

HEIRS OF SERVANDO FRANCO, PETITIONERS, VS. SPOUSES VERONICA AND DANILO GONZALES, RESPONDENTS.

G.R. No. 159709. June 27, 2012

Ponente: BERSAMIN, J.

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BERSAMIN, J.:

There is novation when there is an irreconcilable incompatibility between the old and the new obligations. There is no novation in case of only slight modifications; hence, the old obligation prevails.

The petitioners challenge the decision promulgated on March 19, 2003,[1] whereby the Court of Appeals (CA) upheld the issuance of a writ of execution by the Regional Trial Court (RTC), Branch 16, in Malolos, Bulacan.

Antecedents

The Court adopts the following summary of the antecedents rendered by the Court in *Medel v. Court of Appeals*,[2] the case from which this case originated, to wit:

On November 7, 1985, Servando Franco and Leticia Medel (hereafter Servando and Leticia) obtained a loan from Veronica R. Gonzales (hereafter Veronica), who was engaged in the money lending business under the name “Gonzales Credit Enterprises”, in the amount of P50,000.00, payable in two months. Veronica gave only the amount of P47,000.00, to the borrowers, as she retained P3,000.00, as advance interest for one month at 6% per month. Servando and Leticia executed a promissory note for P50,000.00, to evidence the loan, payable on January 7, 1986.

On November 19, 1985, Servando and Leticia obtained from Veronica another loan in the amount of P90,000.00, payable in two months, at 6% interest per month. They executed a promissory note to evidence the loan, maturing on January 19, 1986. They received only P84,000.00, out of the proceeds of the loan.

On maturity of the two promissory notes, the borrowers failed to pay the indebtedness.

On June 11, 1986, Servando and Leticia secured from Veronica still another loan in the amount of P300,000.00, maturing in one month, secured by a real estate mortgage over a property belonging to Leticia Makalintal Yaptinchay, who issued a special power of attorney in favor of Leticia Medel, authorizing her to execute the mortgage. Servando and Leticia executed a promissory note in favor of Veronica to pay the sum of P300,000.00, after a month, or on July 11, 1986. However, only the sum of P275,000.00, was given to them out of the proceeds of the loan.

Like the previous loans, Servando and Medel failed to pay the third loan on maturity.

On July 23, 1986, Servando and Leticia with the latter's husband, Dr. Rafael Medel, consolidated all their previous unpaid loans totaling P440,000.00, and sought from Veronica another loan in the amount of P60,000.00, bringing their indebtedness to a total of P500,000.00, payable on August 23, 1986. They executed a promissory note, reading as follows:

“Baliwag, Bulacan July 23, 1986

“Maturity Date August 23, 1986

“P500,000.00

“FOR VALUE RECEIVED, I/WE jointly and severally promise to pay to the order of VERONICA R. GONZALES doing business in the business style of GONZALES CREDIT ENTERPRISES, Filipino, of legal age, married to Danilo G. Gonzales, Jr., of Baliwag Bulacan, the sum of PESOS FIVE HUNDRED THOUSAND (P500,000.00) Philippine Currency with interest thereon at the rate of 5.5 PER CENT per month plus 2% service charge per annum from date hereof until fully paid according to the amortization schedule contained herein. (Underscoring supplied)

“Payment will be made in full at the maturity date.

“Should I/WE fail to pay any amortization or portion hereof when due, all the other installments together with all interest accrued shall immediately be due and payable and I/WE hereby agree to pay an additional amount equivalent to one per cent (1%) per month of the amount due and demandable as penalty charges in the form of liquidated damages until fully paid; and the further sum of TWENTY FIVE PER CENT (25%) thereof in full, without deductions as Attorney's Fee whether actually incurred or not, of the total amount due and demandable, exclusive of costs and judicial or extra judicial expenses. (Underscoring supplied)

“I, WE further agree that in the event the present rate of interest on loan is increased by law or the Central Bank of the Philippines, the holder shall have the option to apply and collect the increased interest charges without notice although the original interest have already been collected wholly or partially unless the contrary is required by law.

“It is also a special condition of this contract that the parties herein agree that the amount of peso-obligation under this agreement is based on the present value of peso, and if there be any change in the value thereof, due to extraordinary inflation or deflation, or any other cause or reason, then the peso-obligation herein contracted shall be adjusted in accordance with the value of the peso then prevailing at the time of the complete fulfillment of obligation.

“Demand and notice of dishonor waived. Holder may accept partial payments and grant renewals of this note or extension of payments, reserving rights against each and all indorsers and all parties to this note.

“IN CASE OF JUDICIAL Execution of this obligation, or any part of it, the debtors waive all his/their rights under the provisions of Section 12, Rule 39, of the Revised Rules of Court.”

On maturity of the loan, the borrowers failed to pay the indebtedness of P500,000.00, plus interests and penalties, evidenced by the above-quoted promissory note.

On February 20, 1990, Veronica R. Gonzales, joined by her husband Danilo G. Gonzales, filed with the Regional Trial Court of Bulacan, Branch 16, at Malolos, Bulacan, a complaint for collection of the full amount of the loan including interests and other charges.

In his answer to the complaint filed with the trial court on April 5, 1990, defendant Servando alleged that he did not obtain any loan from the plaintiffs; that it was defendants Leticia and Dr. Rafael Medel who borrowed from the plaintiffs the sum of P500,000.00, and actually received the amount and benefited therefrom; that the loan was secured by a real estate mortgage executed in favor of the plaintiffs, and that he (Servando Franco) signed the promissory note only as a witness.

In their separate answer filed on April 10, 1990, defendants Leticia and Rafael Medel alleged that the loan was the transaction of Leticia Yaptinchay, who executed a mortgage in favor of the plaintiffs over a parcel of real estate situated in San Juan, Batangas; that the interest rate is excessive at 5.5% per month with additional service charge

of 2% per annum, and penalty charge of 1% per month; that the stipulation for attorney's fees of 25% of the amount due is unconscionable, illegal and excessive, and that substantial payments made were applied to interest, penalties and other charges.

After due trial, the lower court declared that the due execution and genuineness of the four promissory notes had been duly proved, and ruled that although the Usury Law had been repealed, the interest charged by the plaintiffs on the loans was unconscionable and "revolting to the conscience". Hence, the trial court applied "the provision of the New [Civil] Code" that the "legal rate of interest for loan or forbearance of money, goods or credit is 12% per annum."

Accordingly, on December 9, 1991, the trial court rendered judgment, the dispositive portion of which reads as follows:

"WHEREFORE, premises considered, judgment is hereby rendered, as follows:

"1. Ordering the defendants Servando Franco and Leticia Medel, jointly and severally, to pay plaintiffs the amount of P47,000.00 plus 12% interest per annum from November 7, 1985 and 1% per month as penalty, until the entire amount is paid in full.

"2. Ordering the defendants Servando Franco and Leticia Y. Medel to plaintiffs, jointly and severally the amount of P84,000.00 with 12% interest per annum and 1% per cent per month as penalty from November 19, 1985 until the whole amount is fully paid;

"3. Ordering the defendants to pay the plaintiffs, jointly and severally, the amount of P285,000.00 plus 12% interest per annum and 1% per month as penalty from July 11, 1986, until the whole amount is fully paid;

"4. Ordering the defendants to pay plaintiffs, jointly and severally, the amount of P50,000.00 as attorney's fees;

"5. All counterclaims are hereby dismissed.

"With costs against the defendants."

In due time, both plaintiffs and defendants appealed to the Court of Appeals.

In their appeal, plaintiffs-appellants argued that the promissory note, which consolidated all the unpaid loans of the defendants, is the law that governs the parties. They further argued that Circular No. 416 of the Central Bank prescribing the rate of interest for loans or forbearance of money, goods or credit at 12% per annum, applies only in the absence of a stipulation on interest rate, but not when the parties agreed thereon.

The Court of Appeals sustained the plaintiffs-appellants' contention. It ruled that "the Usury Law having become 'legally inexistent' with the promulgation by the Central Bank in 1982 of Circular No. 905, the lender and borrower could agree on any interest that may be charged on the loan". The Court of Appeals further held that "the imposition of 'an additional amount equivalent to 1% per month of the amount due and demandable as penalty charges in the form of liquidated damages until fully paid' was allowed by law".

Accordingly, on March 21, 1997, the Court of Appeals promulgated its decision reversing that of the Regional Trial Court, disposing as follows:

"WHEREFORE, the appealed judgment is hereby MODIFIED such that defendants are hereby ordered to pay the plaintiffs the sum of P500,000.00, plus 5.5% per month interest and 2% service charge per annum effective July 23, 1986, plus 1% per month of the total amount due and demandable as penalty charges effective August 24, 1986, until the entire amount is fully paid.

"The award to the plaintiffs of P50,000.00 as attorney's fees is affirmed. And so is the imposition of costs

against the defendants.

“SO ORDERED.”

On April 15, 1997, defendants-appellants filed a motion for reconsideration of the said decision. By resolution dated November 25, 1997, the Court of Appeals denied the motion.[3]

On review, the Court in *Medel v. Court of Appeals* struck down as void the stipulation on the interest for being iniquitous or unconscionable, and revived the judgment of the RTC rendered on December 9, 1991, viz:

WHEREFORE, the Court hereby REVERSES and SETS ASIDE the decision of the Court of Appeals promulgated on March 21, 1997, and its resolution dated November 25, 1997. Instead, we render judgment REVIVING and AFFIRMING the decision dated December 9, 1991, of the Regional Trial Court of Bulacan, Branch 16, Malolos, Bulacan, in Civil Case No. 134-M-90, involving the same parties.

No pronouncement as to costs in this instance.

SO ORDERED.[4]

Upon the finality of the decision in *Medel v. Court of Appeals*, the respondents moved for execution.[5] Servando Franco opposed,[6] claiming that he and the respondents had agreed to fix the entire obligation at P775,000.00.[7] According to Servando, their agreement, which was allegedly embodied in a receipt dated February 5, 1992,[8] whereby he made an initial payment of P400,000.00 and promised to pay the balance of P375,000.00 on February 29, 1992, superseded the July 23, 1986 promissory note.

The RTC granted the motion for execution over Servando’s opposition, thus:

There is no doubt that the decision dated December 9, 1991 had already been affirmed and had already become final and executory. Thus, in accordance with Sec. 1 of Rule 39 of the 1997 Rules of Civil Procedure, execution shall issue as a matter of right. It has likewise been ruled that a judgment which has acquired finality becomes immutable and unalterable and hence may no longer be modified at any respect except only to correct clerical errors or mistakes (*Korean Airlines Co. Ltd. vs. C.A.*, 247 SCRA 599). In this respect, the decision deserves to be respected.

The argument about the modification of the contract or non-participation of defendant Servando Franco in the proceedings on appeal on the alleged belief that the payment he made had already absolved him from liability is of no moment. Primarily, the decision was for him and Leticia Medel to pay the plaintiffs jointly and severally the amounts stated in the Decision. In other words, the liability of the defendants thereunder is solidary. Based on this aspect alone, the new defense raised by defendant Franco is unavailing.

WHEREFORE, in the light of all the foregoing, the Court hereby grants the Motion for Execution of Judgment.

Accordingly, let a writ of execution be issued for implementation by the Deputy Sheriff of this Court.

SO ORDERED.[9]

On March 8, 2001, the RTC issued the writ of execution.[10]

Servando moved for reconsideration,[11] but the RTC denied his motion.[12]

On March 19, 2003, the CA affirmed the RTC through its assailed decision, ruling that the execution was proper because of Servando’s failure to comply with the terms of the compromise agreement, stating:[13]

Petitioner cannot deny the fact that there was no full compliance with the tenor of the compromise agreement. Private respondents on their part did not disregard the payments made by the petitioner. They even offered that

whatever payments made by petitioner, it can be deducted from the principal obligation including interest. However, private respondents posit that the payments made cannot alter, modify or revoke the decision of the Supreme Court in the instant case.

In the case of *Prudence Realty and Development Corporation vs. Court of Appeals*, the Supreme Court ruled that:

“When the terms of the compromise judgment is violated, the aggrieved party must move for its execution, not its invalidation.”

It is clear from the aforementioned jurisprudence that even if there is a compromise agreement and the terms have been violated, the aggrieved party, such as the private respondents, has the right to move for the issuance of a writ of execution of the final judgment subject of the compromise agreement.

Moreover, under the circumstances of this case, petitioner does not stand to suffer any harm or prejudice for the simple reason that what has been asked by private respondents to be the subject of a writ of execution is only the balance of petitioner’s obligation after deducting the payments made on the basis of the compromise agreement.

WHEREFORE, premises considered, the instant petition is hereby **DENIED DUE COURSE** and consequently **DISMISSED** for lack of merit.

SO ORDERED.

His motion for reconsideration having been denied,[14] Servando appealed. He was eventually substituted by his heirs, now the petitioners herein, on account of his intervening death. The substitution was pursuant to the resolution dated June 15, 2005.[15]

Issue

The petitioners submit that the CA erred in ruling that:

I

THE 9 DECEMBER 1991 DECISION OF BRANCH 16 OF THE REGIONAL TRIAL COURT OF MALOLOS, BULACAN WAS NOT NOVATED BY THE COMPROMISE AGREEMENT BETWEEN THE PARTIES ON 5 FEBRUARY 1992.

II

THE LIABILITY OF THE PETITIONER TO RESPONDENTS SHOULD BE BASED ON THE DECEMBER 1991 DECISION OF BRANCH 16 OF THE REGIONAL TRIAL COURT OF MALOLOS, BULACAN AND NOT ON THE COMPROMISE AGREEMENT EXECUTED IN 1992.

The petitioners insist that the RTC could not validly enforce a judgment based on a promissory note that had been already novated; that the promissory note had been impliedly novated when the principal obligation of P500,000.00 had been fixed at P750,000.00, and the maturity date had been extended from August 23, 1986 to February 29, 1992.

In contrast, the respondents aver that the petitioners seek to alter, modify or revoke the final and executory decision of the Court; that novation did not take place because there was no complete incompatibility between the promissory note and the memorandum receipt; that Servando’s previous payment would be deducted from the total liability of the debtors based on the RTC’s decision.

Issue

Was there a novation of the August 23, 1986 promissory note when respondent Veronica Gonzales issued the February 5, 1992 receipt?

Ruling

The petition lacks merits.

I

Novation did not transpire because no irreconcilable incompatibility existed between the promissory note and the receipt

To buttress their claim of novation, the petitioners rely on the receipt issued on February 5, 1992 by respondent Veronica whereby Servando's obligation was fixed at P750,000.00. They insist that even the maturity date was extended until February 29, 1992. Such changes, they assert, were incompatible with those of the original agreement under the promissory note.

The petitioners' assertion is wrong.

A novation arises when there is a substitution of an obligation by a subsequent one that extinguishes the first, either by changing the object or the principal conditions, or by substituting the person of the debtor, or by subrogating a third person in the rights of the creditor.[16] For a valid novation to take place, there must be, therefore: (a) a previous valid obligation; (b) an agreement of the parties to make a new contract; (c) an extinguishment of the old contract; and (d) a valid new contract.[17] In short, the new obligation extinguishes the prior agreement only when the substitution is unequivocally declared, or the old and the new obligations are incompatible on every point. A compromise of a final judgment operates as a novation of the judgment obligation upon compliance with either of these two conditions.[18]

The receipt dated February 5, 1992, excerpted below, did not create a new obligation incompatible with the old one under the promissory note, viz:

February 5, 1992

Received from SERVANDO FRANCO BPI Manager's Check No. 001700 in the amount of P400,00.00 as partial payment of loan. Balance of P375,000.00 to be paid on or before FEBRUARY 29, 1992. In case of default an interest will be charged as stipulated in the promissory note subject of this case.

(Sgd)

V. Gonzalez[19]

To be clear, novation is not presumed. This means that the parties to a contract should expressly agree to abrogate the old contract in favor of a new one. In the absence of the express agreement, the old and the new obligations must be incompatible on every point.[20] According to *California Bus Lines, Inc. v. State Investment House, Inc.*: [21]

The extinguishment of the old obligation by the new one is a necessary element of novation which may be effected either expressly or impliedly. The term "expressly" means that the contracting parties incontrovertibly disclose that their object in executing the new contract is to extinguish the old one. Upon the other hand, no specific form is required for an implied novation, and all that is prescribed by law would be an incompatibility between the two contracts. While there is really no hard and fast rule to determine what might constitute to be a sufficient change that can bring about novation, the touchstone for contrariety, however, would be an irreconcilable incompatibility between the old and the new obligations.

There is incompatibility when the two obligations cannot stand together, each one having its independent

existence. If the two obligations cannot stand together, the latter obligation novates the first.[22] Changes that breed incompatibility must be essential in nature and not merely accidental. The incompatibility must affect any of the essential elements of the obligation, such as its object, cause or principal conditions thereof; otherwise, the change is merely modificatory in nature and insufficient to extinguish the original obligation.[23]

In light of the foregoing, the issuance of the receipt created no new obligation. Instead, the respondents only thereby recognized the original obligation by stating in the receipt that the P400,000.00 was “partial payment of loan” and by referring to “the promissory note subject of the case in imposing the interest.” The loan mentioned in the receipt was still the same loan involving the P500,000.00 extended to Servando. Adherence to the interest stipulated in the promissory note indicated that the contract still subsisted, not replaced and extinguished, as the petitioners claim.

The receipt dated February 5, 1992 was only the proof of Servando’s payment of his obligation as confirmed by the decision of the RTC. It did not establish the novation of his agreement with the respondents. Indeed, the Court has ruled that an obligation to pay a sum of money is not novated by an instrument that expressly recognizes the old, or changes only the terms of payment, or adds other obligations not incompatible with the old ones, or the new contract merely supplements the old one.[24] A new contract that is a mere reiteration, acknowledgment or ratification of the old contract with slight modifications or alterations as to the cause or object or principal conditions can stand together with the former one, and there can be no incompatibility between them.[25] Moreover, a creditor’s acceptance of payment after demand does not operate as a modification of the original contract.[26]

Worth noting is that Servando’s liability was joint and solidary with his co-debtors. In a solidary obligation, the creditor may proceed against any one of the solidary debtors or some or all of them simultaneously.[27] The choice to determine against whom the collection is enforced belongs to the creditor until the obligation is fully satisfied.[28] Thus, the obligation was being enforced against Servando, who, in order to escape liability, should have presented evidence to prove that his obligation had already been cancelled by the new obligation or that another debtor had assumed his place. In case of change in the person of the debtor, the substitution must be clear and express,[29] and made with the consent of the creditor.[30] Yet, these circumstances did not obtain herein, proving precisely that Servando remained a solidary debtor against whom the entire or part of the obligation might be enforced.

Lastly, the extension of the maturity date did not constitute a novation of the previous agreement. It is settled that an extension of the term or period of the maturity date does not result in novation.[31]

II

Total liability to be reduced by P400,000.00

The petitioners argue that Servando’s remaining liability amounted to only P375,000.00, the balance indicated in the February 5, 1992 receipt. Accordingly, the balance was not yet due because the respondents did not yet make a demand for payment.

The petitioners cannot be upheld.

The balance of P375,000.00 was premised on the taking place of a novation. However, as found now, novation did not take place. Accordingly, Servando’s obligation, being solidary, remained to be that decreed in the December 9, 1991 decision of the RTC, inclusive of interests, less the amount of P400,000.00 that was meanwhile paid by him.

WHEREFORE, the Court AFFIRMS the decision of the Court of Appeals promulgated on March 19, 2003;

ORDERS the Regional Trial Court, Branch 16, in Malolos, Bulacan to proceed with the execution based on its decision rendered on December 9, 1991, deducting the amount of P400,000.00 already paid by the late Servando Franco; and DIRECTS the petitioners to pay the costs of suit.

SO ORDERED.

Leonardo-De Castro, (Acting Chairperson), Del Castillo, Villarama, Jr., and Perlas-Bernabe, JJ., concur.

[1] Rollo, pp. 103-110; penned by Associate Justice Bernardo P. Abesamis (retired), with Associate Justice Juan Q. Enriquez, Jr. (retired) and Associate Justice Edgardo F. Sundiam (deceased) concurring.

[2] G.R. No. 131622, November 27, 1998, 299 SCRA 481.

[3] Id., pp. 483-488.

[4] Id., p. 490.

[5] Records, pp. 202-204.

[6] Id., pp. 211-218.

[7] Rollo, pp. 5-6

[8] Id., p. 20.

[9] Records, pp. 238-239.

[10] Id., pp. 240-241.

[11] Id., pp. 245-253.

[12] Id., pp. 316-317.

[13] Rollo, pp. 108-109.

[14] CA rollo, p. 246.

[15] Rollo, p. 181.

[16] Foundation Specialists, Inc. v. Betonval Ready Concrete, Inc., G.R. No. 170674, August 24, 2009, 596 SCRA 697, 706-707.

[17] Valenzuela v. Kalayaan Development & Industrial Corporation, G.R. No. 163244, June 22, 2009, 590 SCRA 380, 391; Bautista v. Pilar Development Corporation, G.R. No. 135046, August 17, 1999, 312 SCRA 611, 618.

[18] Magbanua v. Uy, G.R. No. 161003, May 6, 2005, 458 SCRA 184, 197.

[19] Rollo, p. 20.

[20] Valenzuela v. Kalayaan Development & Industrial Corporation, *supra*, note 17, pp. 390-391.

[21] G.R. No. 147950, December 11, 2003, 418 SCRA 297, 309-310.

[22] Valenzuela v. Kalayaan Development & Industrial Corporation, *supra*, note 17; California Bus Lines, Inc. v. State Investment House, Inc., *supra*, note 21; Kwong v. Gargantos, G.R. No. 152984, November 22, 2006, 507 SCRA 540, 548.

[23] Transpacific Battery Corporation v. Security Bank & Trust Co., G.R. No. 173565, May 8, 2009, 587 SCRA 536, 546.

[24] Aguilar v. Manila Banking Corporation, G.R. No. 157911, September 19, 2006, 502 SCRA 354; Spouses Reyes v. BPI Family Savings Bank, Inc., G.R. Nos. 149840-41, March 31, 2006, 486 SCRA 276.

[25] Jurado, Comments and Jurisprudence on Obligations and Contracts (2002 ed.), p. 331.

[26] Valenzuela v. Kalayaan Development & Industrial Corporation, *supra*, note 17.

[27] Article 1216, Civil Code.

[28] Ang v. Associated Bank, G.R. No. 146511, September 5, 2007, 532 SCRA 244, 276; Inciong, Jr. v. Court of Appeals, G.R. No. 96405, June 26, 1996, 257 SCRA 578, 588.

[29] Garcia v. Llamas, G.R. No. 154127, December 8, 2003, 417 SCRA 292, 302.

[30] Article 1293, Civil Code.

[31] California Bus Lines, Inc. v. State Investment House, Inc., *supra*, note 21; Garcia, Jr. v. Court of Appeals, G.R. No. 80201, November 20, 1990, 191 SCRA 493, 502.

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