

ENGR. RICARDO O. VASQUEZ, PETITIONER, VS. PHILIPPINE NATIONAL BANK AND NOTARY PUBLIC JUDE[] JOSE F. LATORRE, JR., PUBLIC AUCTION OFFICER, RESPONDENTS.

G.R. No. 228355. August 28, 2019

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CAGUIOA, J:

Before the Court are two consolidated petitions.

In G.R. No. 228355, petitioner Engr. Ricardo O. Vasquez (Vasquez) filed a Petition for Review on Certiorari[1] under Rule 45 dated January 6, 2017 (Vasquez Petition) against Philippine National Bank (PNB), partially assailing the Decision[2] dated April 29, 2016 (assailed Decision) and Resolution[3] dated November 8, 2016 (assailed Resolution) rendered by the Court of Appeals (CA) in CA-G.R. CV No. 102669.

G.R. No. 228397, in turn, is the Petition for Review on Certiorari[4] under Rule 45 dated January 12, 2017, filed by PNB (PNB Petition) against Vasquez, also praying for the reversal of the CA's assailed Decision and Resolution.

The Facts and Antecedent Proceedings

As culled from the CA's recital of the facts in the assailed Decision, as well as from the records of the instant case, the pertinent facts and antecedent proceedings are as follows:

Engineer Ricardo Vasquez x x x applied for and was granted a loan by the Philippine National Bank x x x [on November 8, 1996] under the latter's Pangkabuhayan ng Bayan Program, in the amount of Six Hundred Thousand Pesos (P600,000.00)[, as evidenced by Promissory Note No. (PN) 009/96PNB[5] dated November 8, 1996.] Later on, [Vasquez] again obtained another loan under the Revolving Credit Line (RCL) in the sum of Eight Hundred Thousand Pesos (P800,000.00)[, as evidenced by PN 031/96RCL[6] dated November 8, 1996.] The aforesaid loans[, having a total amount of P1,400,000.00] were secured by four (4) parcels of land [(subject properties)] located in Trece Martirez, Province of Cavite covered by [Transfer Certificates of Title (TCT)] Nos. 295114,[7] 295115,[8] 322380[9] and 322381[10] owned and registered [under the name of Vasquez] by way of [a] Real Estate Mortgage Agreement.[11] [A Credit Agreement[12] dated November 8, 1996, with the General Conditions (For Individual Borrower) attached as its Annex "A," was executed by the parties.]

On June 21, 1999, however, [Vasquez] filed a Complaint[13] against [PNB and the notary public who was assigned by PNB as the public auction sale officer, Jude Jose F. Latorre, Jr. (Latorre, Jr.), before the Regional Trial Court of Imus, Cavite, Branch 20 (RTC)] for specific performance, annulment of foreclosure proceedings and damages with prayer for the issuance of a preliminary injunction. [The case was docketed as Civil Case No. 1927-99.] In his [C]omplaint, [Vasquez] alleged the following, among others:

"3. The rate of interest agreed upon by the parties in these loan agreements is only 17% (and up to 18% for 3 years) and to liquidate these accounts, [Vasquez] in fact made partial payments totalling (sic) P221,991.36 but he subsequently suspended further payment when [PNB] unilaterally escalated upwardly the interest rate from

[the] stipulated [rate of] 17% to 33.00% to 24%, to 34%, to 29% to 21.70% and 20.186% even without prior knowledge and conformity of [Vasquez] as borrower. This is shown by the Sept. 15, 1998 statement of account sent by [PNB] to [Vasquez] depicting the overcharging and excessive interest imposed upon including imposition of 23% penalties that the REM did not provide.

"4. Alarmed by [PNB's] unbridled (sic) upward unilateral escalation of interest that ballooned to staggering P2,071,189.64 (as of Sept. 22, 1998) and lately P2,363,315.40 (per notice of Auction Sale) as early as April 05, 1998, and Oct. 17, 1998, [Vasquez] sent [PNB] tow (sic) letter-requests for recomputation of his account to delete the excess interest and penalties that the parties did not agree in the first place.["]

In support of his prayer of issuance of a preliminary injunction, [Vasquez] claimed that due to the unilateral escalation of interest rates, it resulted to a rapid surge of his actual monetary obligation, thus, placing him in a situation where he could no longer pay his obligations with the bank. As he could no longer comply with his mounting monetary obligation, his properties were being subjected to foreclosure proceedings which might later result to his ejectment.

[Vasquez] prayed that the interest in excess of [the] stipulated [rate of] 17% x x x be declared x x x illegal. He further prayed for payment of P250,000.00 representing moral damages, P100,000.00 as actual damages and P100,000.00 attorney's fees.

[The evidence on record reveals that a Notice of Sale[14] dated May 24, 1999 was issued by Latorre, Jr., evidencing that, upon the extra-judicial petition for sale under Act No. 3135, as amended, filed by PNB, a public auction of the subject properties registered in the name of Vasquez to satisfy the indebtedness, which PNB pegged at P2,363,315.40, was set on June 24, 1999.]

On July 29, 1999, [PNB] filed its Answer with Counterclaim[15] which denied all the allegations cited by [Vasquez]. In its Answer, [PNB] prayed for the dismissal of the complaint for lack of merit and legal basis. It likewise prayed the [RTC] for [Vasquez] to pay the bank exemplary, moral, nominal and temperate damages of P500,000.00 each, P500,000.00 litigation expenses and P200,000.00 attorney's fees.

[PNB] averred that [Vasquez] had no cause of action against the bank because the purported increases in the interest rate in the loan agreements [were] freely, voluntarily and mutually agreed upon by the parties. Furthermore, the penalty charges imposed to [Vasquez were] provided for in the Credit Agreement to which the former agreed and signed.

On August 9, 1999, the [RTC] issued an Order[16] setting the pre-trial on September 17, 1999. The same Order denied the prayer of [Vasquez] for a writ of preliminary injunction for being moot and academic inasmuch as the act to be enjoined was already consummated.

The original pre-trial date was however cancelled and reset several times mostly for possible settlement. After almost eight years, pre-trial finally proceeded and was terminated on May 22, 2007. Thereafter, the parties presented their witnesses and evidence in support of their respective claims.

At the onset of [Vasquez'] direct examination, the [RTC] had the chance to elucidate the following facts:

1. The subject properties [of] the Real Estate Mortgage have already been foreclosed and [Vasquez] failed to intervene in the foreclosure proceedings.
2. [Vasquez] also failed to secure a writ of preliminary injunction as he filed the case on June 21, 1999 or three (3) days before the foreclosure proceedings on June 24, 1999.

To support his claim, [Vasquez] testified that he secured a loan from [PNB] through its Pangkabuhayan ng Bayan

Program amounting to Six Hundred Thousand Pesos (P600,000.00) which was later increased. The aforesaid loans were secured by parcels of land located at Tanza, Cavite. [Vasquez] averred that the initial stipulated interest for the loans was seventeen (17%) percent.

On cross-examination, [Vasquez] said that he voluntarily signed the loan agreements and that he fully understood the terms and conditions set forth therein, including the payment of interest rates and penalty charges in case of default. [Vasquez] further stated that while he recognized the right of the bank to increase or decrease the interest rate, he insisted that no notice was given by the bank before it actually increased the interest rate. [Vasquez] claimed that he tried to tender his payment to the bank but the same was not accepted. He, however, admitted that when the same was declined by the bank, he did not make any efforts to consign any amount to the Court pending payment with the bank.

For its part, [PNB] presented the testimonies of Atty. Ariston Flores and Glenda Agbayani.

Atty. Flores' testimony was offered in order to prove that [Vasquez] obtained loans from PNB and that the latter failed to fully satisfy his obligation with the bank. As a consequence of such failure, the bank imposed penalties and charges as stated in the loan agreements. Atty. Flores stated that the bank only imposes the penalty charge of thirty-six (36%) percent in addition to interest rate when the borrower failed to settle his or her obligation with the bank.

On cross-examination, Atty. Flores clarified that the interest rate imposed under the Pangkabuhayan ng Bayan Program was 16.5% for one year while an 18% interest rate for 90 days was imposed to [Vasquez] under the Revolving Credit Line and promissory note.

[PNB's] second witness Glenda Agbayani was the Loan Processor at the time [Vasquez] obtained the loans. Agbayani corroborated the testimony of Atty. Flores as to the rate of interest imposed under the Pangkabuhayan ng Bayan Program and Revolving Credit Line. She likewise denied that the bank unilaterally increased the interest rate[.]

On October 2, 2013 the [RTC] rendered a [Decision][17] dismissing the [C]omplaint of [Vasquez], to wit:

"Wherefore, premises considered, judgment [is] hereby rendered as follows, viz:

1. DENYING plaintiffs' complainant for lack of factual and legal basis; and
2. DENYING defendant's counterclaim for lack of merit

"No pronouncement as to costs.

"SO ORDERED."

[In sum, the RTC held that the Credit Agreement and the Promissory Notes were executed by the parties willfully and voluntarily.[18] Further, there was no evidence presented to support Vasquez' assertion that he had already partially paid the loan obligations.][19]

[Vasquez] filed a Motion for Reconsideration[20] but was likewise denied by the [RTC].[21]

The Ruling of the CA

In the assailed Decision, the CA modified the RTC's Decision. The CA held that the RTC was correct in holding that Vasquez failed to discharge the burden of showing that the obligation has already been discharged.[22] As to the issue of the validity of the foreclosure proceedings, the CA held that the "record is bereft of any allegation and/or evidence that could aid this Court in resolving this issue." [23]

However, the CA found that the evidence presented during the trial established that the subject loan obligations involved the unilateral imposition of increased interest rates. The CA held that the unilateral imposition of increased interest rates is violative of the principle of mutuality of contracts and declared the same void. Hence, the CA imposed the applicable legal rate of interest of 12% per annum. The CA also held that the penalty interest of 36% is unconscionable. The penalty charge was reduced to 12% per annum.

Hence, the dispositive portion of the assailed Decision reads:

WHEREFORE, in view of the foregoing premises, the assailed Decision of the court a quo is hereby AFFIRMED with MODIFICATIONS. The plaintiff-appellant is hereby ordered to pay the principal loan amount of P1,400,000.00 plus interest rate of 12% per annum and penalty rate of 12% per annum from the time of the maturity of the loans until the obligations are fully paid.

No pronouncement as to costs.

SO ORDERED.[24]

PNB filed its Motion for Partial Reconsideration[25] on May 25, 2016, while Vasquez filed his Motion for Reconsideration[26] on May 25, 2016 and his Supplemental Motion for Reconsideration[27] on June 13, 2016. The CA denied the Motions for Reconsideration of both PNB and Vasquez in the assailed Resolution.

Hence, the instant appeal filed by both parties.

Issues

In the Vasquez Petition, Vasquez raises three grounds for the Court's consideration. First, Vasquez argues that while the CA was correct in holding that the interest rates imposed by PNB on the subject loans were void because PNB unilaterally imposed increased interest rates, the CA erred in imposing a 12% per annum interest on the subject loans as the interest rate should be 6% per annum based on applicable jurisprudence. Second, Vasquez alleges that he had already made partial payments on the subject loan obligations, i.e., P983,343.38. Lastly, Vasquez maintains that the CA erred in not ordering the nullity of the foreclosure of the subject properties.[28]

In the PNB Petition, PNB likewise raised three grounds in support of the said Petition. First, PNB argues that the CA committed a serious and reversible error in arriving at the conclusion that the interests applied on the subject loans were void and that the stipulated penalty interest of 36% per annum is unconscionable. Second, assuming arguendo that the interests and penalties imposed on the subject loans were void, the principal amounts of the subject loans should be subjected to the stipulated rates of interests and penalty. And lastly, PNB alleges that, having been in default, it acted accordingly when it foreclosed the subject properties.[29]

In essence, the critical issues that must be resolved by the Court which are determinative in resolving the above-mentioned issues identified by the parties are the following:

(1)

Whether the interest rate scheme imposed by PNB under the Credit Agreement and other loan documents is valid, and

(2)

If PNB's imposition of interest rates is found to be null and void, what are the implications of such holding on the foreclosure of the mortgaged properties and the principal loan obligation of Vasquez.

The Court's Ruling

The Validity of the Unilateral Determination of Interest Rates by PNB

The instant case is centered on two loans procured by Vasquez from PNB. It is undisputed that Vasquez procured a loan from PNB under the Pangkabuhayan ng Bayan Program in the amount of P600,000.00 (Pangkabuhayan Loan). The said loan is evidenced by PN 009/96PNB dated November 8, 1996.

Vasquez also procured another loan from PNB under the Revolving Credit Line (RCL) in the sum of P800,000.00, which is evidenced by PN 031/96RCL, which was also executed on November 8, 1996.

It is also not disputed that the parties executed a Real Estate Mortgage to secure Vasquez' aforementioned loans. The Real Estate Mortgage covers the subject properties located in Trece Martirez, Cavite and covered by TCT Nos. 295114, 295115, 322380 and 322381 registered under the name of Vasquez.

To recall, both loans are covered under the Credit Agreement, which was similarly executed on November 8, 1996. The Credit Agreement contains the various terms and conditions that govern the loan agreement between Vasquez and PNB. Under the Credit Agreement, it was made clear that the principal loan obligation of Vasquez totaled P1,400,000.00.

What are the conventional or monetary interest rates fixed by the parties that were imposed upon the two loans procured by Vasquez? PNB asserts that the interest rates imposed upon the loan obligations were fixed and stipulated. According to PNB, the Pangkabuhayan Loan amounting to P600,000.00 has a stipulated interest rate of 16.5% per annum fixed for one year, while the RCL amounting to P800,000.00 has a stipulated interest rate of 18% per annum.

After a close examination of the evidence on record, contrary to the position of PNB, the Court finds that the interest rates imposed by PNB on the subject loans are not, in reality, fixed to 16.5% and 18% per annum.

As seen on the first page of the Credit Agreement, in the proviso on the interest rate to be imposed on the Pangkabuhayan Loan, instead of identifying a fixed and specific rate of interest, it indicated that "the Borrower agrees to pay interest on the Loan at the rate per annum of Prime Rate plus Spread [i]nterest rate." [30] The loan documents on record do not elaborate as to how the "Prime Rate plus Spread" is determined. There is no reference rate on which the "Prime Rate plus Spread" is based. On the other hand, the proviso on the specific interest rate to be imposed on the RCL obligation was left blank. [31]

Further, on the face of PN 009/96PNB evidencing the Pangkabuhayan Loan, it merely states that the P600,000.00 principal obligation shall be paid together with interest at the "applicable" [32] interest rate. As to the RCL, PN 031/96RCL similarly indicates that the interest rate to be paid is the "applicable" [33] interest rate, without indicating what exactly is the applicable interest rate.

In *Spouses Silos v. Philippine National Bank*, [34] PNB implemented an identical interest rate scheme, wherein PNB imposed on the petitioners therein interest to be determined based on the "prime rate plus applicable spread in effect." [35]

In the aforesaid case, the Court invalidated the imposition of interest as it found that such method of fixing interest rates based on the "prime rate plus applicable spread in effect" is based on a "one-sided, indeterminate, and subjective criteria such as profitability, cost of money, bank costs, etc., [that] is arbitrary for there is no fixed standard or margin above or below these considerations." [36]

In the fairly recent case of *Security Bank Corp. v. Spouses Mercado*, [37] the petitioner therein likewise implemented a similar interest rate scheme wherein the respondents therein were made to pay "Security Bank's prevailing lending rate[.]" [38]

In the said case, likening Security Bank's imposition of the "prevailing lending rate" to the "prime rate plus applicable spread" which was deemed invalid in *Spouses Silos v. Philippine National Bank*, the Court held that imposing the "prevailing lending rate" is not synonymous with the usual banking practice of imposing the "prevailing market rate." The Court explained that the latter is valid "because it cannot be said to be dependent solely on the will of the bank as it is also dependent on the prevailing market rates. The fluctuation in the market rates is beyond the control of the bank." [39] However, when banks impose "prevailing lending rates," such imposition is considered one-sided, arbitrary, and potestative as the bank is "still the one who determines its own prevailing lending rate." [40]

But even assuming for the sake of argument that the parties indeed came into an agreement in the Pangkabuhayan Loan and RCL and were able to specifically stipulate on the applicable monetary interest rates at 16.5% per annum and 18% per annum, and not at "prime rate plus spread," the Court finds that the monetary interest rates imposed in the instant case may still not be considered as fixed.

A key provision of the Credit Agreement readily reveals that even if the parties were able to stipulate on the aforementioned interest rates, such rates were still subject to unilateral modification by PNB. Simply stated, under the Credit Agreement entered into by the parties, a supposedly fixed and specified rate of interest is, in reality, never really fixed. The interest rates are beholden to the sole will of PNB.

According to Section 6.02(b) of the General Conditions (for Individual Borrower) of the Credit Agreement, in a situation wherein there is a fixed interest rate, PNB still reserves the right to unilaterally modify the said interest rate at any time depending on whatever policy PNB adopts in the future:

"(b) In case of fixed interest rate, the Bank reserves the right to increase at any time the interest rate on the Loan/Availments/Advances/Trust Receipt/s within the limits allowed by Law depending on whatever policy the Bank may adopt in the future; x x x." [41]

The one-side imposition of interest in favor of PNB is made even more pronounced under Section 6.02(a) of the Credit Agreement's General Conditions, which state that "the Bank reserves the right to increase or decrease the interest rate should the Bank's cost of money to fund or maintain such Loans/Availments/Advances/Trust Receipt/s while outstanding increase or decrease, respectively." [42]

Also, Section 6.02(c) of the same document states that "[t]he Bank's determination of the amount of interest payable hereunder shall be conclusive and binding on the Borrower/s in the absence of manifest error in the computation." [43] Hence, under the Credit Agreement, PNB is allowed to modify the rate of interest even without the consent of Vasquez as PNB's determination of the applicable interest rates is deemed conclusive and binding.

Aside from the foregoing, on the first page of the Credit Agreement itself, it also unequivocally states that PNB "reserves the right to increase or decrease x x x the rate of interest x x x in the event of changes in x x x the Bank's overall cost of funds." [44]

The two promissory notes covering the subject loans also contain the same proviso, [45] providing that the stipulated interest rate, assuming there was any, may be increased or decreased by PNB even without Vasquez's consent if there is change in the overall cost of the loans.

Even the Real Estate Mortgage provided that "[t]he rate of interest charged on the obligation secured by this mortgage x x x shall be subject during the life of this contract to such an increase within the rate allowed by law as the Board of Directors of the MORTGAGEE [PNB] may prescribe for 's debtors." [46]

When PNB extrajudicially demanded the payment of the loan obligations on September 22, 1998 through its demand letter [47] of even date, it based the demand of payment on the Statement of Account [48] as of September

15, 1998, which details all the amounts of interest imposed upon Vasquez's loans, from the inception of the loan up to September 15, 1998. The Statement of Account is instructive as to how PNB actually applied the interest rate scheme upon Vasquez.

The Statement of Account reveals that PNB imposed varying interest rates on the loan obligations. As to the Pangkabuhayan Loan, the monetary interest rate was increased from 16%, which was applied from August 7, 1997 to November 7, 1997, to 33%, which was applied from November 7, 1997 to September 15, 1998.[49] With respect to the RCL, from a period spanning November 3, 1997 to September 15, 1998, the interest rates were modified, from 34% to 29%, from 29% to 21.70%, and from 21.70% to 20.189%.[50] The Court finds that PNB clearly failed to sufficiently explain exactly how PNB arrived at such increased rates.

It also did not escape the attention of the Court that during the trial, when the RTC pressed PNB on the issue of whether there was a notice of escalation issued by PNB before applying the interest rates on the subject loans, the counsel of PNB, Atty. Dennis Somera (Somera), admitted that there were no notices of escalation sent to Vasquez:

ATTY. SOMERA:

There was no notice of escalation from the bank. It was just a statement of account, your Honor.[51]

Hence, it is crystal clear that PNB decided on its own to modify and increase the rates of interest, without notifying and informing Vasquez before it modified the monetary interest rates, and the basis for such modification. PNB merely sent statements of accounts already imposing the interest rates unilaterally determined by PNB.

Interestingly, PNB itself, in its Petition, readily acknowledged in no uncertain terms that, even without prior notice, "PNB may modify interest rates depending on future policy adopted by it[.]"[52] In effect, PNB has recognized that the interest rates it imposed are not fixed in nature and that it modified interest rates depending on its own policy without prior notice.

As explained by the Court in *Spouses Silos v. Philippine National Bank*, the Court has, in a long line of cases, repeatedly struck down provisions in credit documents issued by PNB, which are completely identical or similar to the provisions found in the loan documents in the instant case:

Decisions of the Court where PNB's imposition of interest rates was declared invalid

Subject provisions of the loan documents imposing interest rate that were invalidated by the Court

Philippine National Bank v. Court of Appeals[53]

"The Borrowers hereby agree to be bound by the rules and regulations of the Central Bank and the current and general policies of the Bank and those which the Bank may adopt in the future, which may have relation to or in any way affect the Line, which rules, regulations and policies are incorporated herein by reference as if set forth herein in full."[54]

Philippine National Bank v. Court of Appeals,[55]

"The BANK reserves the right to increase the interest rate within the limits allowed by law at any time depending on whatever policy it may adopt in the future; Provided, that the interest rate on this accommodation shall be correspondingly decreased in the event that the applicable maximum interest is reduced by law or by the Monetary Board. In either case, the adjustment in the interest rate agreed upon shall take effect on the effectivity date of the increase or decrease in the maximum interest rate."[56]

Sps. Almeda v. CA,[57]

"The Bank reserves the right to increase the interest rate within the limits allowed by law at any time depending on whatever policy it may adopt in the future; provided, that the interest rate on this/these accommodations shall be correspondingly decreased in the event that the applicable maximum interest rate is reduced by law or by the Monetary Board. In either case, the adjustment in the interest rate agreed upon shall take effect on the effectivity date of the increase or decrease of the maximum interest rate."[58]

Philippine National Bank v. Court of Appeals,[59]

"For value received, I/we, [private respondents] jointly and severally promise to pay to the ORDER of the PHILIPPINE NATIONAL BANK, at its office in San Jose City, Philippines, the sum of FIFTEEN THOUSAND ONLY (P15,000.00), Philippine Currency, together with interest thereon at the rate of 12% per annum until paid, which interest rate the Bank may at any time without notice, raise within the limits allowed by law, and I/we also agree to pay jointly and severally ___% per annum penalty charge, by way of liquidated damages should this note be unpaid or is not renewed on due date."[60]

New Sampaguita Builders Construction, Inc. (NSBCI) v. PNB,[61]

"[W]ithin the limits allowed by law at any time depending on whatever policy it may adopt in the future."[62]

Philippine National Bank v. Spouses Rocamora,[63]

"For value received, we, jointly and severally, promise to pay to the ORDER of the PHILIPPINE NATIONAL BANK, at its office in Pto. Princesa City, Philippines, the sum of xxx together with interest thereon at the rate of 12% per annum until paid, which interest rate the Bank may at any time, without notice, raise within the limits allowed by law, and I/we also agree to pay jointly and severally, 5% per annum penalty charge, by way of liquidated damages, should this note be unpaid or is not renewed on due date."[64]

The foregoing shows that the nullity of PNB's unilateral determination of interest rates in the instant case follows a long line of judicial precedent.

At this juncture, the Court clarifies that there may be instances wherein an interest rate scheme which does not specifically indicate a particular interest rate may be validly imposed. Such interest rate scheme refers to what is typically called a floating interest rate system.

In *Security Bank Corp. v. Spouses Mercado*, the Court explained that floating rates of interest refer to the variable interest rates stated on a market-based reference rate agreed upon by the parties. Stipulations on floating rate of interest differ from escalation clauses. Escalation clauses are stipulations which allow for the increase of the original fixed interest rate. In contrast, a floating rate of interest pertains to the interest rate itself that is not fixed as it is dependent on a market-based reference that was agreed upon by the parties.[65]

In the aforesaid case, citing the Manual of Regulations of Banks (MORB) of the Bangko Sentral ng Pilipinas (BSP), the Court explained that the BSP allows banks and borrowers to agree on a floating rate of interest provided that it must be based on market-based reference rates:

§ X305.3 Floating rates of interest. The rate of interest on a floating rate loan during each interest period shall be stated on the basis of Manila Reference Rates (MRRs), T-Bill Rates or other market based reference rates plus a margin as may be agreed upon by the parties.[66]

The Court explained that "[t]his BSP requirement is consistent with the principle that the determination of interest rates cannot be left solely to the will of one party. It further emphasizes that the reference rate must be stated in writing, and must be agreed upon by the parties."[67] Hence, in order for the concept of a floating rate of interest to apply, it presupposes that a market-based reference rate is indicated in writing and agreed upon by the parties.

In the aforesaid case, the Court did not deem the interest rate imposed therein as an impossible floating rate of interest because the "reference rates are not contained in writing as required by law and the BSP." [68]

Applying the foregoing in the instant case, a perusal of the loan documents reveals that PNB did not envision a rate scheme wherein a non-fixed interest rate is made dependent on a market-based reference rate. There is absolutely no market-based reference rate indicated in the loan documents. On the contrary, PNB admits that under the Credit Agreement, the interest rates are made dependent on "whatever policy it may adopt in the future," [69] and not on MRRs, T-Bill Rates or other similar market-based reference rates as required by the BSP. The fact alone that there is no market-based reference rate stipulated in writing negates any idea that a floating rate of interest system is applicable in the instant case.

Moreover, the witnesses for PNB testified that the interest rate scheme envisioned by PNB was one wherein specific rates were pegged, i.e., 16.5% and 18% per annum, subject to subsequent increase and the imposition of penalty charges in case of default. [70] As already explained, stipulating a specific rate of interest is antithetical to the concept of a floating rate of interest because in a floating interest rate system, the specific interest rate is not fixed and is dictated by a market-based reference rate. In the instant case, a floating rate of interest system was clearly not agreed upon by the parties as PNB alleges that it applied fixed interest rates subject to escalation.

But, as already extensively explained, the specific and fixed interest rates supposedly imposed by PNB, aside from not having any clear support on the face of the loan documents submitted into evidence, are not, in reality, fixed because the rates are subject to modification based on the unilateral determination of PNB.

The Court also clarifies that not all escalation clauses are invalid. As explained in *Sps. Almeda v. CA*, "[e]scalation clauses are not basically wrong or legally objectionable so long as they are not solely potestative but based on reasonable and valid grounds. Here, as clearly demonstrated above, not only the increases of the interest rates on the basis of the escalation clause patently unreasonable and unconscionable, but also there are no valid and reasonable standards upon which the increases are anchored." [71]

Applying the foregoing in the instant case, to reiterate once more, PNB itself readily admits in its Petition that the modification of the applicable interest rates under the Credit Agreement is made dependent "on [the] future policy adopted by [PNB]." [72] It has been indubitably established that the escalation of interest rates in the instant case is solely potestative on the part of the creditor and not anchored on valid and reasonable standards.

Considering the foregoing, without a doubt, the interest rate scheme imposed upon Vasquez under the loan agreement is clearly one-sided, unilateral, and violative of one of the fundamental characteristics of contracts - which is the essential equality of the contracting parties, oftentimes called the principle of mutuality of contracts. [73] Therefore, the interest rate scheme provided under the Credit Agreement and the promissory notes is null and void.

The principle of mutuality of contracts is pronounced in Article 1308 of the Civil Code, which states that a contract "must bind both contracting parties; its validity or compliance cannot be left to the will of one of them." The principle of mutuality of contracts dictates that a contract must be rendered void when the execution of its terms is skewed in favor of one party. [74] As explained by recognized Civil Law Commentator, former CA Justice Eduardo P. Caguioa, the reason for this principle "is in order to maintain the enforceability of contracts, for otherwise the same would be illusory." [75]

As applied to the imposition of monetary interest, the Court has held that "[t]here is no mutuality of contracts when the determination or imposition of interest rates is at the sole discretion of a party to the contract. Further, escalation clauses in contracts are void when they allow the creditor to unilaterally adjust the interest rates without

the consent of the debtor." [76] Jurisprudence holds that provisions in a loan agreement that grant lenders unrestrained power to increase interest rates, penalties and other charges at the latter's sole discretion and without giving prior notice to and securing the consent of the borrowers reek of unilateral authority that is anathema to the mutuality of contracts and enable lenders to take undue advantage of borrowers. [77] The rate of interest is a principal condition, if not the most important component, of a loan agreement. Thus, "any modification thereof must be mutually agreed upon; otherwise, it has no binding effect." [78]

In *Security Bank Corp. v. Spouses Mercado*, "[s]tipulations as to the payment of interest are subject to the principle of mutuality of contracts. As a principal condition and an important component in contracts of loan, interest rates are only allowed if agreed upon by express stipulation of the parties, and only when reduced into writing. Any change to it must be mutually agreed upon, or it produces no binding effect." [79]

Illustrative is the case of *Sps. Limso v. Philippine National Bank*. [80] The said case, which also features PNB, involved loan agreements that merely provided the imposition of interest rates. However, the specific interest rates were not clearly stipulated in the loan documents. Subsequent increases in the interest rates were made at the sole discretion of PNB. The Court held therein that the interest rates were null and void and struck them down for being unreasonable and for being violative of the principle of the mutuality of contracts, even if the debtors therein readily consented to the arrangement. [81]

The exact same situation presented in the aforesaid case is present here.

While providing the payment of interest on the subject loans, the loan documents executed by the parties, on their face, failed to clearly and definitively fix the specific interest rates to be applied on the subject loans. Further, under the Credit Agreement, PNB reserved its unilateral right to increase or decrease the interest rate, should PNB's cost of money to fund or maintain the loan change. Then, as proven by the Statement of Account on record, subsequent increases in the monetary interest were unilaterally made by PNB which were admittedly without notifying Vasquez beforehand. Hence, the interest rates imposed by PNB in the instant case should be deemed null and void for being violative of the principle of mutuality of contracts, even assuming *arguendo* that Vasquez intelligently consented to the interest rates provisos found in the Credit Agreement and the other loan documents.

Therefore, considering the foregoing discussion, the Court finds no error in the CA's finding in the assailed Decision that the interest rate scheme imposed by PNB on Vasquez' loan obligation was unilateral in nature, and, necessarily, null and void.

The Effect of the Nullity of the Interest Rates Imposed by PNB on the Foreclosure of the Mortgaged Properties

The record shows that the four parcels of lands registered in the name of Vasquez were already foreclosed by PNB, with the auction sale having been conducted on June 24, 1999.

Now that the Court has ruled that the interest rates imposed by PNB on the principal loan obligation of P1,400,000.00 are null and void for being unilateral impositions that violate the principle of mutuality of contracts, what is the effect of such holding on the foreclosure sale of the subject properties?

Jurisprudence has held that in a situation wherein a debtor was not given an opportunity to settle his/her debt at the correct amount due to the imposition of a null and void interest rate scheme, no foreclosure proceedings may be instituted. The registration of such foreclosure sale has been held to be invalid and cannot vest title over the mortgaged property.

In a situation wherein null and void interest rates are imposed under a contract of loan, the non-payment of the principal loan obligation does not place the debtor in a state of default, considering that under Article 1252 of the

Civil Code, if a debt produces interest, payment of the principal shall not be deemed to have been made until the interests have been covered. Necessarily, since the obligation of making interest payments in the instant case is illegal and thus non-demandable, the payment of the principal loan obligation was likewise not yet demandable on the part of PNB. With Vasquez not being in a state of default, the foreclosure of the subject properties should not have proceeded.

In *Heirs of Zoilo Espiritu v. Sps. Landrito*,^[82] the loan obligation involved, which was secured by a mortgage, was marred by an iniquitous imposition of monetary interest because the creditors omitted to specifically identify the imposable interest rate, just as in the instant case. Because of the failure of the debtors to pay back the loan, the mortgaged property was foreclosed. The debtors failed to redeem the foreclosed property. The Court in that case held that the foreclosure proceedings should not be given effect, viz.:

x x x If the foreclosure proceedings were considered valid, this would result in an inequitable situation wherein the Spouses Landrito will have their land foreclosed for failure to pay an over-inflated loan only a small part of which they were obligated to pay.

x x x x

Since the Spouses Landrito, the debtors in this case, were not given an opportunity to settle their debt, at the correct amount and without the iniquitous interest imposed, no foreclosure proceedings may be instituted. A judgment ordering a foreclosure sale is conditioned upon a finding on the correct amount of the unpaid obligation and the failure of the debtor to pay the said amount. In this case, it has not yet been shown that the Spouses Landrito had already failed to pay the correct amount of the debt and, therefore, a foreclosure sale cannot be conducted in order to answer for the unpaid debt. The foreclosure sale conducted upon their failure to pay P874,125 in 1990 should be nullified since the amount demanded as the outstanding loan was overstated; consequently it has not been shown that the mortgagors — the Spouses Landrito, have failed to pay their outstanding obligation. Moreover, if the proceeds of the sale together with its reasonable rates of interest were applied to the obligation, only a small part of its original loans would actually remain outstanding, but because of the unconscionable interest rates, the larger part corresponded to said excessive and iniquitous interest.

As a result, the subsequent registration of the foreclosure sale cannot transfer any rights over the mortgaged property to the Spouses Espiritu. The registration of the foreclosure sale, herein declared invalid, cannot vest title over the mortgaged property. The Torrens system does not create or vest title where one does not have a rightful claim over a real property. It only confirms and records title already existing and vested. It does not permit one to enrich oneself at the expense of another. Thus, the decree of registration, even after the lapse of one (1) year, cannot attain the status of indefeasibility.^[83]

Similarly, in *Sps. Albos v. Sps. Embisan*,^[84] the extra-judicial foreclosure sale of a mortgaged property, which was foreclosed due to the non-payment of a loan, was invalidated because the interest rates imposed on the loan were found to be null and void due to their unconscionability.

In *Sps. Castro v. Tan*,^[85] on the basis of the nullity of the imposed interest rates due to their iniquity, the Court nullified the foreclosure proceedings "since the amount demanded as the outstanding loan was overstated. Consequently, it has not been shown that the respondents have failed to pay the correct amount of their outstanding obligation. Accordingly, we declare the registration of the foreclosure sale invalid and cannot vest title over the mortgaged property."^[86]

Also, in *Sps. Andal v. PNB*,^[87] the Court upheld the nullification of the foreclosure sale, affirming the appellate court's holding that "since the interest rates are null and void, [respondent] bank has no right to foreclose [petitioners-spouses'] properties and any foreclosure thereof is illegal. x x x. Since there was no default yet, it is

premature for [respondent] bank to foreclose the properties subject of the real estate mortgage contract." [88]

Hence, based on established jurisprudence, the fact that the interest rate scheme imposed upon Vasquez was null and void inevitably leads to the invalidity of the foreclosure sale. It would be unjust if the foreclosure sale of the subject properties was considered valid, as this would result in an inequitable situation wherein Vasquez would have his properties foreclosed for failure to pay a loan that was unduly inflated due to the unilateral and one-sided imposition of monetary interest.

Therefore, the CA was incorrect in finding that there is no evidence presented that warrants the nullification of the foreclosure sale of the subject properties. The Court rules that the foreclosure sale of the subject properties is null and void. Necessarily, the said foreclosure sale cannot be deemed to have transferred the right of ownership and possession to PNB and its successors-in-interest.

The Effect of the Nullity of the Interest Rates Imposed by PNB on the Loan Obligation of Vasquez

Despite the foregoing, the Court stresses that Vasquez is not completely off the hook.

The Court has held that in a situation wherein the interest rate scheme imposed by the bank was struck down because the bank was allowed under the loan agreement to unilaterally determine and increase the impossible interest rate, thus being null and void, "only the interest rate imposed is nullified; hence, it is deemed not written in the contract. The agreement on payment of interest on the principal loan obligation remains." [89] Hence, Vasquez is still obligated to pay back the principal loan obligation of P1,400,000.00 with interest.

The Court cannot give credence to Vasquez's argument that he has already made considerable partial payments that warrant the significant reduction of the principal loan balance. A perusal of the documents offered into evidence by Vasquez that purportedly support the assertion that substantial partial payments had been made reveals that none of the cash vouchers and receipts of payment referred to the subject loans. None of the documents referred to payments made in satisfaction of the loans evidenced by PN 009/96PNB and PN 031/96RCL.

The Court notes, however, that Check Voucher No. RCP-97-012 evidences the payment of P24,266.68 with respect to PN 009/96, referring to the Pangkabuhayan Loan. The Court notes that the said voucher bears the receiving stamp of PNB dated February 7, 1997. Hence, this amount should be deducted from the outstanding principal loan obligation of Vasquez. The outstanding principal loan obligation is P1,375,733.32.

What then would be the conventional or monetary interest rate to be imposed on the outstanding principal loan obligation?

Jurisprudence has held that in a similar situation wherein an interest rate on a loan has been declared null and void due to the violation of the mutuality of contracts, the Court shall apply the applicable legal rate of interest, which refers to "the prevailing rate at the time when the agreement was entered into." [90] In the instant case, the legal rate of interest prevailing at the time of the entering of the Credit Agreement is 12%. Hence, the CA did not err in imposing monetary interest of 12% on the outstanding principal loan obligation. Although, in accordance with *Nacar v. Gallery Frames*, [91] the monetary interest rate of 12% per annum should be applied from the time the agreement was entered into until June 30, 2013. Starting July 1, 2013 until the finality of this Decision, the monetary interest rate that shall be applied to the principal loan obligation is 6% per annum.

Vasquez argues that the impossible monetary interest should be pegged at 6% per annum all throughout, citing *Nacar v. Gallery Frames*. [92] In arguing that 6% should be the impossible interest rate all throughout, Vasquez cites the aforesaid case, which states that "[i]n the absence of stipulation, the rate of interest shall be 6% per

annum to be computed from default, i.e., from judicial or extrajudicial demand under and subject to the provisions of Article 1169 of the Civil Code." [93]

Vasquez's argument is erroneous.

It must be recalled that there are two types of interest — monetary interest and compensatory interest. Interest as a compensation fixed by the parties for the use or forbearance of money is referred to as monetary interest, while interest that may be imposed by law or by courts as penalty for damages is referred to as compensatory interest. [94]

The 6% per annum to be computed from default cited by Vasquez, referring to *Nacar v. Gallery Frames*, [95] refers to an award of interest in the concept of actual and compensatory damages when a loan obligation is breached. But the 12% per annum interest imposed by the CA on the principal loan obligation, which is pegged at the legal rate of interest prevailing at the time the agreement was entered into, [96] refers to monetary or conventional interest, and not compensatory interest. Again, jurisprudence holds that when the provision on the loan agreement on monetary or conventional interest is struck down for being null and void, the courts shall replace the null and void interest rate with the legal rate of interest prevailing at the time the agreement was entered into. As stated earlier, such legal rate is 12% per annum, to be applied from the time the loan agreement was entered into until June 30, 2013. Then, from July 1, 2013 until the finality of this Decision, the monetary interest rate that shall be applied to the principal loan obligation is 6% per annum. To arrest the incurring of interest pending litigation, an option that would have been available to the debtor was to consign the amount of the principal loan obligation before the RTC. This was not done by Vasquez.

For its part, PNB argues that, upon the declaration of nullity of the interest adjustment clauses of the loan documents, the originally stipulated interest rates of 16.5% per annum for the Pangkabuhayan Loan and 18% per annum for the RCL should be imposed, and not the legal rate of 12% per annum.

PNB's argument is likewise erroneous.

The Court has previously held that when an escalation clause has been annulled, ordinarily, the principal amount of the loan should be subjected to the original or stipulated interest rate of interest. [97] However, such rule does not find any application in the instant case. As already explained extensively, the Court finds that the loan documents, on their face, are ambiguous and unclear as to the real stipulated rate of interest. Further, the Court has also found that the original interest rate scheme envisioned under the Credit Agreement, owing to its unilateral nature that violates the principle of mutuality of contracts, is null and void. Hence, with respect to the imposition of monetary or conventional interest, the Court cannot refer back to the allegedly stipulated interest rate scheme. It shall resort to the imposition of the legal rate of interest at the time of the entering of the loan agreement, i.e., 12% per annum.

Now, with respect to the imposition of interest in the nature of a penalty or compensatory interest, the Court holds that the imposition of penalty interest on Vasquez prior to the finality of this Decision would be inequitable, bearing in mind that the interest rate scheme previously imposed by PNB upon the subject loans was null and void. Vasquez cannot be considered in default as PNB had no right to demand and Vasquez had no obligation to pay illegal monetary interest.

As illustrated in *Sps. Andal v. PNB*, a debtor whose loan was subjected to a null and void interest rate scheme cannot be considered in default for his/her inability to pay arbitrary, illegal and unconscionable interest rates and penalty charges unilaterally imposed:

It is worth mentioning that both the RTC and the CA are one in saying that '[petitioners-spouses) cannot be

considered in default for their inability to pay the arbitrary, illegal and unconscionable interest rates and penalty charges unilaterally imposed by [respondent] bank.' This is precisely the reason why the foreclosure proceedings involving petitioners-spouses' properties were invalidated. As pointed out by the CA, 'since the interest rates are null and void, [respondent] bank has no right to foreclose [petitioners-spouses'] properties and any foreclosure thereof is illegal. x x x. Since there was no default yet, it is premature for [respondent] bank to foreclose the properties subject of the real estate mortgage contract.'[98]

In accordance with the aforesaid case, Vasquez is considered in default only upon failure to pay the obligation here stated upon finality of this Decision. However, according to *Nacar v. Gallery Frames*,[99] when the judgment of the court awarding a sum of money becomes final and executory, legal interest shall be imposed on the sum with a rate of 6% per annum from such finality until its full satisfaction.

Hence, bearing in mind the foregoing, legal interest, with the rate of 6% per annum, shall be imposed upon the outstanding principal loan obligation and the monetary interest imposed on the said amount upon the finality of this Decision until full satisfaction.

WHEREFORE, in view of the foregoing, the Petition in G.R. No. 228355 is PARTIALLY GRANTED, while the Petition in G.R. No. 228397 is DENIED. The Decision dated April 29, 2016 and Resolution dated November 8, 2016 of the Court of Appeals in CA-G.R. CV No. 102669 is REVERSED and SET ASIDE.

Petitioner Vasquez is ORDERED TO PAY respondent PNB the outstanding principal loan obligation of P1,375,733.32. Monetary or conventional interest on the aforesaid principal obligation shall be imposed at the rate of 12% per annum computed from the date of avilment of the subject loans as borne by the loan documents, i.e., November 8, 1996, up to June 30, 2013, and at the rate of 6% per annum from July 1, 2013 until full payment.

The foreclosure sale of the subject properties is hereby declared NULL AND VOID. Ownership and possession over the subject properties are REVERTED to petitioner Ricardo O. Vasquez. The certificates of title covering the subject properties issued and registered as a consequence of the foreclosure sale are hereby ordered CANCELLED. Transfer Certificates of Title Nos. 295114, 295115, 322380 and 322381 are hereby ordered RECONSTITUTED in the name of petitioner Ricardo O. Vasquez.

Let a copy of this Decision be furnished to the Register of Deeds of Trece Martirez, Province of Cavite.

SO ORDERED.

Carpio (Chairperson), J. Reyes, Jr., Lazaro-Javier, and Zalameda, JJ., concur.

[*] Spelled as "Judge" in some parts of the rollo (G.R. Nos. 228355 & 228397) and CA rollo.

[1] Rollo (G.R. No. 228355), pp. 9-23.

[2] Id. at 133-144. Penned by Associate Justice Carmelita Salandanan Manahan with Associate Justices Japar B. Dimaampao and Franchito N. Diamante, concurring.

[3] Id. at 149-151.

[4] Rollo (G.R. No. 228397), pp. 31-53.

[5] Rollo (G.R. No. 228355), pp. 197-198.

[6] Id. at 201-202.

[7] Id. at 205-208.

- [8] Id. at 209-212.
- [9] Id. at 213-216.
- [10] Id. at 217-220.
- [11] Id. at 203-204.
- [12] Rollo (G.R. No. 228397), pp. 83-92.
- [13] Records, pp. 2-6.
- [14] Rollo (G.R. No. 228355), pp. 106-107.
- [15] Id. at 30-34.
- [16] Records, p. 58. Penned by Executive Judge Lucenito N. Tagle.
- [17] Id. at 330-333. Penned by Presiding Judge Fernando Felicen.
- [18] Rollo (G.R. No. 228355), p. 113.
- [19] Id. at 114.
- [20] Records, pp. 334-335.
- [21] Rollo (G.R. No. 228355), pp. 134-138.
- [22] Id. at 139.
- [23] Id. at 143.
- [24] Id.
- [25] Rollo (G.R. No. 228397), pp. 71-80.
- [26] Rollo (G.R. No. 228355), pp. 145-146.
- [27] Id. at 147-148.
- [28] Id. at 13.
- [29] Rollo (G.R. No. 228397), p. 41.
- [30] Id. at 83.
- [31] Id.
- [32] Rollo (G.R. No. 228355), p. 197.
- [33] Id. at 201.
- [34] 738 Phil. 156 (2014).
- [35] Id. at 194; emphasis supplied.
- [36] Id. at 192; emphasis supplied.
- [37] G.R. Nos. 192934 & 197010, June 27, 2018, accessed at <<http://elibrary.judiciary.gov.ph/thebookshelf/showdocs/1/64177>>.

[38] Id.

[39] Id.

[40] Id.

[41] Rollo (G.R. No. 228397), p. 91; emphasis and underscoring supplied.

[42] Id.; emphasis supplied.

[43] Id.; emphasis supplied.

[44] Id. at 83.

[45] Rollo (G.R. No. 228355), pp. 81 and 93.

[46] Rollo (G.R. No. 228355), p. 204.

[47] Id. at 100.

[48] Id. at 101-102.

[49] Id. at 101.

[50] Id. at 102.

[51] TSN, September 18, 2012, p. 19.

[52] Rollo (G.R. No. 228397), p. 43.

[53] 273 Phil. 789 (1991).

[54] Id. at 792.

[55] 308 Phil. 18 (1994).

[56] Id. at 20.

[57] 326 Phil. 309 (1996).

[58] Id. at 317.

[59] 328 Phil. 54 (1996).

[60] Id. at 56.

[61] 479 Phil. 483 (2004).

[62] Id. at 496.

[63] 616 Phil. 369 (2009).

[64] Id. at 374.

[65] Supra note 37.

[66] Manual of Regulations for Banks, Vol. 1; emphasis and underscoring supplied.

[67] Security Bank Corp. v. Spouses Mercado, supra note 37; emphasis supplied.

[68] Id.

[69] Rollo (G.R. No. 228397), p. 43; underscoring supplied.

[70] Id. at 37-38.

[71] Supra note 57, at 322; emphasis supplied.

[72] Rollo (G.R. No. 228397), p. 43.

[73] Desiderio P. Jurado, COMMENTS AND JURISPRUDENCE ON OBLIGATIONS AND CONTRACTS, 9[th] ed., 1987, pp. 351-352.

[74] Sps. Limso v. Philippine National Bank, 779 Phil. 287, 370 (2016).

[75] Eduardo P. Caguioa, COMMENTS AND CASES ON CIVIL LAW, CIVIL CODE OF THE PHILIPPINES, 2[nd] ed., 1983, Vol. IV, p. 460.

[76] Sps. Limso v. Philippine National Bank, supra note 74, at 366-367.

[77] New Sampaguita Builders Construction, Inc. (NSBCI) v. PNB, supra note 61, at 486.

[78] Spouses Silos v. Philippine National Bank, supra note 34, at 193.

[79] Supra note 37.

[80] Supra note 74.

[81] Id. at 302-303.

[82] 549 Phil. 180 (2007).

[83] Id. at 193-195.

[84] 748 Phil. 907, 919 (2014).

[85] 620 Phil. 239 (2009).

[86] Id. at 253.

[87] 722 Phil. 273 (2013).

[88] Id. at 284.

[89] Sps. Limso v. Philippine National Bank, supra note 74, at 379; emphasis supplied.

[90] Id. at 380; emphasis supplied.

[91] 716 Phil. 267, 281 (2013).

[92] Id.

[93] Id. at 282.

[94] Hun Hyung Park v. Eung Won Choi, G.R. No. 220826, March 27, 2019, accessed at <<http://elibrary.judiciary.gov.ph/thebookshelf/showdocs/1/65094>>.

[95] Supra note 91, at 282-283.

[96] Referring to the date of the availment of the loan.

[97] Equitable PCI Bank v. Ng Sheung Ngor, 565 Phil. 520, 539 (2007).

[98] Supra note 87, at 284; emphasis supplied.

[99] Supra note 91, at 283.

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