

Title: Spouses Eduardo and Lydia Silos vs. Philippine National Bank: A Case of Unilateral Interest Rate Modifications and Violations of the Truth in Lending Act

Facts:

In August 1987, Spouses Eduardo and Lydia Silos entered into a one-year revolving credit line agreement with Philippine National Bank (PNB) for P150,000.00, secured by a Real Estate Mortgage. This credit line was increased to P1.8 million in July 1988 and further to P2.5 million in July 1989, with an additional mortgage secured. The Siloses also issued eight promissory notes under a Credit Agreement that allowed PNB, without the borrowers' consent, to unilaterally modify the rate of interest based on the bank's future policy or shift between interest rate systems. The promissory notes allowed PNB to adjust the interest rates within legal limits. Throughout the credit line's life, interest rates increased from the original 19.5% to as high as 32%, which were all paid by the Siloses without failure.

However, by 1997, during the Asian financial crisis, the Siloses could not keep up with the soaring interest rates, leading to the default of their sole outstanding promissory note for P2.5 million - PN 9707237, which was due on October 28, 1997. PNB foreclosed on the mortgage due to non-payment, and the properties were auctioned off to PNB for P4,324,172.96 on January 14, 1999.

Subsequently, the Siloses filed a civil case challenging the legality of the foreclosure and seeking an accounting of the credit from PNB, asserting that they overpaid interests due to the bank's unilateral, arbitrary imposition of interest rates, making the foreclosure unnecessary and wrongful.

Issues:

1. Whether the unilateral and arbitrary imposition by PNB of the interest rates without the consent of the Siloses is valid and legally binding.
2. Whether the stipulation in the credit agreements allowing PNB to modify interest rates at will is contrary to law and public policy.
3. Whether the penalties stipulated in the promissory note can be included in the foreclosure amount.
4. Whether the Court of Appeals and the lower court erred in not nullifying the interest rates imposed in the credit agreements which were unilaterally determined by PNB.

Court's Decision:

The Supreme Court granted the petition, holding that:

1. Any modification in the contract, such as the interest rates, must be mutually agreed upon; otherwise, it has no binding effect. Since the Siloses did not consent to the modified rates, the unilateral imposition of interest rates by PNB is invalid.
2. The stipulation granting PNB the right to adjust the interest rates without the borrower's consent is void for being violative of the principle of mutuality of contracts and against public policy.
3. Penalties stipulated in the promissory note cannot be included in the foreclosure amount because the mortgage agreements did not explicitly secure them.
4. The principle of estoppel does not apply to the Siloses as it cannot be predicated on an illegal act. The court annulled and set aside the Court of Appeals decision, reinstating the award of 1% attorney's fees.

Doctrine:

1. Any change in a vital component of a loan agreement, such as interest rates, must be mutually agreed upon. Otherwise, it is void for lack of consent, violating the principle of mutuality of contracts.
2. Stipulations in loan agreements granting banks the unilateral right to adjust interest rates without the borrower's consent are contrary to law and public policy.
3. Penalties that are not explicitly part of the secured amount in mortgage agreements cannot be included in the foreclosure amount.

Class Notes:

- Key elements: principle of mutuality of contracts, violation of the Truth in Lending Act, and the importance of mutual consent in contract modifications.
- Article 1308 of the Civil Code emphasizes that contracts must bind both parties; validity or compliance cannot be left to the will of one of them.
- The Truth in Lending Act requires full disclosure of the cost of credit to prevent uninformed use of credit.

Historical Background:

This case reflects the challenges faced by borrowers against unilateral and arbitrary bank policies on interest rates, particularly during the financial crises that test the legal system's capacity to protect the rights of the weaker party in contract negotiations. The decision underscores the Supreme Court's stance on upholding fairness, mutuality, and transparency in loan agreements.