

SECOND DIVISION

[G.R. No. 164549, September 18, 2009]

**PHILIPPINE NATIONAL BANK, PETITIONER, VS. SPOUSES
AGUSTIN AND PILAR ROCAMORA, RESPONDENTS.**

D E C I S I O N

BRION, J.:

We resolve in this petition for review on *certiorari*^[1] the legal propriety of the deficiency judgment that the petitioner Philippine National Bank (*PNB*) seeks against the respondents - the spouses Agustin and Pilar Rocamora (*spouses Rocamora*).

THE FACTUAL ANTECEDENTS

On September 25, 1981, the **spouses Rocamora obtained a loan from PNB in the aggregate amount of P100,000.00** under the Cottage Industry Guarantee and Loan Fund (*CIGLF*). The loan was payable in five years, under the following terms: P35,000 payable semi-annually and P65,000 payable annually. In addition to the principal amount, the spouses Rocamora agreed to pay interest at the rate of 12% per annum, plus a penalty fee of 5% per annum in case of delayed payments. The spouses Rocamora signed two promissory notes^[2] evidencing the loan.

To secure their loan obligations, the spouses Rocamora executed two mortgages: a real estate mortgage^[3] over a property covered by Transfer Certificate of Title No. 7160 in the amount of P10,000, and a chattel mortgage^[4] over various machineries in the amount of P25,000. Payment of the remaining P65,000 was under the *CIGLF* guarantee, with the spouses Rocamora paying the required guarantee fee.

Both the promissory note and the real estate mortgage deed contained an **escalation clause** that allowed PNB to increase the 12% interest rate at anytime without notice, within the limits allowed by law. The pertinent portion of the promissory note stated:

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. [Emphasis supplied.]

While paragraph (k) of the real estate mortgage deed provided:

(k) INCREASE OF INTEREST RATE

The MORTGAGEE reserves the right to increase the interest rate charged on the obligation secured by this mortgage including any amount which it may have advanced 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 the accommodation/s secured by the mortgage 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 in that maximum interest rate. [Emphasis supplied.]

The spouses Rocamora only paid a total of P32,383.65^[5] on the loan. Hence, the PNB commenced foreclosure proceedings in August and October 1990. The foreclosure of the mortgaged properties yielded P75,500.00 as total proceeds.

After the foreclosure, PNB found that the recovered proceeds and the amounts the spouses Rocamora previously paid were not sufficient to satisfy the loan obligations. PNB thus filed, on January 18, 1994, a **complaint for deficiency judgment**^[6] before the Regional Trial Court (RTC) of Puerto Princesa City, Branch 48. The PNB alleged that **as of January 7, 1994, the outstanding balance of the spouses Rocamora's loan (including interests and penalties) was P206,297.47**, broken down as follows:

Principal.....	P 79,484.65
Total interest due up to 01-07-94.....	51,229.35
Total penalty due up to 01-07-94.....	75,583.47
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TOTAL AMOUNT DUE AND PAYABLE.....	206,297.47 ^[7]

The PNB claimed that the outstanding *principal* balance as of foreclosure date (September 19, 1990) was P79,484.65, plus interest and penalties, for a total due and demandable obligation of P250,812.10. Allegedly, after deducting the P75,500 proceeds of the foreclosure sale, the spouses Rocamora still owed the bank P206,297.47.

The spouses Rocamora refused to pay the amount claimed as deficiency. They alleged that the PNB "practically created" the deficiency by (a) increasing the interest rates from 12% to 42% per annum, and (b) failing to immediately foreclose the mortgage pursuant to Presidential Decree No. 385 (PD 385 or the Mandatory Foreclosure Law) to prevent the interest and penalty charges from accruing.

The RTC dismissed PNB's complaint in its decision dated November 10, 1999.^[8] The trial court invalidated the escalation clause in the promissory note and the resulting increased interest rates. The court also rejected PNB's reason for the delay in commencing foreclosure proceedings, ruling that the delay was contrary to the immediate and mandatory foreclosure that PD 385 required. The finding that the bank's actions were contrary to law, justice, and morals justified the award of actual, moral, and exemplary damages to the spouses Rocamora. Attorney's fees and costs of

suit were also ordered paid.^[9]

Except for modifications in the awarded damages, the Court of Appeals (CA) decision of March 23, 2004 affirmed the RTC ruling.^[10] The CA held that the PNB effectively negated the principle of mutuality of contracts when it increased the interest rates without the spouses Rocamora's conformity. The CA also found the long delay in the foreclosure of the mortgage, apparently a management lapse, prejudicial to the spouses Rocamora's interests and contrary as well to law and justice. More importantly, the CA found insufficient evidence to support the P206,297.47 deficiency claim; the bank's testimonial and documentary evidence did not support the deficiency claim that, moreover, was computed based on bloated interest rates. The CA maintained these rulings despite the motion for reconsideration PNB filed;^[11] hence, PNB's present recourse to this Court.

THE PETITION

In insisting that it is entitled to a deficiency judgment of P206,297.47, PNB argues that the RTC and the CA erred in invalidating the escalation clause in the parties' agreement because it fully complied with the requirements for a valid escalation clause under this Court's following pronouncement in *Banco Filipino Savings and Mortgage Bank v. Navarro*:^[12]

It is now clear that from March 17, 1980 [the effectivity date of Presidential Decree No. 1684 allowing the increase in the stipulated rate of interest], **escalation clauses, to be valid, should specifically provide: (1) that there can be an increase in interest if increased by law or by the Monetary Board; and (2) in order for such stipulation to be valid, it must include a provision for reduction of the stipulated interest "in the event that the applicable maximum rate of interest is reduced by law or by the Monetary Board."** [Emphasis supplied.]

The PNB posits that the presence of a "de-escalation clause" (referring to the second of the above requirements, which was designed to prevent a resulting one-sided situation on the part of the lender-bank) in the real estate mortgage deed rules out any violation of the principle of mutuality of contracts.

The PNB also contends that it did not unreasonably delay the institution of foreclosure proceedings by acting three years after the spouses Rocamora defaulted on their obligation. Under Article 1142 of the Civil Code, a mortgage action prescribes in 10 years; the same 10-year period is provided in Article 1144 (1) for actions based on written contracts. Thus, the PNB alleges that it had 10 years from 1987 (the time when the spouses Rocamora allegedly defaulted from paying their loan obligation) to institute the foreclosure proceedings. Its decision to foreclose in 1990 - three years after the default - should not be taken against it, especially since the delay was prompted by the bank's sincere desire to assist the spouses Rocamora.

Additionally, the PNB claims that the decision to foreclose is entirely the bank's prerogative. The provisions of PD 385 should not be read as a limitation affecting the right of banks to foreclose within the 10-year period granted under the Civil Code.

While PD 385 requires government banks to immediately foreclose mortgages under specified conditions, the provision does not limit the period within which the bank can foreclose; to hold otherwise would be contrary to the stated objectives of PD 385 to enhance the resources of government financial institutions and to facilitate the financing of essential development programs and projects.

On the basis of these arguments, the PNB contests the damages awarded to the spouses Rocamora, as the PNB had no malice, nor any furtive design: when it increased the interest rates pursuant to the escalation clause; when it decided to foreclose the mortgages only in 1990; and when it sought to claim the deficiency. PNB claimed all these to be proper acts made in the exercise of its rights.

Opposing the PNB's arguments, the spouses Rocamora allege the following:

- a. The PNB failed to sufficiently and satisfactorily prove the amount of P250,812.10, claimed to be the total obligation due at the time of foreclosure, against which the proceeds of the foreclosure sale (P75,500.00) were deducted and which became the basis of the bank's deficiency claim (P206,297.47);
- b. The "ballooning" of the spouses Rocamora's loan obligation was the PNB's own doing when it increased the interest rates and failed to immediately foreclose the mortgages;
- c. The PNB's unilateral increase of interest rates violated the principle of mutuality of contracts;
- d. The PNB failed to comply with the immediate and mandatory foreclosure required under PD 385; and
- e. The PNB failed to call on the CIGLF which secured the payment of P65,000.00 of the loan.

THE COURT'S RULING

We find no basis to reverse the CA's decision and, consequently, deny the petition.

Proof of Deficiency Claim Necessary

The foreclosure of chattel and real estate mortgages is governed by Act Nos. 1508 and 3135, respectively. Although both laws do not contain a provision expressly or impliedly authorizing the mortgagee to recover the deficiency resulting after the foreclosure proceeds are deducted from the principal obligation, the Court has construed the laws' silence as a grant to the mortgagee of the right to maintain an action for the deficiency; the mortgages are given merely as security, not as settlement or satisfaction of the indebtedness.^[13]

As in any claim for payment of money, a mortgagee must be able to prove the basis for the deficiency judgment it seeks. The right of the mortgagee to pursue the debtor arises only when the proceeds of the foreclosure sale are ascertained to be insufficient to cover the obligation and the other costs at the time of the sale.^[14] Thus, the amount of the obligation prior to foreclosure and the proceeds of the foreclosure are material in a claim for deficiency.

In this case, both the RTC and the CA found that PNB failed to prove the claimed deficiency; its own testimonial and documentary evidence in fact contradicted one another. The PNB alleged that the spouses Rocamora's obligation at the time of foreclosure (September 19, 1990) amounted to P250,812.10, yet its own documentary evidence^[15] showed that, as of that date, the total obligation was only P206,664.34; the PNB's own witness, Mr. Reynaldo Caso, testified that the amount due from the spouses Rocamora was only P206,664.34.

At any rate, whether the total obligation due at the time of foreclosure was P250,812.10 as PNB insisted or P206,664.34 as its own record disclosed, our own computation of the amounts involved does not add up to the P206,297.47 PNB claimed as deficiency.^[16] We find it significant that PNB has been consistently unable to provide a detailed and credible accounting of the claimed deficiency. What appears clear is that after adding up the spouses Rocamora's partial payments and the proceeds of the foreclosure, the PNB has already received a total of P107,883.68 as payment for the spouses Rocamora's P100,000.00 loan; the claimed P206,297.47 deficiency consisted mainly of interests and penalty charges (or about 61.5% of the amount claimed). The spouses Rocamora posit that their loan would not have bloated to more than double the original amount if PNB had not increased the interest rates and had it immediately foreclosed the mortgages.

Escalation clauses do not authorize the unilateral increase of interest rates

Escalation clauses are valid and do not contravene public policy.^[17] These clauses are common in credit agreements as means of maintaining fiscal stability and retaining the value of money on long-term contracts. To avoid any resulting one-sided situation that escalation clauses may bring, we required in *Banco Filipino*^[18] the inclusion in the parties' agreement of a de-escalation clause that would authorize a reduction in the interest rates corresponding to downward changes made by law or by the Monetary Board.

The validity of escalation clauses notwithstanding, we cautioned that these clauses do not give creditors the unbridled right to adjust interest rates *unilaterally*.^[19] As we said in the same *Banco Filipino* case, **any increase in the rate of interest made pursuant to an escalation clause must be the result of an agreement between the parties.**^[20] The minds of all the parties must meet on the proposed modification as this modification affects an important aspect of the agreement. There can be no contract in the true sense in the absence of the element of an agreement, *i.e.*, the parties' mutual consent. Thus, **any change must be mutually agreed upon, otherwise, the change carries no binding effect.**^[21] A stipulation on the validity or compliance with the contract that is left solely to the will of one of the parties is void; the stipulation goes against the principle of mutuality of contract under Article 1308 of the Civil Code.^[22] As correctly found by the appellate court, even with a de-escalation clause, no matter how elaborately worded, an unconsented increase in interest rates is ineffective if it transgresses the principle of mutuality of contracts.

Precisely for this reason, we struck down in several cases - many of them involving PNB - the increase of interest rates unilaterally imposed by creditors. In the 1991 case of *PNB v. CA and Ambrosio Padilla*,^[23] we declared: