

FELIX LAUREANO, PLAINTIFF AND APPELLANT, VS. EUGENIO KILAYCO AND CELSA LIZARES DE KILAYCO, DEFENDANTS AND APPELLEES.*G.R. No. 10419, November 10, 1915*

Ponente: CARSON, J.

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On the 20th day of February, 1913, the defendants in this action executed a written agreement wherein, for and in consideration of certain money lent to them by the plaintiff, they obligated themselves to pay the sum of P10,200 in monthly installments of P500, payable on the 15th day of each month, the first installment to be paid on the 15th day of April, 1913. By way of security for the loan they executed a chattel mortgage upon certain property, including the fittings and stock of a certain drug store. They obligated themselves, also, in the event of failure to pay any of the installments on the date upon which such, installments fell due, to pay interest at the rate of 15 per cent on all such overdue and unpaid installments until the date of payment; and, further, in the event that the plaintiff should be compelled to have recourse to the courts for the recovery of the money lent, to pay to plaintiff, by way of indemnification, the sum of P2,000. At the time of the trial, which took place in the month of October, 1914, it appeared that there was still due and unpaid under the contract the sum of P3,433.75, including in that amount the last installment due on the 15th day of November, 1914, and interest at the rate of 15 per cent upon the installments due and unpaid prior to the date of the trial. The defendants there and then offered to pay the total amount of P3,433.75 which appeared to be due on account of unpaid installments under the contract, including interest at the rate of 15 per cent from the date when such installments fell due; and, their offer having been declined in open court, deposited that amount with the clerk of the court, for payment to the plaintiff in full settlement of their obligation under the contract.

Counsel for plaintiff declined to accept the money thus tendered and contended that he was entitled to receive not only the amount of the unpaid installments due upon the debt, but also, by way of indemnification, the indemnity of P2,000 which defendants obligated themselves to pay to plaintiff in the event that he should find it necessary to institute proceedings in court to recover the debt; and, alleging that defendants had unlawfully sold, without plaintiff's knowledge or consent, the drug store on which the defendants had executed a chattel mortgage, counsel claimed also the sum of P10,000 under the provisions of section 12 of Act No. 1508 (Chattel Mortgage Law).

The trial judge, being of opinion that the deposit by the defendants with the clerk of the court of the sum of P3,433.75 constituted a settlement in full of their indebtedness under the contract, dismissed the complaint at the cost of the plaintiff.

From this judgment plaintiff appealed and assigns as error:

- "1. The failure of the trial court to give judgment against the defendants for the sum of P2,000, the indemnification agreed upon in the event that plaintiff should be compelled to institute legal proceedings to recover the debt.

2. The costs of the action.

"3. The sum of P10,000 to which he claims he is entitled under the provisions of section 12 of Act No. 1508, read together with section 10 of the same Act."

We will examine the last assignment of error first.

Sections 10 and 12 of Act No. 1508 are as follows:

"SEC. 10. A mortgagor of personal property shall not sell or pledge such property, or any part thereof, mortgaged by him without the consent of the mortgagee in writing on the back of the mortgage and on the margin of the record thereof in the office where such mortgage is recorded.

"SEC. 12. If a mortgagor violates either of the three last preceding sections he shall be fined a sum double the value of the property so wrongfully removed from the province, sold, pledged or mortgaged, one-half to the use of the party injured and the other half to the use of the Treasury of the Philippine Islands, or he may be imprisoned for a period not exceeding six months, or punished by both such fine and imprisonment, in the discretion of the court."

Without stopping to consider the legal effect of a chattel mortgage purporting to subject to mortgage the stock of a store, where it manifestly appears that it is the intent of the parties that the owner of the store shall continue the business without interruption, it is a sufficient answer to the contentions of plaintiff in this regard to direct attention to the terms of section 12 of the Act, which clearly contemplate that the fine and imprisonment which may be imposed thereunder are to be imposed in the course of a criminal action, wherein the accused is entitled to the benefit of the safeguards which the law of criminal procedure throws about the accused in every case in which he is charged with the commission of an offense defined and penalized by law. It follows, of course, that plaintiff's claim of one-half of the fine which he alleges should be imposed upon the defendants because of the alleged sale of the mortgaged property cannot be enforced in this action.

Plaintiff's claim to the agreed upon indemnity of P2,000 raises a question of greater difficulty.

We are of opinion, however, that the clauses of the contract providing for the payment of interest at an increased rate in the event of failure to pay any of the installments at the date upon which they fell due and providing further for the payment, by way of indemnification, of the sum of P2,000 in the event that plaintiff should find it necessary to institute proceedings for the enforcement of the contract, must be construed as penalties in the sense in which that term is used in articles 1152, 1153, 1154 and 1155 of the Civil Code.

In its decision dated March 24, 1909, the supreme court of Spain held that "el señalamiento de crecidos intereses para el caso de satisfacer el capital al veneer la obligacion, debe interpretarse como clausula penal." (The fixing of an increased rate of interest in the event of paying off the principal when the obligation becomes due should be construed as a penal clause.)

It needs no citation of authority to sustain a holding that a stipulation for the payment of P2,000 by way of indemnification, in the event of the failure to pay all or any part of an indebtedness of P10,200 in the event that the creditor should find it necessary to have recourse to the courts in the enforcement of the debt, is a penalty which, under the provisions of article 1154 of the code, the courts are authorized to modify in the sound exercise of their discretion when the principal obligation has been complied with by the debtor either in part or irregularly ("en parte o irregularmente").

In its decision of November 20, 1907, the supreme court of Spain held that "aun estipulado en la escritura que en su caso serian de cuenta y cargo del deudor las costas, daños y perjuicios, la aplicacion de esta penalidad queda sometida al prudente arbitrio de los Tribunales." (Even when it is stipulated in the instrument that, in a given

case, the cost, losses and damages shall be chargeable to the debtor and be borne by him the application of this penalty shall rest in the sound discretion of the courts.)

Under all the circumstances of this case, wherein the principal indebtedness appears to have been amply secured by a chattel mortgage, and wherein the greater part of the indebtedness had been paid at the time when the action was brought, and wherein the debtor tendered payment in full pending the proceedings in the court below and deposited the amount of the indebtedness then unpaid, together with 15 per cent interest, in the hands of the clerk of the court for the benefit of the creditor, and wherein substantial payments upon the principal obligation, amounting to some P2,000, had been made by the debtor and accepted by the creditor long prior to the institution of the action, we are of opinion that the trial judge properly exercised the discretion conferred upon him under article 1154 of the Civil Code by modifying the penalties prescribed under the contract so as to limit the right of the plaintiff thereunder to interest at the rate of 15 per cent upon the last installments which had become overdue under the terms of the contract.

It is true that it was said in a former decision (*Lambert vs. Fox*, 26 Phil. Rep., 588) that in this jurisdiction there is no substantial difference between a penalty and liquidated damages so far as legal results are concerned; but this statement is to be construed in connection with the case with reference to which it was made and, on examination, it will be found that it is strictly applicable only to cases wherein there has been neither a "partial or irregular" compliance with the terms of the contract, so that the courts have no authority to proceed under the provisions of article 1154 of the Civil Code which is as follows:

"The judge shall equitably mitigate the penalty if the principal obligation should have been partly or irregularly fulfilled by the debtor."

As was said by the supreme court of Spain in its sentence dated June 13, 1906, construing the provisions of book 4, title 1, chapter 3, section 6 of the Civil Code:

"The rules and prescriptions governing penal matters are fundamentally applicable to the penal sanctions of civil character."

It follows that, in any case wherein there has been a partial or irregular compliance with the provisions in a contract for special indemnification in the event of failure to comply with its terms, courts will rigidly apply the doctrine of strict construction against the enforcement in its entirety of the indemnification, where it is clear from the terms of the contract that the amount or character of the indemnity is fixed without regard to the probable damages which might be anticipated as a result of a breach of the terms of the contract; or, in other words, where the indemnity provided for is essentially a mere penalty having for its principal object the enforcement of compliance with the contract. But the courts will be slow in exercising the jurisdiction conferred upon them in article 1154 so as to modify the terms of an agreed upon indemnification where it appears that in fixing such indemnification the parties had in mind a fair and reasonable compensation for actual damages anticipated as a result of a breach of the contract, or, in other words, where the principal purpose of the indemnification agreed upon appears to have been to provide for the payment of actual anticipated and liquidated damages rather than the penalization of a breach of the contract.

It will readily be seen that the application of these principles to the particular facts in any case in which there has been a "partial or irregular performance" of the condition of a contract which provides a penalty or liquidated damages for noncompliance therewith will lead to results substantially identical with those arrived at in like cases in the United States under generally accepted doctrine touching the enforcement of such contracts. (Cf. *Ency. of U. S. Supreme Court Reports*, vol. 5, p. 176, "Liquidated Damages," and cases there cited.)

The application of these principles to the case at bar leaves no doubt in our mind as to the propriety of the action

of the court below in restricting the right of the plaintiff to recover under the penal clauses set forth in his contract the interest at the rate of 15 per cent agreed upon by the parties in the event of failure to pay the various installments of his indebtedness on the day and date when they fell due.

As to the third assignment of error, touching the judgment of the court against plaintiff for costs, we need only indicate that while it is true, as contended by plaintiff, that a tender of payment made after action has been instituted does not necessarily relieve a defendant, in an action for a sum of money, from the costs incurred prior to the date of the tender, it may and as a general rule should relieve him of all costs thereafter in the event that plaintiff declines to accept payment as tendered, and if it thereafter appears that the tender actually made was for the full amount due at the time when it was made. In the case at bar the total amount ultimately found due by the trial court was paid into court during the course of the trial, and we are of opinion that under all the circumstances of the case no error was committed by the trial judge in the exercise of his discretion in imposing the costs of the trial upon plaintiff, who declined to accept tender of payment of the full amount due and thus terminate the proceedings without further cost or expense to either party. (Section 487, Code of Civil Procedure.)

We conclude that the judgment entered in the court below should be affirmed, with the costs of this instance against the appellant. So ordered.

Arellano, C. J., Torres, Trent, and Araullo, JJ., concur.

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