

SECOND DIVISION

[G.R. No. 181045, July 02, 2014]

**SPOUSES EDUARDO AND LYDIA SILOS, PETITIONERS, VS.
PHILIPPINE NATIONAL BANK, RESPONDENT.**

D E C I S I O N

DEL CASTILLO, J.:

In loan agreements, it cannot be denied that the rate of interest is a principal condition, if not the most important component. Thus, any modification thereof must be mutually agreed upon; otherwise, it has no binding effect. Moreover, the Court cannot consider a stipulation granting a party the option to prepay the loan if said party is not agreeable to the arbitrary interest rates imposed. Premium may not be placed upon a stipulation in a contract which grants one party the right to choose whether to continue with or withdraw from the agreement if it discovers that what the other party has been doing all along is improper or illegal.

This Petition for Review on *Certiorari*^[1] questions the May 8, 2007 Decision^[2] of the Court of Appeals (CA) in CA-G.R. CV No. 79650, which affirmed with modifications the February 28, 2003 Decision^[3] and the June 4, 2003 Order^[4] of the Regional Trial Court (RTC), Branch 6 of Kalibo, Aklan in Civil Case No. 5975.

Factual Antecedents

Spouses Eduardo and Lydia Silos (petitioners) have been in business for about two decades of operating a department store and buying and selling of ready-to-wear apparel. Respondent Philippine National Bank (PNB) is a banking corporation organized and existing under Philippine laws.

To secure a one-year revolving credit line of P150,000.00 obtained from PNB, petitioners constituted in August 1987 a **Real Estate Mortgage**^[5] over a 370-square meter lot in Kalibo, Aklan covered by Transfer Certificate of Title No. (TCT) T-14250. In July 1988, the credit line was increased to P1.8 million and the mortgage was correspondingly increased to P1.8 million.^[6] And in July 1989, a **Supplement** to the Existing Real Estate Mortgage^[7] was executed to cover the same credit line, which was increased to P2.5 million, and additional security was given in the form of a 134-square meter lot covered by TCT T-16208. In addition, petitioners issued **eight Promissory Notes**^[8] and signed a **Credit Agreement**.^[9] This July 1989 Credit Agreement contained a stipulation on interest which provides as follows:

1.03. Interest. (a) **The Loan shall be subject to interest at the rate of 19.5% per annum.** Interest shall be payable in advance every one hundred twenty days at the rate prevailing at the time of the renewal.

(b) **The Borrower agrees that the Bank may modify the interest rate in the Loan depending on whatever policy the Bank may adopt in the future**, including without limitation, the shifting from the floating interest rate system to the fixed interest rate system, or vice versa. Where the Bank has imposed on the Loan interest at a rate *per annum*, which is equal to the Bank's spread over the current floating interest rate, **the Borrower hereby agrees that the Bank may, without need of notice to the Borrower, increase or decrease its spread over the floating interest rate at any time depending on whatever policy it may adopt in the future.**^[10] (Emphases supplied)

The eight Promissory Notes, on the other hand, contained a stipulation granting PNB the right to increase or reduce interest rates "*within the limits allowed by law or by the Monetary Board.*"^[11] The Real Estate Mortgage agreement provided the same right to increase or reduce interest rates "*at any time depending on whatever policy PNB may adopt in the future.*"^[12]

Petitioners religiously paid interest on the notes at the following rates:

1. 1st Promissory Note dated July 24, 1989 – 19.5%;
2. 2nd Promissory Note dated November 22, 1989 – 23%;
3. 3rd Promissory Note dated March 21, 1990 – 22%;
4. 4th Promissory Note dated July 19, 1990 – 24%;
5. 5th Promissory Note dated December 17, 1990 – 28%;
6. 6th Promissory Note dated February 14, 1991 – 32%;
7. 7th Promissory Note dated March 1, 1991 – 30%; and
8. 8th Promissory Note dated July 11, 1991 – 24%.^[13]

In August 1991, an **Amendment to Credit Agreement**^[14] was executed by the parties, with the following stipulation regarding interest:

1.03. Interest on Line Availments. (a) **The Borrowers agree to pay interest on each Availment** from date of each Availment up to but not including the date of full payment thereof **at the rate *per annum* which is determined by the Bank to be prime rate plus applicable spread in effect as of the date of each Availment.**^[15] (Emphases supplied)

Under this Amendment to Credit Agreement, petitioners issued in favor of

PNB the following **18 Promissory Notes**, which petitioners settled – except the last (the note covering the principal) – at the following interest rates:

1. 9th Promissory Note dated November 8, 1991 – 26%;

2. 10th Promissory Note dated March 19, 1992 – 25%;
3. 11th Promissory Note dated July 11, 1992 – 23%;
4. 12th Promissory Note dated November 10, 1992 – 21%;
5. 13th Promissory Note dated March 15, 1993 – 21%;
6. 14th Promissory Note dated July 12, 1993 – 17.5%;
7. 15th Promissory Note dated November 17, 1993 – 21%;
8. 16th Promissory Note dated March 28, 1994 – 21%;
9. 17th Promissory Note dated July 13, 1994 – 21%;
10. 18th Promissory Note dated November 16, 1994 – 16%;
11. 19th Promissory Note dated April 10, 1995 – 21%;
12. 20th Promissory Note dated July 19, 1995 – 18.5%;
13. 21st Promissory Note dated December 18, 1995 – 18.75%;
14. 22nd Promissory Note dated April 22, 1996 – 18.5%;
15. 23rd Promissory Note dated July 22, 1996 – 18.5%;
16. 24th Promissory Note dated November 25, 1996 – 18%;
17. 25th Promissory Note dated May 30, 1997 – 17.5%; and
18. 26th Promissory Note **(PN 9707237)** dated July 30, 1997 – 25%.^[16]

The 9th up to the 17th promissory notes provide for the payment of interest at the “*rate the Bank may at any time without notice, raise within the limits allowed by law* x x x.”^[17] On the other hand, the 18th up to the 26th promissory notes – including PN 9707237, which is the 26th promissory note – carried the following provision:

x x x For this purpose, I/We agree that **the rate of interest herein stipulated may be increased or decreased for the subsequent Interest Periods, with prior notice to the Borrower in the event of changes in interest rate prescribed by law or the Monetary Board of the Central Bank of the Philippines, or in the Bank’s overall cost of funds. I/We hereby agree that in the event I/we are not agreeable to the interest rate fixed for any Interest Period, I/we shall have the option to prepay the loan or credit facility without penalty within ten (10) calendar days from the Interest Setting Date.**^[18] (Emphasis supplied)

Respondent regularly renewed the line from 1990 up to 1997, and petitioners made good on the promissory notes, religiously paying the interests without objection or

fail. But in 1997, petitioners faltered when the interest rates soared due to the Asian financial crisis. Petitioners' sole outstanding promissory note for P2.5 million – PN 9707237 executed in July 1997 and due 120 days later or on October 28, 1997 – became past due, and despite repeated demands, petitioners failed to make good on the note.

Incidentally, PN 9707237 provided for the penalty equivalent to 24% *per annum* in case of default, as follows:

Without need for notice or demand, failure to pay this note or any installment thereon, when due, shall constitute default and in such cases or in case of garnishment, receivership or bankruptcy or suit of any kind filed against me/us by the Bank, the outstanding principal of this note, at the option of the Bank and without prior notice of demand, shall immediately become due and payable and shall be **subject to a penalty charge of twenty four percent (24%) per annum based on the defaulted principal amount.** x x x^[19] (Emphasis supplied)

PNB prepared a Statement of Account^[20] as of October 12, 1998, detailing the amount due and demandable from petitioners in the total amount of P3,620,541.60, broken down as follows:

Principal	P 2,500,000.00
Interest	538,874.94
Penalties	<u>581,666.66</u>
Total	P 3,620,541.60

Despite demand, petitioners failed to pay the foregoing amount. Thus, PNB foreclosed on the mortgage, and on January 14, 1999, TCTs T-14250 and T-16208 were sold to it at auction for the amount of P4,324,172.96.^[21] The sheriff's certificate of sale was registered on March 11, 1999.

More than a year later, or on March 24, 2000, petitioners filed Civil Case No. 5975, seeking annulment of the foreclosure sale and an accounting of the PNB credit. Petitioners theorized that after the first promissory note where they agreed to pay 19.5% interest, the succeeding stipulations for the payment of interest in their loan agreements with PNB – which allegedly left to the latter the sole will to determine the interest rate – became null and void. Petitioners added that because the interest rates were fixed by respondent without their prior consent or agreement, these rates are void, and as a result, petitioners should only be made liable for interest at the legal rate of 12%. They claimed further that they overpaid interests on the credit, and concluded that due to this overpayment of steep interest charges, their debt should now be deemed paid, and the foreclosure and sale of TCTs T-14250 and T-16208 became unnecessary and wrongful. As for the imposed penalty of P581,666.66, petitioners alleged that since the Real Estate Mortgage and the Supplement thereto did not include penalties as part of the secured amount, the same should be excluded from the foreclosure amount or bid price, even if such penalties are provided for in the final Promissory Note, or PN 9707237.^[22]

In addition, petitioners sought to be reimbursed an alleged overpayment of

P848,285.00 made during the period August 21, 1991 to March 5, 1998, resulting from respondent's imposition of the alleged illegal and steep interest rates. They also prayed to be awarded P200,000.00 by way of attorney's fees.^[23]

In its Answer,^[24] PNB denied that it unilaterally imposed or fixed interest rates; that petitioners agreed that without prior notice, PNB may modify interest rates depending on future policy adopted by it; and that the imposition of penalties was agreed upon in the Credit Agreement. It added that the imposition of penalties is supported by the all-inclusive clause in the Real Estate Mortgage agreement which provides that the mortgage shall stand as security for any and all other obligations of whatever kind and nature owing to respondent, which thus includes penalties imposed upon default or non-payment of the principal and interest on due date.

On pre-trial, the parties mutually agreed to the following material facts, among others:

- a) That since 1991 up to 1998, petitioners had paid PNB the total amount of P3,484,287.00;^[25] and
- b) That PNB sent, and petitioners received, a March 10, 2000 demand letter.^[26]

During trial, petitioner Lydia Silos (Lydia) testified that the Credit Agreement, the Amendment to Credit Agreement, Real Estate Mortgage and the Supplement thereto were all prepared by respondent PNB and were presented to her and her husband Eduardo only for signature; that she was told by PNB that the latter alone would determine the interest rate; that as to the Amendment to Credit Agreement, she was told that PNB would fill up the interest rate portion thereof; that at the time the parties executed the said Credit Agreement, she was not informed about the applicable spread that PNB would impose on her account; that the interest rate portion of all Promissory Notes she and Eduardo issued were always left in blank when they executed them, with respondent's mere assurance that it would be the one to enter or indicate thereon the prevailing interest rate at the time of availment; and that they agreed to such arrangement. She further testified that the two Real Estate Mortgage agreements she signed did not stipulate the payment of penalties; that she and Eduardo consulted with a lawyer, and were told that PNB's actions were improper, and so on March 20, 2000, they wrote to the latter seeking a recomputation of their outstanding obligation; and when PNB did not oblige, they instituted Civil Case No. 5975.^[27]

On cross-examination, Lydia testified that she has been in business for 20 years; that she also borrowed from other individuals and another bank; that it was only with banks that she was asked to sign loan documents with no indicated interest rate; that she did not bother to read the terms of the loan documents which she signed; and that she received several PNB statements of account detailing their outstanding obligations, but she did not complain; that she assumed instead that what was written therein is correct.^[28]

For his part, PNB Kalibo Branch Manager Diosdado Aspa, Jr. (Aspa), the sole witness for respondent, stated on cross-examination that as a practice, the determination of the prime rates of interest was the responsibility solely of PNB's Treasury Department which is based in Manila; that these prime rates were simply