

SECOND DIVISION

[G.R. No. 168940, November 24, 2009]

**SPS. ISAGANI CASTRO AND DIOSDADA CASTRO, PETITIONERS,
VS. ANGELINA DE LEON TAN, SPS. CONCEPCION T. CLEMENTE
AND ALEXANDER C. CLEMENTE, SPS. ELIZABETH T. CARPIO AND
ALVIN CARPIO, SPS. MARIE ROSE T. SOLIMAN AND ARVIN
SOLIMAN AND JULIUS AMIEL TAN, RESPONDENTS.**

D E C I S I O N

DEL CASTILLO, J.:

The imposition of an unconscionable rate of interest on a money debt, even if knowingly and voluntarily assumed, is immoral and unjust. It is tantamount to a repugnant spoliation and an iniquitous deprivation of property, repulsive to the common sense of man. It has no support in law, in principles of justice, or in the human conscience nor is there any reason whatsoever which may justify such imposition as righteous and as one that may be sustained within the sphere of public or private morals.^[1]

In this Petition for Review on *Certiorari*,^[2] petitioners assail the October 29, 2004 Decision^[3] and July 18, 2005 Resolution^[4] of the Court of Appeals (CA) in CA-G.R. CV No. 76842, affirming the June 11, 2002 Decision^[5] of the Regional Trial Court of Bulacan, Branch 79, which equitably reduced the stipulated interest rate in an agreement entered into by the parties from 60% per annum (or 5% per month) to 12% per annum, with the modification that herein respondents may redeem the mortgaged property notwithstanding the lapse of redemption period on grounds of equity and substantial justice.

Factual antecedents

Respondent Angelina de Leon Tan, and her husband Ruben Tan were the former registered owners of a 240-square meter residential lot, situated at *Barrio Canalate*, Malolos, Bulacan and covered by Transfer Certificate of Title No. T-8540. On February 17, 1994, they entered into an agreement with petitioners spouses Isagani and Diosdada Castro denominated as *Kasulatan ng Sanglaan ng Lupa at Bahay (Kasulatan)* to secure a loan of P30,000.00 they obtained from the latter. Under the *Kasulatan*, the spouses Tan undertook to pay the mortgage debt within six months or until August 17, 1994, with an interest rate of 5% per month, compounded monthly.

When her husband died on September 2, 1994, respondent Tan was left with the responsibility of paying the loan. However, she failed to pay the same upon maturity. Thereafter, she offered to pay petitioners the principal amount of P30,000.00 plus a portion of the interest but petitioners refused and instead demanded payment of the total accumulated sum of P359,000.00.

On February 5, 1999, petitioners caused the extrajudicial foreclosure of the real estate mortgage and emerged as the only bidder in the auction sale that ensued. The period of redemption expired without respondent Tan having redeemed the property; thus title over the same was consolidated in favor of petitioners. After a writ of possession was issued, the Sheriff ejected respondents from the property and delivered the possession thereof to petitioners.

Proceedings before the Regional Trial Court

On September 26, 2000, respondent Tan, joined by respondents Sps. Concepcion T. Clemente and Alexander C. Clemente, Sps. Elizabeth T. Carpio and Alvin Carpio, Sps. Marie Rose T. Soliman and Arvin Soliman and Julius Amiel Tan filed a Complaint for Nullification of Mortgage and Foreclosure and/or Partial Rescission of Documents and Damages^[6] before the Regional Trial Court of Malolos, Bulacan. They alleged, *inter alia*, that the interest rate imposed on the principal amount of P30,000.00 is unconscionable.^[7]

On June 11, 2002, the trial court rendered judgment in favor of respondents, viz:

PREMISES CONSIDERED, this Court cannot declare the mortgage and foreclosure null and void but the x x x *Kasulatan ng Sanglaan ng Lupa* x x x herebelow quoted:

2. Na ang nasabing pagkakautang ay aming babayaran sa loob ng anim (6) na buwan simula sa petsa ng kasulatang ito o dili kaya ay sa bago dumating ang Agosto 17, 1994 na may pakinabang na 5% bawat buwan. Na ang tubo ay aani pa rin ng tubong 5% bawat buwan.

Is partially rescinded to only 12% interest per annum and additional one percent a month penalty charges - as liquidated damages beginning February 17, 1994 up to June 21, 2000 per Delivery of Possession x x x and/or for the defendants to accept the offer of P200,000.00 by the plaintiffs to redeem or reacquire the property in *litis*.

The Court is not inclined to award moral damages since plaintiffs failed to buttress her claim of moral damages and/or proof of moral damages. x x x

No award of attorney's fees because the general rule is that no [premium] should be placed on the right to litigate. x x x

The counterclaim of the defendants is hereby DISMISSED for lack of merit.

Costs against the defendants.

SO ORDERED."^[8]

Proceedings before the Court of Appeals

Petitioners appealed to the Court of Appeals which affirmed the trial court's finding that the interest rate stipulated in the *Kasulatan* is iniquitous or unconscionable and, thus, its equitable reduction to the legal rate of 12% per annum is warranted.^[9] At the same time, the appellate court declared that respondents may redeem the mortgaged property notwithstanding the expiration of the period of redemption, in the interest of substantial justice and equity.^[10] The dispositive portion of said Decision reads:

WHEREFORE, the appealed judgment is hereby AFFIRMED with the MODIFICATION that plaintiffs-appellees may redeem the mortgaged property by paying the defendants-appellants spouses Isagani and Diosdada Castro the amount of P30,000.00, with interest thereon at 12% per annum from February 17, 1994 until fully paid plus penalty charges at the same rate from February 17, 1994 to June 21, 2000.

SO ORDERED.^[11]

Petitioners' Motion for Reconsideration was denied by the Court of Appeals in a Resolution dated July 18, 2005.

Issues

Hence, the present Petition for Review on *Certiorari* raising the following issues:

1. THE COURT OF APPEALS GROSSLY ERRED IN NULLIFYING THE INTEREST RATE VOLUNTARILY AGREED UPON BY THE PETITIONERS AND RESPONDENTS AND EXPRESSLY STIPULATED IN THE CONTRACT OF MORTGAGE ENTERED INTO BETWEEN THEM.
2. THE COURT OF APPEALS GROSSLY ERRED IN MAKING A CONTRACT BETWEEN THE PETITIONERS AND RESPONDENTS BY UNILATERALLY CHANGING THE TERMS AND CONDITIONS OF THE CONTRACT OF MORTGAGE ENTERED INTO BETWEEN THEM.
3. THE COURT OF APPEALS GROSSLY ERRED IN EXTENDING THE PERIOD OF REDEMPTION IN FAVOR OF THE RESPONDENTS IN VIOLATION OF THE CLEAR AND UNEQUIVOCAL PROVISIONS OF ACT NO. 3135 PROVIDING A PERIOD OF ONLY ONE YEAR FOR THE REDEMPTION OF A FORECLOSED REAL PROPERTY.^[12]

Petitioners' Arguments

Petitioners contend that with the removal by the *Bangko Sentral* of the ceiling on the rate of interest that may be stipulated in a contract of loan,^[13] the lender and the borrower could validly agree on any interest rate on loans. Thus, the Court of Appeals gravely erred when it declared the stipulated interest in the *Kasulatan* as

null as if there was no express stipulation on the compounded interest.^[14]

Respondents' Arguments

On the other hand, respondents assert that the appellate court correctly struck down the said stipulated interest for being excessive and contrary to morals, if not against the law.^[15] They also point out that a contract has the force of law between the parties, but only when the terms, clauses and conditions thereof are not contrary to law, morals, public order or public policy.^[16]

Our Ruling

The petition lacks merit.

The Court of Appeals correctly found that the 5% monthly interest, compounded monthly, is unconscionable and should be equitably reduced to the legal rate of 12% per annum.

While we agree with petitioners that parties to a loan agreement have wide latitude to stipulate on any interest rate in view of the Central Bank Circular No. 905 s. 1982 which suspended the Usury Law ceiling on interest effective January 1, 1983, it is also worth stressing that interest rates whenever unconscionable may still be declared illegal. There is certainly nothing in said circular which grants lenders *carte blanche* authority to raise interest rates to levels which will either enslave their borrowers or lead to a hemorrhaging of their assets.^[17]

In several cases, we have ruled that stipulations authorizing iniquitous or unconscionable interests are contrary to morals, if not against the law. In *Medel v. Court of Appeals*,^[18] we annulled a stipulated 5.5% per month or 66% per annum interest on a P500,000.00 loan and a 6% per month or 72% per annum interest on a P60,000.00 loan, respectively, for being excessive, iniquitous, unconscionable and exorbitant. In *Ruiz v. Court of Appeals*,^[19] we declared a 3% monthly interest imposed on four separate loans to be excessive. In both cases, the interest rates were reduced to 12% per annum.

In this case, the 5% monthly interest rate, or 60% per annum, compounded monthly, stipulated in the *Kasulatan* is even higher than the 3% monthly interest rate imposed in the *Ruiz* case. Thus, we similarly hold the 5% monthly interest to be excessive, iniquitous, unconscionable and exorbitant, contrary to morals, and the law. It is therefore void *ab initio* for being violative of Article 1306^[20] of the Civil Code. With this, and in accord with the *Medel* and *Ruiz* cases, we hold that the Court of Appeals correctly imposed the legal interest of 12% per annum in place of the excessive interest stipulated in the *Kasulatan*.

The Court of Appeals did not unilaterally change the terms and conditions of the Contract of Mortgage entered into between the petitioners and the respondents.

Petitioners allege that the *Kasulatan* was entered into by the parties freely and voluntarily.^[21] They maintain that there was already a meeting of the minds between the parties as regards the principal amount of the loan, the interest

thereon and the property given as security for the payment of the loan, which must be complied with in good faith.^[22] Hence, they assert that the Court of Appeals should have given due respect to the provisions of the *Kasulatan*.^[23] They also stress that it is a settled principle that the law will not relieve a party from the effects of an unwise, foolish or disastrous contract, entered into with all the required formalities and with full awareness of what he was doing.^[24]

Petitioners' contentions deserve scant consideration. In *Abe v. Foster Wheeler Corporation*,^[25] we held that the freedom of contract is not absolute. The same is understood to be subject to reasonable legislative regulation aimed at the promotion of public health, morals, safety and welfare. One such legislative regulation is found in Article 1306 of the Civil Code which allows the contracting parties to "establish such stipulations, clauses, terms and conditions as they may deem convenient, provided they are not contrary to law, morals, good customs, public order or public policy."

To reiterate, we fully agree with the Court of Appeals in holding that the compounded interest rate of 5% per month, is iniquitous and unconscionable. Being a void stipulation, it is deemed inexistent from the beginning. The debt is to be considered without the stipulation of the iniquitous and unconscionable interest rate. Accordingly, the legal interest of 12% per annum must be imposed in lieu of the excessive interest stipulated in the agreement, in line with our ruling in *Ruiz v. Court of Appeals*,^[26] thus:

The foregoing rates of interests and surcharges are in accord with *Medel vs. Court of Appeals*, *Garcia vs. Court of Appeals*, *Bautista vs. Pilar Development Corporation*, and the recent case of *Spouses Solangon vs. Salazar*. This Court invalidated a stipulated 5.5% per month or 66% per annum interest on a P500,000.00 loan in *Medel* and a 6% per month or 72% per annum interest on a P60,000.00 loan in *Solangon* for being excessive, iniquitous, unconscionable and exorbitant. In both cases, we reduced the interest rate to 12% per annum. We held that while the Usury Law has been suspended by Central Bank Circular No. 905, s. 1982, effective on January 1, 1983, and parties to a loan agreement have been given wide latitude to agree on any interest rate, still stipulated interest rates are illegal if they are unconscionable. Nothing in the said circular grants lenders *carte blanche* authority to raise interest rates to levels which will either enslave their borrowers or lead to a hemorrhaging of their assets. On the other hand, in *Bautista vs. Pilar Development Corp.*, this Court upheld the validity of a 21% per annum interest on a P142,326.43 loan, and in *Garcia vs. Court of Appeals*, sustained the agreement of the parties to a 24% per annum interest on an P8,649,250.00 loan. It is on the basis of these cases that we reduce the 36% per annum interest to 12%. An interest of 12% per annum is deemed fair and reasonable. While it is true that this Court invalidated a much higher interest rate of 66% per annum in *Medel* and 72% in *Solangon* it has sustained the validity of a much lower interest rate of 21% in *Bautista* and 24% in *Garcia*. We still find the 36% per annum interest rate in the case at bar to be substantially greater than those