

**INSULAR BANK OF ASIA AND AMERICA, PLAINTIFF-APPELLANT, VS.
SPOUSES EPIFANIA SALAZAR AND RICARDO SALAZAR,
DEFENDANTS-APPELLEES.**

G.R. No. 82082. March 25, 1988

Ponente: GUTIERREZ, JR., J.

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GUTIERREZ, JR., J.:

This is an appeal by the Insular Bank of Asia and America (IBAA) from the judgment of the Regional Trial Court of Leyte in Civil Case No. 6932 for collection of a sum of money with preliminary attachment. The appeal was originally brought to the Court of Appeals but was certified to us by that tribunal because it raises only a question of law.

The facts are not disputed.

On November 22, 1978, defendants-appellees, Epifania Salazar and Ricardo Salazar obtained a loan from the plaintiff-appellant in the amount of Forty Two Thousand and Fifty Pesos (P42,050.00) payable on or before December 12, 1980. This loan transaction was evidenced by a promissory note where the defendants-appellees bound themselves jointly and severally to pay the amount with interest at 19% per annum and with the express authority to increase without notice the rate of interest up to the maximum allowed by law and subject further to penalty charges or liquidated damages upon default equivalent to 2% per month on any amount due and unpaid. In the event the account was referred to an attorney for collection, the defendants-appellees were also bound to pay 25% of any amount due as attorney's fees plus expenses of litigation and costs.

In accordance with the agreement, the plaintiff-appellant increased the rate of interest to 21% pursuant to Central Bank Circular No. 705 dated December 1, 1979.

The promissory note matured but the defendants-appellees failed to pay their account. It was only after several demands that the defendants-appellees were able to make partial payment. As of November 25, 1983, they were able to pay a total of P68,676.75 which payments were applied to partially satisfy the penalty and interest charges.

On September 12, 1984, the plaintiff-appellant filed a complaint with the Regional Trial Court alleging that the defendants-appellees were indebted to IBAA in the amount of P87,647.19 as of September 15, 1984, including interest at 21% per annum, penalty charges, and attorney's fees.

At the pre-trial on October 31, 1984, the parties and their counsels appeared. The defendant-spouses admitted the execution of the promissory note in consideration of P48,050.00. The trial court then rendered a summary judgment the dispositive portion of which reads:

"WHEREFORE, judgment is hereby ordered in favor of the plaintiff ordering the defendant spouses Ricardo Salazar and Epifania Salazar to pay Insular Bank of Asia and America (IBAA) the sum of Eleven Thousand Two Hundred Fifty Three Pesos and Twenty Five Centavos (P11,253.25), with interest thereon at the rate of 19% per annum from the filing of the complaint on September 12, 1984 until fully paid. The defendants are

further ordered to pay the plaintiff attorney's fees in the amount of One Thousand Pesos (P1,000.00) and to pay the costs." (p. 4, Plaintiff-Appellant's Brief).

Plaintiff-appellant now raises the following assigned errors:

- THE LOWER COURT ERRED IN NOT AWARDING TO PLAINTIFF-APPELLANT PENALTY CHARGES OR LIQUIDATED DAMAGES IN THE AMOUNT OF 2% PER MONTH ON ALL AMOUNTS DUE AND UNPAID;
- THE LOWER COURT ERRED IN NOT AWARDING INTEREST ON THE LOAN AT 21% PER ANNUM;
- THE LOWER COURT ERRED IN THE COMPUTATION OF THE AMOUNT OF OBLIGATION DUE FROM DEFENDANTS-APPELLEES IN FAVOR OF PLAINTIFF-APPELLANT;
- THE LOWER COURT ERRED IN NOT AWARDING PLAINTIFF-APPELLANT ATTORNEY'S FEES EQUIVALENT TO 25% OF THE AMOUNT DUE AND EXPENSES OF LITIGATION; and
- THE LOWER COURT ERRED IN NOT ORDERING DEFENDANTS-APPELLEES TO JOINTLY AND SEVERALLY PAY THE OBLIGATION. (pp. 4-5, Plaintiff-Appellant's Brief)

The Escalation Clause provided in the promissory note reads:

"The interest herein charged shall be subject to increase, without notice, depending on whatever policy IBAA may in the future adopt conformable to law, especially to compensate for any increase in Central Bank interests or rediscounting rates."

Finding strength in the argument that the promissory note is the contract between the parties and, under the law, obligations arising from contracts have the force of law between the parties, the plaintiff-appellant increased the interest rate to 21% per annum effective December 1, 1979 pursuant to Central Bank Circular No. 705.

In line with the Court's ruling in the case of *Banco Filipino v. Navarro* (G.R. No. L-46591, July 28, 1987), the interest rate may not be increased by the plaintiff-appellant in the instant case.

It is the rule that escalation clauses are valid stipulations in commercial contracts to maintain fiscal stability and to retain the value of money in long term contracts. However, the enforceability of such stipulations are subject to certain conditions.

In the *Banco Filipino* case, the borrower questioned the additional interest charges on the loan of P41,300.00 she obtained when the interest rates were increased from 12% to 17% per Central Bank Circular No. 494, issued on January 2, 1976. In a letter written by the Central Bank to the borrower, some clarifications were made. Pertinent portions of the letter read:

"In this connection, please be advised that the Monetary Board, in its Resolution No. 1155 dated June 11, 1976 adopted the following guidelines to govern interest rate adjustments by banks and non-banks performing quasi-banking functions on loans already existing as of January 3, 1976, in the light of Central Bank Circulars Nos. 492-498:

"1. Only banks and non-bank financial intermediaries performing quasi-banking functions may increase interest rates on loans already existing as of January 2, 1976, provided that:

"a. The pertinent loan contracts/documents contain escalation clauses expressly authorizing lending bank or non-bank performing quasi-banking functions to increase the rate of interest stipulated in the contract, in the event that any law or Central Bank regulation is promulgated increasing the maximum interest rate for loans; and

"b. Said loans were directly granted by them and the remaining maturities thereof were more than 730 days as of January 2, 1976; and

"2. The increase in the rate of interest can be effective only as of January 2, 1976 or on a later date." (emphasis supplied)

Moreover, in its comment and supplemental comment submitted upon orders of this Court, the Central Bank took the position that the issuance of its circulars is a valid exercise of its authority to prescribe maximum rates of interest and based on the general principles of contract, the Escalation Clause is a valid provision in the loan agreement provided that -- (1) the increased rate imposed or charged by petitioner does not exceed the ceiling fixed by law or the Monetary Board; (2) the increase is made effective not earlier than the effectivity of the law or regulation authorizing such an increase and (3) the remaining maturities of the loans are more than 730 days as of the effectivity of the law or regulation authorizing such an increase. (Underlining supplied)

In the case at bar, the loan was obtained on November 21, 1978 and was payable on or before December 12, 1980. Central Bank Circular No. 705, authorizing the increase from 19% to 21% was issued on December 1, 1979. Obviously, as of this date, December 1, 1979, the remaining maturity of the loan was less than 730 days. Hence, the plaintiff-appellant's second assignment of error is without merit.

With respect to the penalty clause, we have upheld the validity of such agreements in several cases. As the Court stated in the case of *Government Service Insurance System v. Court of Appeals* (145 SCRA 311, 321):

"In the *Bachrach* case (*supra*) the Supreme Court ruled that the Civil Code permits the agreement upon a penalty apart from the interest. Should there be such an agreement, the penalty does not include the interest, and as such the two are different and distinct things which may be demanded separately. Reiterating the same principle in the later case of *Equitable Banking Corp. (supra)*, where this Court held that the stipulation about payment of such additional rate partakes of the nature of a penalty clause, which is sanctioned by law."

In the case of *Equitable Banking Corporation v. Liwanag* (32 SCRA 293, 297), the Court explained:

xxx xxx xxx

"x x x We have not overlooked the 14% interest that appellant has been sentenced to pay. This may appear to be usurious, but it is not so. The rate stipulated was 9%, subject, however, to an additional rate of 5%, in the event of default. The stipulation about payment of such additional rate partakes of the nature of a penalty clause, which is sanctioned by law, (Art. 1226, Civil Code of the Philippines), although 'the penalty may also be reduced by the courts if it is iniquitous or unconscionable.' (Art. 1229, Civil Code of the Philippines) x x x."

Admittedly, the defendants-appellees in the instant case failed to pay the loan on the due date. However, with earnest efforts, they tried to pay the loan little by little so that as of November 25, 1983, a total of P68,676.75 had been paid. The plaintiff-appellant, on the other hand, merely applied this amount to satisfy the penalty and interest charges which it additionally imposed. We do not find any evidence of bad faith on the part of the defendants-appellees in their failure to pay the loan on time. Efforts were indeed made to make good their promise. We note the trial court's observation that the plaintiff-appellant did not even state in the complaint that the defendants-appellees had made partial payments, making it appear that the spouses Salazars refuted to pay the loan. In their answer with counterclaim, the defendants-appellees alleged that the bank neglected to credit said payments in the defendants' account folio and subjected it as it did to the additional charges. Furthermore, we agree with the trial court that the bank has already profited considerably from the loan. In a span of about six (6) years, the bank was enriched by P26,626.75 (p. 17, Records). The penalty charges of 2% a month are, therefore, out of proportion to the damage incurred by the bank. In accordance with Article 1229 of the Civil Code, the

Court is constrained to reduce the penalty for being highly iniquitous.

With respect to the attorney's fees, the court is likewise empowered to reduce the same if they are unreasonable or unconscionable notwithstanding the express contract for attorney's fees. The award of one thousand (P1,000.00) pesos by the trial court appears to be enough.

The promissory note signed by the defendants-appellants states that the loan of P42,050.00 shall bear interest at the rate of 19% per annum. This would yield an interest of P7,989.50 per annum or a total of P46,339.10 from November 22, 1978 to September 12, 1984, the date of filing the complaint. Penalty interest of 1% a month or 12% per annum is reasonable so that from December 12, 1980 up to September 12, 1984, penalty charges should be P19,202.83. Considering that the defendants-appellees have paid the amount of P68,676.75, they, therefore, owed the bank the amount of P38,915.18 when the complaint was filed. There is no indication in the records as to the fluctuation of actual interest rates from 1984 and, therefore, we order interest at the legal rate of 12% per annum on the unpaid amount.

WHEREFORE, the decision of the lower court is MODIFIED. The defendants-appellants Ricardo Salazar and Epifania Salazar are ordered to pay Insular Bank of Asia and America (IBAA) the sum of THIRTY-EIGHT THOUSAND NINE HUNDRED FIFTEEN PESOS and EIGHTEEN CENTAVOS (P38,915.18) with interest thereon at the rate of Twelve Percent (12%) per annum from the filing of the complaint until fully paid.

SO ORDERED.

Fernan, (Chairman), Feliciano, and Cortes, JJ., concur.

Bidin, J., took no part,

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