371 Phil. 533

FIRST DIVISION

[G.R. No. 135046, August 17, 1999]

SPOUSES FLORANTE AND LAARNI BAUTISTA, PETITIONERS, VS. PILAR DEVELOPMENT CORPORATION, RESPONDENT.

D E C I S I O N

PUNO, J.:

This petition for review seeks to reverse and set aside the Decision and Resolution of the Court of Appeals in CA-G.R. CV No. 51363[1] which reversed the Decision of the Regional Trial Court, Makati, Branch 138 in Civil Case No. 17702.[2]

The following facts are uncontroverted.

In 1978, petitioner spouses Florante and Laarni Bautista purchased a house and lot in Pilar Village, Las Pinas, Metro Manila. To partially finance the purchase, they obtained from the Apex Mortgage & Loan Corporation (Apex) a loan in the amount of P100,180.00. They executed a promissory note on December 22, 1978 obligating themselves, jointly and severally, to pay the "principal sum of P100,180.00 with interest rate of 12% and service charge of 3%" for a period of 240 months, or twenty years, from date, in monthly installments of P1,378.83.[3] Late payments were to be charged a penalty of one and one-half per cent (1 1/2%) of the amount due. In the same promissory note, petitioners authorized Apex to "increase the rate of interest and/or service charges" without notice to them in the event that a law, Presidential Decree or any Central Bank regulation should be enacted increasing the lawful rate of interest and service charges on the loan.[4] Payment of the promissory note was secured by a second mortgage on the house and lot purchased by petitioners.[5]

Petitioner spouses failed to pay several installments. On September 20, 1982, they executed another promissory note in favor of Apex. This note was in the amount of P142,326.43 at the increased interest rate of twenty-one per cent (21%) per annum with no provision for service charge but with penalty charge of 1 1/2% for late payments. Payment was to be made for a period of 196 months or 16.33 years in monthly installments of P2,576.68, inclusive of principal and interest. Petitioner spouses also authorized Apex to "increase/decrease the rate of interest and/or service charges" on the note in the event any law or Central Bank regulation shall be passed increasing or decreasing the same.[6]

In November 1983, petitioner spouses again failed to pay the installments. On June 6, 1984, Apex assigned the second promissory note to respondent Pilar Development Corporation without notice to petitioners.

On August 31, 1987, respondent corporation, as successor-in-interest of Apex,

instituted against petitioner spouses Civil Case No. 17702 before the Regional Trial Court, Makati, Branch 138. Respondent corporation sought to collect from petitioners the amount of P140,515.11 representing the unpaid balance of the principal debt from November 23, 1983, including interest at the rate of twenty-one per cent (21%) under the second promissory note, and 25% and 36% per annum in accordance with Central Bank Circular No. 905, series of 1982. Respondent also sought payment of ten per cent (10%) of the amount due as attorney's fees.[7]

In their answer, petitioner spouses mainly contended that the terms of the second promissory note increasing the interest rate to 21% and the escalation clauses authorizing Apex to increase interest rates pursuant to any law or Central Bank regulation are null and void in the absence of a de-escalation clause in the same note.[8]

After pre-trial, both parties submitted the case for decision on the sole issue of the interest rate.

The trial court rendered judgment on September 22, 1995. It ordered petitioner spouses to pay respondent corporation the sum of P140,515.11, with interest at the rate of 12% per annum, plus service charge, *viz*:

> "WHEREFORE, judgment is hereby rendered as follows:
>
> (a) Plaintiff is entitled to collect from the defendants the amount of P140,515.11 with interest at the rate of 12% per annum from November 23, 1983 until the amount is fully paid plus the stipulated service charge;
>
> (b) Ordering defendants as joint and several obligors to pay plaintiff the amount stated in paragraph (a) hereof;
>
> (c) Counterclaim is hereby dismissed.
>
> No pronouncement as to costs.
>
> SO ORDERED."[9]

Both parties appealed to the Court of Appeals. In a Decision dated May 14, 1998, the appellate court reversed the trial court by applying the interest rate of 21% per annum, and adding attorney's fees of 10%. Thus:

> "IN VIEW OF ALL THE FOREGOING, the appealed judgment is hereby REVERSED and SET ASIDE and a new one entered ordering the defendants to pay the plaintiffs the amount of P142,326.43, as principal with interest at the rate of 21% from November 23, 1983 until the amount is fully paid; the sum equivalent to 10% of the amount due as attorney's fees and the costs of this suit.
>
> SO ORDERED." [10]

Petitioner spouses moved for reconsideration. In a Resolution dated August 18, 1998, the Court of Appeals denied the motion but reduced the principal amount of the obligation from P142,326.42 to P140,515.11.[11]

Hence this recourse.

Petitioner spouses claim that the Court of Appeals erred:

I

IN RULING THAT THE TWO (2) PROMISSORY NOTES EXECUTED BY THE PARTIES ARE INDEPENDENT OF EACH OTHER.

CONVERSELY, IN NOT RULING THAT THE SAID PROMISSORY NOTES CONSTITUTE A SINGLE-LOAN TRANSACTION.

II

IN RULING THAT THE APPLICABLE RATE OF INTEREST IS 21% PER ANNUM AS STIPULATED IN THE SECOND PROMISSORY NOTE.

CONVERSELY, IN NOT RULING THAT THE ESCALATION OF INTEREST RATE FROM 12% PER ANNUM (1ST PROMISSORY NOTE) TO 21% PER ANNUM (2ND PROMISSORY NOTE) IS UNLAWFUL.

III

IN RULING THAT 10% OF THE AMOUNT DUE IS AWARDABLE AS ATTORNEY'S FEES.

CONVERSELY, IN NOT RULING THAT THE AWARD OF 10% ATTORNEY'S FEES IS NOT PROPER UNDER THE CIRCUMSTANCES.

IV

IN RULING THAT NOTICE OF ASSIGNMENT OF CREDIT IS "POINTLESS AND UNSUSTAINABLE."

CONVERSELY, IN NOT RULING THAT NOTICE TO THE DEBTOR IS REQUIRED WHEN CREDIT IS ASSIGNED.

V

IN NOT RULING THAT UNDER THE CIRCUMSTANCES PETITIONERS ARE ENTITLED TO MORAL AND EXEMPLARY DAMAGES.[12]

The controversy in this petition involves the rate of interest respondent creditor is entitled to collect on petitioners' loan: whether it be 12% under the promissory note of December 22, 1978, or 21% under the promissory note of September 20, 1982.

Petitioners claim that the interest rate of 12% per annum should be adjudged inasmuch as the two promissory notes constitute one transaction. Allegedly, the first note defined the terms and conditions of the loan while the second note is merely an extension of and derives its existence from the former. Hence, the second note is governed by the stipulations in the first note.[13]

The two promissory notes are identically entitled "Promissory Note with Authority to Assign Credit." The notes were prepared by Apex in standard form and consist of two (2) pages each. Except for one or two stipulations, they contain the same provisions and the same blanks for the amount of the loan and other pertinent data subject of each note. However, on the upper right portion of the second note, there appears a typewritten entry which reads:

"This cancels PN # A-387-78 dated December 22, 1978."[14]

Correspondingly, on the face of each page of the first promissory note, *i.e.*, PN No. A-387-78 dated December 22, 1978, the word "Cancelled" is boldly stamped twice with the date "September 16, 1982" and a signature written in a space inside the letters of the word.[15]

The first promissory note was cancelled by the express terms of the second promissory note. To cancel is to strike out, to revoke, rescind or abandon, to terminate.[16] In fine, the first note was revoked and terminated. Simply put, it was novated. The extinguishment of an obligation by the substitution or change of the obligation by a subsequent one which extinguishes or modifies the first is a novation.[17] Novation is made either by changing the object or principal conditions, referred to as an objective or real novation; or by substituting the person of the debtor or subrogating a third person to the rights of the creditor, which is known as subjective or personal novation.[18] In both objective and subjective novation, a dual purpose is achieved-- an obligation is extinguished and a new one is created in lieu thereof.[19] Novation may either be express, when the new obligation declares in unequivocal terms that the old obligation is extinguished; or implied, when the new obligation is on every point incompatible with the old one.[20] Express novation takes place when the contracting parties expressly disclose that their object in making the new contract is to extinguish the old contract, otherwise the old contract remains in force and the new contract is merely added to it, and each gives rise to an obligation still in force.[21]

Novation has four (4) essential requisites: (1) the existence of a previous valid obligation; (2) the agreement of all parties to the new contract; (3) the extinguishment of the old contract; and (4) the validity of the new one.[22] In the instant case, all four requisites have been complied with. The first promissory note was a valid and subsisting contract when petitioner spouses and Apex executed the second promissory note. The second promissory note absorbed the unpaid principal and interest of P142,326.43 in the first note which amount became the principal debt therein, payable at a higher interest rate of 21% per annum. Thus, the terms of the second promissory note provided for a higher principal, a higher interest rate, and a higher monthly amortization, all to be paid within a shorter period of 16.33 years. These changes are substantial and constitute the principal conditions of the obligation.[23] Both parties voluntarily accepted the terms of the second note; and also in the same note, they unequivocally stipulated to extinguish the first note. Clearly, there was *animus novandi*, an express intention to novate.[24] The first promissory note was cancelled and replaced by the second note. This second note became the new contract governing the parties' obligations.