419 Phil. 857

SECOND DIVISION

[G.R. No. 116285, October 19, 2001]

ANTONIO TAN, PETITIONER, VS. COURT OF APPEALS AND THE CULTURAL CENTER OF THE PHILIPPINES, RESPONDENTS.

D E C I S I O N

DE LEON, JR., J.:

Before us is a petition for review of the Decision[1] dated August 31, 1993 and Resolution[2] dated July 13, 1994 of the Court of Appeals affirming the Decision[3] dated May 8, 1991 of the Regional Trial Court (RTC) of Manila, Branch 27.

The facts are as follows:

On May 14, 1978 and July 6, 1978, petitioner Antonio Tan obtained two (2) loans each in the principal amount of Two Million Pesos (P2,000,000.00), or in the total principal amount of Four Million Pesos (P4,000,000.00) from respondent Cultural Center of the Philippines (CCP, for brevity) evidenced by two (2) promissory notes with maturity dates on May 14, 1979 and July 6, 1979, respectively. Petitioner defaulted but after a few partial payments he had the loans restructured by respondent CCP, and petitioner accordingly executed a promissory note (Exhibit "A") on August 31, 1979 in the amount of Three Million Four Hundred Eleven Thousand Four Hundred Twenty-One Pesos and Thirty-Two Centavos (P3,411,421.32) payable in five (5) installments. Petitioner Tan failed to pay any installment on the said restructured loan of Three Million Four Hundred Eleven Thousand Four Hundred Twenty-One Pesos and Thirty-Two Centavos (P3,411,421.32), the last installment falling due on December 31, 1980. In a letter dated January 26, 1982, petitioner requested and proposed to respondent CCP a mode of paying the restructured loan, i.e., (a) twenty percent (20%) of the principal amount of the loan upon the respondent giving its conformity to his proposal; and (b) the balance on the principal obligation payable in thirty-six (36) equal monthly installments until fully paid. On October 20, 1983, petitioner again sent a letter to respondent CCP requesting for a moratorium on his loan obligation until the following year allegedly due to a substantial deduction in the volume of his business and on account of the peso devaluation. No favorable response was made to said letters. Instead, respondent CCP, through counsel, wrote a letter dated May 30, 1984 to the petitioner demanding full payment, within ten (10) days from receipt of said letter, of the petitioner's restructured loan which as of April 30, 1984 amounted to Six Million Eighty-Eight Thousand Seven Hundred Thirty-Five Pesos and Three Centavos (P6,088,735.03).

On August 29, 1984, respondent CCP filed in the RTC of Manila a complaint for collection of a sum of money, docketed as Civil Case No. 84-26363, against the petitioner after the latter failed to settle his said restructured loan obligation. The petitioner interposed the defense that he merely accommodated a friend, Wilson

Lucmen, who allegedly asked for his help to obtain a loan from respondent CCP. Petitioner claimed that he has not been able to locate Wilson Lucmen. While the case was pending in the trial court, the petitioner filed a Manifestation wherein he proposed to settle his indebtedness to respondent CCP by proposing to make a down payment of One Hundred Forty Thousand Pesos (P140,000.00) and to issue twelve (12) checks every beginning of the year to cover installment payments for one year, and every year thereafter until the balance is fully paid. However, respondent CCP did not agree to the petitioner's proposals and so the trial of the case ensued.

On May 8, 1991, the trial court rendered a decision, the dispositive portion of which reads:

> WHEREFORE, judgment is hereby rendered in favor of plaintiff and against defendant, ordering defendant to pay plaintiff, the amount of P7,996,314.67, representing defendant's outstanding account as of August 28, 1986, with the corresponding stipulated interest and charges thereof, until fully paid, plus attorney's fees in an amount equivalent to 25% of said outstanding account, plus P50,000.00, as exemplary damages, plus costs.
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> Defendant's counterclaims are ordered dismissed, for lack of merit.
>
> SO ORDERED.[4]

The trial court gave five (5) reasons in ruling in favor of respondent CCP. First, it gave little weight to the petitioner's contention that the loan was merely for the accommodation of Wilson Lucmen for the reason that the defense propounded was not credible in itself. Second, assuming, *arguendo*, that the petitioner did not personally benefit from the said loan, he should have filed a third party complaint against Wilson Lucmen, the alleged accommodated party but he did not. Third, for three (3) times the petitioner offered to settle his loan obligation with respondent CCP. Fourth, petitioner may not avoid his liability to pay his obligation under the promissory note (Exh. "A") which he must comply with in good faith pursuant to Article 1159 of the New Civil Code. Fifth, petitioner is estopped from denying his liability or loan obligation to the private respondent.

The petitioner appealed the decision of the trial court to the Court of Appeals insofar as it charged interest, surcharges, attorney's fees and exemplary damages against the petitioner. In his appeal, the petitioner asked for the reduction of the penalties and charges on his loan obligation. He abandoned his alleged defense in the trial court that he merely accommodated his friend, Wilson Lucmen, in obtaining the loan, and instead admitted the validity of the same. On August 31, 1993, the appellate court rendered a decision, the dispositive portion of which reads:

> WHEREFORE, with the foregoing modification, the judgment appealed from is hereby AFFIRMED.
>
> SO ORDERED.[5]

In affirming the decision of the trial court imposing surcharges and interest, the appellate court held that:

> We are unable to accept appellant's (petitioner's) claim for modification on the basis of alleged partial or irregular performance, there being none. Appellant's offer or tender of payment cannot be deemed as a partial or irregular performance of the contract, not a single centavo appears to have been paid by the defendant.

However, the appellate court modified the decision of the trial court by deleting the award for exemplary damages and reducing the amount of awarded attorney's fees to five percent (5%), by ratiocinating as follows:

> Given the circumstances of the case, plus the fact that plaintiff was represented by a government lawyer, We believe the award of 25% as attorney's fees and P500,000.00 as exemplary damages is out of proportion to the actual damage caused by the non-performance of the contract and is excessive, unconscionable and iniquitous.

In a Resolution dated July 13, 1994, the appellate court denied the petitioner's motion for reconsideration of the said decision.

Hence, this petition anchored on the following assigned errors:

> I
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> THE HONORABLE COURT OF APPEALS COMMITTED A MISTAKE IN GIVING ITS IMPRIMATUR TO THE DECISION OF THE TRIAL COURT WHICH COMPOUNDED INTEREST ON SURCHARGES.
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> II
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> THE HONORABLE COURT OF APPEALS ERRED IN NOT SUSPENDING IMPOSITION OF INTEREST FOR THE PERIOD OF TIME THAT PRIVATE RESPONDENT HAS FAILED TO ASSIST PETITIONER IN APPLYING FOR RELIEF OF LIABILITY THROUGH THE COMMISSION ON AUDIT AND THE OFFICE OF THE PRESIDENT.
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> III
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> THE HONORABLE COURT OF APPEALS ERRED IN NOT DELETING AWARD OF ATTORNEY'S FEES AND IN REDUCING PENALTIES.

Significantly, the petitioner does not question his liability for his restructured loan under the promissory note marked Exhibit "A". The first question to be resolved in the case at bar is whether there are contractual and legal bases for the imposition of

the penalty, interest on the penalty and attorney's fees.

The petitioner imputes error on the part of the appellate court in not totally eliminating the award of attorney's fees and in not reducing the penalties considering that the petitioner, contrary to the appellate court's findings, has allegedly made partial payments on the loan. And if penalty is to be awarded, the petitioner is asking for the non-imposition of interest on the surcharges inasmuch as the compounding of interest on surcharges is not provided in the promissory note marked Exhibit "A". The petitioner takes exception to the computation of the private respondent whereby the interest, surcharge and the principal were added together and that on the total sum interest was imposed. Petitioner also claims that there is no basis in law for the charging of interest on the surcharges for the reason that the New Civil Code is devoid of any provision allowing the imposition of interest on surcharges.

We find no merit in the petitioner's contention. Article 1226 of the New Civil Code provides that:

> In obligations with a penal clause, the penalty shall substitute the indemnity for damages and the payment of interests in case of non-compliance, if there is no stipulation to the contrary. Nevertheless, damages shall be paid if the obligor refuses to pay the penalty or is guilty of fraud in the fulfillment of the obligation.
>
> The penalty may be enforced only when it is demandable in accordance with the provisions of this Code.

In the case at bar, the promissory note (Exhibit "A") expressly provides for the imposition of both interest and penalties in case of default on the part of the petitioner in the payment of the subject restructured loan. The pertinent[6] portion of the promissory note (Exhibit "A") imposing interest and penalties provides that:

> For value received, I/We jointly and severally promise to pay to the CULTURAL CENTER OF THE PHILIPPINES at its office in Manila, the sum of THREE MILLION FOUR HUNDRED ELEVEN THOUSAND FOUR HUNDRED + PESOS (P3,411,421.32) Philippine Currency, xxx.
>
> xxx xxx
> xxx
>
> With interest at the rate of FOURTEEN per cent (14%) per annum from the date hereof until paid. PLUS THREE PERCENT (3%) SERVICE CHARGE.
>
> In case of non-payment of this note at maturity/on demand or upon default of payment of any portion of it when due, I/We jointly and severally agree to pay additional penalty charges at the rate of TWO per cent (2%) per month on the total amount due until paid, payable and

> computed monthly. Default of payment of this note or any portion thereof when due shall render all other installments and all existing promissory notes made by us in favor of the CULTURAL CENTER OF THE PHILIPPINES immediately due and demandable. (Underscoring supplied)
>
> xxx xxx
> xxx

The stipulated fourteen percent (14%) per annum interest charge until full payment of the loan constitutes the monetary interest on the note and is allowed under Article 1956 of the New Civil Code.[7] On the other hand, the stipulated two percent (2%) per month penalty is in the form of penalty charge which is separate and distinct from the monetary interest on the principal of the loan.

Penalty on delinquent loans may take different forms. In *Government Service Insurance System v. Court of Appeals,*[8] this Court has ruled that the New Civil Code permits an agreement upon a penalty apart from the monetary interest. If the parties stipulate this kind of agreement, the penalty does not include the monetary interest, and as such the two are different and distinct from each other and may be demanded separately. Quoting *Equitable Banking Corp. v. Liwanag,*[9] the GSIS case went on to state that such a stipulation about payment of an additional interest rate partakes of the nature of a penalty clause which is sanctioned by law, more particularly under Article 2209 of the New Civil Code which provides that:

> If the obligation consists in the payment of a sum of money, and the debtor incurs in delay, the indemnity for damages, there being no stipulation to the contrary, shall be the payment of the interest agreed upon, and in the absence of stipulation, the legal interest, which is six per cent per annum.

The penalty charge of two percent (2%) per month in the case at bar began to accrue from the time of default by the petitioner. There is no doubt that the petitioner is liable for both the stipulated monetary interest and the stipulated penalty charge. The penalty charge is also called penalty or compensatory interest. Having clarified the same, the next issue to be resolved is whether interest may accrue on the penalty or compensatory interest without violating the provisions of Article 1959 of the New Civil Code, which provides that:

Without prejudice to the provisions of Article 2212, interest due and unpaid shall not earn interest. However, the contracting parties may by stipulation capitalize the interest due and unpaid, which as added principal, shall earn new interest.

According to the petitioner, there is no legal basis for the imposition of interest on the penalty charge for the reason that the law only allows imposition of interest on monetary interest but not the charging of interest on penalty. He claims that since there is no law that allows imposition of interest on penalties, the penalties should not earn interest. But as we have already explained, penalty clauses can be in the form of penalty or compensatory interest. Thus, the compounding of the penalty or compensatory interest is sanctioned by and allowed pursuant to the above-quoted