

****Title:****

Sps. Puerto vs. Court of Appeals, et al.

****Facts:****

Spouses Sinfronio and Esperanza Puerto were the registered owners of a house and lot in Quezon City. They mortgaged this property to Spouses Inocencio and Eleuteria Cortes to secure a loan of PHP 200,000, as evidenced by a Deed of Real Estate Mortgage executed on May 8, 1972. The mortgage did not stipulate any interest, but allowed foreclosure upon failure to repay within a year.

Esperanza Puerto claimed that the mortgage consideration was only PHP 150,000, with an additional PHP 50,000 representing prepaid interest. She further testified about various amounts and valuables received as part of the loan, asserting a verbal agreement with the Cortes spouses regarding interest payments and concealment of the usurious nature of the loan.

The Corteses claimed they granted a straightforward loan of PHP 200,000 and presented receipts signed by Esperanza as evidence. When the Puerto spouses failed to repay the loan by its maturity on May 8, 1973, the Corteses foreclosed the property, becoming the highest bidders in its public auction on October 4, 1973. The title was then transferred to the Cortes spouses.

Despite a lease allowing the Puertos to stay on the property, they failed to pay rent beginning February 1976, prompting the Cortes spouses to file an ejectment case. In response, the Puertos filed a lawsuit to nullify the mortgage and foreclosure, alleging usurious interest.

The trial court dismissed the Puertos' complaint and ordered them to pay rent arrears. The appellate court initially reversed this ruling, declaring the mortgage void due to usury, but later reinstated its decision in favor of the Cortes spouses upon reconsideration. The Puertos then petitioned the Supreme Court for review.

****Issues:****

1. Did the loan transaction between the Puertos and the Cortes violate the Usury Law?
2. If usurious, what is the effect of this violation on the validity of the real estate mortgage and its foreclosure?
3. Was the foreclosure of the property valid?

Court's Decision:

This Supreme Court case revolved around whether the loan transaction violated the Usury Law and the consequent validity of the mortgage and foreclosure. The Court found that:

1. **Violation of Usury Law:** The Court ruled that the loan was usurious. The interest hidden within the value of the jewelry provided as part of the loan was in excess of the legal limit of 12% per annum, as stipulated in the Usury Law (Act No. 2655, as amended by P.D. 116).
2. **Effect of Usury Violation:** Citing the Usury Law, the Court held that any stipulation demanding a higher interest rate than permitted is void. However, the principal loan remains valid, separable from the void interest stipulation.
3. **Invalid Foreclosure:** The foreclosure stemmed from an invalid usurious mortgage and was consequently declared void.

The Court ordered the cancellation of the title in the Cortes' name, required the Corteses to return the property to the Puertos, and mandated the Puertos to repay the principal loan amount with legal interest.

Doctrine:

- **Usury Law Application:** Any loan stipulating an interest rate above the legal maximum is void with respect to the interest but not the principal amount.
- **Separation of Principal and Interest:** In cases of usurious loan agreements, the principal remains enforceable, while the illegal interest provision is nullified.
- **Foreclosure Invalidation:** Foreclosures based on usurious mortgage agreements are ineffective.

Class Notes:

- **Elements of Usury:** Excessive interest charged beyond legal thresholds; consideration of subsidiary elements like padded valuations of securities.
- **Effect of Illegal Interest:** Nullifies only the interest provision, not the principal loan obligation.
- **Usury Law (Act No. 2655, Sec. 2 & 7):** Stipulations for excessive interest are void; foreclosure arising from usurious mortgages is void.
- **Rights of Parties Post-Usury Determination:** Restores original positions prior to the usurious transaction with appropriate damage compensation via statutory interest.

Historical Background:

The case took place under the enforcement of the Usury Law (Act No. 2655), highlighting

the judicial system's role in policing predatory financial practices. At the time, the Philippine legal landscape strictly regulated interest rates, reflecting broader concerns about economic fairness and the protection of borrowers from exploitative lending practices.

The Supreme Court's decision in this case serves as a reminder of the judiciary's vigilance in upholding laws against usury and ensuring equitable treatment in financial transactions. This reinforces principles long established to protect borrowers and maintain fair economic practices.