

PHILIPPINE NATIONAL BANK, Petitioner, vs. SPOUSES WILFREDO and ESTELA ENCINA, Respondents.

G.R. No. 174055. February 12, 2008

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TINGA, J.:

The Philippine National Bank (PNB) assails the Decision[1] of the Court of Appeals dated 15 May 2005, rendered in CA-G.R. CV No. 79094 which, among others, declared null and void the interest rate imposed by PNB on the loan obtained from it by respondents and the consequent extrajudicial foreclosure of the properties offered as security for the loan.

The facts are summarized by the appellate court, thus:

On September 13, 1995, as additional capital for their metal craft business, plaintiffs-appellants ENCINA obtained a P500,000.00 loan with defendant-appellee PNB, secured by a promissory note, a real estate mortgage, and a credit agreement, on parcels of land covered by Transfer Certificate of Title (TCT) Nos. T-6788 and T-6789 located at Occidental Mindoro.

Thereafter, or on September 6, 1996, plaintiffs-appellants obtained an additional P200,000.00 loan with defendant-appellee PNB as additional capital for palay production, embodied in a credit agreement and a promissory note, secured by the same parcels of land. The loan obligations of plaintiffs-appellants ENCINA were fully paid on February 4, 1997.

Another loan in the amount of P400,000.00 as capital for a common carrier business was obtained by plaintiffs-appellants ENCINA with defendant-appellee PNB, secured by a promissory note and a time loan commercial credit agreement, likewise secured by the parcels of land covered by TCT Nos. T-6788 and T-6789.

Defendant-appellee PNB subsequently granted a P1,250,000.00 all purpose credit facility to plaintiffs-appellants ENCINA to be used by plaintiffs-appellants ENCINA exclusively for their metal craft business. Plaintiffs-appellants ENCINA availed of the amount of P1,050,000.00 of the credit facility, evidenced by a promissory note dated February 13, 1998 secured by the same parcels of land as well. Plaintiffs-appellants ENCINA later on availed of the remaining P200,000.00 credit facility, secured by a promissory note dated May 22, 1998.

On the maturity date of the P1,250,000.00 loan obligation, plaintiffs-appellants ENCINA failed to pay, prompting defendant-appellee PNB to demand the same from plaintiffs-appellants ENCINA, in letters dated January 5, 1999, January 21, 1999, March 5, 1999, April 16, 1999, and May 27, 1999. Demands from defendant-appellee PNB were left unheeded, prompting defendant appellee PNB to file a petition for sale of the mortgaged properties with defendant-appellee Ex-Officio Sheriff of the Regional Trial Court of San Jose, Occidental Mindoro on September 20, 1999.

The extra-judicial sale of the mortgaged properties of plaintiff-appellant ENCINA was published in "The Island Observer," a newspaper of general circulation in the province of Occidental Mindoro, on October 4, 11, and 18, 1999. A notice of extra-judicial sale was issued on October 4, 1999. The foreclosure sale was thereafter

conducted on November 15, 1999 with defendant-appellee PNB as the highest bidder. A certificate of sale dated November 16, 1999 was then issued in favor of defendant-appellee PNB.

Thereafter, or on January 22, 2001, titles to the subject properties were consolidated in defendant-appellee PNB's name, to which TCT Nos. 16919 and 16920 were issued.

On November 15, 2001, a contract of lease was executed between defendant-appellee PNB and plaintiffs-appellants ENCINA over the subject properties, pursuant to a request made by plaintiffs-appellants ENCINA that they be allowed by defendant-appellee PNB to lease the subject premises for a monthly rental of P7,500.00.

Finally, on July 18, 2002, plaintiffs-appellants ENCINA sued defendants-appellees in an action for the nullification of foreclosure sale and damages, with prayer for extension and/or grace period, with the RTC of San Jose, Occidental [Mindoro], Branch 46, docketed as Civil Case No. R-1304, alleging that their loan obligations, being agricultural, hence, with longer gestation periods, should have been restructured by defendant-appellee PNB for a longer period of at least seven years; that no penalties should have been imposed by defendant-appellee PNB; that the extra-judicial foreclosure sale of their properties was null and void; that for being in violation of the Usury Law, the loan contracts and all accessory contracts pertaining thereto were null and void; and that the foreclosure proceedings under RA 3135 were not complied with, hence, the entire foreclosure proceedings were null and void.

In the motion to dismiss filed by defendant-appellee PNB on October 11, 2002, it averred that plaintiffs-appellants ENCINA could no longer seek for (sic) longer gestation periods for their agricultural loans, since plaintiffs-appellants ENCINA's agricultural loans dated September 13, 1995 and February 13, 1998 have already been fully paid by them on February 4, 1997; that plaintiffs-appellants ENCINA failed to settle their loan for metal craft business and not their agricultural loans; that the Usury Law was inapplicable being legally non-existent; that defendant-appellee PNB complied with the requirements of posting and publication set forth in RA 3135; and that plaintiffs-appellants ENCINA had already waived their right to question PNB's title to the properties, considering that plaintiffs-appellants [ENCINA] requested from PNB that they be allowed to lease the subject premises from PNB.[2]

In its Order[3] dated 10 March 2003, the trial court dismissed the complaint.

The dismissal was reversed by the Court of Appeals principally on its finding that there was no definite agreement as to the interest rate to be imposed on the loan. Therefore, the loan cannot be said to have matured so as to justify the extrajudicial foreclosure of the mortgaged properties. The appellate court denied reconsideration in its Resolution[4] dated August 4, 2006.

PNB contends that the Court of Appeals should not have rendered a decision on the merits considering that the parties have not offered evidence on their respective claims and defenses, the complaint having been dismissed by the trial court on PNB's motion. It also argues that respondents should be deemed to have admitted PNB's ownership over and title to the foreclosed properties when they leased the foreclosed properties from PNB.

It insists that the determination of the applicable interest rate was not left to its sole will because respondents agreed that the interest rates are to be set by PNB's management for each of the interest periods and the latter had the option to accept or reject the rate imposed on their loan. It further avers that there is nothing on record to support the appellate court's conclusion that the foreclosure proceedings, the public sale, and the certificate of sale are null and void.[5]

Respondents insist on the nullity of the provision in the promissory notes to the effect that the rate of interest "will be set by the Management" of PNB, echoing the appellate court's declaration that this provision violates the principle of mutuality of contracts.[6]

The case before the Court of Appeals was filed pursuant to Rule 41 of the 1997 Rules of Civil Procedure which provides that an ordinary appeal may be filed to question a judgment or final order of the Regional Trial Court rendered in the exercise of its original jurisdiction. The appeal limits the questions to be reviewed to errors of fact or law committed by the trial court.

In this case, the issue presented to the appellate court was the propriety of the dismissal of respondents' complaint principally on the ground that it states no cause of action. The appellate court was called upon to review the sufficiency of the allegations made in the complaint constituting the cause of action and thereafter to determine whether the trial court erred in dismissing the complaint.

A cause of action exists if the following elements are present, namely: (1) a right in favor of the plaintiff by whatever means and under whatever law it arises or is created; (2) an obligation on the part of the named defendant to respect or not to violate such right; and (3) an act or omission on the part of such defendant violative of the right of the plaintiff or constituting a breach of the obligation of the defendant to the plaintiff for which the latter may maintain an action for recovery of damages.[7]

In order to sustain a dismissal on the ground that the complaint states no cause of action, the insufficiency of the cause of action must appear on the face of the complaint, and the test of the sufficiency of the facts alleged in the complaint to constitute a cause of action is whether or not, admitting the facts alleged, the court could render a valid judgment upon the same in accordance with the prayer of the complaint. For this purpose, the motion to dismiss must hypothetically admit the truth of the facts alleged in the complaint.[8]

In their complaint, respondents averred:

FIRST CAUSE OF ACTION:

5. The loan is an agricultural loan to be used as operating capital in palay production as evidenced by the Credit Agreement (hereto attached as Annex "H");

6. Being an agricultural loan with long gestation period, the loan should have been restructured for a longer period of at least seven (7) years and no penalties should have been imposed pursuant to Central Bank Circulars and the Agricultural Modernization Act of 1997;

7. In spite of the request of the Plaintiffs to restructure the loan or for a grace period, the Defendant Bank failed and refused to do so. Furthermore, penalty charges should not have been imposed;

8. The Plaintiffs requested for a detailed computation of the amount due considering the payments that were made but the Defendant Bank failed and refused to do so;

9. That in view of the violation of the Central Bank Circulars and the Agricultural Modernization Act of 1997, the Extra-judicial Foreclosure Sale of the subject properties issued in favor of the Defendant Bank is null and void, including all proceedings thereto.

SECOND CAUSE OF ACTION

10. Considering that all the loan covered by the said Promissory Notes are secured with a mortgage upon registered real estate, all those contracts of loan are null and void because they are in violation of or contrary to the provisions of the Usury Law (Act No. 2655, as amended) particularly Section 2 thereof which is photocopied hereunder from Philippine Permanent and General Statutes, to wit:

x x x

11. In view of the violation of the Usury Law, the contracts of loan, and its accessory contracts are likewise null and void, namely: a) Real Estate Mortgage Contract, as well as Promissory Notes executed therewith are

also null and void.

12. That in view of the nullity of the contracts of loan and the real estate mortgage contracts, the Extra-judicial Foreclosure Sale of subject property issued in favor of the Defendant Bank is also null and void, including all proceedings thereto, the minutes and the subsequent Certificate of Sale is also void;

THIRD CAUSE OF ACTION

13. The Extra-judicial foreclosure proceedings and public auction sale of the properties of the Plaintiffs failed to comply with the provisions of Section 3, of Act No. 3135, as amended, which provides:

Section 3. Notice shall be given by posting notices of the sale for not less than twenty days in at least three public places of the municipality or city where the property is situated, and if such property is worth more than four hundred pesos, such notice shall also be published once a week for at least three consecutive weeks in a newspaper of general circulation in the municipality or city.

14. The failure of the Defendants to comply with the foreclosure proceedings under Section 3 of Act 3135, as amended, would render the foreclosure proceedings null and void;[9]

PNB should be deemed to have admitted the foregoing averments, at least hypothetically, when it filed a motion to dismiss the complaint. Its motion, however, assails the veracity of these allegations, claiming that the foreclosure of the mortgaged properties was due to the non-payment by the Encina spouses of their metal craft business loan and not their agricultural loan.

Nothing is more settled than the rule that in a motion to dismiss for failure to state a cause of action, the inquiry is into the sufficiency, not the veracity, of the material allegations. If the motion assails, directly or indirectly, the veracity of the allegations in the complaint, it is improper to grant the motion upon the assumption that the averments in the motion are true and those in the complaint are not. The sufficiency of the motion should be tested on the strength of the allegations of fact contained in the complaint and no other. If the allegations of the complaint are sufficient in form and substance but their veracity and correctness are assailed, it is incumbent upon the court to deny the motion to dismiss and require the defendant to answer and go to trial to prove his defense. The veracity of the assertions of the parties can be ascertained at the trial of the case on the merits.[10]

Assuming the facts alleged in the complaint to be true, i.e., that the Encina spouses incurred an agricultural loan which, under the Agricultural Modernization Act of 1997, has a long gestation period and is not subject

to imposition of penalties, the trial court may render a valid judgment. Thus, we find that, at least as regards the first cause of action, the complaint sufficiently establishes a cause of action. The trial court should not have dismissed the same regardless of the defenses averred by PNB. It is incumbent upon PNB to disprove the existence of the cause of action by evidence whether at the trial or at the preliminary hearing of affirmative defenses.

The Court of Appeals, however, exacerbated the error by going beyond the issues in the appeal and resolving the case on the basis only of the pleadings of the parties. Worse, the appellate court reversed the trial court's decision on the ground that the mechanism for setting the interest rate as stipulated in the loan contract violated the principle of mutuality of contracts—an issue which was never raised in the complaint nor even in the Encina spouses' brief as plaintiffs-appellants. PNB was obviously deprived of its right to be heard on this issue.

As borne by the records, the Encina spouses never challenged the validity of their loan and the accessory contracts with PNB on the ground that they violated the principle of mutuality of contracts in view of the provision therein that the interest rate shall "be set by management." Their only contention concerning the interest rate was that the charges imposed by the bank violated the Usury Law. This was the essence of the second cause of action alleged

in the complaint.

It should be definitively ruled in this regard that the Usury Law had been rendered legally ineffective by Resolution No. 224 dated 3 December 1982 of the Monetary Board of the Central Bank, and later by Central Bank Circular No. 905 which took effect on 1 January 1983 and removed the ceiling on interest rates for secured and unsecured loans regardless of maturity. The effect of these circulars is to allow the parties to agree on any interest that may be charged on a loan. The virtual repeal of the Usury Law is within the range of judicial notice which courts are bound to take into account.[11] After all, the fundamental tenet is that the law is deemed part of the contract.[12] Thus, the trial court was correct in ruling that the second cause of action was without basis.

In any event, the Court of Appeals ruled that even if there was no stipulated interest rate, the mortgage itself remained valid. If that is so, the foreclosure proceedings cannot be invalidated based solely on the alleged violation of the principle of mutuality. The appellate court held:

The promissory notes and the real estate mortgages however remain valid even assuming *arguendo* that there was no stipulated interest rate that was agreed upon. The obligation of plaintiffs-appellants ENCINA to pay the principal loan is nevertheless valid even if the interest is void. This is so because a contract of loan should be divided into two parts: (1) the principal and (2) the accessory stipulations – the principal one is to pay the debt and the accessory stipulation is to pay interest thereon. The two stipulations are divisible and the principal can still stand without the stipulation on the interest. The prestation of the debtor to pay the principal debt, which is the cause of the contract, is not illegal. The illegality lies only in the failure to stipulate or agree on the interest – leaving it to only one of the parties to fix or determine. Being separable, only the interest unilaterally fixed by one party should be deemed void, which cannot be interpreted to mean forfeiture even of the principal, for this would unjustly enrich the borrower at the expense of the lender.

Plaintiffs-appellants ENCINA freely and voluntarily agreed to the provisions in regard to repayment of the principal when they affixed their signatures thereto. Thus, the said mortgage contract binds them because Article 1159 of the New Civil Code provides that obligations arising from contracts have the force of law between the contracting parties.

Since the promissory notes and the real estate mortgage are valid and only the unilaterally imposed interest rates are wholly void, plaintiffs-appellants ENCINA have still to be directed to pay defendant-appellee PNB the principal amount of the loan which remains valid with interest at the legal rate of 12% per annum from the date the loan was granted up to full payment, less payments already made, within ninety (90) days from the finality of the decision, otherwise, the defendant-appellee PNB shall be entitled to foreclose the mortgaged property and sell the same at public auction to satisfy the loan.(Emphasis not ours)[13]

Curiously, even as they assert that the principle of mutuality was violated by the failure to stipulate an interest rate, the Encina spouses concurred with the appellate court and even reproduced verbatim the latter's discussion on the validity of the promissory notes and real estate mortgages,[14] effectively admitting that these contracts are binding on them.

As regards the third cause of action, we deem the allegations in the complaint groundless as well. The complaint merely reproduced the provision of Act 3135 which the Encina spouses claim PNB had violated but failed to state the ultimate facts constituting such violation. The statement of a mere conclusion of law renders a complaint vulnerable to a motion to dismiss on the ground of failure to state a cause of action.[15]

In sum, in view of the factual issues raised by PNB in its motion to dismiss, the just and fair resolution of the present controversy demands further proceedings in the RTC with regard to the first cause of action mentioned in the complaint. We shall refrain from taking them up in this Decision.

WHEREFORE, premises considered, the petition is GRANTED IN PART. The Decision of the Court of Appeals

dated 15 May 2005 and its Resolution dated 4 August 2006 are REVERSED and SET ASIDE. This case is ordered REMANDED to the court of origin which is directed to resolve the same with dispatch only with respect to the first cause of action alleged in the Complaint. Costs against petitioner.

SO ORDERED.

Quisumbing, (Chairperson), Carpio, Carpio-Morales, and Velasco, Jr., JJ., concur.

[1] Rollo, pp. 9-20; penned by Associate Justice Vicente Q. Roxas and concurred in by Associate Justices Godardo A. Jacinto and Juan Q. Enriquez, Jr.

[2]Id. at 10-13.

[3] Id. at 87-91.

[4] Id. at 22-23.

[5] Id. at 245-264; Memorandum dated 12 June 2007.

[6] Id. at 221-233; Memorandum dated 16 April 2007.

[7] Balo v. Court of Appeals, G.R. No. 129704, 30 September 2005, 471 SCRA 227, 236-237.

[8] Danfoss, Inc. v. Continental Cement Corporation, G.R. No. 143788, 9 September 2005, 469 SCRA 505, 512.

[9]Rollo, pp. 65-68.

[10] Balo v. Court of Appeals, supra note 7, citing Galeon v. Galeon, 49 SCRA 516.

[11] Tan v. Court of Appeals, 356 Phil. 1058 (1998).

[12] Department of Health v. C.V. Canchela and Associates, G.R. Nos. 151373-74, November 17, 2005, 475 SCRA 218; Airline Pilots Association of the Philippines v. NLRC, 328 Phil. 814 (1996).

[13]Rollo, pp. 18-19.

[14]Id. at. 193-194; Comment of respondents.

[15] Banco Filipino Savings and Mortgage Bank v. Court of Appeals, G.R. No. 143896, 8 July 2005, 463 SCRA 64; Abacan v. Northwestern University, Inc., G.R. No. 140777, 8 April 2005, 455 SCRA 136.

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