

## SECOND DIVISION

**[ G.R. No. 174055, February 12, 2008 ]**

**PHILIPPINE NATIONAL BANK, Petitioner, vs. SPOUSES  
WILFREDO and ESTELA ENCINA, Respondents.**

### **D E C I S I O N**

**TINGA, J.:**

The Philippine National Bank (PNB) assails the Decision<sup>[1]</sup> of the Court of Appeals dated 15 May 2005, rendered in CA-G.R. CV No. 79094 which, among others, declared null and void the interest rate imposed by PNB on the loan obtained from it by respondents and the consequent extrajudicial foreclosure of the properties offered as security for the loan.

The facts are summarized by the appellate court, thus:

On September 13, 1995, as additional capital for their metal craft business, plaintiffs-appellants ENCINA obtained a P500,000.00 loan with defendant-appellee PNB, secured by a promissory note, a real estate mortgage, and a credit agreement, on parcels of land covered by Transfer Certificate of Title (TCT) Nos. T-6788 and T-6789 located at Occidental Mindoro.

Thereafter, or on September 6, 1996, plaintiffs-appellants obtained an additional P200,000.00 loan with defendant-appellee PNB as additional capital for palay production, embodied in a credit agreement and a promissory note, secured by the same parcels of land. The loan obligations of plaintiffs-appellants ENCINA were fully paid on February 4, 1997.

Another loan in the amount of P400,000.00 as capital for a common carrier business was obtained by plaintiffs-appellants ENCINA with defendant-appellee PNB, secured by a promissory note and a time loan commercial credit agreement, likewise secured by the parcels of land covered by TCT Nos. T-6788 and T-6789.

Defendant-appellee PNB subsequently granted a P1,250,000.00 all purpose credit facility to plaintiffs-appellants ENCINA to be used by plaintiffs-appellants ENCINA exclusively for their metal craft business. Plaintiffs-appellants ENCINA availed of the amount of P1,050,000.00 of the credit facility, evidenced by a promissory note dated February 13, 1998 secured by the same parcels of land as well. Plaintiffs-appellants ENCINA later on availed of the remaining P200,000.00 credit facility, secured by a promissory note dated May 22, 1998.

On the maturity date of the P1,250,000.00 loan obligation, plaintiffs-appellants ENCINA failed to pay, prompting defendant-appellee PNB to demand the same from plaintiffs-appellants ENCINA, in letters dated January 5, 1999, January 21, 1999, March 5, 1999, April 16, 1999, and May 27, 1999. Demands from defendant-appellee PNB were left unheeded, prompting defendant appellee PNB to file a petition for sale of the mortgaged properties with defendant-appellee Ex-Officio Sheriff of the Regional Trial Court of San Jose, Occidental Mindoro on September 20, 1999.

The extra-judicial sale of the mortgaged properties of plaintiff-appellant ENCINA was published in "The Island Observer," a newspaper of general circulation in the province of Occidental Mindoro, on October 4, 11, and 18, 1999. A notice of extra-judicial sale was issued on October 4, 1999. The foreclosure sale was thereafter conducted on November 15, 1999 with defendant-appellee PNB as the highest bidder. A certificate of sale dated November 16, 1999 was then issued in favor of defendant-appellee PNB.

Thereafter, or on January 22, 2001, titles to the subject properties were consolidated in defendant-appellee PNB's name, to which TCT Nos. 16919 and 16920 were issued.

On November 15, 2001, a contract of lease was executed between defendant-appellee PNB and plaintiffs-appellants ENCINA over the subject properties, pursuant to a request made by plaintiffs-appellants ENCINA that they be allowed by defendant-appellee PNB to lease the subject premises for a monthly rental of P7,500.00.

Finally, on July 18, 2002, plaintiffs-appellants ENCINA sued defendants-appellees in an action for the nullification of foreclosure sale and damages, with prayer for extension and/or grace period, with the RTC of San Jose, Occidental [Mindoro], Branch 46, docketed as Civil Case No. R-1304, alleging that their loan obligations, being agricultural, hence, with longer gestation periods, should have been restructured by defendant-appellee PNB for a longer period of at least seven years; that no penalties should have been imposed by defendant-appellee PNB; that the extra-judicial foreclosure sale of their properties was null and void; that for being in violation of the Usury Law, the loan contracts and all accessory contracts pertaining thereto were null and void; and that the foreclosure proceedings under RA 3135 were not complied with, hence, the entire foreclosure proceedings were null and void.

In the motion to dismiss filed by defendant-appellee PNB on October 11, 2002, it averred that plaintiffs-appellants ENCINA could no longer seek for (sic) longer gestation periods for their agricultural loans, since plaintiffs-appellants ENCINA's agricultural loans dated September 13, 1995 and February 13, 1998 have already been fully paid by them on February 4, 1997; that plaintiffs-appellants ENCINA failed to settle their loan for metal craft business and not their agricultural loans; that the Usury Law was inapplicable being legally non-existent; that defendant-appellee PNB complied with the requirements of posting and publication

set forth in RA 3135; and that plaintiffs-appellants ENCINA had already waived their right to question PNB's title to the properties, considering that plaintiffs-appellants [ENCINA] requested from PNB that they be allowed to lease the subject premises from PNB.<sup>[2]</sup>

In its Order<sup>[3]</sup> dated 10 March 2003, the trial court dismissed the complaint.

The dismissal was reversed by the Court of Appeals principally on its finding that there was no definite agreement as to the interest rate to be imposed on the loan. Therefore, the loan cannot be said to have matured so as to justify the extrajudicial foreclosure of the mortgaged properties. The appellate court denied reconsideration in its Resolution<sup>[4]</sup> dated August 4, 2006.

PNB contends that the Court of Appeals should not have rendered a decision on the merits considering that the parties have not offered evidence on their respective claims and defenses, the complaint having been dismissed by the trial court on PNB's motion. It also argues that respondents should be deemed to have admitted PNB's ownership over and title to the foreclosed properties when they leased the foreclosed properties from PNB.

It insists that the determination of the applicable interest rate was not left to its sole will because respondents agreed that the interest rates are to be set by PNB's management for each of the interest periods and the latter had the option to accept or reject the rate imposed on their loan. It further avers that there is nothing on record to support the appellate court's conclusion that the foreclosure proceedings, the public sale, and the certificate of sale are null and void.<sup>[5]</sup>

Respondents insist on the nullity of the provision in the promissory notes to the effect that the rate of interest "will be set by the Management" of PNB, echoing the appellate court's declaration that this provision violates the principle of mutuality of contracts.<sup>[6]</sup>

The case before the Court of Appeals was filed pursuant to Rule 41 of the 1997 Rules of Civil Procedure which provides that an ordinary appeal may be filed to question a judgment or final order of the Regional Trial Court rendered in the exercise of its original jurisdiction. The appeal limits the questions to be reviewed to errors of fact or law committed by the trial court.

In this case, the issue presented to the appellate court was the propriety of the dismissal of respondents' complaint principally on the ground that it states no cause of action. The appellate court was called upon to review the sufficiency of the allegations made in the complaint constituting the cause of action and thereafter to determine whether the trial court erred in dismissing the complaint.

A cause of action exists if the following elements are present, namely: (1) a right in favor of the plaintiff by whatever means and under whatever law it arises or is created; (2) an obligation on the part of the named defendant to respect or not to violate such right; and (3) an act or omission on the part of such defendant violative of the right of the plaintiff or constituting a breach of the obligation of the defendant to the plaintiff for which the latter may maintain an action for recovery of damages.

<sup>[7]</sup>

In order to sustain a dismissal on the ground that the complaint states no cause of action, the insufficiency of the cause of action must appear on the face of the complaint, and the test of the sufficiency of the facts alleged in the complaint to constitute a cause of action is whether or not, admitting the facts alleged, the court could render a valid judgment upon the same in accordance with the prayer of the complaint. For this purpose, the motion to dismiss must hypothetically admit the truth of the facts alleged in the complaint.<sup>[8]</sup>

In their complaint, respondents averred:

#### FIRST CAUSE OF ACTION:

5. The loan is an agricultural loan to be used as operating capital in palay production as evidenced by the Credit Agreement (hereto attached as Annex "H");

6. Being an agricultural loan with long gestation period, the loan should have been restructured for a longer period of at least seven (7) years and no penalties should have been imposed pursuant to Central Bank Circulars and the Agricultural Modernization Act of 1997;

7. In spite of the request of the Plaintiffs to restructure the loan or for a grace period, the Defendant Bank failed and refused to do so. Furthermore, penalty charges should not have been imposed;

8. The Plaintiffs requested for a detailed computation of the amount due considering the payments that were made but the Defendant Bank failed and refused to do so;

9. That in view of the violation of the Central Bank Circulars and the Agricultural Modernization Act of 1997, the Extra-judicial Foreclosure Sale of the subject properties issued in favor of the Defendant Bank is null and void, including all proceedings thereto.

#### SECOND CAUSE OF ACTION

10. Considering that all the loan covered by the said Promissory Notes are secured with a mortgage upon registered real estate, all those contracts of loan are null and void because they are in violation of or contrary to the provisions of the Usury Law (Act No. 2655, as amended) particularly Section 2 thereof which is photocopied hereunder from Philippine Permanent and General Statutes, to wit:

x x x

11. In view of the violation of the Usury Law, the contracts of loan, and its accessory contracts are likewise null and void, namely: a) Real Estate Mortgage Contract, as well as Promissory Notes executed therewith are also null and void.

12. That in view of the nullity of the contracts of loan and the real estate