351 Phil. 664

SECOND DIVISION

[G.R. No. 126490, March 31, 1998]

ESTRELLA PALMARES, PETITIONER, VS. COURT OF APPEALS AND M.B. LENDING CORPORATION, RESPONDENTS.

D E C I S I O N

REGALADO, J.:

Where a party signs a promissory note as a co-maker and binds herself to be jointly and severally liable with the principal debtor in case the latter defaults in the payment of the loan, is such undertaking of the former deemed to be that of a surety as an insurer of the debt, or of a guarantor who warrants the solvency of the debtor?

Pursuant to a promissory note dated March 13, 1990, private respondent M.B. Lending Corporation extended a loan to the spouses Osmeña and Merlyn Azarraga, together with petitioner Estrella Palmares, in the amount of ₱30,000.00 payable on or before May 12, 1990, with compounded interest at the rate of 6% per annum to be computed every 30 days from the date thereof.[1] On four occasions after the execution of the promissory note and even after the loan matured, petitioner and the Azarraga spouses were able to pay a total of ₱16,300.00, thereby leaving a balance of ₱13,700.00. No payments were made after the last payment on September 26, 1991.[2]

Consequently, on the basis of petitioner's solidary liability under the promissory note, respondent corporation filed a complaint[3] against petitioner Palmares as the lone party-defendant, to the exclusion of the principal debtors, allegedly by reason of the insolvency of the latter.

In her Amended Answer with Counterclaim,[4] petitioner alleged that sometime in August 1990, immediately after the loan matured, she offered to settle the obligation with respondent corporation but the latter informed her that they would try to collect from the spouses Azarraga and that she need not worry about it; that there has already been a partial payment in the amount of ₱17,010.00; that the interest of 6% per month compounded at the same rate per month, as well as the penalty charges of 3% per month, are usurious and unconscionable; and that while she agrees to be liable on the note but only upon default of the principal debtor, respondent corporation acted in bad faith in suing her alone without including the Azarragas when they were the only ones who benefited from the proceeds of the loan.

During the pre-trial conference, the parties submitted the following issues for the resolution of the trial court: (1) what the rate of interest, penalty and damages should be; (2) whether the liability of the defendant (herein petitioner) is primary or subsidiary; and (3) whether the defendant Estrella Palmares is only a guarantor with a subsidiary liability and not a co-maker with primary liability.[5]

Thereafter, the parties agreed to submit the case for decision based on the pleadings filed and the memoranda to be submitted by them. On November 26, 1992, the

Regional Trial Court of Iloilo City, Branch 23, rendered judgment dismissing the complaint without prejudice to the filing of a separate action for a sum of money against the spouses Osmeña and Merlyn Azarraga who are primarily liable on the instrument.[6] This was based on the findings of the court *a quo* that the filing of the complaint against herein petitioner Estrella Palmares, to the exclusion of the Azarraga spouses, amounted to a discharge of a prior party; that the offer made by petitioner to pay the obligation is considered a valid tender of payment sufficient to discharge a person's secondary liability on the instrument; that petitioner, as co-maker, is only secondarily liable on the instrument; and that the promissory note is a contract of adhesion.

Respondent Court of Appeals, however, reversed the decision of the trial court, and rendered judgment declaring herein petitioner Palmares liable to pay respondent corporation:

> 1. The sum of ₱13,700.00 representing the outstanding balance still due and owing with interest at six percent (6%) per month computed from the date the loan was contracted until fully paid;
>
> 2. The sum equivalent to the stipulated penalty of three percent (3%) per month, of the outstanding balance;
>
> 3. Attorney's fees at 25% of the total amount due per stipulations;
>
> 4. Plus costs of suit.[7]

Contrary to the findings of the trial court, respondent appellate court declared that petitioner Palmares is a surety since she bound herself to be jointly and severally or solidarily liable with the principal debtors, the Azarraga spouses, when she signed as a co-maker. As such, petitioner is primarily liable on the note and hence may be sued by the creditor corporation for the entire obligation. It also adverted to the fact that petitioner admitted her liability in her Answer although she claims that the Azarraga spouses should have been impleaded. Respondent court ordered the imposition of the stipulated 6% interest and 3% penalty charges on the ground that the Usury Law is no longer enforceable pursuant to Central Bank Circular No. 905. Finally, it rationalized that even if the promissory note were to be considered as a contract of adhesion, the same is not entirely prohibited because the one who adheres to the contract is free to reject it entirely; if he adheres, he gives his consent.

Hence this petition for review on *certiorari* wherein it is asserted that:

> A. The Court of Appeals erred in ruling that Palmares acted as surety and is therefore solidarily liable to pay the promissory note.
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> 1. The terms of the promissory note are vague. Its conflicting provisions do not establish Palmares' solidary liability.
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> 2. The promissory note contains provisions which establish the co-maker's liability as that of a guarantor.
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> 3. There is no sufficient basis for concluding that Palmares' liability is solidary.
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> 4. The promissory note is a contract of adhesion and should be construed against M.B. Lending Corporation.

5. Palmares cannot be compelled to pay the loan at this point.

B. Assuming that Palmares' liability is solidary, the Court of Appeals erred in strictly imposing the interests and penalty charges on the outstanding balance of the promissory note.

The foregoing contentions of petitioner are denied and contradicted in their material points by respondent corporation. They are further refuted by accepted doctrines in the American jurisdiction after which we patterned our statutory law on suretyship and guaranty. This case then affords us the opportunity to make an extended exposition on the ramifications of these two specialized contracts, for such guidance as may be taken therefrom in similar local controversies in the future.

The basis of petitioner Palmares' liability under the promissory note is expressed in this wise:

> ATTENTION TO CO-MAKERS: PLEASE READ WELL
>
> I, Mrs. Estrella Palmares, as the Co-maker of the above-quoted loan, have fully understood the contents of this Promissory Note for Short-Term Loan:
>
> That as Co-maker, I am fully aware that I shall be jointly and severally or solidarily liable with the above principal maker of this note;
>
> That in fact, I hereby agree that M.B. LENDING CORPORATION may demand payment of the above loan from me in case the principal maker, Mrs. Merlyn Azarraga defaults in the payment of the note subject to the same conditions above-contained.[8]

Petitioner contends that the provisions of the second and third paragraph are conflicting in that while the second paragraph seems to define her liability as that of a surety which is joint and solidary with the principal maker, on the other hand, under the third paragraph her liability is actually that of a mere guarantor because she bound herself to fulfill the obligation only in case the principal debtor should fail to do so, which is the essence of a contract of guaranty. More simply stated, although the second paragraph says that she is liable as a surety, the third paragraph defines the nature of her liability as that of a guarantor. According to petitioner, these are two conflicting provisions in the promissory note and the rule is that clauses in the contract should be interpreted in relation to one another and not by parts. In other words, the second paragraph should not be taken in isolation, but should be read in relation to the third paragraph.

In an attempt to reconcile the supposed conflict between the two provisions, petitioner avers that she could be held liable only as a guarantor for several reasons. *First*, the words "jointly and severally or solidarily liable" used in the second paragraph are technical and legal terms which are not fully appreciated by an ordinary layman like herein petitioner, a 65-year old housewife who is likely to enter into such transactions without fully realizing the nature and extent of her liability. On the contrary, the wordings used in the third paragraph are easier to comprehend. *Second*, the law looks upon the contract of suretyship with a jealous eye and the rule is that the obligation of the surety cannot be extended by implication beyond specified limits, taking into consideration the peculiar nature of a surety agreement which holds the surety liable despite the absence of any direct consideration received from either the principal obligor or the creditor. *Third*, the promissory note is a contract of adhesion since it was

prepared by respondent M.B. Lending Corporation. The note was brought to petitioner partially filled up, the contents thereof were never explained to her, and her only participation was to sign thereon. Thus, any apparent ambiguity in the contract should be strictly construed against private respondent pursuant to Art. 1377 of the Civil Code. [9]

Petitioner accordingly concludes that her liability should be deemed restricted by the clause in the third paragraph of the promissory note to be that of a guarantor.

Moreover, petitioner submits that she cannot as yet be compelled to pay the loan because the principal debtors cannot be considered in default in the absence of a judicial or extrajudicial demand. It is true that the complaint alleges the fact of demand, but the purported demand letters were never attached to the pleadings filed by private respondent before the trial court. And, while petitioner may have admitted in her Amended Answer that she received a demand letter from respondent corporation sometime in 1990, the same did not effectively put her or the principal debtors in default for the simple reason that the latter subsequently made a partial payment on the loan in September, 1991, a fact which was never controverted by herein private respondent.

Finally, it is argued that the Court of Appeals gravely erred in awarding the amount of ₱2,745,483.39 in favor of private respondent when, in truth and in fact, the outstanding balance of the loan is only ₱13,700.00. Where the interest charged on the loan is exorbitant, iniquitous or unconscionable, and the obligation has been partially complied with, the court may equitably reduce the penalty[10] on grounds of substantial justice. More importantly, respondent corporation never refuted petitioner's allegation that immediately after the loan matured, she informed said respondent of her desire to settle the obligation. The court should, therefore, mitigate the damages to be paid since petitioner has shown a sincere desire for a compromise.[11]

After a judicious evaluation of the arguments of the parties, we are constrained to dismiss the petition for lack of merit, but to except therefrom the issue anent the propriety of the monetary award adjudged to herein respondent corporation.

At the outset, let it here be stressed that even assuming *arguendo* that the promissory note executed between the parties is a contract of adhesion, it has been the consistent holding of the Court that contracts of adhesion are not invalid *per se* and that on numerous occasions the binding effects thereof have been upheld. The peculiar nature of such contracts necessitate a close scrutiny of the factual milieu to which the provisions are intended to apply. Hence, just as consistently and unhesitatingly, but without categorically invalidating such contracts, the Court has construed obscurities and ambiguities in the restrictive provisions of contracts of adhesion strictly albeit not unreasonably against the drafter thereof when justified in light of the operative facts and surrounding circumstances.[12] The factual scenario obtaining in the case before us warrants a liberal application of the rule in favor of respondent corporation.

The Civil Code pertinently provides:

> Art. 2047. By guaranty, a person called the guarantor binds himself to the creditor to fulfill the obligation of the principal debtor in case the latter should fail to do so.
>
> If a person binds himself solidarily with the principal debtor, the provisions of Section 4, Chapter 3, Title I of this Book shall be observed. In such case the contract is

called a suretyship.

It is a cardinal rule in the interpretation of contracts that if the terms of a contract are clear and leave no doubt upon the intention of the contracting parties, the literal meaning of its stipulation shall control.[13] In the case at bar, petitioner expressly bound herself to be jointly and severally or solidarily liable with the principal maker of the note. The terms of the contract are clear, explicit and unequivocal that petitioner's liability is that of a surety.

Her pretension that the terms "jointly and severally or solidarily liable" contained in the second paragraph of her contract are technical and legal terms which could not be easily understood by an ordinary layman like her is diametrically opposed to her manifestation in the contract that she "fully understood the contents" of the promissory note and that she is "fully aware" of her solidary liability with the principal maker. Petitioner admits that she voluntarily affixed her signature thereto; ergo, she cannot now be heard to claim otherwise. Any reference to the existence of fraud is unavailing. Fraud must be established by clear and convincing evidence, mere preponderance of evidence not even being adequate. Petitioner's attempt to prove fraud must, therefore, fail as it was evidenced only by her own uncorroborated and, expectedly, self-serving allegations.[14]

Having entered into the contract with full knowledge of its terms and conditions, petitioner is estopped to assert that she did so under a misapprehension or in ignorance of their legal effect, or as to the legal effect of the undertaking.[15] The rule that ignorance of the contents of an instrument does not ordinarily affect the liability of one who signs it also applies to contracts of suretyship. And the mistake of a surety as to the legal effect of her obligation is ordinarily no reason for relieving her of liability.[16]

Petitioner would like to make capital of the fact that although she obligated herself to be jointly and severally liable with the principal maker, her liability is deemed restricted by the provisions of the third paragraph of her contract wherein she agreed "that M.B. Lending Corporation may demand payment of the above loan from me in case the principal maker, Mrs. Merlyn Azarraga defaults in the payment of the note," which makes her contract one of guaranty and not suretyship. The purported discordance is more apparent than real.

A surety is an insurer of the debt, whereas a guarantor is an insurer of the solvency of the debtor.[17] A suretyship is an undertaking that the debt shall be paid; a guaranty, an undertaking that the debtor shall pay.[18] Stated differently, a surety promises to pay the principal's debt if the principal will not pay, while a guarantor agrees that the creditor, after proceeding against the principal, may proceed against the guarantor if the principal is unable to pay.[19] A surety binds himself to perform if the principal does not, without regard to his ability to do so. A guarantor, on the other hand, does not contract that the principal will pay, but simply that he is able to do so.[20] In other words, a surety undertakes directly for the payment and is so responsible at once if the principal debtor makes default, while a guarantor contracts to pay if, by the use of due diligence, the debt cannot be made out of the principal debtor.[21]

Quintessentially, the undertaking to pay upon default of the principal debtor does not automatically remove it from the ambit of a contract of suretyship. The second and third paragraphs of the aforequoted portion of the promissory note do not contain any other condition for the enforcement of respondent corporation's right against petitioner.