending on whatever policy it may adopt in the future*." Thus, in *Philippine National Bank v. Court of Appeals*,[64] such stipulation and similar ones were declared in violation of Article 1308[65] of the Civil Code. In a second case, *Philippine National Bank v. Court of Appeals*,[66] the very same stipulations found in the credit agreement and the promissory notes prepared and issued by the respondent were again invalidated. The Court therein said:

> The **Credit Agreement** provided inter alia, that —
>
> (a) **The BANK reserves the right to increase the interest rate within the limits allowed by law at any time depending on whatever policy it may adopt in the future**; Provided, that the interest rate on this accommodation shall be correspondingly decreased in the event that the applicable maximum interest is reduced by law or by the Monetary Board. In either case, the adjustment in the interest rate agreed upon shall take effect on the effectivity date of the increase or decrease in the maximum interest rate.
>
> The **Promissory Note**, in turn, **authorized the PNB to raise the rate of interest, at any time without notice, beyond the stipulated rate of 12% but only "within the limits allowed by law."**
>
> The **Real Estate Mortgage** contract likewise provided that —
>
> (k) INCREASE OF INTEREST RATE: **The rate of interest charged** on the obligation secured by this mortgage as well as the interest on the amount which may have been advanced by the MORTGAGEE, in accordance with the provision hereof, **shall be subject during the life of this**

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64 273 Phil. 789, 796-797, 799 (1991).

65 Art. 1308. The contract must bind both contracting parties; its validity or compliance cannot be left to the will of one of them.

66 G.R. No. 107569, November 8, 1994, 238 SCRA 20.

> **contract to such an increase within the rate allowed by law, as the Board of Directors of the MORTGAGEE may prescribe for its debtors**.
>
> x x x x

In making the unilateral increases in interest rates, petitioner bank relied on the escalation clause contained in their credit agreement which provides, as follows:

> The Bank reserves the right to increase the interest rate within the limits allowed by law at any time depending on **whatever policy it may adopt in the future** and provided, that, the interest rate on this accommodation shall be correspondingly decreased in the event that the applicable maximum interest rate is reduced by law or by the Monetary Board. In either case, the adjustment in the interest rate agreed upon shall take effect on the effectivity date of the increase or decrease in maximum interest rate.

This clause is authorized by Section 2 of Presidential Decree (P.D.) No. 1684 which further amended Act No. 2655 ("The Usury Law"), as amended, thus:

> Section 2. The same Act is hereby amended by adding a new section after Section 7, to read as follows:
>
> > Sec. 7-a. Parties to an agreement pertaining to a loan or forbearance of money, goods or credits may stipulate that the rate of interest agreed upon may be increased in the event that the applicable maximum rate of interest is increased by law or by the Monetary Board; Provided, That such stipulation shall be valid only if there is also a stipulation in the agreement that the rate of interest agreed upon shall be reduced in the event that the applicable maximum rate of interest is reduced by law or by the Monetary Board; Provided further, That the adjustment in the rate of interest agreed upon shall take effect on or after the effectivity of the increase or decrease in the maximum rate of interest.

Section 1 of P.D. No. 1684 also empowered the Central Bank's Monetary Board to prescribe the maximum rates of interest for loans and certain forbearances. Pursuant to such authority, the Monetary Board issued Central Bank (C.B.) Circular No. 905, series of 1982, Section 5 of which provides:

> Sec. 5. Section 1303 of the Manual of Regulations (for Banks and Other Financial Intermediaries) is hereby amended to read as follows:

> Sec. 1303. Interest and Other Charges. — The rate of interest, including commissions, premiums, fees and other charges, on any loan, or forbearance of any money, goods or credits, regardless of maturity and whether secured or unsecured, shall not be subject to any ceiling prescribed under or pursuant to the Usury Law, as amended.

P.D. No. 1684 and C.B. Circular No. 905 no more than allow contracting parties to stipulate freely regarding any subsequent adjustment in the interest rate that shall accrue on a loan or forbearance of money, goods or credits. In fine, they can agree to adjust, upward or downward, the interest previously stipulated. **However, contrary to the stubborn insistence of petitioner bank, the said law and circular did not authorize either party to unilaterally raise the interest rate without the other's consent**.

It is basic that there can be no contract in the true sense in the absence of the element of agreement, or of mutual assent of the parties. If this assent is wanting on the part of the one who contracts, his act has no more efficacy than if it had been done under duress or by a person of unsound mind.

Similarly, **contract changes must be made with the consent of the contracting parties. The minds of all the parties must meet as to the proposed modification, especially when it affects an important aspect of the agreement. In the case of loan contracts, it cannot be gainsaid that the rate of interest is always a vital component**, for it can make or break a capital venture. Thus, any change must be mutually agreed upon, otherwise, it is bereft of any binding effect.

We cannot countenance petitioner bank's posturing that the escalation clause at bench gives it unbridled right to unilaterally upwardly adjust the interest on private respondents' loan. That would completely take away from private respondents the right to assent to an important modification in their agreement, and would negate the element of mutuality in contracts. In Philippine National Bank v. Court of Appeals, et al., 196 SCRA 536, 544-545 (1991) we held —

> x x x **The unilateral action of the PNB in increasing the interest rate on the private respondent's loan violated the mutuality of contracts ordained in Article 1308 of the Civil Code**:
>
> > Art. 1308. The contract must bind both contracting parties; its validity or compliance cannot be left to the will of one of them.
>
> In order that obligations arising from contracts may have the force of law between the parties, there must be mutuality between the parties based on their essential equality. A contract containing a condition which makes its fulfillment dependent exclusively upon the uncontrolled will of one of the contracting parties, is void . . . . Hence, even assuming that the . . . loan

> agreement between the PNB and the private respondent gave the PNB a license (although in fact there was none) to increase the interest rate at will during the term of the loan, that license would have been null and void for being violative of the principle of mutuality essential in contracts. It would have invested the loan agreement with the character of a contract of adhesion, where the parties do not bargain on equal footing, the weaker party's (the debtor) participation being reduced to the alternative "to take it or leave it" . . . . Such a contract is a veritable trap for the weaker party whom the courts of justice must protect against abuse and imposition.[67] (Emphases supplied)

Then again, in a third case, *Spouses Almeda v. Court of Appeals*,[68] the Court invalidated the very same provisions in the respondent's prepared Credit Agreement, declaring thus:

> The binding effect of any agreement between parties to a contract is premised on two settled principles: (1) that any obligation arising from contract has the force of law between the parties; and (2) that there must be mutuality between the parties based on their essential equality. Any contract which appears to be heavily weighed in favor of one of the parties so as to lead to an unconscionable result is void. Any stipulation regarding the validity or compliance of the contract which is left solely to the will of one of the parties, is likewise, invalid.
>
> **It is plainly obvious, therefore, from the undisputed facts of the case that respondent bank unilaterally altered the terms of its contract with petitioners by increasing the interest rates on the loan without the prior assent of the latter**. In fact, the manner of agreement is itself explicitly stipulated by the Civil Code when it provides, in Article 1956 that "No interest shall be due unless it has been expressly stipulated in writing." **What has been "stipulated in writing" from a perusal of interest rate provision of the credit agreement signed between the parties is that petitioners were bound merely to pay 21% interest, subject to a possible escalation or de-escalation, when 1) the circumstances warrant such escalation or de-escalation; 2) within the limits allowed by law; and 3) upon agreement.**
>
> **Indeed, the interest rate which appears to have been agreed upon by the parties to the contract in this case was the 21% rate stipulated in the interest provision. Any doubt about this is in fact readily resolved by a careful reading of the credit agreement because the same plainly uses the phrase "interest rate agreed upon," in reference to the original 21% interest rate.** x x x
>
> x x x x
>
> Petitioners never agreed in writing to pay the increased interest rates demanded by respondent bank in contravention to the tenor of their credit agreement. That an increase in interest rates from 18% to as much as 68% is

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67 Id. at 22-26.

68 326 Phil. 309 (1996).

> excessive and unconscionable is indisputable. **Between 1981 and 1984, petitioners had paid an amount equivalent to virtually half of the entire principal (₱7,735,004.66) which was applied to interest alone. By the time the spouses tendered the amount of ₱40,142,518.00 in settlement of their obligations; respondent bank was demanding ₱58,377,487.00 over and above those amounts already previously paid by the spouses.**
>
> Escalation clauses are not basically wrong or legally objectionable so long as they are not solely potestative but based on reasonable and valid grounds. Here, as clearly demonstrated above, not only [are] the increases of the interest rates on the basis of the escalation clause patently unreasonable and unconscionable, but also there are no valid and reasonable standards upon which the increases are anchored.
>
> x x x x
>
> In the face of the unequivocal interest rate provisions in the credit agreement and in the law requiring the parties to agree to changes in the interest rate in writing, we hold that the unilateral and progressive increases imposed by respondent PNB were null and void. Their effect was to increase the total obligation on an eighteen million peso loan to an amount way over three times that which was originally granted to the borrowers. That these increases, occasioned by crafty manipulations in the interest rates is unconscionable and neutralizes the salutary policies of extending loans to spur business cannot be disputed.[69] (Emphases supplied)

Still, in a fourth case, *Philippine National Bank v. Court of Appeals*,[70] the above doctrine was reiterated:

> The promissory note contained the following stipulation:
>
> For value received, I/we, [private respondents] jointly and severally promise to pay to the ORDER of the PHILIPPINE NATIONAL BANK, at its office in San Jose City, Philippines, the sum of FIFTEEN THOUSAND ONLY (₱15,000.00), Philippine Currency, together **with interest thereon at the rate of 12% *per annum* until paid, which interest rate the Bank may at any time without notice, raise within the limits allowed by law**, and I/we also agree to pay jointly and severally ____% *per annum* penalty charge, by way of liquidated damages should this note be unpaid or is not renewed on due dated.
>
> Payment of this note shall be as follows:
>
> *THREE HUNDRED SIXTY FIVE DAYS* AFTER DATE
>
> On the reverse side of the note the following condition was stamped:
>
> All short-term loans to be granted starting January 1, 1978 shall be made subject to the condition that any and/or all extensions hereof that will leave any portion of the amount still unpaid after 730 days shall automatically convert the

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69 Id. at 316-317, 322, 325.

70 328 Phil. 54 (1996).

outstanding balance into a medium or long-term obligation as the case may be and **give the Bank the right to charge the interest rates prescribed under its policies** from the date the account was originally granted.

To secure payment of the loan the parties executed a real estate mortgage contract which provided:

(k) INCREASE OF INTEREST RATE:

The rate of interest charged on the obligation secured by this mortgage as well as the interest on the amount which may have been advanced by the MORTGAGEE, in accordance with the provision hereof, **shall be subject during the life of this contract to such an increase within the rate allowed by law, as the Board of Directors of the MORTGAGEE may prescribe for its debtors**.

x x x x

To begin with, PNB's argument rests on a misapprehension of the import of the appellate court's ruling. The Court of Appeals nullified the interest rate increases not because the promissory note did not comply with P.D. No. 1684 by providing for a de-escalation, but because the absence of such provision made the clause so one-sided as to make it unreasonable.

That ruling is correct. It is in line with our decision in *Banco Filipino Savings & Mortgage Bank v. Navarro* that although P.D. No. 1684 is not to be retroactively applied to loans granted before its effectivity, there must nevertheless be a de-escalation clause to mitigate the one-sidedness of the escalation clause. Indeed because of concern for the unequal status of borrowers *vis-a-vis* the banks, our cases after Banco Filipino have fashioned the rule that **any increase in the rate of interest made pursuant to an escalation clause must be the result of agreement between the parties**.

Thus in *Philippine National Bank v. Court of Appeals,* two promissory notes authorized PNB to increase the stipulated interest *per annum* "within the limits allowed by law at any time depending on whatever policy [PNB] may adopt in the future; Provided, that the interest rate on this note shall be correspondingly decreased in the event that the applicable maximum interest rate is reduced by law or by the Monetary Board." The real estate mortgage likewise provided:

The rate of interest charged on the obligation secured by this mortgage as well as the interest on the amount which may have been advanced by the MORTGAGEE, in accordance with the provisions hereof, shall be subject during the life of this contract to such an increase within the rate allowed by law, as the Board of Directors of the MORTGAGEE may prescribe for its debtors.

Pursuant to these clauses, PNB successively increased the interest from 18% to 32%, then to 41% and then to 48%. **This Court declared the increases unilaterally imposed by [PNB] to be in violation of the principle of mutuality** as embodied in Art. 1308 of the Civil Code, which provides that "[t]he contract must bind both contracting parties; its validity or compliance cannot be left to the will of one of them." As the Court explained:

In order that obligations arising from contracts may have the force of law between the parties, there must be mutuality between the parties based on their essential equality. A contract containing a condition which makes its fulfillment dependent exclusively upon the uncontrolled will of one of the contracting parties, is void (Garcia vs. Rita Legarda, Inc., 21 SCRA 555). Hence, even assuming that the P1.8 million loan agreement between the PNB and the private respondent gave the PNB a license (although in fact there was none) to increase the interest rate at will during the term of the loan, that license would have been null and void for being violative of the principle of mutuality essential in contracts. It would have invested the loan agreement with the character of a contract of adhesion, where the parties do not bargain on equal footing, the weaker party's (the debtor) participation being reduced to the alternative "to take it or leave it" (Qua vs. Law Union & Rock Insurance Co., 95 Phil. 85). Such a contract is a veritable trap for the weaker party whom the courts of justice must protect against abuse and imposition.

A similar ruling was made in Philippine National Bank v. Court of Appeals. The credit agreement in that case provided:

The BANK reserves the right to increase the interest rate within the limits allowed by law at any time depending on whatever policy it may adopt in the future: Provided, that the interest rate on this accommodation shall be correspondingly decreased in the event that the applicable maximum interest is reduced by law or by the Monetary Board. . . .

As in the first case, PNB successively increased the stipulated interest so that what was originally 12% *per annum* became, after only two years, 42%. In declaring the increases invalid, we held:

We cannot countenance petitioner bank's posturing that the escalation clause at bench gives it unbridled right to unilaterally upwardly adjust the interest on private respondents' loan. That would completely take away from private respondents the right to assent to an important modification in their agreement, and would negate the element of mutuality in contracts.

Only recently we invalidated another round of interest increases decreed by PNB pursuant to a similar agreement it had with other borrowers:

[W]hile the Usury Law ceiling on interest rates was lifted by C.B. Circular 905, **nothing in the said circular could possibly be read as granting respondent bank *carte blanche* authority to raise interest rates to levels which would either enslave its borrowers or lead to a hemorrhaging of their assets**.

In this case no attempt was made by PNB to secure the conformity of private respondents to the successive increases in the interest rate. Private respondents' assent to the increases can not be implied from their lack of response to the letters sent by PNB, informing them of the increases. For as stated in one case, no one receiving a proposal to change a contract is obliged to answer the proposal.[71] (Emphasis supplied)

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[71] Id. at 56-57, 60-63.

We made the same pronouncement in a fifth case, *New Sampaguita Builders Construction, Inc. v. Philippine National Bank*,[72] thus –

> Courts have the authority to strike down or to modify provisions in promissory notes that grant the lenders unrestrained power to increase interest rates, penalties and other charges at the latter's sole discretion and without giving prior notice to and securing the consent of the borrowers. This unilateral authority is anathema to the mutuality of contracts and enable lenders to take undue advantage of borrowers. Although the Usury Law has been effectively repealed, courts may still reduce iniquitous or unconscionable rates charged for the use of money. **Furthermore, excessive interests, penalties and other charges not revealed in disclosure statements issued by banks, even if stipulated in the promissory notes, cannot be given effect under the Truth in Lending Act**.[73] (Emphasis supplied)

Yet again, in a sixth disposition, *Philippine National Bank v. Spouses Rocamora*,[74] the above pronouncements were reiterated to debunk PNB's repeated reliance on its invalidated contract stipulations:

> We repeated this rule in the 1994 case of PNB v. CA and Jayme-Fernandez and the 1996 case of PNB v. CA and Spouses Basco. **Taking no heed of these ruling**s, the escalation clause PNB used in the present case to justify the increased interest rates is no different from the escalation clause assailed in the 1996 PNB case; in both, the interest rates were increased from the agreed 12% *per annum* rate to 42%. x x x
>
> x x x x
>
> **On the strength of this ruling, PNB's argument – that the spouses Rocamora's failure to contest the increased interest rates that were purportedly reflected in the statements of account and the demand letters sent by the bank amounted to their implied acceptance of the increase – should likewise fail.**
>
> Evidently, PNB's failure to secure the spouses Rocamora's consent to the increased interest rates prompted the lower courts to declare excessive and illegal the interest rates imposed. To go around this lower court finding, PNB alleges that the ₱206,297.47 deficiency claim was computed using only the original 12% *per annum* interest rate. We find this unlikely. Our examination of PNB's own ledgers, included in the records of the case, clearly indicates that PNB imposed interest rates higher than the agreed 12% *per annum* rate. This confirmatory finding, albeit based solely on ledgers found in the records, reinforces the application in this case of the rule that findings of the RTC, when affirmed by the CA, are binding upon this Court.[75] (Emphases supplied)

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72 *New Sampaguita Builders Construction, Inc. v. Philippine National Bank*, supra note 55.
73 Id. at 486.
74 616 Phil. 369 (2009).
75 Id. at 382-383.

Verily, all these cases, including the present one, involve identical or similar provisions found in respondent's credit agreements and promissory notes. Thus, the July 1989 Credit Agreement executed by petitioners and respondent contained the following stipulation on interest:

> 1.03. Interest. (a) The Loan shall be subject to interest at the rate of 19.5% [*per annum*]. Interest shall be payable in advance every one hundred twenty days at the rate prevailing at the time of the renewal.
>
> (b) The Borrower agrees that **the Bank may modify the interest rate in the Loan depending on whatever policy the Bank may adopt in the future**, including without limitation, the shifting from the floating interest rate system to the fixed interest rate system, or vice versa. Where the Bank has imposed on the Loan interest at a rate *per annum* which is equal to the Bank's spread over the current floating interest rate, **the Borrower hereby agrees that the Bank may, without need of notice to the Borrower, increase or decrease its spread over the floating interest rate at any time depending on whatever policy it may adopt in the future**.[76] (Emphases supplied)

while the eight promissory notes issued pursuant thereto granted PNB the right to increase or reduce interest rates "*within the limits allowed by law or the Monetary Board*"[77] and the Real Estate Mortgage agreement included the same right to increase or reduce interest rates "*at any time depending on whatever policy PNB may adopt in the future*."[78]

On the basis of the Credit Agreement, petitioners issued promissory notes which they signed in blank, and respondent later on entered their corresponding interest rates, as follows:

> 1st Promissory Note dated July 24, 1989 – 19.5%;
> 2nd Promissory Note dated November 22, 1989 – 23%;
> 3rd Promissory Note dated March 21, 1990 – 22%;
> 4th Promissory Note dated July 19, 1990 – 24%;
> 5th Promissory Note dated December 17, 1990 – 28%;
> 6th Promissory Note dated February 14, 1991 – 32%;
> 7th Promissory Note dated March 1, 1991 – 30%; and
> 8th Promissory Note dated July 11, 1991 – 24%.[79]

On the other hand, the August 1991 Amendment to Credit Agreement contains the following stipulation regarding interest:

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76 Records, p. 74.
77 Id. at 192.
78 Id. at 74, dorsal portion.
79 Id. at 192-199.

> 1.03. Interest on Line Availments. (a) **The Borrowers agree to pay interest on each Availment** from date of each Availment up to but not including the date of full payment thereof **at the rate *per annum* which is determined by the Bank to be prime rate plus applicable spread in effect as of the date of each Availment**.[80] (Emphases supplied)

and under this Amendment to Credit Agreement, petitioners again executed and signed the following promissory notes in blank, for the respondent to later on enter the corresponding interest rates, which it did, as follows:

> 9th Promissory Note dated November 8, 1991 – 26%;
> 10th Promissory Note dated March 19, 1992 – 25%;
> 11th Promissory Note dated July 11, 1992 – 23%;
> 12th Promissory Note dated November 10, 1992 – 21%;
> 13th Promissory Note dated March 15, 1993 – 21%;
> 14th Promissory Note dated July 12, 1993 – 17.5%;
> 15th Promissory Note dated November 17, 1993 – 21%;
> 16th Promissory Note dated March 28, 1994 – 21%;
> 17th Promissory Note dated July 13, 1994 – 21%;
> 18th Promissory Note dated November 16, 1994 – 16%;
> 19th Promissory Note dated April 10, 1995 – 21%;
> 20th Promissory Note dated July 19, 1995 – 18.5%;
> 21st Promissory Note dated December 18, 1995 – 18.75%;
> 22nd Promissory Note dated April 22, 1996 – 18.5%;
> 23rd Promissory Note dated July 22, 1996 – 18.5%;
> 24th Promissory Note dated November 25, 1996 – 18%;
> 25th Promissory Note dated May 30, 1997 – 17.5%; and
> 26th Promissory Note **(PN 9707237)** dated July 30, 1997 – 25%.[81]

The 9th up to the 17th promissory notes provide for the payment of interest at the "*rate the Bank may at any time without notice, raise within the limits allowed by law x x x*."[82] On the other hand, the 18th up to the 26th promissory notes – which includes PN 9707237 – carried the following provision:

> x x x For this purpose, I/We agree that **the rate of interest herein stipulated may be increased or decreased for the subsequent Interest Periods, with prior notice to the Borrower in the event of changes in interest rate prescribed by law or the Monetary Board of the Central Bank of the Philippines, or in the Bank's overall cost of funds. I/We hereby agree that in the event I/we are not agreeable to the interest rate fixed for any Interest Period, I/we shall have the option to prepay the loan or credit facility**

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80 Id. at 56.
81 Id. at 174-191.
82 Id. at 191.

> **without penalty within ten (10) calendar days from the Interest Setting Date**.[83] (Emphasis supplied)

These stipulations must be once more invalidated, as was done in previous cases. The common denominator in these cases is the lack of agreement of the parties to the imposed interest rates. For this case, this lack of consent by the petitioners has been made obvious by the fact that they signed the promissory notes in blank for the respondent to fill. We find credible the testimony of Lydia in this respect. Respondent failed to discredit her; in fact, its witness PNB Kalibo Branch Manager Aspa admitted that interest rates were fixed solely by its Treasury Department in Manila, which were then simply communicated to all PNB branches for implementation. If this were the case, then this would explain why petitioners had to sign the promissory notes in blank, since the imposable interest rates have yet to be determined and fixed by respondent's Treasury Department in Manila.

Moreover, in Aspa's enumeration of the factors that determine the interest rates PNB fixes – such as cost of money, foreign currency values, bank administrative costs, profitability, and considerations which affect the banking industry – it can be seen that considerations which affect PNB's borrowers are ignored. A borrower's current financial state, his feedback or opinions, the nature and purpose of his borrowings, the effect of foreign currency values or fluctuations on his business or borrowing, etc. – these are not factors which influence the fixing of interest rates to be imposed on him. Clearly, respondent's method of fixing interest rates based on one-sided, indeterminate, and subjective criteria such as profitability, cost of money, bank costs, etc. is arbitrary for there is no fixed standard or margin above or below these considerations.

> The stipulation in the promissory notes subjecting the interest rate to review does not render the imposition by UCPB of interest rates on the obligations of the spouses Beluso valid. According to said stipulation:
>
> > The interest rate shall be subject to review and may be increased or decreased by the LENDER **considering among others the prevailing financial and monetary conditions; or the rate of interest and charges which other banks or financial institutions charge or offer to charge for similar accommodations; and/or the resulting profitability to the LENDER** after due consideration of all dealings with the BORROWER.
>
> **It should be pointed out that the authority to review the interest rate was given [to] UCPB alone as the lender**. Moreover, UCPB may apply the considerations enumerated in this provision as it wishes. As worded in the above provision, UCPB may give as much weight as it desires to each of the following considerations: (1) the prevailing financial and monetary condition; (2) the rate of interest and charges which other banks or financial institutions charge or offer to

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[83] Id. at 174.

> charge for similar accommodations; and/or (3) the resulting profitability to the LENDER (UCPB) after due consideration of all dealings with the BORROWER (the spouses Beluso). **Again, as in the case of the interest rate provision, there is no fixed margin above or below these considerations**.
>
> In view of the foregoing, the Separability Clause cannot save either of the two options of UCPB as to the interest to be imposed, as both options violate the principle of mutuality of contracts.[84] (Emphases supplied)

To repeat what has been said in the above-cited cases, any modification in the contract, such as the interest rates, must be made with the consent of the contracting parties. The minds of all the parties must meet as to the proposed modification, especially when it affects an important aspect of the agreement. In the case of loan agreements, the rate of interest is a principal condition, if not the most important component. Thus, any modification thereof must be mutually agreed upon; otherwise, it has no binding effect.

What is even more glaring in the present case is that, the stipulations in question no longer provide that the parties shall agree upon the interest rate to be fixed; -instead, they are worded in such a way that the borrower shall agree to *whatever* interest rate respondent fixes. In credit agreements covered by the above-cited cases, it is provided that:

> The Bank reserves the right to increase the interest rate within the limits allowed by law at any time depending on whatever policy it may adopt in the future: Provided, that, the interest rate on this accommodation shall be correspondingly decreased in the event that the applicable maximum interest rate is reduced by law or by the Monetary Board. In either case, the adjustment in **the interest rate agreed upon** shall take effect on the effectivity date of the increase or decrease in maximum interest rate.[85] (Emphasis supplied)

Whereas, in the present credit agreements under scrutiny, it is stated that:

> IN THE JULY 1989 CREDIT AGREEMENT
>
> (b) **The Borrower agrees** that the Bank may modify the interest rate on the Loan depending on whatever policy the Bank may adopt in the future, including without limitation, the shifting from the floating interest rate system to the fixed interest rate system, or vice versa. Where the Bank has imposed on the Loan interest at a rate *per annum*, which is equal to the Bank's spread over the current floating interest rate, **the Borrower hereby agrees** that the Bank may, **without need of notice to the Borrower**, increase or decrease its spread over the floating interest rate at any time depending on whatever policy it may adopt in the future.[86] (Emphases supplied)

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84 *United Coconut Planters Bank v. Spouses Beluso*, supra note 49 at 342-343.
85 See *Philippine National Bank v. Court of Appeals*, supra note 66 at 22.
86 Records, p. 47.

IN THE AUGUST 1991 AMENDMENT TO CREDIT AGREEMENT

> 1.03. Interest on Line Availments. (a) **The Borrowers agree** to pay interest on each Availment from date of each Availment up to but not including the date of full payment thereof at the rate *per annum* which is determined by the Bank to be prime rate plus applicable spread in effect as of the date of each Availment.[87] (Emphasis supplied)

Plainly, with the present credit agreement, the element of consent or agreement by the borrower is now *completely lacking*, which makes respondent's unlawful act all the more reprehensible.

Accordingly, petitioners are correct in arguing that estoppel should not apply to them, for "[e]stoppel cannot be predicated on an illegal act. As between the parties to a contract, validity cannot be given to it by estoppel if it is prohibited by law or is against public policy."[88] It appears that by its acts, respondent violated the Truth in Lending Act, or Republic Act No. 3765, which was enacted "to protect x x x citizens from a lack of awareness of the true cost of credit to the user by using a full disclosure of such cost with a view of preventing the uninformed use of credit to the detriment of the national economy."[89] The law "gives a detailed enumeration of the specific information required to be disclosed, among which are the interest and other charges incident to the extension of credit."[90] Section 4 thereof provides that a disclosure statement must be furnished prior to the consummation of the transaction, thus:

> SEC. 4. Any creditor shall furnish to each person to whom credit is extended, prior to the consummation of the transaction, a clear statement in writing setting forth, to the extent applicable and in accordance with rules and regulations prescribed by the Board, the following information:
>
> (1) the cash price or delivered price of the property or service to be acquired;
>
> (2) the amounts, if any, to be credited as down payment and/or trade-in;
>
> (3) the difference between the amounts set forth under clauses (1) and (2);
>
> (4) the charges, individually itemized, which are paid or to be paid by such person in connection with the transaction but which are not incident to the extension of credit;
>
> (5) the total amount to be financed;
>
> (6) the finance charge expressed in terms of pesos and centavos; and

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87 Id. at 56.

88 *United Coconut Planters Bank v. Spouses Beluso*, supra note 50 at 343.

89 Section 2 thereof.

90 *Heirs of Zoilo Espiritu v. Spouses Landrito*, 549 Phil. 180, 190-191 (2007).

> (7) the percentage that the finance bears to the total amount to be financed expressed as a simple annual rate on the outstanding unpaid balance of the obligation**.**

Under Section 4(6), "finance charge" represents the amount to be paid by the debtor incident to the extension of credit such as interest or discounts, collection fees, credit investigation fees, attorney's fees, and other service charges. The total finance charge represents the difference between (1) the aggregate consideration (down payment plus installments) on the part of the debtor, and (2) the sum of the cash price and non-finance charges.[91]

By requiring the petitioners to sign the credit documents and the promissory notes in blank, and then unilaterally filling them up later on, respondent violated the Truth in Lending Act, and was remiss in its disclosure obligations. In one case, which the Court finds applicable here, it was held:

> UCPB further argues that **since the spouses Beluso were duly given copies of the subject promissory notes after their execution, then they were duly notified of the terms thereof, in substantial compliance with the Truth in Lending Act.**
>
> Once more, we disagree. Section 4 of the Truth in Lending Act clearly provides that the disclosure statement must be furnished prior to the consummation of the transaction:
>
> > SEC. 4. Any creditor shall furnish to each person to whom credit is extended, prior to the consummation of the transaction, a clear statement in writing setting forth, to the extent applicable and in accordance with rules and regulations prescribed by the Board, the following information:
> >
> > (1) the cash price or delivered price of the property or service to be acquired;
> >
> > (2) the amounts, if any, to be credited as down payment and/or trade-in;
> >
> > (3) the difference between the amounts set forth under clauses (1) and (2);
> >
> > (4) the charges, individually itemized, which are paid or to be paid by such person in connection with the transaction but which are not incident to the extension of credit;
> >
> > (5) the total amount to be financed;
> >
> > (6) the finance charge expressed in terms of pesos and centavos; and

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91 Central Bank Circular No. 158.

> (7) the percentage that the finance bears to the total amount to be financed expressed as a simple annual rate on the outstanding unpaid balance of the obligation.
>
> **The rationale of this provision is to protect users of credit from a lack of awareness of the true cost thereof, proceeding from the experience that banks are able to conceal such true cost by hidden charges, uncertainty of interest rates, deduction of interests from the loaned amount, and the like. The law thereby seeks to protect debtors by permitting them to fully appreciate the true cost of their loan, to enable them to give full consent to the contract, and to properly evaluate their options in arriving at business decisions.** Upholding UCPB's claim of substantial compliance would defeat these purposes of the Truth in Lending Act. **The belated discovery of the true cost of credit will too often not be able to reverse the ill effects of an already consummated business decision.**
>
> **In addition, the promissory notes, the copies of which were presented to the spouses Beluso after execution, are not sufficient notification from UCPB. As earlier discussed, the interest rate provision therein does not sufficiently indicate with particularity the interest rate to be applied to the loan covered by said promissory notes**.[92] (Emphases supplied)

However, the one-year period within which an action for violation of the Truth in Lending Act may be filed evidently prescribed long ago, or sometime in 2001, one year after petitioners received the March 2000 demand letter which contained the illegal charges.

The fact that petitioners later received several statements of account detailing its outstanding obligations does not cure respondent's breach. To repeat, the belated discovery of the true cost of credit does not reverse the ill effects of an already consummated business decision.[93] Neither may the statements be considered proposals sent to secure the petitioners' conformity; they were sent after the imposition and application of the interest rate, and not before. And even if it were to be presumed that these are proposals or offers, there was no acceptance by petitioners. "No one receiving a proposal to modify a loan contract, especially regarding interest, is obliged to answer the proposal."[94]

Loan and credit arrangements may be made enticing by, or "sweetened" with, offers of low initial interest rates, but actually accompanied by provisions written in fine print that allow lenders to later on increase or decrease interest rates unilaterally, without the consent of the borrower, and depending on complex and subjective factors. Because they have been lured into these contracts by initially low interest rates, borrowers get caught and stuck in the web of subsequent steep rates and penalties, surcharges and the like. Being ordinary individuals or entities, they naturally dread legal complications and cannot afford court litigation; they

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92 *United Coconut Planters Bank v. Spouses Beluso*, supra note 50 at 356-358.

93 Id. at 358.

94 *New Sampaguita Builders Construction, Inc. v. Philippine National Bank*, supra note 55 at 500.

succumb to whatever charges the lenders impose. At the very least, borrowers should be charged *rightly*; but then again this is not possible in a one-sided credit system where the temptation to abuse is strong and the willingness to rectify is made weak by the eternal desire for profit.

Given the above supposition, the Court cannot subscribe to respondent's argument that in every repricing of petitioners' loan availment, they are given the right to question the interest rates imposed. The import of respondent's line of reasoning cannot be other than that if one out of every hundred borrowers questions respondent's practice of unilaterally fixing interest rates, then only the loan arrangement with that lone complaining borrower will enjoy the benefit of review or re-negotiation; as to the 99 others, the questionable practice will continue unchecked, and respondent will continue to reap the profits from such unscrupulous practice. The Court can no more condone a view so perverse. This is exactly what the Court meant in the immediately preceding cited case when it said that "the belated discovery of the true cost of credit does not reverse the ill effects of an already consummated business decision;"[95] as to the 99 borrowers who did not or could not complain, the illegal act shall have become a *fait accompli* – to their detriment, they have *already* suffered the oppressive rates.

Besides, that petitioners are given the right to question the interest rates imposed is, under the circumstances, irrelevant; we have a situation where the petitioners do not stand on equal footing with the respondent. It is doubtful that any borrower who finds himself in petitioners' position would dare question respondent's power to arbitrarily modify interest rates at any time. In the second place, on what basis could any borrower question such power, when the criteria or standards – which are really one-sided, arbitrary and subjective – for the exercise of such power are precisely lost on him?

For the same reasons, the Court cannot validly consider that, as stipulated in the 18th up to the 26th promissory notes, petitioners are granted the option to prepay the loan or credit facility without penalty within 10 calendar days from the Interest Setting Date if they are not agreeable to the interest rate fixed. It has been shown that the promissory notes are executed and signed in blank, meaning that by the time petitioners learn of the interest rate, they are already bound to pay it because they have already pre-signed the note where the rate is subsequently entered. Besides, premium may not be placed upon a stipulation in a contract which grants one party the right to choose whether to continue with or withdraw from the agreement if it discovers that what the other party has been doing all along is improper or illegal.

Thus said, respondent's arguments relative to the credit documents – that documentary evidence prevails over testimonial evidence; that the credit

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95 Id.

documents are in proper form, presumed regular, and endure, against arbitrary claims by petitioners, experienced business persons that they are, they signed questionable loan documents whose provisions for interest rates were left blank, and yet they continued to pay the interests without protest for a number of years – deserve no consideration.

With regard to interest, the Court finds that since the escalation clause is annulled, the principal amount of the loan is subject to the original or stipulated rate of interest, and upon maturity, the amount due shall be subject to legal interest at the rate of 12% *per annum*. This is the uniform ruling adopted in previous cases, including those cited here.[96] The interests paid by petitioners should be applied first to the payment of the stipulated or legal and unpaid interest, as the case may be, and later, to the capital or principal.[97] Respondent should then refund the excess amount of interest that it has illegally imposed upon petitioners; "[t]he amount to be refunded refers to that paid by petitioners when they had no obligation to do so."[98] Thus, the parties' original agreement stipulated the payment of 19.5% interest; however, this rate was intended to apply only to the first promissory note which expired on November 21, 1989 and was paid by petitioners; it was not intended to apply to the whole duration of the loan. Subsequent higher interest rates have been declared illegal; but because only the rates are found to be improper, the obligation to pay interest subsists, the same to be fixed at the legal rate of 12% *per annum*. However, the 12% interest shall apply only until June 30, 2013. Starting July 1, 2013, the prevailing rate of interest shall be 6% *per annum* pursuant to our ruling in *Nacar v. Gallery Frames*[99] and *Bangko Sentral ng Pilipinas*-Monetary Board Circular No. 799.

Now to the issue of penalty. PN 9707237 provides that failure to pay it or any installment thereon, when due, shall constitute default, and a penalty charge of 24% *per annum* based on the defaulted principal amount shall be imposed. Petitioners claim that this penalty should be excluded from the foreclosure amount or bid price because the Real Estate Mortgage and the Supplement thereto did not specifically include it as part of the secured amount. Respondent justifies its inclusion in the secured amount, saying that the purpose of the penalty or a penal clause is to ensure the performance of the obligation and substitute for damages and the payment of interest in the event of non-compliance.[100] Respondent adds that the imposition and collection of a penalty is a normal banking practice, and the standard rate *per annum* for all commercial banks, at the time, was 24%. Its inclusion as part of the secured amount in the mortgage agreements is thus valid and necessary.

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96 See also *Equitable PCI Bank v. Ng Sheung Ngor*, 565 Phil. 520, 539 (2007).

97 *Hodges v. Salas*, 63 Phil. 567, 574 (1936), citing *Aguilar v. Rubiato and Gonzalez Vila*, 40 Phil. 570 (1920); *Go Chioco v. Martinez*, 45 Phil. 256, 279-282 (1923); *Gui Jong & Co. v. Rivera and Avellar*, 45 Phil. 778, 784 (1924); *Sajo v. Gustilo*, 48 Phil. 451, 462 (1925).

98 See *Philippine Savings Bank v. Castillo*, G.R. No. 193178, May 30, 2011, 649 SCRA 527, 538.

99 G.R. No. 189871, August 13, 2013.

100 Citing Article 1226 of the Civil Code and Paras, Civil Code of the Philippines Annotated (Commentaries) Vol. IV, 1989 12th edition, p. 298.

The Court sustains petitioners' view that the penalty may not be included as part of the secured amount. Having found the credit agreements and promissory notes to be tainted, we must accord the same treatment to the mortgages. After all, "[a] mortgage and a note secured by it are deemed parts of one transaction and are construed together."[101] Being so tainted and having the attributes of a contract of adhesion as the principal credit documents, we must construe the mortgage contracts strictly, and against the party who drafted it. An examination of the mortgage agreements reveals that nowhere is it stated that penalties are to be included in the secured amount. Construing this silence strictly against the respondent, the Court can only conclude that the parties did not intend to include the penalty allowed under PN 9707237 as part of the secured amount. Given its resources, respondent could have – if it truly wanted to – conveniently prepared and executed an amended mortgage agreement with the petitioners, thereby including penalties in the amount to be secured by the encumbered properties. Yet it did not.

With regard to attorney's fees, it was plain error for the CA to have passed upon the issue since it was not raised by the petitioners in their appeal; it was the respondent that improperly brought it up in its appellee's brief, when it should have interposed an appeal, since the trial court's Decision on this issue is adverse to it. It is an elementary principle in the subject of appeals that an appellee who does not himself appeal cannot obtain from the appellate court any affirmative relief other than those granted in the decision of the court below.

> x x x [A]n appellee, who is at the same time not an appellant, may on appeal be permitted to make counter assignments of error in ordinary actions, when the purpose is merely to defend himself against an appeal in which errors are alleged to have been committed by the trial court both in the appreciation of facts and in the interpretation of the law, in order to sustain the judgment in his favor but not when his purpose is to seek modification or reversal of the judgment, in which case it is necessary for him to have excepted to and appealed from the judgment.[102]

Since petitioners did not raise the issue of reduction of attorney's fees, the CA possessed no authority to pass upon it at the instance of respondent. The ruling of the trial court in this respect should remain undisturbed.

For the fixing of the proper amounts due and owing to the parties – to the respondent as creditor and to the petitioners who are entitled to a refund as a consequence of overpayment considering that they paid more by way of interest charges than the 12% *per annum*[103] herein allowed – the case should be remanded

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101 *Philippine Bank of Communications v. Court of Appeals*, supra note 51 at 314.
102 *Saenz v. Mitchell*, 60 Phil. 69, 80 (1934).
103 Or 6% *per annum*, when applicable.

to the lower court for proper accounting and computation, applying the following procedure:

1. The 1st Promissory Note with the 19.5% interest rate is deemed proper and paid;

2. All subsequent promissory notes (from the 2nd to the 26th promissory notes) shall carry an interest rate of only 12% *per annum*.[104] Thus, interest payment made in excess of 12% on the 2nd promissory note shall immediately be applied to the principal, and the principal shall be accordingly reduced. The reduced principal shall then be subjected to the 12%[105] interest on the 3rd promissory note, and the excess over 12% interest payment on the 3rd promissory note shall again be applied to the principal, which shall again be reduced accordingly. The reduced principal shall then be subjected to the 12% interest on the 4th promissory note, and the excess over 12% interest payment on the 4th promissory note shall again be applied to the principal, which shall again be reduced accordingly. And so on and so forth;

3. **After the above procedure is carried out, the trial court shall be able to conclude if petitioners a) still have an OUTSTANDING BALANCE/OBLIGATION or b) MADE PAYMENTS OVER AND ABOVE THEIR TOTAL OBLIGATION (principal and interest)**;

4. Such **outstanding balance/obligation, if there be any**, shall then be subjected to a **12% *per annum* interest** from October 28, 1997 until January 14, 1999, which is the date of the auction sale;

5. Such outstanding balance/obligation shall also be charged a **24% *per annum* penalty** from August 14, 1997 until January 14, 1999. But from this total penalty, the petitioners' previous payment of penalties in the amount of ₱202,000.00 made on January 27, 1998[106] shall be DEDUCTED;

6. To this outstanding balance (3.), the interest (4.), penalties (5.), and the final and executory award of **1% attorney's fees** shall be ADDED;

7. The sum total of the outstanding balance (3.), interest (4.) and 1% attorney's fees (6.) shall be DEDUCTED from the bid price of

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104 Or 6% *per annum*, when applicable.
105 Id.
106 *Rollo*, p. 63.

₱4,324,172.96. The penalties (5.) are not included because they are not included in the secured amount;

8. The difference in (7.) [₱4,324,172.96 LESS sum total of the outstanding balance (3.), interest (4.), and 1% attorney's fees (6.)] shall be DELIVERED TO THE PETITIONERS;

9. Respondent may then proceed to consolidate its title to TCTs T-14250 and T-16208;

10. **ON THE OTHER HAND**, if after performing the procedure in (2.), it turns out that petitioners made an **OVERPAYMENT**, the interest (4.), penalties (5.), and the award of 1% attorney's fees (6.) shall be DEDUCTED from the overpayment. There is no outstanding balance/obligation precisely because petitioners have paid beyond the amount of the principal and interest;

11. If the overpayment exceeds the sum total of the interest (4.), penalties (5.), and award of 1% attorney's fees (6.), the excess shall be RETURNED to the petitioners, with legal interest, under the principle of *solutio indebiti*;[107]

12. Likewise, if the overpayment exceeds the total amount of interest (4.) and award of 1% attorney's fees (6.), the trial court shall INVALIDATE THE EXTRAJUDICIAL FORECLOSURE AND SALE;

13. **HOWEVER**, if the total amount of interest (4.) and award of 1% attorney's fees (6.) exceed petitioners' overpayment, then the excess shall be DEDUCTED from the bid price of ₱4,324,172.96;

14. The difference in (13.) [₱4,324,172.96 LESS sum total of the interest (4.) and 1% attorney's fees (6.)] shall be DELIVERED TO THE PETITIONERS;

15. Respondent may then proceed to consolidate its title to TCTs T-14250 and T-16208. The outstanding penalties, if any, shall be collected by other means.

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[107] Also, under the Civil Code, Art. 1413, interest paid in excess of the interest allowed by the usury laws may be recovered by the debtor, with interest thereon from the date of the payment.

From the above, it will be seen that if, after proper accounting, it turns out that the petitioners made payments exceeding what they actually owe by way of principal, interest, and attorney's fees, then the mortgaged properties need not answer for any outstanding secured amount, because there is not any; quite the contrary, respondent must refund the excess to petitioners. In such case, the extrajudicial foreclosure and sale of the properties shall be declared null and void for obvious lack of basis, the case being one of *solutio indebiti* instead. If, on the other hand, it turns out that petitioners' overpayments in interests do not exceed their total obligation, then the respondent may consolidate its ownership over the properties, since the period for redemption has expired. Its only obligation will be to return the difference between its bid price (₱4,324,172.96) and petitioners' total obligation outstanding – except penalties – after applying the latter's overpayments.

WHEREFORE, premises considered, the Petition is **GRANTED**. The May 8, 2007 Decision of the Court of Appeals in CA-G.R. CV No. 79650 is **ANNULLED** and **SET ASIDE**. Judgment is hereby rendered as follows:

1. The interest rates imposed and indicated in the 2nd up to the 26th Promissory Notes are **DECLARED NULL AND VOID**, and such notes shall instead be subject to interest at the rate of twelve percent (12%) *per annum* up to June 30, 2013, and starting July 1, 2013, six percent (6%) *per annum* until full satisfaction;

2. The penalty charge imposed in Promissory Note No. 9707237 shall be **EXCLUDED** from the amounts secured by the real estate mortgages;

3. The trial court's award of one per cent (1%) attorney's fees is **REINSTATED**;

4. The case is ordered **REMANDED** to the Regional Trial Court, Branch 6 of Kalibo, Aklan for the computation of overpayments made by petitioners spouses Eduardo and Lydia Silos to respondent Philippine National Bank, taking into consideration the foregoing dispositions, and applying the procedure hereinabove set forth;

5. Thereafter, the trial court is **ORDERED** to make a determination as to the validity of the extrajudicial foreclosure and sale, declaring the same null and void in case of overpayment and ordering the release and return of Transfer Certificates of Title Nos. T-14250 and TCT T-16208 to petitioners, or ordering the delivery to the petitioners of the difference between the bid price and the total remaining obligation of petitioners, if any;

6. In the meantime, the respondent Philippine National Bank is **ENJOINED** from consolidating title to Transfer Certificates of Title Nos. T-14250 and T-16208 until all the steps in the procedure above set forth have been taken and applied;

7. The reimbursement of the excess in the bid price of ₱377,505.99, which respondent Philippine National Bank is ordered to reimburse petitioners, should be **HELD IN ABEYANCE** until the true amount owing to or owed by the parties as against each other is determined;

8. Considering that this case has been pending for such a long time and that further proceedings, albeit uncomplicated, are required, the trial court is **ORDERED** to proceed with dispatch.

SO ORDERED.

MARIANO C. DEL CASTILLO
Associate Justice

WE CONCUR:

ANTONIO T. CARPIO
Associate Justice
Chairperson

TERESITA J. LEONARDO-DE CASTRO
Associate Justice

JOSE PORTUGAL PEREZ
Associate Justice

ESTELA M. PERLAS-BERNABE
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.

ANTONIO T. CARPIO
Associate Justice
Chairperson

CERTIFICATION

Pursuant to Section 13, Article VIII 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.

MARIA LOURDES P. A. SERENO
Chief Justice