

SECOND DIVISION

[G.R. No. 233974, July 02, 2018]

**CATALINA F. ISLA, ELIZABETH ISLA, AND GILBERT F. ISLA,
PETITIONERS, V. GENEVIRA[*] P. ESTORGA, RESPONDENT.**

DECISION

PERLAS-BERNABE, J.:

Before the Court is a petition for review on *certiorari*^[1] filed by petitioners Catalina F. Isla (Catalina), Elizabeth Isla, and Gilbert F. Isla (collectively, petitioners) assailing the Decision^[2] dated May 31, 2017 and the Resolution^[3] dated August 24, 2017 of the Court of Appeals (CA) in CA-G.R. CV No. 101743, which affirmed with modification the Decision^[4] dated December 10, 2012 of the Regional Trial Court of Pasay City, Branch 112 (RTC) in Civil Case No. 07-0014, directing petitioners to pay respondent Genevira P. Estorga (respondent) the following sums: (a) P100,000.00 representing the principal of the loan obligation; (b) an amount equivalent to twelve percent (12%) of P100,000.00 computed from November 16, 2006 until full payment, representing interest on the loan; (c) an amount equivalent to six percent (6%) of the sums due in (a) and (b) *per annum* computed from the finality of the CA Decision until full payment, representing legal interest; and (d) P20,000.00 as attorney's fees.

The Facts

On December 6, 2004, petitioners obtained a loan in the amount of P100,000.00 from respondent, payable anytime from six (6) months to one (1) year and subject to interest at the rate of ten percent (10%) per month, payable on or before the end of each month. As security, a real estate mortgage^[5] was constituted over a parcel of land located in Pasay City, covered by Transfer Certificate of Title (TCT) No. 132673^[6] and registered under the name of Edilberto Isla (Edilberto), who is married to Catalina (subject property). When petitioners failed to pay the said loan, respondent sought assistance from the barangay, and consequently, a *Kasulatan ng Pautang*^[7] dated December 8, 2005 was executed. Petitioners, however, failed to comply with its terms, prompting respondent to send a demand letter^[8] dated November 16, 2006. Once more, petitioners failed to comply with the demand, causing respondent to file a Petition for Judicial Foreclosure^[9] against them before the RTC.^[10]

For their part,^[11] petitioners maintained that the subject mortgage was not a real estate mortgage but a mere loan, and that the stipulated interest of ten percent (10%) per month was exorbitant and grossly unconscionable.^[12] They also insisted that since petitioners were not the absolute owners of the subject property - as the

same was allegedly owned by Edilberto – they could not have validly constituted the subject mortgage thereon.^[13]

The RTC Ruling

In a Decision^[14] dated December 10, 2012, the RTC granted the Petition for Judicial Foreclosure, finding that petitioners themselves admitted that: (a) they obtained a loan in the amount of P100,000.00 and that the said loan was secured by a real estate mortgage over the subject property; and (b) the subject mortgage was annotated on TCT No. 132673.^[15] Further, the RTC observed that while it is true that the present action pertains to a judicial foreclosure, the underlying principle is that a real estate mortgage is but a security and not a satisfaction of indebtedness. Thus, it is only proper to render petitioners solidarily liable to pay respondent and/or foreclose the subject mortgage should they fail to fulfill their obligation.^[16]

Consequently, the RTC directed petitioners to pay respondent the amounts of P100,000.00 with twelve percent (12%) interest per annum from December 2007 until fully paid and P20,000.00 as attorney's fees. Alternatively, in the event that petitioners fail to pay or deposit with the Clerk of Court the said amounts within a period of six (6) months from receipt of a copy of the RTC Decision, it held that the subject property will be foreclosed and sold at public auction to satisfy the mortgage debt, and the surplus, if any, will be delivered to petitioners with reasonable interest under the law.^[17]

Aggrieved, respondent appealed^[18] to the CA.

The CA Ruling

In a Decision^[19] dated May 31, 2017, the CA affirmed with modification the RTC Decision, and accordingly, ordered petitioners to pay respondent the following sums: (a) P100,000.00 representing the principal of the loan obligation; (b) an amount equivalent to twelve percent (12%) of P100,000.00 computed per year from November 16, 2006 until full payment, representing interest on the loan; (c) an amount equivalent to six percent (6%) of the sums due in (a) and (b) per annum computed from the finality of the CA Decision until full payment, representing legal interest; and (d) P20,000.00 as attorney's fees.^[20]

The CA held that in light of the registry return receipt bearing the signature of Catalina, it was established that petitioners indeed received the demand letter dated November 16, 2006.^[21] Meanwhile, it did not agree with the RTC's order providing petitioners alternative remedies, which remedies are, by law, mutually exclusive. Thus, since respondent's Petition for Judicial Foreclosure was essentially an action to collect a sum of money, she is then barred from causing the foreclosure of the subject mortgage.^[22]

Moreover, the CA ruled that the RTC erred in imposing the interest rate of twelve percent (12%) per annum from December 2007 until full payment. It likewise held that the stipulated interest of ten percent (10%) per month on the real estate mortgage is exorbitant. And finally, it declared that respondent is entitled to the award of attorney's fees based on equity and in the exercise of its discretion.^[23]

Undaunted, petitioners sought partial reconsideration,^[24] claiming that the award of attorney's fees was without factual, legal, and equitable justification and should therefore be deleted.^[25] The same, however, was denied in a Resolution^[26] dated August 24, 2017; hence, the instant petition, claiming that the CA gravely erred not only in awarding attorney's fees despite the absence of factual justification in the body of its Decision but also in imposing interest of twelve percent (12%) per annum interest until full payment.^[27]

In her Comment,^[28] respondent retorted that the CA's award of attorney's fees was proper and within the discretion of the court. Likewise, the CA correctly imposed interest at the rate of twelve percent (12%) per annum to the principal loan obligation of petitioners.^[29]

The Issues Before the Court

The issue for the Court's resolution is whether or not the CA erred in awarding: (a) twelve percent (12%) interest on the principal obligation until full payment; and (b) attorney's fees.

The Court's Ruling

The petition is partly meritorious.

I.

In their petition, petitioners contest the interest imposed on the principal amount of the loan at the rate of twelve percent (12%) per annum from the date of extrajudicial demand until full payment, as stated in paragraph 2 of the CA ruling. In this regard, they argue that pursuant to *ECE Realty and Development, Inc. v. Hernandez (ECE Realty)*,^[30] the applicable interest rate should only be six percent (6%).^[31]

The argument is untenable.

Case law states that there are two (2) types of interest, namely, monetary interest and compensatory interest. Monetary interest is the compensation fixed by the parties for the use or forbearance of money. On the other hand, compensatory interest is that imposed by law or by the courts as penalty or indemnity for damages. Accordingly, the right to recover interest arises only either by virtue of a contract (monetary interest) or as damages for delay or failure to pay the principal loan on which the interest is demanded (compensatory interest).^[32]

Anent monetary interest, the parties are free to stipulate their preferred rate. However, courts are allowed to equitably temper interest rates that are found to be excessive, iniquitous, unconscionable, and/or exorbitant,^[33] such as stipulated interest rates of three percent (3%) per month or higher.^[34] In such instances, it is well to clarify that only the unconscionable interest rate is nullified and deemed not written in the contract; whereas the parties' agreement on the payment of interest on the principal loan obligation subsists.^[35] It is as if the parties failed to specify the interest rate to be imposed on the principal amount, in which case **the legal rate of interest prevailing at the time the agreement was entered into** is applied by

the Court.^[36] This is because, according to jurisprudence, the legal rate of interest is the presumptive reasonable compensation for borrowed money.^[37]

In this case, petitioners and respondent entered into a loan obligation and clearly stipulated for the payment of monetary interest. However, the stipulated interest of ten percent (10%) per month was found to be unconscionable, and thus, the courts *a quo* struck down the same and pegged a new monetary interest of twelve percent (12%) per annum, which was the prevailing legal rate of interest for loans and forbearances of money at the time the loan was contracted on December 6, 2004.

In *Spouses Abella v. Spouses Abella*,^[38] the Court was also faced with a situation where the parties entered into a loan with an agreement to pay monetary interest. Since the stipulated rate of interest by the parties was found to be unconscionable, the Court struck down the same and substituted it with the prevailing legal interest rate at the time the loan was perfected, *i.e.*, twelve percent (12%) per annum. In holding that such rate shall persist in spite of supervening events, the Court held:

Jurisprudence is clear about the applicable interest rate if a written instrument fails to specify a rate. In *Spouses Toring v. Spouses Olan* [(589 Phil. 362 [2008])], this court clarified the effect of Article 1956 of the Civil Code and noted that the legal rate of interest (then at 12%) is to apply: "In a loan or forbearance of money, according to the Civil Code, the interest due should be that stipulated in writing, and *in the absence thereof*, the rate **shall** be 12% per annum."

Spouses Toring cites and restates (practically verbatim) what this court settled in *Security Bank and Trust Company v. Regional Trial Court of Makati, Branch 61* [(331 Phil. 787 [1996])]: "In a loan or forbearance of money, the interest due should be that stipulated in writing, and *in the absence thereof*, the rate **shall** be 12% per annum."

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The rule is not only definite; it is cast in mandatory language. From *Eastern Shipping [Lines, Inc. v. CA]* [(G.R. No. 97412, July 12, 1994, 234 SCRA 78)] to *Security Bank* to *Spouses Toring*, jurisprudence has repeatedly used the word "shall," a term that has long been settled to denote something imperative or operating to impose a duty. Thus, the rule leaves no room for alternatives or otherwise does not allow for discretion. It *requires* the application of the legal rate of interest.

Our intervening Decision in *Nacar v. Gallery Frames* [(716 Phil. 267 [2013])] recognized that the legal rate of interest has been reduced to 6% per annum[.]

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Nevertheless, both Bangko Sentral ng Pilipinas Circular No. 799, Series of 2013 and *Nacar* retain the definite and mandatory framing of the rule articulated in *Eastern Shipping*, *Security Bank*, and *Spouses Toring*. *Nacar* even restates *Eastern Shipping*:

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