

**BANCO FILIPINO SAVINGS AND MORTGAGE BANK, PETITIONER, VS.
HON. MIGUEL NAVARRO, PRESIDING JUDGE, COURT OF FIRST
INSTANCE OF MANILA, BRANCH XXXI AND FLORANTE DEL VALLE,
RESPONDENTS.**

G.R. No. L-46591. July 28, 1987

Ponente: MELENCIO-HERRERA, J.

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MELENCIO-HERRERA, J.:

This is a Petition to review on certiorari the Decision of respondent Court, the dispositive portion of which decrees:

"WHEREFORE, the Court finds that the enforcement of the escalation clause retroactively before the lapse of the 15-year period stated in the promissory note is contrary to Sec. 3 of Presidential Decree No. 116 and Sec. 109 of Republic Act No. 265, and hereby declares null and void the said escalation clause. The respondent Banco Filipino Savings and Mortgage Bank is hereby ordered to desist from enforcing the increased rate of interest on petitioner's loan.

"SO ORDERED."

The facts are not in dispute:

On May 20, 1975, respondent Florante del Valle (the BORROWER) obtained a loan secured by a real estate mortgage (the LOAN, for short) from petitioner BANCO FILIPINO[1] in the sum of Forty-one Thousand Three Hundred (P41,300.00) Pesos, payable and to be amortized within fifteen (15) years at twelve (12%) per cent interest annually. Hence, the LOAN still had more than 730 days to run by January 2, 1976, the date when CIRCULAR No. 494 was issued by the Central Bank.

Stamped on the promissory note evidencing the loan is an Escalation Clause, reading as follows:

"I/We hereby authorize Banco Filipino to correspondingly increase the interest rate stipulated in this contract without advance notice to me/us in the event a law should be enacted increasing the lawful rates of interest that may be charged on this particular kind of loan."

The Escalation Clause is based upon Central Bank CIRCULAR No. 494 issued on January 2, 1976, the pertinent portion of which reads:

"3. The maximum rate of interest, including commissions, premiums, fees and other charges on loans with maturity of more than seven hundred thirty (730) days, by banking institutions, including thrift banks and rural banks, or by financial intermediaries authorized to engage in quasi-banking functions shall be nineteen per cent (19%) per annum.

"xxx xxx xxx

"7. Except as provided in this Circular and Circular No. 493, loans or renewals thereof shall continue to be

governed by the Usury Law, as amended."

CIRCULAR No. 494 was issued pursuant to the authority granted to the Monetary Board by Presidential Decree No. 116 (Amending Further Certain Sections of the Usury Law) promulgated on January 29, 1973, the applicable section of which provides:

"Sec. 2. The same Act is hereby amended by adding the following section immediately after Section one thereof, which reads as follows:

"Sec. 1-a. The Monetary Board is hereby authorized to prescribe the maximum rate or rates of interest for the loan or renewal thereof or the forbearance of any money, goods or credits, and to change such rate or rates whenever warranted by prevailing economic and social conditions: Provided, that such changes shall not be made oftener than once every twelve months."

The same grant of authority appears in P.D. No. 858, promulgated on December 31, 1975, except that the limitation on the frequency of changes was eliminated.

On the strength of CIRCULAR No. 494 BANCO FILIPINO gave notice to the BORROWER on June 30, 1976 of the increase of interest rate on the LOAN from 12% to 17% per annum effective on March 1, 1976.

On September 24, 1976, Ms. Mercedes C. Paderes of the Central Bank wrote a letter to the BORROWER as follows:

"September 24, 1976

Mr. Florante del Valle
14 Palanca Street
B.F. Homes, Parañaque
Rizal

Dear Mr. del Valle:

This refers to your letter dated August 28, 1976 addressed to the Governor, Central Bank of the Philippines, seeking clarification and our official stand on Banco Filipino's recent decision to raise interest rates on lots bought on installment from 12% to 17% per annum.

A verification made by our Examiner of the copy of your Promissory Note on file with Banco Filipino showed that the following escalation clause with your signature is stamped on the Promissory Note:

'I/We hereby authorize Banco Filipino to correspondingly increase the interest rate stipulated in this contract without advance notice to me/us in the event a law should be enacted increasing the lawful rates of interest that may be charged on this particular kind of loan.'

In this connection, please be advised that the Monetary Board, in its Resolution No. 1155 dated June 11, 1976, adopted the following guidelines to govern interest rate adjustments by banks and non-banks performing quasi-banking functions on loans already existing as of January 3, 1976, in the light of Central Bank Circulars Nos. 492-498:

'1. Only banks and non-bank financial intermediaries performing quasi-banking functions may increase interest rates on loans already existing as of January 2, 1976, provided that:

a. The pertinent loan contracts/documents contain escalation clauses expressly authorizing lending bank or non-bank performing quasi-banking functions to increase the rate of interest stipulated in the contract, in the event that any law or Central Bank regulation is promulgated increasing the maximum interest rate for loans; and

b. Said loans were directly granted by them and the remaining maturities thereof were more than 730 days as of January 2, 1976; and

2. The increase in the rate of interest can be effective only as of January 2, 1976 or on a later date.'

"The foregoing guidelines, however, shall not be understood as precluding affected parties from questioning before a competent court of justice the legality or validity of such escalation clauses.

"We trust the above guidelines would help you resolve your problems regarding additional interest charges of Banco Filipino.

Very truly yours,

(Sgd.) MERCEDES C. PAREDES
Director"

Contending that CIRCULAR No. 494 is not the law contemplated in the Escalation Clause of the promissory note, the BORROWER filed suit against BANCO FILIPINO for "Declaratory Relief" with respondent Court, praying that the Escalation Clause be declared null and void and that BANCO FILIPINO be ordered to desist from enforcing the increased rate of interest on the BORROWER's real estate loan.

For its part, BANCO FILIPINO maintained that the Escalation Clause signed by the BORROWER authorized it to increase the interest rate once a law was passed increasing the rate of interest and that its authority to increase was provided for by CIRCULAR No. 494.

In its judgment, respondent Court nullified the Escalation Clause and ordered BANCO FILIPINO to desist from enforcing the increased rate of interest on the BORROWER's loan. It reasoned out that P.D. No. 116 does not expressly grant the Central Bank authority to maximize interest rates with retroactive effect and that BANCO FILIPINO cannot legally impose a higher rate of interest before the expiration of the 15-year period in which the loan is to be paid other than the 12% per annum in force at the time of the execution of the loan.

It is from that Decision in favor of the BORROWER that BANCO FILIPINO has come to this instance on review by Certiorari. We gave due course to the Petition, the question being one of law.

On February 24, 1983, the parties represented by their respective counsel, not only moved to withdraw the appeal on the ground that it had become moot and academic "because of recent developments in the rules and regulations of the Central Bank," but also prayed that "the decision rendered in the Court of First Instance be therefore vacated and declared of no force and effect as if the case was never filed," since the parties "would like to end this matter once and for all."

However, "considering the subject matter of the controversy in which many persons similarly situated are interested and because of the need for a definite ruling on the question," the Court, in its Resolution of February 24, 1983, impleaded the Central Bank and required it to submit its Comment, and encouraged homeowners similarly situated as the BORROWER to intervene in the proceedings.

At the hearing on February 24, 1983, one Leopoldo Z. So, a mortgage homeowner at B.F. Resort Subdivision, was present and manifested that he was in a similar situation as the BORROWER. Since then, he has written

several letters to the Court, pleading for early resolution of the case. The Court allowed the intervention of Lolita Perono^[2] and issued a temporary restraining order enjoining the Regional Trial Court (Pasay City Branch) in the case entitled "Banco Filipino Savings and Mortgage Bank vs. Lolita Perono" from issuing a writ of possession over her mortgaged property. Also allowed to intervene were Enrique Tabalon, Jose Llopis, et. als., who had obtained loans with identical escalation clauses from Apex Mortgage and Loans Corporation, apparently an affiliate of BANCO FILIPINO. Upon motion of Jose Llopis, a Temporary Restraining Order was likewise issued enjoining the foreclosure of his real estate mortgage by BANCO FILIPINO.

The Court made it explicit, however, that intervention was allowed only for the purpose of "joining in the discussion of the legal issue involved in this proceedings, to wit, the validity of the so-called 'escalation clause,' or its applicability to existing contracts of loan."

The Central Bank has submitted its Comment and Supplemental Comment and like BANCO FILIPINO, has taken the position that the issuance of its Circulars is a valid exercise of its authority to prescribe maximum rates of interest and that, based on the general principles of contract, the Escalation Clause is a valid provision in the loan agreement provided that "(1) the increased rate imposed or charged by petitioner does not exceed the ceiling fixed by law or the Monetary Board; (2) the increase is made effective not earlier than the effectivity of the law or regulation authorizing such an increase; and (3) the remaining maturities of the loans are more than 730 days as of the effectivity of the law or regulation authorizing such an increase. However, with respect to loan agreements entered into on or after March 17, 1980, such agreement, in order to be valid, must also include a de-escalation clause as required by Presidential Decree No. 1684."^[3]

The substantial question in this case is not really whether the Escalation Clause is a valid or void stipulation. There should be no question that the clause is valid.

"Some contracts contain what is known as an 'escalator clause,' which is defined as one in which the contract fixes a base price but contains a provision that in the event of specified cost increases, the seller or contractor may raise the price up to a fixed percentage of the base. Attacks on such a clause have usually been based on the claim that, because of the open price-provision, the contract was too indefinite to be enforceable and did not evidence an actual meeting of the minds of the parties, or that the arrangement left the price to be determined arbitrarily by one party so that the contract lacked mutuality. In most instances, however, these attacks have been unsuccessful."^[4]

"The Court further finds as a matter of law that the cost of living index adjustment, or escalator clause, is not substantively unconscionable.

"Cost of living index adjustment clauses are widely used in commercial contracts in an effort to maintain fiscal stability and to retain 'real dollar' value to the price terms of long term contracts. The provision is a common one, and has been universally upheld and enforced. Indeed, the Federal government has recognized the efficacy of escalator clauses in tying Social Security benefits to the cost of living index, 42 U.S.C.s 415(i). Pension benefits and labor contracts negotiated by most of the major labor unions are other examples. That inflation, expected or otherwise, will cause a particular bargain to be more costly in terms of total dollars than originally contemplated can be of little solace to the plaintiffs."^[5]

What should be resolved is whether BANCO FILIPINO can increase the interest rate on the LOAN from 12% to 17% per annum under the Escalation Clause. It is our considered opinion that it may not.

The Escalation Clause reads as follows:

"I/We hereby authorize Banco Filipino to correspondingly increase the interest rate stipulated in this contract without advance notice to me/us in the event.

a law
increasing
the lawful rates of interest that may be charged
on this particular
kind of loan" (Paragraphing and italics supplied)

It is clear from the stipulation between the parties that the interest rate may be increased "in the event a law should be enacted increasing the lawful rate of interest that may be charged on this particular kind of loan." The Escalation Clause was dependent on an increase of rate made by "law" alone.

CIRCULAR No. 494, although it has the effect of law, is not a law. "Although a circular duly issued is not strictly a statute or a law, it has, however, the force and effect of law."^[6] (Italics supplied). "An administrative regulation adopted pursuant to law has the force and effect of law."^[7] "That administrative rules and regulations have the force of law can no longer be questioned."^[8]

The distinction between a law and an administrative regulation is recognized in the Monetary Board guidelines quoted in the letter to the BORROWER of Ms. Paderes of September 24, 1976 (*supra*). According to the guidelines, for a loan's interest to be subject to the increases provided in CIRCULAR No. 494, there must be an Escalation Clause allowing the increase "in the event that any law or Central Bank regulation is promulgated increasing the maximum interest rate for loans." The guidelines thus presuppose that a Central Bank regulation is not within the term "any law."

The distinction is again recognized by P.D. No. 1684, promulgated on March 17, 1980, adding Section 7-a to the Usury Law, providing that parties to an agreement pertaining to a loan could 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." To quote:

"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." (Paragraphing and italics supplied).

It is now clear that from March 17, 1980, escalation clauses to be valid should specifically provide: (1) that there can be an increase in interest if increased by law or by the Monetary Board; and (2) in order for such stipulation to be valid, it must include a provision for reduction of the stipulated interest "in the event that the applicable maximum rate of interest is reduced by law or by the Monetary Board."

While P.D. No. 1684 is not to be given retroactive effect, the absence of a de-escalation clause in the Escalation Clause in question provides another reason why it should not be given effect because of its one-sidedness in favor of the lender.

2. The Escalation Clause specifically stipulated that the increase in interest rate was to be "on this particular kind of loan," meaning one secured by registered real estate mortgage.

Paragraph 7 of CIRCULAR No. 494 specifically directs that "loans or renewals continue to be governed by the

Usury Law, as amended." So do Circular No. 586 of the Central Bank, which superseded Circular No. 494, and Circular No. 705, which superseded Circular No. 586. The Usury Law, as amended by Acts Nos. 3291, 3998 and 4070, became effective on May 1, 1916. It provided for the maximum yearly interest of 12% for loans secured by a mortgage upon registered real estate (Section 2), and a maximum annual interest of 14% for loans covered by security other than mortgage upon registered real estate (Section 3). Significant is the separate treatment of registered real estate loans and other loans not secured by mortgage upon registered real estate. It appears clear in the Usury Law that the policy is to make interest rates for loans guaranteed by registered real estate lower than those for loans guaranteed by properties other than registered realty.

On June 15, 1948, Congress approved Republic Act No. 265, creating the Central Bank, and establishing the Monetary Board. That law provides that "the Monetary Board may, within the limits prescribed in the Usury Law,[9] fix the maximum rates of interest which banks may charge for different types of loans and for any other credit operations, x x x" and that "any modification in the maximum interest rates permitted for the borrowing or lending operations of the banks shall apply only to future operations and not to those made prior to the date on which the modification becomes effective" (Section 109).

On January 29, 1973, P.D. No. 116 was promulgated amending the Usury Law. The Decree gave authority to the Monetary Board "to prescribe maximum rates of interest for the loan or renewal thereof or the forbearance of any money, goods or credits, and to change such rate or rates whenever warranted by prevailing economic and social conditions. In one section,[10] the Monetary Board could prescribe the maximum rate of interest for loans secured by mortgage upon registered real estate or by any document conveying such real estate or an interest therein and, in another separate section,[11] the Monetary Board was also granted authority to fix the maximum interest rate for loans secured by types of security other than registered real property. The two sections read:

"SEC. 3. Section two of the same Act is hereby amended to read as follows:

'SEC. 2. No person or corporation shall directly or indirectly take or receive in money or other property, real or personal, or chases in action, a higher rate of interest or greater sum or value, including commissions, premiums, fines and penalties, for the loan or renewal thereof or forbearance of money, goods, or credits, where such loan or renewal or forbearance is secured in whole or in part by a mortgage upon real estate the title to which is duly registered or by any document conveying such real estate or an interest therein, than twelve per centum per annum or the maximum rate prescribed by the Monetary Board and in force at the time the loan or renewal thereof or forbearance is granted: Provided, That the rate of interest under this section or the maximum rate of interest that may be prescribed by the Monetary Board under this section may likewise apply to loans secured by other types of security as may be specified by the Monetary Board.'"

"SEC. 4. Section three of the same Act is hereby amended to read as follows:

'SEC. 3. No person or corporation shall directly or indirectly demand, take, receive, or agree to charge in money or other property, real or personal, a higher rate or greater sum or value for the loan or forbearance of money, goods, or credits, where such loan or forbearance is not secured as provided in Section two hereof, than fourteen per centum per annum or the maximum rate or rates prescribed by the Monetary Board and in force at the time the loan or forbearance is granted.'"

Apparent then is that the separate treatment for the two classes of loans was maintained. Yet, CIRCULAR No. 494 makes no distinction as to the types of loans that it is applicable to unlike Circular No. 586 dated January 1, 1978 and Circular No. 705 dated December 1, 1979, which fix the effective rate of interest on loan transactions with maturities of more than 730 days to not exceeding 19% per annum (Circular No. 586) and not exceeding 21% per annum (Circular No. 705) "on both secured and unsecured loans as defined by the Usury Law, as amended."

In the absence of any indication in CIRCULAR No. 494 as to which particular type of loan was meant by the Monetary Board, the more equitable construction is to limit CIRCULAR No. 494 to loans guaranteed by securities other than mortgage upon registered realty.

WHEREFORE, the Court rules that while an escalation clause like the one in question can ordinarily be held valid, nevertheless, petitioner Banco Filipino cannot rely thereon to raise the interest on the borrower's loan from 12% to 17% per annum because Circular No. 494 of the Monetary Board was not the "law" contemplated by the parties, nor should said Circular be held as applicable to loans secured by registered real estate in the absence of any such specific indication and in contravention of the policy behind the Usury Law. The judgment appealed from is, therefore, hereby affirmed in so far as it orders petitioner Banco Filipino to desist from enforcing the increased rate of interest on petitioner's loan.

The Temporary Restraining Orders heretofore issued are hereby made permanent if the escalation clauses are identical to the one herein and the loans involved have applied the increased rate of interest authorized by Central Bank Circular No. 494.

SO ORDERED.

Teehankee, C.J., Yap, Fernan, Narvasa, Gutierrez, Jr., Cruz, Paras, Feliciano, Gancayco, Padilla, Bidin, Sarmiento, and Cortes, JJ., concur.

[1] BANCO FILIPINO was closed by the CB Monetary Board on January 25, 1985.

[2] p. 161, Rollo. [3] Supplemental Comment by the Central Bank, p. 265, Rollo.

[4] 17 Am. Jur. 2d, pp. 786-787.

[5] *Bennett v. Behring Corp.*, 466 F. Supp. 689 at 699 (1979).

[6] *Pascual vs. Commissioner of Customs*, L-12219, April 25, 1962, 4 SCRA 1020, 1023.

[7] *Valerio vs. Secretary of Agriculture and National Resources*, L-18587, April 23, 1963, 7 SCRA 719, 723.

[8] *Antique Sawmills, Inc. vs. Zayco, et al.*, L-20051, May 30, 1966, 17 SCRA 316, 320.

[9] Act No. 2655, as amended.

[10] Section 3 of P.D. No. 116.

[11] Section 4 of P.D. No. 116.

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