

ROYAL L. RUTTER, PLAINTIFF AND APPELLANT, VS. PLACIDO J. ESTEBAN, DEFENDANT AND APPELLEE.

G. R. No. L-3708. May 18, 1953

Ponente: BAUTISTA ANGELO, J.

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BAUTISTA ANGELO, J.:

On August 20, 1941, Royal L. Rutter sold to Placido J. Esteban two parcels of land situated in the City of Manila for the sum of P9,600 of which P4,800 were paid outright, and the balance of P4,800 was made payable as follows: P2,400 on or before August 7, 1942, and P2,400 on or before August 27, 1943, with interest at the rate of 7 per cent per annum.

To secure the payment of said balance of P4,800, a first mortgage over the same parcels of land has been constituted in favor of the plaintiff. The deed of sale having been registered, a new title was issued in favor of Placido J. Esteban with the mortgage duly annotated on the back thereof.

Placido J. Esteban failed to pay the two installments as agreed upon, as well as the interest that had accrued thereon, and so on August 2, 1949, Royal L. Rutter instituted this action in the Court of First Instance of Manila to recover the balance due, the interest due thereon, and the attorney's fees stipulated in the contract. The complaint also contains a prayer for the sale of the properties mortgaged in accordance with law.

Placido J. Esteban admitted the averments of the complaint, but set up as a defense the moratorium clause embodied in Republic Act No. 342. He claims that this is a prewar obligation contracted on August 20, 1941; that he is a war sufferer, having filed his claim with the Philippine War Damage Commission for the losses he had suffered as a consequence of the last war; and that under section 2 of said Republic Act No. 342, payment of his obligation cannot be enforced until after the lapse of eight years from the settlement of his claim by the Philippine War Damage Commission, and this period has not yet expired.

After a motion for summary judgment has been presented by the defendant, and the requisite evidence submitted covering the relevant facts, the court rendered judgment dismissing the complaint holding that the obligation which plaintiff seeks to enforce is not yet demandable under the moratorium law. Plaintiff filed a motion for reconsideration wherein he raised for the first time the constitutionality of the moratorium law, but the motion was denied. Hence this appeal.

The only question to be determined hinges on the validity of Republic Act No. 342 which was approved by Congress on July 26, 1948. It is claimed that this act if declared applicable to the present case is unconstitutional being violative of the constitutional provision forbidding the impairment of the obligation of contracts (Article III, section 1, Constitution of the Philippines).

Section 2 of Republic Act No. 342 provides that all debts and other monetary obligations contracted before December 8, 1941, any provision in the contract creating the same or in any subsequent agreement affecting such obligation to the contrary notwithstanding, shall not be due and demandable for a period of eight (8) years from

and after settlement of the war damage claim of the debtor by the Philippine War Damage Commission; and section 3 of said Act provides that should the provision of section 2 be declared void and unenforceable, then as regards the obligation affected thereby, the provisions of Executive Order No. 25 dated November 18, 1944, as amended by Executive Order No. 32, dated March 10, 1945, relative to debt moratorium, shall continue to be in force and effect, any contract affecting the same to the contrary notwithstanding, until subsequently repealed or amended by a legislative enactment. It thus clearly appears in said Act that the nullification of its provisions will have the effect of reviving the previous moratorium orders issued by the President of the Philippines.

Statutes declaring a moratorium on the enforcement of monetary obligations are not of recent enactment. These moratorium laws are not new. "For some 1,400 years western civilization has made use of extraordinary devices for saving the credit structure, devices generally known as moratoria. The moratorium is a postponement of fulfilment of obligations decreed by the state through the medium of the courts or the legislature. Its essence is the application of the sovereign power" (58 C. J. S., p. 1208, footnote 87). In the United States, many state legislatures have adopted moratorium laws "during times of financial distress, especially when incident to, or caused by, a war" (41 C. J., p. 213). Thus, such laws "were passed by many state legislatures at the time of the civil war suspending the rights of creditors for a definite and reasonable time, * * * whether they suspend the right of action or make dilatory the remedy" (12 C. J., p. 1078). These laws were declared constitutional. However, some courts have also declared that "such statutes are void as to contracts made before their passage where the suspension of remedies prescribed is indefinite or unreasonable in duration" (12 C. J., 1078). The true test, therefore, of the constitutionality of a moratorium statute lies in the determination of the period of suspension of the remedy. It is required that such suspension be definite and reasonable, otherwise it would be violative of the constitution.

One of the arguments advanced against the validity of the moratorium law is the fact that it impairs the obligation of contracts which is prohibited by the Constitution. This argument, however, does not now hold water. While this may be conceded, it is however justified as a valid exercise by the State of its police power. The leading case on the matter is *Home Building and Loan Association vs. Blaisdell*, 290 U. S., 398, decided by the Supreme Court of the United States on January 8, 1934. Here appellant contested the validity of charter 339 of the laws of Minnesota of 1933, approved April 13, 1933, called the Minnesota Mortgage Moratorium Law, as being repugnant to the contract clause of the Federal Constitution. The statute was sustained by the Supreme Court of Minnesota as an emergency measure. "Although conceding that the obligations of the mortgage contract were impaired, the court decided that what it thus described as an impairment was, notwithstanding the contract clause of the Federal Constitution, within the police power of the State as that power was called into exercise by the public economic emergency which the legislature had found to exist". This theory was upheld by the Supreme Court. Speaking through Chief Justice Hughes, the court made the following pronouncements:

"Not only is the constitutional provision qualified by the measure of control which the State retains over remedial processes, but the State also continues to possess authority to safeguard the vital interest of its people. It does not matter that legislation appropriate to that end 'has the result of modifying or abrogating contracts already in effect.' * * *. Not only are existing laws read into contracts in order to fix obligations as between the parties, but the reservation of essential attributes of sovereign power is also lead into contracts as a postulate of the legal order. The policy of protecting contracts against impairment presupposes the maintenance of a government by virtue of which contractual relations are worth while, a government which retains adequate authority to secure the peace and good order of society. This principle of harmonizing the constitutional prohibition with the necessary residuum of state power has had progressive recognition in the decisions of this court."

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"The economic interests of the State may justify the exercise of its continuing and dominant protective power notwithstanding interference with contracts. * * *."

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"Similarly, where the protective power of the State is exercised in a manner otherwise appropriate in the regulation of a business it is no objection that the performance of existing contracts may be frustrated by the prohibition of injurious practices. * * *."

"* * *. The question is not whether the legislative action affects contracts incidentally, or directly or indirectly, but whether the legislation is addressed to a legitimate end and the measures taken are reasonable and appropriate to that end. * * *."

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"Undoubtedly, whatever is reserved of state power must be consistent with the fair intent of the constitutional limitation of that power. The reserved power cannot be construed so as to destroy the limitation, nor is the limitation to be construed to destroy the reserved power in its essential aspects. They must be construed in harmony with each other. This principle precludes a construction which would permit the State to adopt as its policy the repudiation of debts or the destruction of contracts or the denial of means to enforce them. But it does not follow that conditions may not arise in which a temporary restraint of enforcement may be consistent with the spirit and purpose of the constitutional provision and thus be found to be within the range of the reserved power of the State to protect the vital interests of the community. It cannot be maintained that the constitutional prohibition should be so construed as to prevent limited and temporary interpositions with respect to the enforcement of contracts if made necessary by a great public calamity such as fire, flood, or earthquake. See *American Land Co. vs. Zeiss*, 219 U. S. 47, 55 L. ed. 82, 31 S. Ct. 200. The reservation of state power appropriate to such extraordinary conditions may be deemed to be as much a part of all contracts, as is the reservation of state power to protect the public interest in the other situation to which we have referred. And if state power exists to give temporary relief from the enforcement of contracts in the presence of disasters due to physical causes such as fire, flood or earthquake, that power cannot be said to be nonexistent when the urgent public need demanding such relief is produced by other and economic causes" (78 L. ed. 426, 428-429.)

This decision elicited several comments. One came from the *Harvard Law Review*. It said: "Forsaking its well-trodden path of more than a century, the court sustained the first of the new mortgage moratory laws to meet its scrutiny, and in so doing announced an elastic concept of the contract clause which, if not newly formulated, at least received such unequivocal expression that it bids fair to revolutionize a tradition of constitutional interpretation. * * *. The court rested its decision on the ground that laws altering existing contracts constitute an impairment within the meaning of the contract clause only if they are unreasonable in the light of the circumstances occasioning their enactment. Application of this 'rule of reason' was justified on the theory that all contracts are made subject to an implied reservation of the protective power of the state, and that therefore statutes which validly exercise this reserved power, rather than impairing the obligations of an existing contract, are comprehended within them" (47 *Harvard Law Review*, pp. 660, 661-662).

But the ruling in the *Blaisdell* case has its limitations which should not be overlooked in the determination of the extent to be given to the legislation which attempts to encroach upon the enforcement of a monetary obligation. It must be noted that the application of the reserved power of the State to protect the integrity of the government and the security of the people should be limited to its proper bounds and must be addressed to a legitimate purpose. If these bounds are transgressed, there is no room for the exercise of the power, for the constitutional inhibition against the impairment of contracts would assert itself. We can cite instances by which these bounds may be transgressed. One of them is that the impairment should only refer to the remedy and not to a substantive right.

The State may postpone the enforcement of the obligation but cannot destroy it by making the remedy futile (*W. B. Worthen Co. vs. Kavanaugh*, 79 L. ed. 1298, 1301-1303). Another limitation refers to the propriety of the remedy. The rule requires that the alteration or change that the new legislation desires to write into an existing contract must not be burdened with restrictions and conditions that would make the remedy hardly pursuing (*Bronson vs. Kinziel*, 1 How, 311, 317; 46 Har. Law Review, p. 1070). In other words, the *Blaisdell* case postulates that the protective power of the State, the police power, may only be invoked and justified by an emergency, temporary in nature, and can only be exercised upon reasonable conditions in order that it may not infringe the constitutional provision against impairment of contracts (*First Trust Co. of Lincoln vs. Smith*, 277 N. W., pp. 762, 769). As Justice Cardozo aptly said, "A different situation is presented when extensions are so piled up as to make the remedy a shadow * * *. The changes of remedy now challenged as invalid are to be viewed in combination, with the cumulative significance that each imparts to all. So viewed they are seen to be an oppressive and unnecessary destruction of nearly all the incidents that give attractiveness and value to collateral security (*W. B. Worthen vs. Kavanaugh*, 295 U. S. 56, 62). In fine, the decision in the *Blaisdell* case is predicated on the ground that the laws altering existing contracts will constitute an impairment of the contract clause of the Constitution only if they are unreasonable in the light of the circumstances occasioning their enactment (47 Harvard Law Review, p. 660).

The question now to be determined is, is the period of eight (8) years which Republic Act No. 342 grants to debtors of a monetary obligation contracted before the last global war and who is a war sufferer with a claim duly approved by the Philippine War Damage Commission reasonable under the present circumstances?

It should be noted that Republic Act No. 342 only extends relief to debtors of prewar obligations who suffered from the ravages of the last war and who filed a claim for their losses with the Philippine War Damage Commission. It is therein provided that said obligation shall not be due and demandable for a period of eight (8) years from and after settlement of the claim filed by the debtor with said Commission. The purpose of the law is to afford to prewar debtors an opportunity to rehabilitate themselves by giving them a reasonable time within which to pay their prewar debts so as to prevent them from being victimized by their creditors. While it is admitted in said law that since liberation conditions have gradually returned to normal, this is not so with regard to those who have suffered the ravages of war and so it was therein declared as a policy that as to them the debt moratorium should be continued in force (section 1).

But we should not lose sight of the fact that these obligations had been pending since 1945 as a result of the issuance of Executive Orders Nos. 25 and 32 and at present their enforcement is still inhibited because of the enactment of Republic Act No. 342 and would continue to be unenforceable during the eight-year period granted to prewar debtors to afford them an opportunity to rehabilitate themselves, which in plain language means that the creditors would have to observe a vigil of at least twelve (12) years before they could effect a liquidation of their investment dating as far back as 1941. This period seems to us unreasonable, if not oppressive. While the purpose of Congress is plausible, and should be commended, the relief accorded works injustice to creditors who are practically left at the mercy of the debtors. Their hope to effect collection becomes extremely remote, more so if the credits are unsecured. And the injustice is more patent when, under the law, the debtor is not even required to pay interest during the operation of the relief, unlike similar statutes in the United States (*Home Building and Loan Association vs. Blaisdell*, supra).

There are at least three cases where the Supreme Court of the United States declared the moratorium laws violative of the contract clause of the Constitution because the period granted to debtors as a relief was found unwarranted by the contemplated emergency. One of them is *W. B. Worthen Co. vs. Thomas*, 292 U. S., 426-435; 78 L. ed., 1344, 1347. Here the Legislature of Arkansas passed an act providing for an exemption, "without

limitation as to amount or restriction with respect to particular circumstances or relations, of all monies paid or payable to any resident of the state under any life, sick, accident or disability insurance policy, from liability for the payment of the debts of the recipient", and an attempt was made to apply the statute to debts owing before its approval. The court held that "such an exemption, applied in the case of debts owing before the exemption was created by the legislature, constitutes an unwarranted interference with the obligation of contracts in violation of the constitutional provision", and cannot be sustained even as emergency legislation, because it contains no limitation as to time, amount, circumstances or need (*supra*, 292 U. S., pp. 426-432).

The other case is *W. B. Worthen vs. Kavanaugh* (*supra*). Here certain Municipal Improvement Districts organized under the laws of Arkansas were empowered to issue bonds and to mortgage benefit assessments as security therefor. One of these districts acted upon the powers thus conferred. Some of the bonds were in default for nonpayment of principal and interest. So an action was brought by the bond-holders to foreclose the assessments upon the lots of delinquent owners. These bonds and mortgages were executed under the statutes then in force. Later the legislature of Arkansas passed three acts making changes in the remedies available under the former statutes, which changes were attacked as an unconstitutional impairment of contracts. The court sustained this view holding that the "changes in the remedies available for the enforcement of a mortgage may not, even when the public welfare is invoked as an excuse, be pressed so far as to cut down the security of a mortgage without moderation or reason or in a spirit of oppression. * * *. A State is free to regulate the procedure in its courts even with reference to contracts already made, and moderate extensions of the time for pleading or for trial will ordinarily fall within the power so reserved; but a different situation is presented when extensions are so piled up as to make the remedy a shadow."

The third case is *Louisville Joint Stock Land Bank vs. Radford*, 295 U. S. 555, 79 L. ed. 1593. This case presented for decision the question whether subsection (s) added to section 75 of the Bankruptcy Act by the Frazier-Lemke Act, June 28, 1934, chap. 869, 48 Stat. at L. 1289 U. S. C. title 11, sec. 203, is consistent with the Federal Constitution. The court said that it is unconstitutional if applied to farm mortgages already existing, holding that "property rights of holders of farm mortgages are unconstitutionally taken, in violation of the Fifth Amendment, by a statute (Bankruptcy Act, sec. 75(s) ; Frazier-Lemke Act of June 28, 1934, chap. 869, 48 Stat. at L. 1289) applicable only to debts existing at the time of its enactment, which provides that a farmer whose farm is mortgaged, and who has failed to obtain the consents necessary to a composition under the Bankruptcy Act, may, upon being adjudged a bankrupt, if the mortgagee assents, purchase the mortgaged property at its then appraised value by agreeing to make deferred payments of stated percentages of the appraised value over a period of six years, with interest at 1 per cent per annum, or, if the mortgagee refuses his assent to such purchase, may obtain a stay of all proceedings for a period of five years, during which he shall retain possession of all or any part of his property, under the control of the court, provided he pays a reasonable rental therefor, and that at the end of five years he may pay into court the appraised price thereof, or, if a lien holder shall request a reappraisal by the court, the reappraised price, whereupon the court shall, by an order, turn over full possession and title of the property to the debtor, and he may apply for his discharge."

In addition, we may cite leading state court decisions which practically involved the same ruling and which reflect the tendency of the courts towards legislation involving modification of mortgage or monetary contracts which contains provisions that are deemed unreasonable or oppressive. Some of those which may be deemed representative follows:

- *Pouquette vs. O'Brien*, 100 Pac. 2nd series, 979 (1940). The Supreme Court of Arizona held unconstitutional a 1937 statute authorizing courts to extend for a period of not longer than two years all actions or foreclosures of real estate mortgages, and a 1939 statute authorizing the courts to extend foreclosure proceedings not later than

March 4, 1941.

- First Trust Joint Stock Land Bank of Chicago vs. Adolph Arp et al., 283 N.W. 441, 120 A.L.R. 932 (1939). The Supreme Court of Iowa declared unconstitutional the Moratorium Acts enacted in 1933, 1935 and 1937, providing for extension of the 1933 Moratorium Act covering a period of six years.

- First Trust Co. of Lincoln vs. Smith et al., 277 N.W. 762 (1938). The Supreme Court of Nebraska declared unconstitutional the Nebraska Moratorium Law as re-enacted, extending the benefit of the remedy to a period of six years, as being repugnant to the contract clause of the Constitution.

- Milkint vs. McNeely, Clerk of court, et al., 169 S.E. 790 (1933). The Supreme Court of Appeals of West Virginia declared unconstitutional certain acts of legislature enacted in 1932, extending the period of redemption three years beyond the one-year period then allowed by statute, being an impairment of contract as to sales made prior to enactment thereof.

- Haynes vs. Treadway, 65 Pac. 892 (1901). The Supreme Court of California declared unconstitutional a statute which extends the right of redemption from six months to twelve months being a substantial impairment of the obligation contracts if applied to a mortgage already executed.

- Swinburne vs. Mills, 50 Pac. 489 (1897). The Supreme Court of Washington declared a statute unconstitutional in so far as it provides that, on a decree for foreclosure of a mortgage executed before the act was passed, the debtor shall be entitled to have the order of sale stayed for one year, as being an impairment of the obligation of contract.

These cases apply with added force in this jurisdiction considering the conditions now prevailing in our country. We do not need to go far to appreciate this situation. We can see it and feel it as we gaze around to observe the wave of reconstruction and rehabilitation that has swept the country since liberation thanks to the aid of America and the innate progressive spirit of our people. This aid and this spirit have worked wonders in so short a time that it can now be safely stated that in the main the financial condition of our country and our people, individually and collectively, has practically returned to normal notwithstanding occasional reverses caused by local dissidence and the sporadic disturbance of peace and order in our midst. Business, industry and agriculture have picked up and developed at such stride that we can say that we are now well on the road to recovery and progress. This is so not only as far as our observation and knowledge are capable to take note and comprehend but also because of the official pronouncements made by our Chief Executive in public addresses and in several messages he submitted to Congress on the general state of the nation. To bear this out, it would suffice for us to state some of those public statements which we deem to be most expressive and representative of the general situation. We quote:

"We have balanced our national budget. We shall again have at the end of the current fiscal year a sizeable surplus. * * *

We have greatly improved the economic and financial conditions of the country. Through the Rehabilitation Finance Corporation, loans amounting to P90,480,136 have been granted for the reconstruction and rehabilitation purposes. * * *

We have set up the Central Bank to expand our credit, stabilize our currency and provide a new source of financing for the agricultural and industrial development of the nation.

* * * * *

* * * The commitment thus far made is not only a favorable sign ushering in finally the implementation of our plans of economic development, but a significantly successful test of the solvency of our foreign credit, for it was accepted only after a thorough examination of our resources and development plans by a board of

economists of international authority" (Pres. Quirino's "State-of-the-Nation" Message to the Joint Session of Congress on Jan. 24, 1949, 45 Off. Gaz., Jan., 1949).

"We have strengthened, * * * our internal and external finances. Six years ago, we were a country prostrate from the destruction of war. * * * Today, we can say that our people not only have returned to their prewar activities, but * * * have progressed and prospered far beyond what they ever dreamed of before the war.

* * * Three years ago the national income stood at four billion pesos; today it is over seven billion pesos. * * * The government income has been steadily rising from 60 million pesos in 1946 to approximately 600 million pesos today, also a progress in six years.

* * * * *

* * * The ravages of war are fast disappearing, and instead, what beautiful vistas unfold themselves before our eyes at this moment in our immediate surroundings. Compare this beautiful view with that of the past and all that we have accomplished in scarcely six years of struggle, sacrifice, determination, and bold decision. (Applause.) We have brought this nation out of the paralysis of destruction into economic normalcy and financial stability. * * * * * Our external finances have greatly improved, and * * * our pesos is one of the most stable currencies in the world today. (Applause.) I repeat, our pesos is one of the most stable currencies in the world today.

All these find grateful reflection in a better-sheltered, better-clothed, better-fed, and healthier population that has grown from 18 million to 20 million in a half dozen years, in a school enrollment that has doubled since the outbreak of the last war from less than 2 million to over 4 million young students in the public schools, and in democratic processes that are gaining in vigor and permanence with each passing year" (Address of his Excellency Elpidio Quirino, President of the Philippines, on the occasion of the celebration of the sixth anniversary of the independence of the Philippines, July 4, 1952, Luneta, Manila, 48 Off. Gaz., pp. 3287-3289).

In the face of the foregoing observations, and consistent with what we believe to be as the only course dictated by justice, fairness and righteousness, we feel that the only way open to us under the present circumstances is to declare that the continued operation and enforcement of Republic Act No. 342 at the present time is unreasonable and oppressive, and should not be prolonged a minute longer, and, therefore, the same should be declared null and void and without effect. And what we say here with respect to said Act also holds true as regards Executive Orders Nos. 25 and 32, perhaps with greater force and reason as to the latter, considering that said Orders contain no limitation whatsoever in point of time as regards the suspension of the enforcement and effectivity of monetary obligations. And there is need to make this pronouncement in view of the revival clause embodied in said Act if and when it is declared unconstitutional or invalid.

Wherefore, the decision appealed from will be reversed, without pronouncement as to costs.

Judgment is hereby rendered ordering the defendant to pay the plaintiff the sum of P4,800 with interest thereon at the rate of 7 per cent per annum from August 27, 1942, until its full payment, plus 12 per cent as attorney's fees. Failure to pay this judgment as stated, the properties mortgaged will be sold at public auction and the proceeds applied to its payment in accordance with law. So ordered.

Paras, C. J., Feria, Bengzon, Padilla, Tuason and Labrador, JJ., concur.
Pablo, J., concurs with the dispositive part.

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