

ESTRELLA PALMARES, PETITIONER, VS. COURT OF APPEALS AND M.B. LENDING CORPORATION, RESPONDENTS.

G.R. No. 126490. March 31, 1998

Ponente: REGALADO, J.

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REGALADO, J.:

Where a party signs a promissory note as a co-maker and binds herself to be jointly and severally liable with the principal debtor in case the latter defaults in the payment of the loan, is such undertaking of the former deemed to be that of a surety as an insurer of the debt, or of a guarantor who warrants the solvency of the debtor?

Pursuant to a promissory note dated March 13, 1990, private respondent M.B. Lending Corporation extended a loan to the spouses Osmeña and Merlyn Azarraga, together with petitioner Estrella Palmares, in the amount of P30,000.00 payable on or before May 12, 1990, with compounded interest at the rate of 6% per annum to be computed every 30 days from the date thereof.[1] On four occasions after the execution of the promissory note and even after the loan matured, petitioner and the Azarraga spouses were able to pay a total of P16,300.00, thereby leaving a balance of P13,700.00. No payments were made after the last payment on September 26, 1991.[2]

Consequently, on the basis of petitioner's solidary liability under the promissory note, respondent corporation filed a complaint[3] against petitioner Palmares as the lone party-defendant, to the exclusion of the principal debtors, allegedly by reason of the insolvency of the latter.

In her Amended Answer with Counterclaim,[4] petitioner alleged that sometime in August 1990, immediately after the loan matured, she offered to settle the obligation with respondent corporation but the latter informed her that they would try to collect from the spouses Azarraga and that she need not worry about it; that there has already been a partial payment in the amount of P17,010.00; that the interest of 6% per month compounded at the same rate per month, as well as the penalty charges of 3% per month, are usurious and unconscionable; and that while she agrees to be liable on the note but only upon default of the principal debtor, respondent corporation acted in bad faith in suing her alone without including the Azarragas when they were the only ones who benefited from the proceeds of the loan.

During the pre-trial conference, the parties submitted the following issues for the resolution of the trial court: (1) what the rate of interest, penalty and damages should be; (2) whether the liability of the defendant (herein petitioner) is primary or subsidiary; and (3) whether the defendant Estrella Palmares is only a guarantor with a subsidiary liability and not a co-maker with primary liability.[5]

Thereafter, the parties agreed to submit the case for decision based on the pleadings filed and the memoranda to be submitted by them. On November 26, 1992, the Regional Trial Court of Iloilo City, Branch 23, rendered judgment dismissing the complaint without prejudice to the filing of a separate action for a sum of money against the spouses Osmeña and Merlyn Azarraga who are primarily liable on the instrument.[6] This was based on the findings of the court a quo that the filing of the complaint against herein petitioner Estrella Palmares, to the

exclusion of the Azarraga spouses, amounted to a discharge of a prior party; that the offer made by petitioner to pay the obligation is considered a valid tender of payment sufficient to discharge a person's secondary liability on the instrument; that petitioner, as co-maker, is only secondarily liable on the instrument; and that the promissory note is a contract of adhesion.

Respondent Court of Appeals, however, reversed the decision of the trial court, and rendered judgment declaring herein petitioner Palmares liable to pay respondent corporation:

1. The sum of P13,700.00 representing the outstanding balance still due and owing with interest at six percent (6%) per month computed from the date the loan was contracted until fully paid;
2. The sum equivalent to the stipulated penalty of three percent (3%) per month, of the outstanding balance;
3. Attorney's fees at 25% of the total amount due per stipulations;
4. Plus costs of suit.[7]

Contrary to the findings of the trial court, respondent appellate court declared that petitioner Palmares is a surety since she bound herself to be jointly and severally or solidarily liable with the principal debtors, the Azarraga spouses, when she signed as a co-maker. As such, petitioner is primarily liable on the note and hence may be sued by the creditor corporation for the entire obligation. It also adverted to the fact that petitioner admitted her liability in her Answer although she claims that the Azarraga spouses should have been impleaded. Respondent court ordered the imposition of the stipulated 6% interest and 3% penalty charges on the ground that the Usury Law is no longer enforceable pursuant to Central Bank Circular No. 905. Finally, it rationalized that even if the promissory note were to be considered as a contract of adhesion, the same is not entirely prohibited because the one who adheres to the contract is free to reject it entirely; if he adheres, he gives his consent.

Hence this petition for review on certiorari wherein it is asserted that:

A. The Court of Appeals erred in ruling that Palmares acted as surety and is therefore solidarily liable to pay the promissory note.

1. The terms of the promissory note are vague. Its conflicting provisions do not establish Palmares' solidary liability.
2. The promissory note contains provisions which establish the co-maker's liability as that of a guarantor.
3. There is no sufficient basis for concluding that Palmares' liability is solidary.
4. The promissory note is a contract of adhesion and should be construed against M.B. Lending Corporation.
5. Palmares cannot be compelled to pay the loan at this point.

B. Assuming that Palmares' liability is solidary, the Court of Appeals erred in strictly imposing the interests and penalty charges on the outstanding balance of the promissory note.

The foregoing contentions of petitioner are denied and contradicted in their material points by respondent corporation. They are further refuted by accepted doctrines in the American jurisdiction after which we patterned our statutory law on suretyship and guaranty. This case then affords us the opportunity to make an extended exposition on the ramifications of these two specialized contracts, for such guidance as may be taken therefrom in similar local controversies in the future.

The basis of petitioner Palmares' liability under the promissory note is expressed in this wise:

ATTENTION TO CO-MAKERS: PLEASE READ WELL

I, Mrs. Estrella Palmares, as the Co-maker of the above-quoted loan, have fully understood the contents of this Promissory Note for Short-Term Loan:

That as Co-maker, I am fully aware that I shall be jointly and severally or solidarily liable with the above principal maker of this note;

That in fact, I hereby agree that M.B. LENDING CORPORATION may demand payment of the above loan from me in case the principal maker, Mrs. Merlyn Azarraga defaults in the payment of the note subject to the same conditions above-contained.[8]

Petitioner contends that the provisions of the second and third paragraph are conflicting in that while the second paragraph seems to define her liability as that of a surety which is joint and solidary with the principal maker, on the other hand, under the third paragraph her liability is actually that of a mere guarantor because she bound herself to fulfill the obligation only in case the principal debtor should fail to do so, which is the essence of a contract of guaranty. More simply stated, although the second paragraph says that she is liable as a surety, the third paragraph defines the nature of her liability as that of a guarantor. According to petitioner, these are two conflicting provisions in the promissory note and the rule is that clauses in the contract should be interpreted in relation to one another and not by parts. In other words, the second paragraph should not be taken in isolation, but should be read in relation to the third paragraph.

In an attempt to reconcile the supposed conflict between the two provisions, petitioner avers that she could be held liable only as a guarantor for several reasons. First, the words “jointly and severally or solidarily liable” used in the second paragraph are technical and legal terms which are not fully appreciated by an ordinary layman like herein petitioner, a 65-year old housewife who is likely to enter into such transactions without fully realizing the nature and extent of her liability. On the contrary, the wordings used in the third paragraph are easier to comprehend. Second, the law looks upon the contract of suretyship with a jealous eye and the rule is that the obligation of the surety cannot be extended by implication beyond specified limits, taking into consideration the peculiar nature of a surety agreement which holds the surety liable despite the absence of any direct consideration received from either the principal obligor or the creditor. Third, the promissory note is a contract of adhesion since it was prepared by respondent M.B. Lending Corporation. The note was brought to petitioner partially filled up, the contents thereof were never explained to her, and her only participation was to sign thereon. Thus, any apparent ambiguity in the contract should be strictly construed against private respondent pursuant to Art. 1377 of the Civil Code.[9]

Petitioner accordingly concludes that her liability should be deemed restricted by the clause in the third paragraph of the promissory note to be that of a guarantor.

Moreover, petitioner submits that she cannot as yet be compelled to pay the loan because the principal debtors cannot be considered in default in the absence of a judicial or extrajudicial demand. It is true that the complaint alleges the fact of demand, but the purported demand letters were never attached to the pleadings filed by private respondent before the trial court. And, while petitioner may have admitted in her Amended Answer that she received a demand letter from respondent corporation sometime in 1990, the same did not effectively put her or the principal debtors in default for the simple reason that the latter subsequently made a partial payment on the loan in September, 1991, a fact which was never controverted by herein private respondent.

Finally, it is argued that the Court of Appeals gravely erred in awarding the amount of P2,745,483.39 in favor of private respondent when, in truth and in fact, the outstanding balance of the loan is only P13,700.00. Where the interest charged on the loan is exorbitant, iniquitous or unconscionable, and the obligation has been partially complied with, the court may equitably reduce the penalty[10] on grounds of substantial justice. More

importantly, respondent corporation never refuted petitioner's allegation that immediately after the loan matured, she informed said respondent of her desire to settle the obligation. The court should, therefore, mitigate the damages to be paid since petitioner has shown a sincere desire for a compromise.[11]

After a judicious evaluation of the arguments of the parties, we are constrained to dismiss the petition for lack of merit, but to except therefrom the issue anent the propriety of the monetary award adjudged to herein respondent corporation.

At the outset, let it here be stressed that even assuming arguendo that the promissory note executed between the parties is a contract of adhesion, it has been the consistent holding of the Court that contracts of adhesion are not invalid per se and that on numerous occasions the binding effects thereof have been upheld. The peculiar nature of such contracts necessitate a close scrutiny of the factual milieu to which the provisions are intended to apply. Hence, just as consistently and unhesitatingly, but without categorically invalidating such contracts, the Court has construed obscurities and ambiguities in the restrictive provisions of contracts of adhesion strictly albeit not unreasonably against the drafter thereof when justified in light of the operative facts and surrounding circumstances.[12] The factual scenario obtaining in the case before us warrants a liberal application of the rule in favor of respondent corporation.

The Civil Code pertinently provides:

Art. 2047. By guaranty, a person called the guarantor binds himself to the creditor to fulfill the obligation of the principal debtor in case the latter should fail to do so.

If a person binds himself solidarily with the principal debtor, the provisions of Section 4, Chapter 3, Title I of this Book shall be observed. In such case the contract is called a suretyship.

It is a cardinal rule in the interpretation of contracts that if the terms of a contract are clear and leave no doubt upon the intention of the contracting parties, the literal meaning of its stipulation shall control.[13] In the case at bar, petitioner expressly bound herself to be jointly and severally or solidarily liable with the principal maker of the note. The terms of the contract are clear, explicit and unequivocal that petitioner's liability is that of a surety.

Her pretension that the terms "jointly and severally or solidarily liable" contained in the second paragraph of her contract are technical and legal terms which could not be easily understood by an ordinary layman like her is diametrically opposed to her manifestation in the contract that she "fully understood the contents" of the promissory note and that she is "fully aware" of her solidary liability with the principal maker. Petitioner admits that she voluntarily affixed her signature thereto; ergo, she cannot now be heard to claim otherwise. Any reference to the existence of fraud is unavailing. Fraud must be established by clear and convincing evidence, mere preponderance of evidence not even being adequate. Petitioner's attempt to prove fraud must, therefore, fail as it was evidenced only by her own uncorroborated and, expectedly, self-serving allegations.[14]

Having entered into the contract with full knowledge of its terms and conditions, petitioner is estopped to assert that she did so under a misapprehension or in ignorance of their legal effect, or as to the legal effect of the undertaking.[15] The rule that ignorance of the contents of an instrument does not ordinarily affect the liability of one who signs it also applies to contracts of suretyship. And the mistake of a surety as to the legal effect of her obligation is ordinarily no reason for relieving her of liability.[16]

Petitioner would like to make capital of the fact that although she obligated herself to be jointly and severally liable with the principal maker, her liability is deemed restricted by the provisions of the third paragraph of her contract wherein she agreed "that M.B. Lending Corporation may demand payment of the above loan from me in case the principal maker, Mrs. Merlyn Azarraga defaults in the payment of the note," which makes her contract

one of guaranty and not suretyship. The purported discordance is more apparent than real.

A surety is an insurer of the debt, whereas a guarantor is an insurer of the solvency of the debtor.[17] A suretyship is an undertaking that the debt shall be paid; a guaranty, an undertaking that the debtor shall pay.[18] Stated differently, a surety promises to pay the principal's debt if the principal will not pay, while a guarantor agrees that the creditor, after proceeding against the principal, may proceed against the guarantor if the principal is unable to pay.[19] A surety binds himself to perform if the principal does not, without regard to his ability to do so. A guarantor, on the other hand, does not contract that the principal will pay, but simply that he is able to do so.[20] In other words, a surety undertakes directly for the payment and is so responsible at once if the principal debtor makes default, while a guarantor contracts to pay if, by the use of due diligence, the debt cannot be made out of the principal debtor.[21]

Quintessentially, the undertaking to pay upon default of the principal debtor does not automatically remove it from the ambit of a contract of suretyship. The second and third paragraphs of the aforementioned portion of the promissory note do not contain any other condition for the enforcement of respondent corporation's right against petitioner. It has not been shown, either in the contract or the pleadings, that respondent corporation agreed to proceed against herein petitioner only if and when the defaulting principal has become insolvent. A contract of suretyship, to repeat, is that wherein one lends his credit by joining in the principal debtor's obligation, so as to render himself directly and primarily responsible with him, and without reference to the solvency of the principal.[22]

In a desperate effort to exonerate herself from liability, petitioner erroneously invokes the rule on *strictissimi juris*, which holds that when the meaning of a contract of indemnity or guaranty has once been judicially determined under the rule of reasonable construction applicable to all written contracts, then the liability of the surety, under his contract, as thus interpreted and construed, is not to be extended beyond its strict meaning.[23] The rule, however, will apply only after it has been definitely ascertained that the contract is one of suretyship and not a contract of guaranty. It cannot be used as an aid in determining whether a party's undertaking is that of a surety or a guarantor.

Prescinding from these jurisprudential authorities, there can be no doubt that the stipulation contained in the third paragraph of the controverted suretyship contract merely elucidated on and made more specific the obligation of petitioner as generally defined in the second paragraph thereof. Resultantly, the theory advanced by petitioner, that she is merely a guarantor because her liability attaches only upon default of the principal debtor, must necessarily fail for being incongruent with the judicial pronouncements adverted to above.

It is a well-entrenched rule that in order to judge the intention of the contracting parties, their contemporaneous and subsequent acts shall also be principally considered.[24] Several attendant factors in that genre lend support to our finding that petitioner is a surety. For one, when petitioner was informed about the failure of the principal debtor to pay the loan, she immediately offered to settle the account with respondent corporation. Obviously, in her mind, she knew that she was directly and primarily liable upon default of her principal. For another, and this is most revealing, petitioner presented the receipts of the payments already made, from the time of initial payment up to the last, which were all issued in her name and of the Azarraga spouses.[25] This can only be construed to mean that the payments made by the principal debtors were considered by respondent corporation as creditable directly upon the account and inuring to the benefit of petitioner. The concomitant and simultaneous compliance of petitioner's obligation with that of her principals only goes to show that, from the very start, petitioner considered herself equally bound by the contract of the principal makers.

In this regard, we need only to reiterate the rule that a surety is bound equally and absolutely with the

principal,[26] and as such is deemed an original promisor and debtor from the beginning.[27] This is because in suretyship there is but one contract, and the surety is bound by the same agreement which binds the principal.[28] In essence, the contract of a surety starts with the agreement,[29] which is precisely the situation obtaining in this case before the Court.

It will further be observed that petitioner's undertaking as co-maker immediately follows the terms and conditions stipulated between respondent corporation, as creditor, and the principal obligors. A surety is usually bound with his principal by the same instrument, executed at the same time and upon the same consideration; he is an original debtor, and his liability is immediate and direct.[30] Thus, it has been held that where a written agreement on the same sheet of paper with and immediately following the principal contract between the buyer and seller is executed simultaneously therewith, providing that the signers of the agreement agreed to the terms of the principal contract, the signers were "sureties" jointly liable with the buyer.[31] A surety usually enters into the same obligation as that of his principal, and the signatures of both usually appear upon the same instrument, and the same consideration usually supports the obligation for both the principal and the surety.[32]

There is no merit in petitioner's contention that the complaint was prematurely filed because the principal debtors cannot as yet be considered in default, there having been no judicial or extrajudicial demand made by respondent corporation. Petitioner has agreed that respondent corporation may demand payment of the loan from her in case the principal maker defaults, subject to the same conditions expressed in the promissory note. Significantly, paragraph (G) of the note states that "should I fail to pay in accordance with the above schedule of payment, I hereby waive my right to notice and demand." Hence, demand by the creditor is no longer necessary in order that delay may exist since the contract itself already expressly so declares.[33] As a surety, petitioner is equally bound by such waiver.

Even if it were otherwise, demand on the sureties is not necessary before bringing suit against them, since the commencement of the suit is a sufficient demand.[34] On this point, it may be worth mentioning that a surety is not even entitled, as a matter of right, to be given notice of the principal's default. Inasmuch as the creditor owes no duty of active diligence to take care of the interest of the surety, his mere failure to voluntarily give information to the surety of the default of the principal cannot have the effect of discharging the surety. The surety is bound to take notice of the principal's default and to perform the obligation. He cannot complain that the creditor has not notified him in the absence of a special agreement to that effect in the contract of suretyship.[35]

The alleged failure of respondent corporation to prove the fact of demand on the principal debtors, by not attaching copies thereof to its pleadings, is likewise immaterial. In the absence of a statutory or contractual requirement, it is not necessary that payment or performance of his obligation be first demanded of the principal, especially where demand would have been useless; nor is it a requisite, before proceeding against the sureties, that the principal be called on to account.[36] The underlying principle therefor is that a suretyship is a direct contract to pay the debt of another. A surety is liable as much as his principal is liable, and absolutely liable as soon as default is made, without any demand upon the principal whatsoever or any notice of default.[37] As an original promisor and debtor from the beginning, he is held ordinarily to know every default of his principal.[38]

Petitioner questions the propriety of the filing of a complaint solely against her to the exclusion of the principal debtors who allegedly were the only ones who benefited from the proceeds of the loan. What petitioner is trying to imply is that the creditor, herein respondent corporation, should have proceeded first against the principal before suing on her obligation as surety. We disagree.

A creditor's right to proceed against the surety exists independently of his right to proceed against the principal.[39] Under Article 1216 of the Civil Code, the creditor may proceed against any one of the solidary

debtors or some or all of them simultaneously. The rule, therefore, is that if the obligation is joint and several, the creditor has the right to proceed even against the surety alone.[40] Since, generally, it is not necessary for a creditor to proceed against a principal in order to hold the surety liable, where, by the terms of the contract, the obligation of the surety is the same as that of the principal, then as soon as the principal is in default, the surety is likewise in default, and may be sued immediately and before any proceedings are had against the principal.[41] Perforce, in accordance with the rule that, in the absence of statute or agreement otherwise, a surety is primarily liable, and with the rule that his proper remedy is to pay the debt and pursue the principal for reimbursement, the surety cannot at law, unless permitted by statute and in the absence of any agreement limiting the application of the security, require the creditor or obligee, before proceeding against the surety, to resort to and exhaust his remedies against the principal, particularly where both principal and surety are equally bound.[42]

We agree with respondent corporation that its mere failure to immediately sue petitioner on her obligation does not release her from liability. Where a creditor refrains from proceeding against the principal, the surety is not exonerated. In other words, mere want of diligence or forbearance does not affect the creditor's rights vis-à-vis the surety, unless the surety requires him by appropriate notice to sue on the obligation. Such gratuitous indulgence of the principal does not discharge the surety whether given at the principal's request or without it, and whether it is yielded by the creditor through sympathy or from an inclination to favor the principal, or is only the result of passiveness. The neglect of the creditor to sue the principal at the time the debt falls due does not discharge the surety, even if such delay continues until the principal becomes insolvent.[43] And, in the absence of proof of resultant injury, a surety is not discharged by the creditor's mere statement that the creditor will not look to the surety,[44] or that he need not trouble himself.[45] The consequences of the delay, such as the subsequent insolvency of the principal,[46] or the fact that the remedies against the principal may be lost by lapse of time, are immaterial.[47]

The *raison d'être* for the rule is that there is nothing to prevent the creditor from proceeding against the principal at any time.[48] At any rate, if the surety is dissatisfied with the degree of activity displayed by the creditor in the pursuit of his principal, he may pay the debt himself and become subrogated to all the rights and remedies of the creditor.[49]

It may not be amiss to add that leniency shown to a debtor in default, by delay permitted by the creditor without change in the time when the debt might be demanded, does not constitute an extension of the time of payment, which would release the surety.[50] In order to constitute an extension discharging the surety, it should appear that the extension was for a definite period, pursuant to an enforceable agreement between the principal and the creditor, and that it was made without the consent of the surety or with a reservation of rights with respect to him. The contract must be one which precludes the creditor from, or at least hinders him in, enforcing the principal contract within the period during which he could otherwise have enforced it, and which precludes the surety from paying the debt.[51]

None of these elements are present in the instant case. Verily, the mere fact that respondent corporation gave the principal debtors an extended period of time within which to comply with their obligation did not effectively absolve herein petitioner from the consequences of her undertaking. Besides, the burden is on the surety, herein petitioner, to show that she has been discharged by some act of the creditor,[52] herein respondent corporation, failing in which we cannot grant the relief prayed for.

As a final issue, petitioner claims that assuming that her liability is solidary, the interests and penalty charges on the outstanding balance of the loan cannot be imposed for being illegal and unconscionable. Petitioner additionally theorizes that respondent corporation intentionally delayed the collection of the loan in order that the interests and penalty charges would accumulate. The statement, likewise traversed by said respondent, is

misleading.

In an affidavit[53] executed by petitioner, which was attached to her petition, she stated, among others, that:

8. During the latter part of 1990, I was surprised to learn that Merlyn Azarraga's loan has been released and that she has not paid the same upon its maturity. I received a telephone call from Mr. Augusto Banusing of MB Lending informing me of this fact and of my liability arising from the promissory note which I signed.

9. I requested Mr. Banusing to try to collect first from Merlyn and Osmeña Azarraga. At the same time, I offered to pay MB Lending the outstanding balance of the principal obligation should he fail to collect from Merlyn and Osmeña Azarraga. Mr. Banusing advised me not to worry because he will try to collect first from Merlyn and Osmeña Azarraga.

10. A year thereafter, I received a telephone call from the secretary of Mr. Banusing who reminded that the loan of Merlyn and Osmeña Azarraga, together with interest and penalties thereon, has not been paid. Since I had no available funds at that time, I offered to pay MB Lending by delivering to them a parcel of land which I own. Mr. Banusing's secretary, however, refused my offer for the reason that they are not interested in real estate.

11. In March 1992, I received a copy of the summons and of the complaint filed against me by MB Lending before the RTC-Iloilo. After learning that a complaint was filed against me, I instructed Sheila Gatia to go to MB Lending and reiterate my first offer to pay the outstanding balance of the principal obligation of Merlyn Azarraga in the amount of P30,000.00.

12. Ms. Gatia talked to the secretary of Mr. Banusing who referred her to Atty. Venus, counsel of MB Lending.

13. Atty. Venus informed Ms. Gatia that he will consult Mr. Banusing if my offer to pay the outstanding balance of the principal obligation loan (sic) of Merlyn and Osmeña Azarraga is acceptable. Later, Atty. Venus informed Ms. Gatia that my offer is not acceptable to Mr. Banusing.

The purported offer to pay made by petitioner can not be deemed sufficient and substantial in order to effectively discharge her from liability. There are a number of circumstances which conjointly inveigh against her aforesaid theory.

1. Respondent corporation cannot be faulted for not immediately demanding payment from petitioner. It was petitioner who initially requested that the creditor try to collect from her principal first, and she offered to pay only in case the creditor fails to collect. The delay, if any, was occasioned by the fact that respondent corporation merely acquiesced to the request of petitioner. At any rate, there was here no actual offer of payment to speak of but only a commitment to pay if the principal does not pay.

2. Petitioner made a second attempt to settle the obligation by offering a parcel of land which she owned. Respondent corporation was acting well within its rights when it refused to accept the offer. The debtor of a thing cannot compel the creditor to receive a different one, although the latter may be of the same value, or more valuable than that which is due.[54] The obligee is entitled to demand fulfillment of the obligation or performance as stipulated. A change of the object of the obligation would constitute novation requiring the express consent of the parties.[55]

3. After the complaint was filed against her, petitioner reiterated her offer to pay the outstanding balance of the obligation in the amount of P30,000.00 but the same was likewise rejected. Again, respondent corporation cannot be blamed for refusing the amount being offered because it fell way below the amount it had computed, based on the stipulated interests and penalty charges, as owing and due from herein petitioner. A debt shall not be

understood to have been paid unless the thing or service in which the obligation consists has been completely delivered or rendered, as the case may be.[56] In other words, the prestation must be fulfilled completely. A person entering into a contract has a right to insist on its performance in all particulars.[57]

Petitioner cannot compel respondent corporation to accept the amount she is willing to pay because the moment the latter accepts the performance, knowing its incompleteness or irregularity, and without expressing any protest or objection, then the obligation shall be deemed fully complied with.[58] Precisely, this is what respondent corporation wanted to avoid when it continually refused to settle with petitioner at less than what was actually due under their contract.

This notwithstanding, however, we find and so hold that the penalty charge of 3% per month and attorney's fees equivalent to 25% of the total amount due are highly inequitable and unreasonable.

It must be remembered that from the principal loan of P30,000.00, the amount of P16,300.00 had already been paid even before the filing of the present case. Article 1229 of the Civil Code provides that the court shall equitably reduce the penalty when the principal obligation has been partly or irregularly complied with by the debtor. And, even if there has been no performance, the penalty may also be reduced if it is iniquitous or leonine.

In a case previously decided by this Court which likewise involved private respondent M.B. Lending Corporation, and which is substantially on all fours with the one at bar, we decided to eliminate altogether the penalty interest for being excessive and unwarranted under the following rationalization:

Upon the matter of penalty interest, we agree with the Court of Appeals that the economic impact of the penalty interest of three percent (3%) per month on total amount due but unpaid should be equitably reduced. The purpose for which the penalty interest is intended - that is, to punish the obligor - will have been sufficiently served by the effects of compounded interest. Under the exceptional circumstances in the case at bar, e.g., the original amount loaned was only P15,000.00; partial payment of P8,600.00 was made on due date; and the heavy (albeit still lawful) regular compensatory interest, the penalty interest stipulated in the parties' promissory note is iniquitous and unconscionable and may be equitably reduced further by eliminating such penalty interest altogether.[59]

Accordingly, the penalty interest of 3% per month being imposed on petitioner should similarly be eliminated.

Finally, with respect to the award of attorney's fees, this Court has previously ruled that even with an agreement thereon between the parties, the court may nevertheless reduce such attorney's fees fixed in the contract when the amount thereof appears to be unconscionable or unreasonable.[60] To that end, it is not even necessary to show, as in other contracts, that it is contrary to morals or public policy.[61] The grant of attorney's fees equivalent to 25% of the total amount due is, in our opinion, unreasonable and immoderate, considering the minimal unpaid amount involved and the extent of the work involved in this simple action for collection of a sum of money. We, therefore, hold that the amount of P10,000.00 as and for attorney's fee would be sufficient in this case.[62]

WHEREFORE, the judgment appealed from is hereby **AFFIRMED**, subject to the **MODIFICATION** that the penalty interest of 3% per month is hereby deleted and the award of attorney's fees is reduced to P10,000.00.

SO ORDERED.

Melo, Puno, Mendoza, and Martinez, JJ., concur.

[1] Annex C, Petition; Rollo, 49.

[2] Rollo, 38.

- [3] Annex D, id., ibid., 51.
- [4] Annex H, id., ibid., 69.
- [5] Rollo, 76.
- [6] Annex I, Petition; Rollo, 73; penned by Presiding Judge Tito G. Gustilo.
- [7] Annex A, id., ibid., 36; Associate Justice Jose C. de la Rama, ponente, with Associate Justices Emeterio C. Cui and Eduardo G. Montenegro, concurring.
- [8] Rollo, 50.
- [9] Art. 1377. The interpretation of obscure words or stipulations in a contract shall not favor the party who caused the obscurity.
- [10] Article 1229, Civil Code.
- [11] Citing Article 2031, id.
- [12] Philippine Airlines, Inc. vs. Court of Appeals, et al., G.R. No. 119706, March 14, 1996, 255 SCRA 48.
- [13] Abella vs. Court of Appeals, et al., G.R. No. 107606, June 20, 1996, 257 SCRA 482.
- [14] Inciong, Jr. vs. Court of Appeals, et al., G.R. No. 96405, June 26, 1996, 257 SCRA 578.
- [15] 72 CJS, Principal and Surety, § 83, 565.
- [16] Churchill vs. Bradley, 5 A. 189.
- [17] Northern State Bank of Grand Forks vs. Bellamy, 125 N.W. 888.
- [18] Shearer vs. R.S. Peele & Co., 36 N.E. 455.
- [19] W.T. Rawleigh Co. vs. Overstreet, et al., 32 S.E. 2d 574.
- [20] Manry vs. Waxelbaum Co., 33 S.E. 701.
- [21] 40A Words and Phrases 429.
- [22] Erbeling vs. Noland, Co., Inc., 64 S.E. 2d 218.
- [23] Covey, et al. vs. Schiesswohl, 114 P. 292.
- [24] Article 1371, Civil Code.
- [25] Rollo, 67-68.
- [26] 18A Words and Phrases 657.
- [27] Hall, et al. vs. Weaver, 34 F. 104.
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