

PHILIPPINE SAVINGS BANK, PETITIONER, VS. SPOUSES ALFREDO M. CASTILLO AND ELIZABETH C. CASTILLO, AND SPOUSES ROMEO B. CAPATI AND AQUILINA M. LOBO, RESPONDENTS.

G.R. No. 193178. May 30, 2011

Ponente: NACHURA, J.

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NACHURA, J.:

This is a petition for review on certiorari[1] under Rule 45 of the Rules of Court, seeking to partially reconsider and modify the Decision[2] dated August 27, 2009 and the Resolution[3] dated August 4, 2010 of the Court of Appeals (CA) in CA-G.R. CV No. 86445.

Respondent spouses Alfredo M. Castillo and Elizabeth Capati-Castillo were the registered owners of a lot located in Tondo, Manila, covered by Transfer Certificate of Title (TCT) No. 233242. Respondent spouses Romeo B. Capati and Aquilina M. Lobo were the registered owners of another lot, covered by TCT No. 227858, also located in Tondo, Manila.

On May 7, 1997, respondents obtained a loan, with real estate mortgage over the said properties, from petitioner Philippine Savings Bank, as evidenced by a Promissory Note with a face value of P2,500,000.00. The Promissory Note, in part, reads:

FOR VALUE RECEIVED, I/We, solidarily, jointly and severally, promise to pay to the order of PHILIPPINE SAVINGS BANK, at its head office or at the above stated Branch the sum of TWO MILLION FIVE HUNDRED THOUSAND PESOS ONLY (P2,500,000.00), Philippine currency, with interest at the rate of seventeen per centum (17%) per annum, from date until paid, as follows:

P43,449.41 (principal and interest) monthly for fifty nine (59) months starting June 07, 1997 and every 7[th] day of the month thereafter with balloon payment on May 07, 2002.

Also, the rate of interest herein provided shall be subject to review and/or adjustment every ninety (90) days.

All amortizations which are not paid on due date shall bear a penalty equivalent to three percent (3%) of the amount due for every month or fraction of a month's delay.

The rate of interest and/or bank charges herein stipulated, during the terms of this promissory note, its extensions, renewals or other modifications, may be increased, decreased or otherwise changed from time to time within the rate of interest and charges allowed under present or future law(s) and/or government regulation(s) as the PHILIPPINE SAVINGS BANK may prescribe for its debtors.

Upon default of payment of any installment and/or interest when due, all other installments and interest remaining unpaid shall immediately become due and payable. Also, said interest not paid when due shall be added to, and become part of the principal and shall likewise bear interest at the same rate herein provided.[4]

From the release of the loan in May 1997 until December 1999, petitioner had increased and decreased the rate of interest, the highest of which was 29% and the lowest was 15.5% per annum, per the Promissory Note.

Respondents were notified in writing of these changes in the interest rate. They neither gave their confirmation thereto nor did they formally question the changes. However, respondent Alfredo Castillo sent several letters to petitioner requesting for the reduction of the interest rates.[5] Petitioner denied these requests.

Respondents regularly paid their amortizations until December 1999, when they defaulted due to financial constraints. Per petitioner's table of application of payment, respondents' outstanding balance was P2,231,798.11.[6] Petitioner claimed that as of February 11, 2000, respondents had a total outstanding obligation of P2,525,910.29.[7] Petitioner sent them demand letters. Respondents failed to pay.

Thus, petitioner initiated an extrajudicial foreclosure sale of the mortgaged properties. The auction sale was conducted on June 16, 2000, with the properties sold for P2,778,611.27 and awarded to petitioner as the only bidder. Being the mortgagee, petitioner no longer paid the said amount but rather credited it to the loan amortizations and arrears, past due interest, penalty charges, attorney's fees, all legal fees and expenses incidental to the foreclosure and sale, and partial payment of the mortgaged debt. On even date, a certificate of sale was issued and submitted to the Clerk of Court and to the Ex-Officio Sheriff of Manila.

On July 3, 2000, the certificate of sale, sans the approval of the Executive Judge of the Regional Trial Court (RTC), was registered with the Registry of Deeds of Manila.

Respondents failed to redeem the property within the one-year redemption period. However, on July 18, 2001, Alfredo Castillo sent a letter to petitioner requesting for an extension of 60 days before consolidation of its title so that they could redeem the properties, offering P3,000,000.00 as redemption price. Petitioner conceded to Alfredo Castillo's request, but respondents still failed to redeem the properties.

On October 1, 2001, respondents filed a case for Reformation of Instruments, Declaration of Nullity of Notarial Foreclosure Proceedings and Certificate of Sale, Cancellation of Annotations on TCT Nos. 233242 and 227858, and Damages, with a plea for the issuance of a temporary restraining order (TRO) and/or writ of preliminary prohibitory injunction, with the RTC, Branch 14, Manila.

On October 5, 2001, the RTC issued a TRO. Eventually, on October 25, 2001, it issued a writ of preliminary injunction.

After trial, the RTC rendered its decision dated July 30, 2005, the dispositive portion of which reads:

WHEREFORE, judgment is hereby rendered in favor of the plaintiffs, and against the defendants in the following manner:

- Declaring the questioned increases of interest as unreasonable, excessive and arbitrary and ordering the defendant Philippine Savings Bank to refund to the plaintiffs, the amount of interest collected in excess of seventeen percent (17%) per annum;
- Declaring the Extrajudicial Foreclosure conducted by the defendants on June 16, 2000 and the subsequent proceedings taken thereafter to be void ab initio. In this connection, defendant Register of Deeds is hereby ordered to cause the cancellation of the corresponding annotations at the back of Transfer Certificates of Title No. 227858 and 233242 in the name of Spouses Alfredo and Elizabeth Castillo and Spouses Romeo Capati and Aquilina M. Lobo;
- Defendant Philippine Savings Bank is adjudged to pay plaintiffs the amount of Php50,000.00 as moral damages; Php50,000.00 as exemplary damages; and attorney's fees in the amount of Php30,000.00 and Php3,000.00 per appearance.
- Defendants' counterclaims are hereby DISMISSED for lack of merit.

With costs against the defendant Philippine Savings Bank, Inc.

SO ORDERED.[8]

Petitioner filed a motion for reconsideration. The RTC partially granted the motion in its November 30, 2005 Order, modifying the interest rate from 17% to 24% per annum.[9]

Petitioner appealed to the CA. The CA modified the decision of the RTC, thus--

WHEREFORE, in view of the foregoing, the Decision of the Regional Trial Court is hereby AFFIRMED WITH MODIFICATIONS. The fallo shall now read:

WHEREFORE, judgment is hereby rendered in favor of the plaintiffs and against the defendants in the following manner:

- Declaring the questioned increases of interest as unreasonable, excessive and arbitrary and ordering the defendant Philippine Savings Bank to refund to the plaintiffs, the amount of interest collected in excess of seventeen percent (17%) per annum;
- Declaring the Extrajudicial Foreclosure conducted by the defendants on June 16, 2000 and the subsequent proceedings taken thereafter to be valid[;]
- Defendant Philippine Savings Bank is adjudged to pay plaintiffs the amount of Php 25,000.00 as moral damages; Php 50,000.00 as exemplary damages; and attorney's fees in the amount of Php 30,000.00 and Php 3,000.00 per appearance;
- Defendants' counterclaims are hereby DISMISSED for lack of merit.

With costs against the defendant Philippine Savings Bank, Inc.

SO ORDERED.[10]

Hence, this petition anchored on the contention that the CA erred in: (1) declaring that the modifications in the interest rates are unreasonable; and (2) sustaining the award of damages and attorney's fees.

The petition should be partially granted.

The unilateral determination and imposition of the increased rates is violative of the principle of mutuality of contracts under Article 1308 of the Civil Code, which provides that "[t]he contract must bind both contracting parties; its validity or compliance cannot be left to the will of one of them." [11] A perusal of the Promissory Note will readily show that the increase or decrease of interest rates hinges solely on the discretion of petitioner. It does not require the conformity of the maker before a new interest rate could be enforced. Any contract which appears to be heavily weighed in favor of one of the parties so as to lead to an unconscionable result, thus partaking of the nature of a contract of adhesion, is void. Any stipulation regarding the validity or compliance of the contract left solely to the will of one of the parties is likewise invalid.

Petitioner contends that respondents acquiesced to the imposition of the modified interest rates; thus, there was no violation of the principle of mutuality of contracts. To buttress its position, petitioner points out that the exhibits presented by respondents during trial contained a uniform provision, which states:

The interest rate adjustment is in accordance with the Conformity Letter you have signed amending your account's interest rate review period from ninety (90) to thirty days.[12]

It further claims that respondents requested several times for the reduction of the interest rates, thus, manifesting their recognition of the legality of the said rates. It also asserts that the contractual provision on the interest rates

cannot be said to be lopsided in its favor, considering that it had, on several occasions, lowered the interest rates.

We disagree. The above-quoted provision of respondents' exhibits readily shows that the conformity letter signed by them does not pertain to the modification of the interest rates, but rather only to the amendment of the interest rate review period from 90 days to 30 days. Verily, the conformity of respondents with respect to the shortening of the interest rate review period from 90 days to 30 days is separate and distinct from and cannot substitute for the required conformity of respondents with respect to the modification of the interest rate itself.

Moreover, respondents' assent to the modifications in the interest rates cannot be implied from their lack of response to the memos sent by petitioner, informing them of the amendments. The said memos were in the nature of a proposal to change the contract with respect to one of its significant components, i.e., the interest rates. As we have held, no one receiving a proposal to change a contract is obliged to answer the proposal.[13] Therefore, respondents could neither be faulted, nor could they be deemed to have assented to the modified interest rates, for not replying to the said memos from petitioner.

We likewise disagree with petitioner's assertion that respondents recognized the legality of the imposed interest rates through the letters requesting for the reduction of the rates. The request for reduction of the interest does not translate to consent thereto. To be sure, a cursory reading of the said letters would clearly show that Alfredo Castillo was, in fact, questioning the propriety of the interest rates imposed on their loan, viz.:

The undersigned is a mortgagor of Philippine Savings Bank with an outstanding balance of TWO MILLION FOUR HUNDRED THIRTY EIGHT THOUSAND SIX HUNDRED SIX and 63/100 (P2,438,606.63) at an interest rate of 26% per annum (as per April 6, 1997 inquiry to Leo of the Accounting Dep't.) and with a monthly amortization of FIFTY EIGHT THOUSAND THREE HUNDRED FIFTY EIGHT AND 38/100 (P58,358.38).

I understand that the present interest rate is lower than the last month's 27%. However, it does not give our company any break from coping with our receivables. Our clients, Mercure Philippine Village Hotel, Puerto Azul Beach Hotel, Grand Air Caterer, to name a few, did not settle their obligation to us inspite of what was agreed upon during our meeting held last February 1998. Their pledge of paying us at least ONE MILLION PESOS PER AFFILIATION, which we allocate to pay our balance to your bank, was not a reliable deal to foresee because, as of this very day, not even half of the amount assured to us was settled. This situation puts the company in critical condition since we will again shoulder all the interests imposed on our loans, while, we ourselves, did not impose any surcharge with our receivables.

In connection with this, may I request for a reduction of interest rate, in my favor, i.e., from 26% to 21% per annum. If such appeal is granted to us, we are assuring you of our prompt payment and keen observance to your rules and regulations.[14]

The undersigned is a mortgagor of Philippine Savings Bank with an outstanding balance of TWO MILLION FOUR HUNDRED THIRTY THREE THOUSAND EIGHTY FOUR and 73/100 (P2,433,084.73) at an interest rate of 22.5% per annum (as per April 24, 1998 memo faxed to us) and with a monthly amortization of FIFTY TWO THOUSAND FIVE HUNDRED FIFTY EIGHT AND 01/100 (P52,55[8].01).

Such reduction of interest rate is an effect of our currency's development. But based on our inquiries and research to different financial institutions, the rate your bank is imposing to us is still higher compared to the eighteen and a half percent (18.5%) others are asking. With this situation, we are again requesting for a decrease on the interest rate, that is, from 22.5% to 18.5%. This figure stated is not fictitious since other bank's advertising are published to leading newspapers. The difference between your rate is visibly greater and has an immense effect on our financial obligations.[15]

The undersigned is a mortgagor at Philippine Savings Bank with an outstanding balance of TWO MILLION

FOUR HUNDRED THOUSAND EIGHT HUNDRED ELEVEN and 03/100 (Php 2,40[0],811.03) at an interest rate of 21% per annum.

Letters of reconsideration were constantly sent to you to grant us lower interest rate. However, no assistance with regard to that request has been extended to us. In view of this, I am requesting for a transfer of our loan from PSBank Head Office to PSBank Mabini Branch. This transfer is purposely intended for an appeal [for] a lower interest rate.[16]

Being a mortgagor of PSBank, I have [been] repeatedly asking for a reduction of your interest rate. However, my request has been denied since the term I started. Many banks offer a much lower interest rate and fair business transactions (e.g. Development Bank of Singapore [which] offers 13% p.a. interest rate).

In this connection, once more, I am requesting for a reduction of the interest rate applied to my loan to maintain our business relationship.[17]

Basic is the rule that there can be no contract in its true sense without the mutual assent of the parties. If this consent is absent on the part of one who contracts, the act has no more efficacy than if it had been done under duress or by a person of unsound mind. Similarly, contract changes must be made with the consent of the contracting parties. The minds of all the parties must meet as to the proposed modification, especially when it affects an important aspect of the agreement. In the case of loan contracts, the interest rate is undeniably always a vital component, for it can make or break a capital venture. Thus, any change must be mutually agreed upon, otherwise, it produces no binding effect.[18]

Escalation clauses are generally valid and do not contravene public policy. They are common in credit agreements as means of maintaining fiscal stability and retaining the value of money on long-term contracts. To prevent any one-sidedness that these clauses may cause, we have held in *Banco Filipino Savings and Mortgage Bank v. Judge Navarro*[19] that there should be a corresponding de-escalation clause that would authorize a reduction in the interest rates corresponding to downward changes made by law or by the Monetary Board. As can be gleaned from the parties' loan agreement, a de-escalation clause is provided, by virtue of which, petitioner had lowered its interest rates.

Nevertheless, the validity of the escalation clause did not give petitioner the unbridled right to unilaterally adjust interest rates. The adjustment should have still been subjected to the mutual agreement of the contracting parties. In light of the absence of consent on the part of respondents to the modifications in the interest rates, the adjusted rates cannot bind them notwithstanding the inclusion of a de-escalation clause in the loan agreement.

The order of refund was based on the fact that the increases in the interest rate were null and void for being violative of the principle of mutuality of contracts. The amount to be refunded refers to that paid by respondents when they had no obligation to do so. Simply put, petitioner should refund the amount of interest that it has illegally imposed upon respondents. Any deficiency in the payment of the obligation can be collected by petitioner in a foreclosure proceeding, which it already did.

On the matter of damages, we agree with petitioner. Moral damages are not recoverable simply because a contract has been breached. They are recoverable only if the party from whom it is claimed acted fraudulently or in bad faith or in wanton disregard of his contractual obligations. The breach must be wanton, reckless, malicious or in bad faith, and oppressive or abusive. Likewise, a breach of contract may give rise to exemplary damages only if the guilty party acted in a fraudulent or malevolent manner.[20]

In this case, we are not sufficiently convinced that fraud, bad faith, or wanton disregard of contractual obligations can be imputed to petitioner simply because it unilaterally imposed the changes in interest rates, which can be attributed merely to bad business judgment or attendant negligence. Bad faith pertains to a dishonest purpose, to

some moral obliquity, or to the conscious doing of a wrong, a breach of a known duty attributable to a motive, interest or ill will that partakes of the nature of fraud. Respondents failed to sufficiently establish this requirement. Thus, the award of moral and exemplary damages is unwarranted. In the same vein, respondents cannot recover attorney's fees and litigation expenses. Accordingly, these awards should be deleted.[21]

However, as regards the above mentioned award for refund to respondents of their interest payments in excess of 17% per annum, the same should include legal interest. In *Eastern Shipping Lines, Inc. v. Court of Appeals*, [22] we have held that when an obligation is breached, and it consists in the payment of a sum of money, the interest on the amount of damages shall be at the rate of 12% per annum, reckoned from the time of the filing of the complaint.[23]

WHEREFORE, the petition is PARTIALLY GRANTED. The assailed Decision dated August 27, 2009 and the Resolution dated August 4, 2010 of the Court of Appeals in CA-G.R. CV No. 86445 are AFFIRMED WITH MODIFICATIONS, such that the award for moral damages, exemplary damages, attorney's fees, and litigation expenses is DELETED, and the order of refund in favor of respondents of interest payments made in excess of 17% per annum shall bear interest of 12% per annum from the time of the filing of the complaint until its full satisfaction.

SO ORDERED.

Carpio, Peralta, Abad and Mendoza, JJ., concur.

[1] Rollo, pp. 12-29.

[2] Penned by Associate Justice Priscilla J. Baltazar-Padilla, with Associate Justices Celia C. Librea-Leagogo and Normandie B. Pizarro, concurring; id. at 30-52.

[3] Id. at 53-54.

[4] Cited in the CA Decision dated August 27, 2009; id. at 32.

[5] Letters dated April 6, 1998, April 30, 1998, September 3, 1998, and July 23, 1999; id. at 60-63.

[6] Id. at 64-66.

[7] Petition for Review on Certiorari; id. at 15.

[8] Cited in CA Decision dated August 27, 2009; id. at 30-31.

[9] Per the CA Decision dated August 27, 2009; id. at 35.

[10] Id. at 50-51.

[11] *Floirendo, Jr. v. Metropolitan Bank and Trust Company*, G.R. No. 148325, September 3, 2007, 532 SCRA 43, 50; *New Sampaguita Builders Construction, Inc. (NSBCI) v. Philippine National Bank*, 479 Phil. 483, 497 (2004); *Philippine National Bank v. Court of Appeals*, G.R. No. 88880, April 30, 1991, 196 SCRA 536, 544-545.

[12] *Supra* note 1, at 19.

[13] *Philippine National Bank v. Court of Appeals*, 328 Phil. 54, 63 (1996); *Philippine National Bank v. Court of Appeals*, G.R. No. 107569, November 8, 1994, 238 SCRA 20, 26-27.

[14] Letter dated April 6, 1998; rollo, p. 60.

[15] Letter dated April 30, 1998; id. at 61.

[16] Letter dated September 3, 1998; id. at 62.

[17] Letter dated July 23, 1999; id. at 63.

[18] Philippine National Bank v. Court of Appeals, supra note 12, at 25-26.

[19] 236 Phil. 370 (1987).

[20] Philippine National Bank v. Rocamora, G.R. No. 164549, September 18, 2009, 600 SCRA 395, 411-412; Pilipinas Shell Petroleum Corporation v. John Bordman, Ltd. of Iloilo, Inc., 509 Phil. 728, 751 (2005).

[21] Philippine National Bank v. Rocamora, supra, at 412.

[22] G.R. No. 97412, July 12, 1994, 234 SCRA 78.

[23] Id. at 95; see Banco Filipino Savings and Mortgage Bank v. Court of Appeals, G.R. No. 129227, May 30, 2000, 332 SCRA 241.

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