STATE INVESTMENT HOUSE, INC., PETITIONER, VS. COURT OF APPEALS, LOMUYON TIMBER INDUSTRIES, INC., AMANDA MALONJAO AND RUFINO MALONJAO, RESPONDENTS.

G.R. No. 112590. July 12, 2001*

Ponente: KAPUNAN, J.

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KAPUNAN, J.:

This is a petition for review of the decision of the Court of Appeals affirming in toto the decision of the Regional Trial Court, National Capital Region, Branch 38 in Civil Case No. 83-18464 for a sum of money.

The undisputed facts, as quoted from the respondent court's decision are as follows:

> On March 9, 1978, Lomuyon Timber Industries, Inc. (hereafter, Lomuyon) agreed to sell to plaintiff its "receivables" at a discount on a with recourse basis (Exh. "A"). It was agreed in that sale that should a receivable remain unpaid, plaintiff, at its discretion, may impose a penalty fee of 3% per month. To secure the payment of the receivables, the Malonjaos also executed in favor of plaintiff, a real estate mortgage over their real property covered by Transfer Certificates of Title Nos. (445856) S-65586 and No. (162775) S-65585 (Exh. "B").
>
> Pursuant to their agreement, on March 9, 10 and 15, 1978 and July 19, 1978, Lomuyon sold to plaintiff for a total consideration of P2,558,073.75 (Exhs. "C", "D", "E" and "F"), various receivables consisting of checks as follows:
>
> TCBTC
>
> 618821 June 9, 1978 P371,319.58
>
> TCBTC
>
> 618820 September 9, 1978 P371,319.58
>
> TCBTC
>
> 618819 December 9, 1978 P371,319.58
>
> TCBTC
>
> 618818 March 9, 1978 P371,319.58

TCBTC

618817 June 9, 1979 P371,319.58

TCBTC

618816 September 9, 1979 P371,319.58

TCBTC

618814 December 9, 1979 P371,319.58

TCBTC

618828 March 9, 1980 P371,319.58

MBTC

06659490 September 30, 1978 60,000.00

(Exhs. "C-1", "D-1", "E-1", "F-1" and "G" to "G-7").

TCBTC (The Consolidated Bank and Trust Corporation) checks were all drawn by Amanda Malonjao to the order of payee Lomuyon which in turn, indorsed the checks to plaintiff. The MBTC (Metropolitan Bank and Trust Company) check was drawn by one Antonietta Malonjao-Roque to the order of payee Amanda Malonjao who in turn, indorsed said check to plaintiff.

When plaintiff presented the checks for payment to the drawee banks, the same were dishonored for having been drawn against insufficient funds (Exhs. "H" to "H-7") except for TCBTC 618821.

Plaintiff made repeated written demands on defendants to make good the checks they indorsed and to pay the penalty charges it has imposed thereon, (Exhs. "I", "J", "K", "L", "L-1", "M" and "N").

Defendants failed to pay the value of the checks. Plaintiff thus decided to undertake foreclosure of the real estate mortgage.

On October 6, 1982, plaintiff filed with the Provincial Sheriff of Rizal a petition for extrajudicial foreclosure of real estate mortgage dated September 28, 1981. In said petition, plaintiff alleged among others, that as of said date, September 28, 1981, defendants' outstanding obligation, inclusive of interest and charges, is P4,809,187.12 (Exh. "O").

On February 14, 1983, the Provincial Sheriff sold at public auction, defendants' mortgaged properties to plaintiff who was the highest bidder for P4,233,874.00. The following day, the Provincial Sheriff issued a Certificate of Sale (Exh. "P").

On June 27, 1983, plaintiff filed the complaint alleging that after deducting the price of the mortgaged properties from defendants' outstanding obligation, there remains a deficiency of P2,601,147.62 as of February 14, 1983,

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which as of May 31, 1983 amounted to P2,876,929.27 inclusive of interest and charges. As an alternative cause of action, plaintiff alleged that it is entitled to recover from the defendant the total value of the checks amounting to P2,239,237.10. Plaintiff further prayed that it be awarded exemplary damages, attorney's fees and litigation expenses (Records, pp. 1-38).

In their answer, defendants admitted having incurred the obligation with the plaintiff brought about by the dishonor of the checks. However, defendants contended that plaintiff's computation of their outstanding obligation is erroneous. Thus, by way of special affirmative defenses, defendants alleged that:

"12. x x x.

"13. The complaint states no cause of action;

"14. The value of the mortgaged properties sold at public auction is more than sufficient to cover the obligation of the defendants;

"15. The alleged purchase price of the mortgaged properties sold at public auction is unconscionably very very low;

"16. Assuming for the sake of argument, that the outstanding obligation of the defendants as of September 26, 1981 (sic) was P4,809,187.12 per statement of account as alleged in the complaint and the alleged purchase price at public auction was P4,233,874.00, the deficiency would only be P575,313.12 and not P2,601,147.62 as erroneously alleged in the complaint.

"17. No demand was ever made upon the defendant;

"18. The interest and charges made by plaintiff is usurious and unconscionable" (id., pp. 91-92).[1]

On January 11, 1981, the trial court rendered its decision with the following dispositive portion:

> WHEREFORE, in view of all the foregoing, judgment is hereby rendered:
>
> - Declaring that the plaintiff is not entitled to any deficiency amount from the defendants;
>
> - Dismissing defendants' counterclaim; and
>
> - Ordering the plaintiff and defendants to pay the costs of suit.
>
> SO ORDERED.[2]

On appeal, petitioner assigned the following errors committed by the trial court:

> - THE LOWER COURT ERRED IN NOT FINDING THAT DEFENDANTS-APPELLEES' OBLIGATION TO SIHI AS OF THE TIME OF FORECLOSURE AUCTION SALE AMOUNTED TO P6,835,021.62 THUS, AFTER DEDUCTING THE AUCTION PRICE OF THE MORTGAGED PROPERTIES IN THE AMOUNT OF P4,233,874.00, THE BALANCE WOULD BE P2,601,141.62.
>
> - THE LOWER COURT ERRED IN FINDING THAT SIHI HAD ALREADY FULLY RECOVERED ITS RECEIVABLES FROM THE DEFENDANTS.
>
> - THE LOWER COURT ERRED IN FINDING THAT SIHI IS NOT ENTITLED TO ANY DEFICIENCY AMOUNT FROM THE DEFENDANTS.[3]

On August 27, 1992, the respondent court rendered the assailed decision disallowing the claim for deficiency on the finding that the penalty charges imposed by petitioner on the principal obligation were highly iniquitous and unconscionable. The subsequent motion for reconsideration was, likewise, denied. Hence, petitioner filed the

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instant petition raising the sole issue that:

> THE COURT OF APPEALS GROSSLY MISAPPRECIATED THE FACTS AND APPLICABLE LAW BY NOT DECLARING THAT SIHI IS STILL ENTITLED TO THE DEFICIENCY AFTER THE FORECLOSURE AUCTION SALE.[4]

In disallowing the claim for deficiency, the respondent court found that the proceeds of the auction sale was sufficient to cover the principal obligation of the private respondent including interest, penalty and other charges. Both the respondent court and the trial court took particular attention on the penalty charge of 3% a month which was imposed on the principal obligation as a result of their default in payments. Undaunted by the disallowance of its claim in the August 27, 1992 decision, petitioner reiterated its position in a motion for reconsideration, averring that the respondent court and the trial court failed to reconcile the figures due it.

Petitioner asserts that as of September 26, 1981, private respondent's obligation amounted to P4,809,187.12. At that time of the foreclosure sale on February 14, 1983, the obligation to SIHI was computed to be P6,833,021.62 inclusive of interest and penalty charges. Considering that the bid price of the foreclosed properties was only P4,233,874.00, petitioner was still entitled to a deficiency of about P2,601,147.62. Petitioner further added that until the original obligation is fully paid, private respondent's outstanding obligation continue to earn interest and penalty charges from day to day. Thus, from the time of the foreclosure sale on February 14, 1983 (P2,601,147.62) up to the filing of the complaint for the deficiency claim on May 31, 1983 (P2,876,929.27), and up to the trial on June 3, 1988 in the RTC, private respondent's outstanding obligation to SIHI rose to P7,651,969.41.

There is no dispute that the payment of penalty is sanctioned by the law, although the penalty may be reduced by the courts if it is iniquitous or unconscionable.[5] Petitioner argues that while it recognizes the authority of the court to reduce the penalty if it is iniquitous or unconscionable, the court, however, does not have the authority to delete the payment of the penalty charges altogether for this is in clear contravention of Article 1229 and the law of contracts between the parties.

This contention is not well-taken.

The Court does not find any reversible error committed by the respondent court in ruling that the petitioner was no longer entitled to recover any deficiency amount after the foreclosure sale on February 14, 1983. Per Statement of Account dated September 21, 1981, the obligation of the private respondent was computed to be P4,809,187.12 inclusive of interest and penalty charges. Since the private respondent failed to fulfill its obligation, petitioner then decided to foreclose the real estate mortgage on two properties of the private respondent. At the time of the auction sale on February 14, 1983, the properties were sold in the amount of P4,223,874.00 with the petitioner as the highest bidder. Deducting this amount from the outstanding obligation of P4,809,187.12 as stipulated in the Statement of Account, there would therefore be a balance of only about P575,313.12.

Whether or not the alleged deficiency from the foreclosure sale was P575,313.12 or P2,601,147.62 as claimed by petitioner was of no moment. The respondent court disallowed the payment of the deficiency altogether because it found that the principal obligation of the private respondent would not have ballooned to such a horrendous amount of P4.8M as of September 21, 1991 if not for the penalty charge of 3% per month or 36% per annum. The trial court justified, to wit:

> x x x [F]rom the various checks the defendants had sold originally to the plaintiff at the beginning of their transactions, it is shown that the amount including interests and other charges, is P2,970,556.64. For a two year period from June 9, 1978 to March 9, 1980 and up to September 26, 1981 the amount grew to P4,809.187.12. In other words, the money of the plaintiff has already earned interests and other charges to more or less

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> P1,638,630.48. As alleged in plaintiff's complaint, the total amount purchased by plaintiff was only for P2,500,000.00. There is reason to believe that the P2,970,566.64 represented by the various checks include therein, the interest and other charges upon their maturity dates. Deducting the amount of P2,500,000.00 from P2,970,556.64 is P420,556.64. In brief, the interests and charges that plaintiff has already earned from the time it has foreclosed defendants' properties has passed the P2,000,000.00.[6]

Contrary to petitioner's contention, the respondent court acted in accordance to Article 1229 when it declared that petitioner was no longer entitled to the payment of the deficiency amount. The disallowance of the payment of deficiency was in effect merely a reduction of the penalty charges and not as a deletion of the penalties as contended by the petitioner.

In the case of Rizal Commercial Banking Corporation vs. Court of Appeals,[7] we held that:

> x x x
>
> On the issue of payment of surcharges and penalties, we partly agree that GOYU's pitiful situation must be taken into account. We do not agree, however, that payment of any amount as surcharges and penalties should altogether be deleted. x x x
>
> Surcharges and penalties agreed to be paid by the debtor in case of default partake of the nature of liquidated damages, covered by Section 4, Chapter 3, Title XVIII of the Civil Code. Article 2227 thereof provides:
> ART. 2227. Liquidated damages, whether intended as an indemnity or penalty, shall be equitably reduced if they are iniquitous and unconscionable.

In exercising this vested power to determine what is iniquitous and unconscionable, the Court must consider the circumstances of each case. It should be stressed that the Court will not make any sweeping ruling that surcharges and penalties imposed by banks for non-payment of the loans extended by them are generally iniquitous and unconscionable. What may be iniquitous and unconscionable in one case, may be totally just and equitable in another. This provision of law will have to be applied to the established facts of any given case. Given the circumstances under which GOYU found itself after the occurrence of the fire, the Court rules the surcharges rates ranging anywhere from 9% to 27%, plus the penalty charges of 36%, to be definitely iniquitous and unconscionable. x x x

Likewise, in the case at bar, the two courts below found the penalty charge of 3% a month or 36% per annum iniquitous and unconscionable. Petitioner computed the amount of P4,809,187.12 as the outstanding obligation of the petitioner as of September 21, 1981 after imposing the 3% penalty charge when petitioner defaulted in their payments. This amount was no longer questioned and was particularly taken into consideration when the mortgaged properties were foreclosed and sold at the auction sale in 1983, obtaining a sum of about P4,223,874.00. These foreclosed properties located in Makati[8] are undoubtedly valuable properties whose market value has greatly appreciated to substantially satisfy the payment of the outstanding obligation. Notwithstanding the balance of P575,313.12, petitioner has clearly recouped its investment and earned more than enough profit in two years (1978-1981) by way of penalty charges. Although petitioner claims that the penalty charge was well within the banking and business practice, no proof was adduced thereof. To allow the petitioner to recover the amount of P6,835,021.21 at the time of the foreclosure sale in 1983, or P7,651,969.41 at the time of the trial of the case in 1988 which amounts are almost three times more than the original investment of about P2,558,073.75 is rather unwarranted. We quote with favor the respondent court's ratiocination:

> The lower court did not err in its ruling under its statement that "since plaintiff had already recovered fully the receivables from the defendants, the court, considering that the plaintiff for the two properties foreclosed by it bidded the amount of P4,233,874.00, far and above the amount it had originally given to the defendants which was only over P2,000,000.00, it is rather most shocking and unconscionable for plaintiff to still collect from

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> the defendants the alleged collectibles of P2,601,147.62 with 3% penalty charges. The plaintiff should have stopped imposing the 3% penalty charges and other burdens when it had consolidated finally the two titles of the properties it had foreclosed" (Decision, p. 8). After due consideration and reflection on all the factual circumstances obtaining in the case at bar, it is Our opinion that the lower court properly exercised its discretion under Article 1229 of the Civil Code to reduce the penalty charges for being highly and grossly unconscionable. x x x[9]

While the Court recognizes the right of the parties to enter into contracts and are expected ro comply with the terms and obligations, this rule is not absolute. The Court allowed to temper interest rates when necessary. Article 1229 of the New Civil Code clearly provides:

> ART. 1229. The judge shall equitably reduce the penalty when the principal obligation has been partly or irregularly complied with by the debtor. Even if there has been no performance, the penalty may also be reduced by the courts if it is iniquitous or unconscionable.

Likewise, Article 2227 provides:

> ART. 2227. Liquidated damages, whether intended as an indemnity or penalty, shall be equitably reduced if they are iniquitous and unconscionable.

ACCORDINGLY, the judgment appealed from is hereby AFFIRMED.

SO ORDERED.

Davide, Jr., C.J., (Chairman), Puno, Pardo, and Ynares-Santiago, JJ., concur.

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[*] This case was transferred to the ponente pursuant to the resolution in A.M. No. 00-9-03-SC. Re: Creation of Special Committee on Case Backlog dated February 27, 2001.

[1] Rollo, pp. 25-28.

[2] Id., at 179.

[3] Id., at 29-30.

[4] Id., at 18.

[5] Consolidated Bank and Trust Corporation (Solidbank) vs. Court of Appeals, 246 SCRA 193 (1995).

[6] Rollo, p. 177.

[7] 289 SCRA 292 (1998).

[8] Rollo, p. 54.

[9] Id., at 30-31.

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