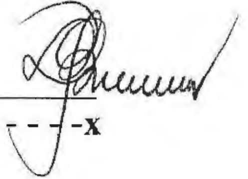
EN BANC

G.R. No. 225433 — LARA'S GIFTS & DECORS, INC., *petitioner, versus* **MIDTOWN INDUSTRIAL SALES, INC.,** *respondent.*

Promulgated:

September 20, 2022



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CONCURRING OPINION

CAGUIOA, *J.*:

For resolution is the Motion for Reconsideration of the Court's August 28, 2019 Decision[1] denying the Petition for Review on *Certiorari* filed by petitioner Lara's Gifts & Decors, Inc. (Lara's Gifts).

The dispositive portion of the August 28, 2019 Decision reads:

> **WHEREFORE**, the Decision dated [April 21, 2016] of the Court of Appeals in CA-G.R. CV No. 102465, affirming the [January 27, 2014] Decision of the Regional Trial Court, Branch 128, Caloocan City, is **AFFIRMED** with **MODIFICATION**, as follows:
>
> Petitioner Lara's Gifts & Decors, Inc., is ordered to pay respondent Midtown Industrial Sales, Inc. [(Midtown)] the following:
>
> 1. ONE MILLION TWO HUNDRED SIXTY THREE THOUSAND ONE HUNDRED FOUR PESOS and 22/100 (₱1,263,104.22) representing the principal amount plus stipulated interest at 24% *per annum* to be computed from [January 22, 2008], the date of extrajudicial demand, until full payment.
>
> 2. Legal interest on the 24% *per annum* interest due on the principal amount accruing as of judicial demand, at the rate of 12% *per annum* from the date of judicial demand on [February 5, 2008] until [June 30, 2013], and thereafter at the rate of 6% *per annum* from [July 1, 2013] until full payment.
>
> 3. The sum of FIFTY THOUSAND PESOS (₱50,000.00) as attorney's fees, plus legal interest thereon at the rate of 6% *per annum* to be computed from the finality of this Decision until full payment.
>
> 4. Cost of the suit.
>
> **SO ORDERED.**[2]

[1] G.R. No. 225433, August 28, 2019, 916 SCRA 1.

[2] Id. at 56.

The *Resolution* affirms the awards in paragraphs 1, 3, and 4, but modifies the August 28, 2019 Decision by deleting the additional award of "interest on interest" in paragraph 2, because the same would be *ultra vires* in an appeal brought by Lara's Gifts.[3]

I wish to concur, even as I clarify, that the imposition of legal interest on the 24% *per annum* interest is deleted only because its imposition became final and executory as to Midtown Industrial Sales, Inc. (Midtown) as it did not appeal the same, and not because it was unconscionable. In my view, the principle of unconscionability applies only to justify the reduction of unconscionable rates **stipulated upon by the parties**, and not legal rates, or those rates prescribed by law.

While the "interest on interest" (hereinafter, interest on accrued interest) ***as stipulated by the parties*** may be nullified when found to be iniquitous or unconscionable, interest on accrued interest is fully provided for and sanctioned by Article 2212 of the Civil Code, which states:

> Article 2212. **Interest due shall earn legal interest** from the time it is judicially demanded, although the obligation may be silent upon this point. (Emphasis supplied)

Concomitantly, in obligations which consist in the payment of a sum of money where the parties do not stipulate on the rate of interest on accrued interest, the legal rate shall apply **by operation of law**, and may not be further reduced or deleted.

The same rule applies to the simple or regular interest which serves as the "indemnity for damages" when the debtor incurs in delay in obligations consisting in the payment of a sum of money. Such interest, which is referred to as compensatory interest (hereinafter, regular compensatory interest) is treated under Article 2209 of the Civil Code, thus:

> Article 2209. 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*.

While the stipulated rate of regular compensatory interest may be similarly nullified when found to be iniquitous or unconscionable, regular compensatory interest shall remain imposable also at the legal rate. Moreover, in situations where the parties do not stipulate on the rate of regular compensatory interest, the legal rate shall apply by operation of law, and may not be further reduced or deleted.

On this basis, **I find that courts are precluded from effecting the wholesale deletion of regular compensatory interest and interest on**

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[3] *Ponencia*, p. 23.

accrued interest, as this would run counter to the express mandate of Articles 2209 and 2212 of the Civil Code. These provisions are clear and leave no room for interpretation — regular compensatory interest and interest on accrued interest shall run on account of delay either in the payment of the principal obligation (in the case of regular compensatory interest) or in the payment of interest due and unpaid (in the case of interest on accrued interest) at the rate stipulated by the parties, or in case of nullity or absence thereof, at the applicable legal rate.

In this connection, **I reiterate that the applicable legal rate shall depend on the nature of the obligation.**

If the obligation constitutes a loan or forbearance contemplated under the Usury Law,[4] the applicable legal rate shall be that prescribed by the *Bangko Sentral ng Pilipinas* (BSP). **On the other hand, if the obligation is one for payment of a sum of money which is not a loan or forbearance, the applicable rate shall be 6% *per annum*, as set by Article 2209 of the Civil Code.** Since the obligation subject of this Petition is one for payment of a sum of money which **does not** constitute a loan or forbearance under the context of the Usury Law, the applicable legal rate of interest on accrued interest is therefore 6% *per annum*.

To this end, I wish to explain the reasons why the principle of unconscionability should only be construed to apply to rates stipulated upon by the parties. Further, I will discuss what I view to be the clear import of Articles 2209 and 2212 with respect to the mandatory imposition of regular compensatory interest and interest on accrued interest.

Finally, I will proceed to reiterate the position set forth in my Concurring and Dissenting Opinion on the August 28, 2019 Decision[5] (*Opinion*) with respect to the differential treatment of loans and forbearances under the Usury Law and all other obligations for payment of a sum of money not falling under the latter's scope.

DISCUSSION

Legal rates (i.e., interest rates prescribed by law) are not subject to reduction or deletion based on the unconscionability standard

For purposes of further clarifying the matter of imposing legal interests to interests, I wish to add that unlike interest rates stipulated upon by the parties which are subject to the unconscionability standard, legal rates prescribed by law are not for the simple reason that the Court's duty is to

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4 Act No. 2655, as amended by Presidential Decree No. (P.D.) 116.

5 Concurring and Dissenting Opinion of Associate Justice Alfredo Benjamin S. Caguioa in *Lara's Gifts & Decors, Inc. v. Midtown Industrial Sales, Inc.*, supra note 1, at 71.

simply apply the law. As a result, legal rates may not be further reduced or altogether deleted by the courts based on the ground of unconscionability.

To further explain, it is best to begin with a run-down of relevant concepts relating to the imposition of interest.

Conventional interest is the stipulated "cost of borrowing money" or the "presumptive reasonable compensation for borrowed money."[6] Conventional interest arises from contract for the use or forbearance of money.[7] Since conventional interest arises from contract, the contracting parties are free to stipulate on their preferred rate. However, the rate of conventional interest stipulated upon by the parties may be declared void if found to be iniquitous, unconscionable, or exorbitant, pursuant to the principles of autonomy and mutuality of contract.

To note, the principle of autonomy under Article 1306 of the Civil Code permits the contracting parties to establish their own stipulations as they may deem convenient. However, such stipulations may be nullified if found to be contrary to law, morals, good customs, public order, or public policy.[8] Moreover, the principle of mutuality enshrined in Article 1308 of the same statute espouses that a contract "must bind both contracting parties; its validity or compliance cannot be left to the will of one of them." Thus, the principle of mutuality of contracts dictates that a contract or a stipulation therein must be rendered void when the execution of its terms is skewed in favor of one party.[9]

Thus, with respect to unconscionable interest rates, the Court held in *Spouses Abella v. Spouses Abella*,[10] the following:

> The imposition of an unconscionable rate of interest on a money debt, even if knowingly and voluntarily assumed, is immoral and unjust. It is tantamount to a repugnant spoliation and an iniquitous deprivation of property, repulsive to the common sense of man. It has no support in law, in principles of justice, or in the human conscience nor is there any reason whatsoever which may justify such imposition as righteous and as one that may be sustained within the sphere of public or private morals.
>
> The imposition of an unconscionable interest rate is void *ab initio* for being "contrary to morals, and the law."[11]

In turn, when the parties stipulate on the payment of conventional interest but the rate agreed upon is found to be void for being unconscionable, the stipulated interest rate is deemed not written in the contract, and shall be replaced by the legal interest rate prevailing at the time the parties entered into

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[6] Id. at 128.

[7] Id.

[8] See generally *Camarines Sur Teachers and Employees Association, Inc. v. Province of Camarines Sur*, G.R. No. 199666, October 7, 2019, 921 SCRA 532.

[9] See generally *Vasquez v. Philippine National Bank*, G.R. Nos. 228355 & 228397, August 28, 2019, 916 SCRA 194, 220-221.

[10] 763 Phil. 372 (2015).

[11] Id. at 388. Citations omitted.

the loan or forbearance in question. In such cases, only the unconscionable stipulated interest is nullified; the obligation to pay conventional interest remains. The legal interest is therefore made to stand as a "surrogate" or "substitute" for the rate of interest so nullified. At present, the rate of legal interest applicable to loans or forbearances of money is that prescribed by the BSP.[12]

On the other hand, **regular compensatory interest** treated in Article 2209 is the interest which is imposed by law as indemnity for damages on account of delay in the payment of the principal obligation. It is demandable even in the absence of an express stipulation regarding the payment of interest and applies in all cases where there is delay in the payment of any sum of money.[13] To quote anew the provision:

> Article 2209. 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*.

As plainly stated in Article 2209, contracting parties are free to stipulate on the indemnity for damages on account of delay in the payment of the principal obligation. The indemnity for damages in obligations consisting of a payment of sum of money may come in the form of: (1) stipulated regular compensatory interest to be applied on the principal obligation; (2) a penal clause imposed in its compensatory (as opposed to punitive) sense; or (3) a fixed amount of liquidated damages.[14]

When the parties agree on the imposition of a penal clause or a fixed amount of liquidated damages as indemnity for damages, such fixed amounts should be understood to take the place of regular compensatory interest which, as Article 2209 explicitly states, applies as "indemnity for damages" only in cases where there is "no stipulation to the contrary."

However, in cases where the contracting parties agree upon the imposition of stipulated regular compensatory interest as indemnity for damages, the stipulated rate will apply. Nevertheless, such stipulated rate, being the result of the agreement of the parties, may also be equitably reduced if found to be unconscionable.

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[12] *See* USURY LAW, Sec. 1, as amended by P.D. 116, Sec. 1, which states:

> Sec. 1. The rate of interest for the loan or forbearance of any money, goods, or credits and the rate allowed in judgments, in the absence of express contract as to such rate of interest, shall be six per centum *per annum* or such rate as may be prescribed by the Monetary Board of the Central Bank of the Philippines for that purpose in accordance with the authority hereby granted.

[13] *See* Concurring and Dissenting Opinion of Associate Justice Alfredo Benjamin S. Caguioa in *Lara's Gifts & Decors, Inc. v. Midtown Industrial Sales, Inc.*, supra note 1.

[14] Liquidated damages are treated under Article 2226 of the Civil Code, which states, "[l]iquidated damages are those agreed upon by the parties to a contract, to be paid in case of breach thereof." Like rates of regular compensatory interest, liquidated damages shall also be equitably reduced if they are found to be iniquitous or unconscionable as provided in Article 2227 of the Civil Code.

In turn, Article 2209 provides that regular compensatory interest shall be applied at the legal rate prevailing at the time the obligation in question was entered into where: (1) there is no stipulation on the payment of regular compensatory interest; or (2) there is a stipulation as to the payment of regular compensatory interest, but rate agreed upon is found to be iniquitous or unconscionable.

As explained in my *Opinion* and further reiterated below, the applicable legal interest rate shall depend on the nature of the obligation involved. When the obligation is a loan or forbearance of money within the context of the Usury Law, the legal interest rate applicable shall be the BSP-prescribed rate. However, if the obligation is one for the payment of a sum of money which is neither a loan nor a forbearance, the interest rate applicable shall be the 6% *per annum* as set by Article 2209 of the Civil Code.

Interest on accrued interest under Article 2212 also partakes the nature of compensatory interest as it also arises on account of delay in payment. However, unlike the compensatory interest contemplated in Article 2209 which arises on account of delay in the payment of the principal obligation, interest on accrued interest arises on account of delay in the payment of stipulated interest.[15] Justice Eduardo P. Caguioa explains that Article 2212 serves as an exception to the general rule on compounding of interest laid down in Article 1959, thus:

> [Article 2212] is an exception to the general rule on compounding interest, *i.e.*, interest on interest, provided for in Article 1959. x x x Under [Article 1959], interest due and unpaid, that is, accrued interest, shall not earn interest unless there is an express agreement between the parties, which agreement must, furthermore, be in writing as required by Article 1956. However, under [Article 2212], interest due and unpaid shall earn legal interest from the time of judicial demand, despite lack of agreement to that effect.[16]

Thus, Article 2212 must be taken in conjunction with Article 1959 which reads:

> Article 1959. 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.** (Emphasis supplied)

Moreover, as explained in my *Opinion*, Article 2212 applies only to obligations containing a stipulation on the payment of interest. To reiterate:

> In *Hun Hyung Park v. Eung Won Choi*, the Court explained however that—

[15] *See* Concurring and Dissenting Opinion of Associate Justice Alfredo Benjamin S. Caguioa in *Lara's Gifts & Decors, Inc. v. Midtown Industrial Sales, Inc.*, supra note 1, at 141, which states that "Article 2212 applies to any accrued stipulated interest."

[16] Eduardo P. Caguioa, COMMENTS AND CASES ON CIVIL LAW, Vol. VI (1970), p. 441.

> x x x **"interest due" in Article 2212 refers only to *accrued* interest.** A look at the counterpart provision of Article 2212 of the new Civil Code, Article 1109 of the old Civil Code, supports this. It provides:
>
>> Art. 1109. Accrued interest shall draw interest at the legal rate from the time the suit is filed for its recovery, even if the obligation should have been silent on this point.
>>
>> In commercial transactions the provisions of the Code of Commerce shall govern.
>>
>> Pawnshops and savings banks shall be governed by their special regulations. x x x
>
> In interpreting the above provision of the old Civil Code, the Court in *Zobel v. City of Manila*, ruled that Article 1109 applies only to conventional obligations containing a stipulation on interest. Similarly, Article 2212 of the new Civil Code contemplates, and therefore applies, only when there exists stipulated or conventional interest. x x x[17] (Emphasis supplied)

Accordingly, contracting parties are also free to stipulate on the rate of interest on accrued interest pursuant to Article 1959. Like the stipulated rate of regular compensatory interest contemplated under Article 2209, the stipulated rate of interest on accrued interest may also be equitably reduced if found to be unconscionable. In such cases, the stipulated rate of interest on accrued interest will be deemed as not written in the contract, and shall be replaced by the applicable legal rate prevailing at the time the contract in question was entered into. Moreover, if there is no rate of interest on accrued interest agreed upon, interest on accrued interest shall nevertheless run from the time of judicial demand at the applicable legal rate, which, as stated, may either be the BSP-prescribed rate, or the rate of 6% specified in Article 2209, depending on the nature of the obligation consisting in the payment of a sum of money.

Finally, it should be emphasized that interest runs solely in connection with obligations consisting of a payment of sum of money. This is apparent from Article 1956 which permits the imposition of conventional interest on simple loans, Article 2209 which constitutes regular compensatory interest as the indemnity for damages in obligations for payment of a sum of money where the parties do not agree on a penal clause or a fixed amount of liquidated damages, and Article 2212 which applies to obligations for payment of a sum of money containing a stipulation on the payment of interest.

At this juncture, a distinction must be drawn between the treatment of interest rates stipulated by the parties and the legal rates

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[17] *See* Concurring and Dissenting Opinion of Associate Justice Alfredo Benjamin S. Caguioa in *Lara's Gifts & Decors, Inc. v. Midtown Industrial Sales, Inc.*, supra note 1, at 141-142. Citations omitted.

prescribed by law. While rates stipulated by the parties are subject to the unconscionability standard, legal interest rates which are prescribed by law are not.

In *Spouses Dela Cruz v. Planters Products, Inc.*,[18] the Court held that interest which accrues as a direct application of law and jurisprudence cannot be deemed inequitable and unconscionable, thus:

> Relevantly, the likelihood of the aggregate interest charged exceeding the principal indebtedness is not remote. In *Apo Fruits Corporation v. Land Bank of the Philippines*, a case involving just compensation for landholdings with legal interest, however, the Court has appropriately observed that the realization of such likelihood was not necessarily inequitable or unconscionable due to its resulting directly from the application of law and jurisprudence, to wit:
>
> > That the legal interest due is now almost equivalent to the principal to be paid is not *per se* an inequitable or unconscionable situation, considering the length of time the interest has remained unpaid — almost twelve long years. From the perspective of interest income, twelve years would have been sufficient for the petitioners to double the principal, even if invested conservatively, had they been promptly paid the principal of the just compensation due them. **Moreover, the interest, however enormous it may be, cannot be inequitable and unconscionable because it resulted directly from the application of law and jurisprudence — standards that have taken into account fairness and equity in setting the interest rates due for the use or forbearance of money.**
>
> That is true herein. Although this case was commenced in 1981, the decision of the trial court was rendered only in 1997, or more than 15 years ago. By appealing to the CA and then to this Court, the petitioners chose to prolong the final resolution of the case; hence, they cannot complain, but must bear the consequences to them of the application of the pertinent law and jurisprudence, no matter how unfavorable to them.[19] (Emphasis supplied)

To bolster the proposition that a rate of interest provided for by law is conceptually incapable of unconscionability, it is fitting to recall that this judicially developed concept resulted from the delicate balancing act between the parties' freedom to contract, on the one hand, and protection against oppressive abuses of such freedom, on the other. As early literature on the matter suggests:

> Most writers agree that the doctrine of unconscionability was included in the Code to avoid these circuitous or indirect objections to form contracts, along with other potential abuses of the bargaining process. Whether it was a good idea to define unconscionability in the words of section 2-302 was the subject of dispute. Surely, unconscionability decisions may be prompted by an emotional reaction to an apparently

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[18] 704 Phil. 28 (2013).

[19] Id. at 59-60. Citation omitted.

unjustifiable, unequal exchange. This notion appears to conflict with the policy of freedom of contract which holds that persons should be able to allocate the burdens of the exchange by agreement, including risks of loss. Some took the position that if unconscionability could be invoked at any time to change the prior allocation of the risks, havoc would result in the commercial world; no one would be able to predict their financial exposure, and litigation costs would rise sharply.

This argument might be valid if courts were motivated solely by emotional and intellectual considerations, *i.e.*, doing justice on an *ad hoc* basis. In fact, however, courts appear to be no more and no less concerned with doing justice where a claim of unconscionability is made than in any other dispute. While an intellectual/emotional component is undoubtedly present, the decisions nevertheless point to a definition of the concept of unconscionability.[20]

Although the degree of unconscionability may be far from clear cut, its rather amorphous or varying application nevertheless makes use of the same litmus test to measure possible unconscionability, that is whether the rate of interest may be so exorbitant and prohibitive as to "shock the conscience," as another scholar describes:

x x x Unconscionability was an arcane, nebulous concept in contract law that courts had used to avoid enforcing contracts that "shock the conscience." The doctrine seeks "the prevention of oppression and unfair surprise" and directs against the "disturbance of allocation of risks because of superior bargaining power." The distinctive element of the unconscionability defense, as opposed to fraud or duress, is its two-pronged analysis: traditionally, a provision must be both procedurally and substantively unconscionable to be held unenforceable. Procedural unconscionability "arises out of defects in the process by which the contract was formed, and can include a variety of inadequacies, such as age, literacy, lack of sophistication, hidden or unduly complex contract terms, bargaining tactics, and the particular setting existing during the contract formation process." **Substantive unconscionability "suggests the exchange of obligations <u>so one-sided</u> as to shock the court's conscience." <u>If a court finds that a provision is substantively unconscionable, it can void the specific provision and leave the rest of the contract intact.</u> Using unconscionability, it is possible for courts to step in and prevent the enforcement of a variety of contract provisions.**[21] (Emphasis and underscoring supplied)

Finally, as yet another scholar elucidates, the doctrine of unconscionability is an instrument of defense against the inequities of strict contract enforcement, to wit:

The doctrine of unconscionability reflects the long-settled principle that courts will not be used as "instruments of inequity and injustice" in the name of freedom of contract. To that end, courts have long invoked the doctrine as a "flexible safety net" to strike down contract terms that are "unreasonably and unexpectedly harsh," "unduly oppressive," or "so one-

[20] Jeffrey C. Fort, *Understanding Unconscionability: Defining the Principle*, LOYOLA UNIVERSITY CHICAGO JOURNAL, Vol. 9, Issue 4, p. 767.

[21] Colleen McCullough, *Unconscionability as a Coherent Legal Concept*, UNIVERSITY OF PENNSYLVANIA LAW REVIEW, Vol. 164, pp. 781-782.

> sided as to shock the conscience." When asked to enforce a contract bearing such terms, courts may invoke unconscionability and refuse to enforce all or portions of the contract at their discretion.[22]

In other words, the historical underpinning of the concept of unconscionability is largely anchored on protecting parties against cruel interest rates that they themselves may have freely imposed in a contract, and is therefore theoretically inapplicable to interest rates that have been provided for not by parties' liberties but by the law. The reduction of a legal interest that is clearly prescribed by law may only be legally plausible on the pretext that the law itself which prescribed such a rate is erroneous. **In such case, the solution would be an amendment of the law, and not an *ad hoc* reduction of statutorily imposed interest rates on a case to case basis.**

Thus, I disagree with the sweeping statement that "interest rates, whether conventional or compensatory, are subject to the 'unconscionability' standard."[23] I respectfully submit that this simplification fails to draw the important distinction between stipulated interest rates and legal interest rates. Since legal interest rates are set by law, they can neither be deemed inequitable nor unconscionable. For this reason, legal interest rates cannot be subject to the unconscionability standard. To repeat, they can neither be reduced nor deleted on the ground of unconscionability.

Therefore, I humbly suggest that for purposes of clarity and accuracy, such sweeping statement be properly qualified to read "**stipulated interest rates**, whether conventional or compensatory, are subject to the 'unconscionability' standard."

Regular compensatory interest under Article 2209 and interest on accrued interest under Article 2212 apply by operation of law

Proceeding from the foregoing discussion, I also submit that regular compensatory interest and interest on accrued interest shall apply by operation of law, and at the very least, at the applicable legal rate.

To recall, regular compensatory interest is that which is contemplated under Article 2209. To restate:

> Article 2209. **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*.** (Emphasis supplied)

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[22] Brady Williams, *Unconscionability as a Sword: The Case for an Affirmative Cause of Action*, CALIFORNIA LAW REVIEW, pp. 2016-2017.

[23] *Ponencia*, p. 13.

On the other hand, the application of interest on accrued interest is anchored on Article 2212 which reads:

> Article 2212. **Interest due shall earn legal interest** from the time it is judicially demanded, although the obligation may be silent upon this point. (Emphasis supplied)

The language of these provisions clearly signal the mandatory imposition of the interest contemplated therein, and thus reinforces the view that legal rates fall outside of the unconscionability standard, as both provisions set the legal rate as the floor for regular compensatory interest and interest on accrued interest. Hence, while the rate of regular compensatory interest and interest on accrued interest agreed upon by the parties may be reduced, they can neither be reduced below the applicable legal rate nor deleted altogether precisely because they accrue by operation of law in case of delay.

On this score, I am unable to agree with the conclusion that Articles 1229 and 2227 of the Civil Code serve as basis to cause a wholesale deletion of interest on accrued interest in this particular case.[24]

Foremost, Articles 1229 and 2227 of the Civil Code pertain to the reduction of **stipulated penalties and liquidated damages**:

> Article 1229. The judge shall equitably reduce the penalty when the principal obligation has been partly or irregularly complied with by the debtor. Even if there has been no performance, the penalty may also be reduced by the courts if it is iniquitous or unconscionable.
>
> Article 2227. Liquidated damages, whether intended as an indemnity or a penalty, shall be equitably reduced if they are iniquitous or unconscionable.

To my mind, the authority of the courts to reduce stipulated penalties or liquidated damages referred to in Articles 1229 and 2227 is precisely intended as a protective measure to preclude iniquitous stipulations, and to prevent situations where contracts are unduly skewed in favor of one party. **Notably, these dangers do not obtain in the context of interest which accrues at the legal rate prescribed by law.**

It may not be amiss to point out that in the cases referenced in the Resolution where the Court resolved to reduce interest rates based on the unconscionability standard, the rates reduced in those cases were in the nature of stipulated rates and/or stipulated penalties agreed upon by the parties.

In *Ligutan v. Court of Appeals*[25] (*Ligutan*), petitioners therein obtained a ₱120,000.00 loan from Security Bank and Trust Company. Petitioners were obliged to pay, upon maturity: (i) the principal with conventional interest at

[24] Id. at 14-15.
[25] 427 Phil. 42 (2002).

the stipulated rate of 15.189% *per annum*; and (ii) a 5% monthly penalty applied on the sum of the outstanding principal and accrued conventional interest in case of default. Further, petitioners were bound to pay 10% of the total amount due by way of attorney's fees.

Ultimately, the Court resolved to affirm the reduction of the rate of monthly penalty from 5% to 3%. It held:

> A penalty clause, expressly recognized by law, is an accessory undertaking to assume greater liability on the part of an obligor in case of breach of an obligation. It functions to strengthen the coercive force of the obligation and to provide, in effect, for what could be the liquidated damages resulting from such a breach. The obligor would then be bound to pay the stipulated indemnity without the necessity of proof on the existence and on the measure of damages caused by the breach. **Although a court may not at liberty ignore the freedom of the parties to agree on such terms and conditions as they see fit that contravene neither law nor morals, good customs, public order or public policy, a stipulated penalty, nevertheless, may be equitably reduced by the courts if it is iniquitous or unconscionable or if the principal obligation has been partly or irregularly complied with.**
>
> The question of whether a penalty is reasonable or iniquitous can be partly subjective and partly objective. Its resolution would depend on such factors as, but not necessarily confined to, the type, extent and purpose of the penalty, the nature of the obligation, the mode of breach and its consequences, the supervening realities, the standing and relationship of the parties, and the like, the application of which, by and large, is addressed to the sound discretion of the court. In *Rizal Commercial Banking Corp. vs. Court of Appeals*, just an example, the Court has tempered the penalty charges after taking into account the debtor's pitiful situation and its offer to settle the entire obligation with the creditor bank. **The stipulated penalty might likewise be reduced when a partial or irregular performance is made by the debtor. The stipulated penalty might even be deleted such as when there has been substantial performance in good faith by the obligor, when the penalty clause itself suffers from fatal infirmity, or when exceptional circumstances so exist as to warrant it.**
>
> The Court of Appeals, exercising its good judgment in the instant case, has reduced the penalty interest from 5% a month to 3% a month which petitioner still disputes. Given the circumstances, not to mention the repeated acts of breach by petitioners of their contractual obligation, the Court sees no cogent ground to modify the ruling of the appellate court.
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> Anent the stipulated interest of 15.189% *per annum*, petitioners, for the first time, question its reasonableness and prays that the Court reduce the amount. This contention is a fresh issue that has not been raised and ventilated before the courts below. In any event, the interest stipulation, on its face, does not appear as being that excessive. The essence or rationale for the payment of interest, quite often referred to as cost of money, is not exactly the same as that of a surcharge or a penalty. A penalty stipulation is not necessarily preclusive of interest, if there is an agreement to that effect, the two being distinct concepts which may separately be demanded. What may justify a court in not allowing the creditor to impose full surcharges and penalties, despite an express stipulation therefor in a valid agreement, may not equally justify the nonpayment or reduction of interest. Indeed, the

> interest prescribed in loan financing arrangements is a fundamental part of the banking business and the core of a bank's existence.[26] (Emphasis and underscoring supplied)

What was therefore reduced by the Court in *Ligutan* was the <u>stipulated rate</u> of regular compensatory interest imposed in the form of a monthly penalty charge, and not regular compensatory interest imposed at the legal rate. Stated differently, that the Court in *Ligutan* reduced the rate of monthly interest from 5% to 3% is of no moment insofar as the legal rate is concerned, since the interest so reduced was one stipulated by the parties. The reduction of the stipulated rate of regular compensatory interest ordered in *Ligutan* was within the Court's judicial prerogative to reduce a stipulated interest rate which it found to be oppressive and unconscionable.

Moreover, in *Barons Marketing Corp. v. Court of Appeals*[27] (*Barons Marketing*) private respondent therein appointed petitioner as one of its dealers for electrical wires and cables. As dealer, petitioner was granted a 60-day credit for its purchases. The credit term was to be reckoned from the date of delivery.

Between December 1986 to August 1987, petitioner purchased, on credit, various products from private respondent in the total amount of ₱4,102,438.30. Under the contract executed by the parties, petitioner bound itself to pay interest at 12% *per annum* on all overdue accounts plus "25% on said amount for attorney's fees and collection." On September 7, 1987, petitioner paid the amount of ₱300,000.00, leaving an unpaid balance of ₱3,802,478.20. Petitioner defaulted, prompting the private respondent to file a collection suit.

While the Court there upheld the liability of petitioner for the unpaid balance and the 12% stipulated compensatory interest, the Court characterized the additional 25% penalty charge as liquidated damages which had been intended to take the place of attorney's fees, and ultimately reduced the same to 10%, thus:

> Under said contract, petitioner is liable to private respondent for the unpaid balance of its purchases from private respondent plus 12% interest. Private respondent's sales invoices expressly provide that:
>
> > x x x Interest at 12% *per annum* will be charged on all overdue account plus 25% on said amount for attorney's fees and collection. x x x
>
> It may also be noted that the above stipulation, insofar as it provides for the payment of "25% on said amount for attorney's fees and collection (sic)," constitutes what is known as a penal clause. Petitioner is thus obliged to pay such penalty in addition to the 12% annual interest, there being an express stipulation to that effect.

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26 Id. at 51-53. Citations omitted.

27 349 Phil. 769 (1998).

Petitioner nevertheless urges this Court to reduce the **attorney's fees** for being "grossly excessive," "considering the nature of the case which is a mere action for collection of a sum of money." It may be pointed out however that the above penalty is supposed to answer not only for attorney's fees but for collection fees as well. Moreover:

> x x x the attorneys' fees here provided is not, strictly speaking, the attorneys' fees recoverable as between attorney and client spoken of and regulated by the Rules of Court. **Rather, the attorneys' fees here are in the nature of liquidated damages and the <u>stipulation</u> therefor is aptly called a penal clause. It has been said that so long as such <u>stipulation</u> does not contravene law, morals, or public order, it is strictly binding upon defendant.** The attorneys' fees so provided are awarded in favor of the litigant, not his counsel. It is the litigant, not counsel, who is the judgment creditor entitled to enforce the judgment by execution.

Nonetheless, courts are empowered to reduce such penalty if the same is "iniquitous or unconscionable." Article 1229 of the Civil Code states thus:

> ART. 1229. The judge shall equitably reduce the penalty when the principal obligation has been partly or irregularly complied with by the debtor. Even if there has been no performance, the penalty may also be reduced by the courts if it is iniquitous or unconscionable. x x x

The sentiments of the law are echoed in Article 2227 of the same Code:

> ART. 2227. Liquidated damages, whether intended as an indemnity or a penalty, shall be equitably reduced if they are iniquitous or unconscionable.

It is true that we have upheld the reasonableness of penalties in the form of attorney's fees consisting of twenty-five percent (25%) of the principal debt plus interest. In the case at bar, however, the interest alone runs to some four and a half million pesos (P4.5M), even exceeding the principal debt amounting to almost four million pesos (P4.0M). Twenty five percent (25%) of the principal and interest amounts to roughly two million pesos (P2M). In real terms, therefore, the attorney's fees and collection fees are manifestly exorbitant. Accordingly, we reduce the same to ten percent (10%) of the principal.[28] (Emphasis and underscoring supplied)

Hence, what was reduced in *Barons Marketing* was the amount of attorney's fees agreed upon by the parties. Again, such attorney's fees were neither in the nature of regular compensatory interest nor interest on accrued interest imposed at the legal rate. The rate so reduced in this case was the rate imposed as attorney's fees, and the Court was, therefore, also within its prerogative to reduce the same for being excessive.

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[28] Id. at 779-781. Citations omitted.

As well, in *Tan v. Court of Appeals*[29] (*Tan*), the Court had the occasion to examine the interest and penalties imposed on a loan amounting to ₱3,411,421.32. The promissory note detailing the loan's conditions read, in part:

> 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 (₱3,411,421.32) Philippine Currency, x x x.
>
> x x x x
>
> **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.[30] (Emphasis supplied)

Thus, the promissory note in *Tan* imposed the following: (i) conventional interest at the rate of 14% *per annum* on the principal loan computed from the date of issuance of the promissory note until full payment, plus a flat 3% service charge also applied on the principal loan; and (ii) regular compensatory interest at the rate of 2% per month, compounded monthly, computed from the time of delay until full payment.

Ultimately, the Court reduced the stipulated 2% monthly compounded penalty charge to a straight interest at the rate of 12% *per annum* which, at the time, was the prevailing legal rate applicable to loans and forbearances of money.[31] In so doing, the Court clarified that the 2% monthly compounded penalty assumes the nature of the indemnity for damages contemplated under Article 2209 of the Civil Code, that is, stipulated regular compensatory interest arising on account of delay in payment of the principal obligation. The relevant portions of the Decision state:

> In the case at bar, the promissory note x x x 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. x x x
>
> x x x x

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29 419 Phil. 857 (2001).

30 Id. at 865.

31 On the legal rate then prevailing, see *Eastern Shipping Lines, Inc. v. Court of Appeals*, 304 Phil. 236, 252-253 (1994) where the Cout held that "[w]hen the obligation is breached, and it consists in the payment of a sum of money, *i.e.*, a loan or forbearance of money, the interest due should be that which may have been stipulated in writing."

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. **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 [or conventional] interest on the principal of the loan.**

Penalty on delinquent loans may take different forms. In *Government Service Insurance System v. Court of Appeals*, 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*, 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** x x x[.]

x x x x

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 [regular] compensatory interest.** x x x[32] (Emphasis and underscoring supplied)

Notwithstanding the reduction of the stipulated penalty to the legal rate of 12% *per annum*, the Court nevertheless upheld the imposition of legal interest on said reduced penalty based on the terms of the promissory note in question, and, more relevantly, Article 2212. Hence, the Court added:

x x x [T]he 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 provision of Article 1959 of the New Civil Code considering that:

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[32] *Tan v. Court of Appeals*, supra note 29, at 864-866. Citations omitted.

> First, there is an express stipulation in the promissory note (Exhibit "A") permitting the compounding of interest. The fifth paragraph of the said promissory note provides that: "Any interest which may be due if not paid shall be added to the total amount when due and shall become part thereof, the whole amount to bear interest at the maximum rate allowed by law." **Therefore, any penalty interest not paid, when due, shall earn the legal interest of twelve percent (12%) [*per annum*], in the absence of express stipulation on the specific rate of interest, as in the case at bar.**
>
> **Second, Article 2212 of the New Civil Code provides that "Interest due shall earn legal interest from the time it is judicially demanded, althongh the obligation may be silent upon this point."** In the instant case, interest likewise began to run on the penalty interest upon the filing of the complaint in court by respondent CCP on August 29, 1984. Hence, the courts *a quo* did not err in ruling that the petitioner is bound to pay the interest on the total amount of the principal, the monetary interest and the penalty interest.[33] (Emphasis supplied)

Equally notable is the case of *Palmares v. Court of Appeals*[34] (*Palmares*). Therein, the Court assessed the validity of the interest and other charges imposed on a short-term loan of ₱30,000.00 obtained by Spouses Osmeña and Merlyn Azarraga (Spouses Azarraga) together with their surety, therein petitioner Estrella Palmares (Estrella). Said loan was issued on March 13, 1990 and payable "on or before May 12, 1990."

Upon Spouses Azarraga's default, M.B. Lending Corporation filed a complaint for sum of money against Estrella to the exclusion of Spouses Azarraga who were allegedly insolvent. In her Answer, Estrella argued that she previously offered to settle the obligation but that M.B. Lending Corporation told her not to worry as there has already been partial payment in the amount of ₱17,010.00. She further claimed that the 6% monthly compounded interest and 3% monthly penalty charge were unconscionable.

The Regional Trial Court (RTC) dismissed the complaint without prejudice to the filing of a separate action against Spouses Azarraga. According to the RTC, the filing of the complaint against Estrella alone amounted to a "discharge of a prior party"[35] and that her prior offer to pay the obligation "is considered a valid tender of payment sufficient to discharge a person's secondary liability."[36]

The CA reversed on appeal and ordered Estrella to pay: (i) the balance of ₱13,700.00 with compounded interest at 6% per month computed from the date the loan was contracted until fully paid; (ii) the sum equivalent to the stipulated monthly penalty of 3% of the outstanding balance; (iii) attorney's fees at 25% of the total amount due; and (iv) costs of suit. Aggrieved, Estrella filed a Petition for Review on *Certiorari* before the Court.

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[33] Id. at 866-867.
[34] 351 Phil. 664 (1998).
[35] Id. at 674.
[36] Id.

The Court resolved to strike down the 3% stipulated monthly penalty and reduce the 25% attorney's fees, thus:

> This notwithstanding, however, we find and so hold that the penalty charge of 3% per month and attorney's fees equivalent to 25% of the total amount due are highly inequitable and unreasonable.
>
> It must be remembered that from the principal loan of ₱30,000.00, the amount of ₱16,300.00 had already been paid even before the filing of the present case. Article 1229 of the Civil Code provides that the court shall equitably reduce the penalty when the principal obligation has been partly or irregularly complied with by the debtor. And, even if there has been no performance, the penalty may also be reduced if it is iniquitous or leonine.
>
> In a case previously decided by this Court which likewise involved private respondent M.B. Lending Corporation, and which is substantially on all fours with the one at bar, we decided to eliminate altogether the penalty interest for being excessive and unwarranted under the following rationalization:
>
>> Upon the matter of penalty interest, we agree with the Court of Appeals that the economic impact of the penalty interest of three percent (3%) per month on total amount due but unpaid should be equitably reduced. The purpose for which the penalty interest is intended — that is, to punish the obligor — will have been sufficiently served by the effects of compounded interest. Under the exceptional circumstances in the case at bar, *e.g.*, the original amount loaned was only ₱15,000.00; partial payment of ₱8,600.00 was made on due date; and the heavy (albeit still lawful) regular compensatory interest, the penalty interest stipulated in the parties' promissory note is iniquitous and unconscionable and may be equitably reduced further by eliminating such penalty interest altogether.
>
> **Accordingly, the penalty interest of 3% per month being imposed on petitioner should similarly be eliminated.**
>
> Finally, with respect to the award of attorney's fees, this Court has previously ruled that even with an agreement thereon between the parties, the court may nevertheless reduce such attorney's fees fixed in the contract when the amount thereof appears to be unconscionable or unreasonable. To that end, it is not even necessary to show, as in other contracts, that it is contrary to morals or public policy. The grant of attorney's fees equivalent to 25% of the total amount due is, in our opinion, unreasonable and immoderate, considering the minimal unpaid amount involved and the extent of the work involved in this simple action for collection of a sum of money. We, therefore, hold that the amount of ₱10,000.00 as and for attorney's fee would be sufficient in this case.[37] (Emphasis supplied)

Nevertheless, even with the wholesale deletion of the 3% stipulated monthly penalty, the debtor's liability to pay the 6% monthly compounded interest remained. This is clear from the dispositive portion in *Palmares*:

[37] Id. at 690-691.Citations omitted.

> **WHEREFORE**, the judgment appealed from is hereby *AFFIRMED*, subject to the *MODIFICATION* that the penalty interest of 3% per month is hereby deleted and the award of attorney's fees is reduced to ₱10,000.00.[38]

A close reading of the penalties imposed in *Palmares* shows that the 3% stipulated monthly penalty deleted by the Court was in the nature of a punitive rather than a compensatory penalty charge intended to be imposed in addition to the regular compensatory interest and interest on accrued interest provided by law.

To digress, stipulated penalties may be enforced either for a compensatory or strictly penal purpose. As explained in *D.M. Ragasa Enterprises, Inc. v. Banco de Oro, Inc.*:[39]

> A penal clause has a three-fold purpose: (1) a coercive purpose or one of guarantee — this is to urge the debtor to the fulfillment of the main obligation under pain of paying the penalty; (2) to serve as liquidated damages — this is to evaluate in advance the damages that may be occasioned by the non-compliance of the obligation; and (3) a strictly penal purpose — this is to punish the debtor for non-fulfillment of the main obligation. While the first purpose is always present, the second purpose is presumed and the third purpose must be expressly agreed upon.
>
> Stated otherwise, the purposes of penalty or penal clause are: (1) *funcion coercitiva o de guarantia* or to insure the performance of the obligation; (2) *funcion liquidatoria* or to liquidate the amount of damages to be awarded to the injured party in case of breach of the principal obligation; and (3) *funcion estrictamente penal* or to punish the obligor in case of breach of the principal obligation, in certain exceptional cases. **The second is evidently compensatory and the third is punitive in character, while the first is the general purpose regardless of whether the penalty is compensatory or punitive.**
>
> **Evidently, the penal clause may be considered either reparation, compensation or substitute for damages, on one hand, or as a punishment in case of breach of the obligation, on the other.** x x x[40] (Emphasis supplied)

Stipulated penalties imposed in the compensatory sense constitutes the indemnity for damages arising from delay contemplated under Article 2209. Accordingly, while the rate of such stipulated penalties may be reduced based on the unconscionability standard as explained above, such rate may not be reduced below the legal rate or altogether deleted as such penalty, in the form of regular compensatory interest, accrues by operation of law, and at the very least, at the applicable legal rate.

On the other hand, stipulated penalties imposed in the punitive sense apply in addition to the regular compensatory interest contemplated under

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38 Id. at 691.
39 833 Phil. 640 (2018).
40 Id. at 661. Citations omitted.

Article 2209. Such punitive penalties, when imposed in the form of additional interest, may be reduced below the applicable legal rate or even deleted altogether.

Now, in *Palmares*, the principal loan in question was purportedly for a term of two months. However, the fact that the 6% monthly interest was "computed every 30 days" from the date of its issuance and likewise compounded each month indicates that the principal amount was actually deemed due 30 days after its issuance.

Viewed in the proper light and bearing in mind that stipulated penalties are imposed either in the compensatory or punitive sense, the charges imposed on the principal loan subject of *Palmares* constitute: (i) regular compensatory interest at the rate of 6% per month applied on the principal loan; (ii) interest on accrued interest also at the rate of 6% per month applied on the outstanding obligation (that is, the sum of the principal loan and accrued regular compensatory interest); and (iii) an **additional** 3% monthly penalty charge imposed on the outstanding balance for a punitive purpose.

Therefore, what was deleted in *Palmares* was neither the regular compensatory interest nor the interest on accrued interest, but rather, the 3% monthly penalty charge imposed in addition thereto. As explained, such monthly penalty charge, being punitive in nature, is subject to reduction below the legal rate or even deletion at the courts' discretion as it is imposed not by operation of law, but solely upon agreement of the contracting parties.

All told, I submit that regular compensatory interest and interest on accrued interest imposed at the legal rate may not be deleted on the ground of unconscionability. The interest on accrued interest thus due on the 24% stipulated penalty charge subject of this Petition must therefore apply by operation of law.

In determining whether stipulated interest rates are unconscionable, courts must assess the economic impact of the stipulated interest rates and penalties in conjunction with the legal interest which accrues by operation of law

I recognize that the *verba legis* application of Articles 2209 and 2212 coupled with the limited application of the unconscionability standard as detailed above may be viewed as an unwarranted crippling of the courts' power to prevent inequity and afford innocent parties protection against unscrupulous individuals who are out to take advantage. However, I find that such a view unduly disregards the fact that courts may take these matters into account in assessing the total economic impact of the interest, penalties, and other changes imposed upon the obligation in question.

Thus, in determining whether stipulated interest rates are unconscionable, courts must assess stipulated interest rates and stipulated penalties in conjunction with such legal interest accruing thereon by operation of law. **While a stipulated interest rate may not appear unconscionable *per se*, it may nevertheless be reduced if its application *vis-a-vis* the prevailing legal interest imposed by law would yield iniquitous results. To note, this is precisely the approach which the Court has taken in the cases above-discussed.**

Guidelines on imposition of interest

In the course of resolving the present Motion for Reconsideration, the *Resolution* also proposes to amend the prevailing guidelines for the imposition of interest set forth in the case of *Eastern Shipping Lines, Inc. v. Court of Appeals*[41] (*Eastern Shipping Lines*) and restated in *Nacar v. Gallery Frames*[42] (*Nacar*). These amended guidelines read:

> A. In obligations consisting of loans or forbearances of money, goods or credit:
>
> 1. The compensatory interest due shall be that which is stipulated by the parties in writing as the penalty or compensatory interest rate, provided it is not unconscionable. In the absence of a stipulated penalty or compensatory interest rate, the compensatory interest due shall be that which is stipulated by the parties in writing as the conventional interest rate, provided it is not unconscionable. In the absence of a stipulated penalty or a stipulated conventional interest rate, or if these rates are unconscionable, **the compensatory interest shall be the prevailing legal interest rate prescribed by the Bangko Sentral ng Pilipinas.** Compensatory interest, in the absence of a stipulated reckoning date, shall be computed from default, *i.e.*, from extrajudicial or judicial demand *until full payment.*
>
> 2. Interest on conventional/monetary interest and stipulated compensatory interest shall accrue at the stipulated interest rate (compounded interest) from the stipulated reckoning point .or, in the absence thereof, from extrajudicial or judicial demand *until full payment,* provided it is not unconscionable. In the absence of a stipulated compounded interest rate or if this rate is unconscionable, the prevailing legal interest rate prescribed by the Bangko Sentral ng Pilipinas shall apply from the time of judicial demand *until full payment.*[43]
>
> B. In obligations not **consisting of loans or forbearances of money, goods or credit**:

[41] Supra note 31.
[42] 716 Phil. 267 (2013).
[43] *Ponencia*, pp. 20-21.

1. For liquidated claims:

   The compensatory interest due shall be that which is stipulated by the parties in writing as the penalty or compensatory interest rate, provided it is not unconscionable. In the absence of a stipulated penalty or compensatory interest rate, or if these rates are unconscionable, the compensatory interest shall be at the rate of 6%. Compensatory interest, in the absence of a stipulated reckoning date, shall be computed from default, *i.e.*, from extrajudicial or judicial demand, *until full payment.*

   a. Interest on stipulated compensatory interest shall accrue at the stipulated interest rate (compounded interest) from the stipulated reckoning point or in the absence thereof, from extrajudicial or judicial demand *until full payment,* provided it is not unconscionable. In the absence of a stipulated compounded interest rate or if this rate is unconscionable, legal interest at the rate of 6% shall apply from the time of judicial demand *until full payment.*

2. For unliquidated claims:

   Compensatory interest on the amount of damages awarded may be imposed in the discretion of the court at the rate of 6% *per annum.* No compensatory interest, however, shall be adjudged on unliquidated claims or damages until the demand can be established with reasonable certainty. Thus, when such certainty cannot be so reasonably established at the time the demand is made, the interest shall begin to run only from the date of judgment of the trial court (at which time, the quantification of damages may be deemed to have been reasonably ascertained) *until full payment.* The actual base for the computation of the interest shall, in any case, be on the principal amount finally adjudged.[44]

I wish to add, however, that the categorization of obligations adopted by the proposed guidelines fails to distinguish loans and forbearances within the context of the Usury Law from all other obligations for payment of a sum of money. As discussed in my *Opinion*, this distinction is crucial in the determination of applicable legal interest rates, as only loans, forbearances, and judgments involving loans and forbearances are subject to the BSP-prescribed interest rates. To quote:

> ***The term "forbearance" must be construed in light of the Usury Law***

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[44] Id.

The *ponencia* adopts the definition of forbearance in *Estores*, and holds that a forbearance has a separate meaning from a loan and should be construed to refer to "arrangements other than loan agreements, where a person acquiesces to the temporary use of his money, goods or credits pending happening of certain events or fulfillment of certain conditions." As a result, the *ponencia* concludes that the same covers even a sale of goods on installment and a sale of anything on credit.

I completely disagree. The definition in *Estores* cites no legal bases. Contrary to the discussion in the *ponencia*, the definition in *Estores* does not at all appear in *Crismina Garments*. In fact, *Crismina Garments* expressly adopted the definition in *Eastern Shipping Lines* that "a 'forbearance' in the context of the usury law is a '**contractual obligation of lender or creditor to refrain, during a given period of time, from requiring the borrower or debtor to repay a loan or debt then due and payable**'" and thus, correctly concluded that "an action for the enforcement of an obligation for payment of money arising from a contract for a piece of work x x x was obviously not a forbearance of money, goods or credit."

Instead, I subscribe to the well-reasoned conclusion in *Reformina* that:

> x x x **Any other kind of monetary judgment which has nothing to do with, nor involving loans or forbearance of any money, goods or credits does not fall within the coverage of the [Usury Law] for it is not within the ambit of the authority granted to the Central Bank. The Monetary Board may not tread on forbidden grounds. It cannot rewrite other laws. That function is vested solely with the legislative authority.** It is axiomatic in legal hermeneutics that statutes should be construed as a whole and not as a series of disconnected articles and phrases. In the absence of a clear contrary intention, words and phrases in statutes should not be interpreted in isolation from one another. A word or phrase in a statute is always used in association with other words or phrases and its meaning may thus be modified or restricted by the latter.

Applying the foregoing rationale, I submit that the phrase "forbearance of money, goods, or credits" must be construed in the narrow context of the Usury Law and in relation to the other provisions found therein. Hence, I find that the BSP has no authority (1) to prescribe interest rates in the absence of stipulation under Section 1 of the Usury Law or (2) to set interest rate ceilings under its Section 1-a, on any transaction that does not fall within the context of usury.

As the Usury Law is of American origin, resort to American jurisprudence on the construction of the term "forbearance" is *apropos*.

It has been held that "[i]nterest is the premium allowed by law for the use of money, while usury is the taking of more for its use than the law allows." In American jurisprudence, it is generally understood that "statutes are passed prohibiting usury, in order to protect needy and necessitous persons from the oppression of usurers, who are eager to take advantage of the distresses of others, and who violate the law only to complete their ruin." This is explained in *Monk v. Goldstein*, *viz.*:

> The test of usury is that there should be a contract for the forbearance of an existing indebtedness or a loan of money or, as otherwise expressed, a profit greater than the lawful rate of interest, intentionally exacted as a bonus for the loan of money, imposed upon the necessities of the borrower in a transaction where the treaty is for a loan and the money is to be returned at all events, which is a violation of the usury laws, it matters not what form or disguise it may assume. x x x "In order to constitute a usurious transaction, four requisites must appear: (1) There must be a loan, express or implied; (2) an understanding between the parties that the money lent shall be returned; (3) that for such loan a greater rate of interest than is allowed by law shall be paid or agreed to be paid, as the case may be; and (4) there must exist a corrupt intent to take more than the legal rate for the use of the money loaned.["] The text-writers declare that these rules are applicable everywhere and under the usury laws of every State, and that unless these four things concur in every transaction it is safe to say that no case of usury can be declared.

In *Hogg v. Ruffner*, the United States of America (US) Supreme Court explained that "[t]o constitute usury, there must either be a loan and a taking of usurious interest, or the taking of more than legal interest for the forbearance of a debt or sum of money due."

Several US cases define forbearance as "the giving of further time for the payment of a debt or an agreement not to enforce a claim at its due date." Similarly, it has been held that "[t]he term 'forbearance' as used in the law of usury, signifies a contractual obligation of a lender or creditor to refrain, during a given period of time, from requiring the borrower or debtor to pay a loan or debt then due and payable." It occurs when "the collection of a mature obligation is postponed in return for some compensation," *i.e.*, interest.

Like the US, Philippine Usury Law penalizes the taking of excessive interest for the loan or forbearance of money, goods, or credits in order to protect the needy from those who seek to exploit them. I believe usury statutes govern such kinds of situations because an opportunity to extort excessive interest in exchange for a reprieve from the immediate performance of a mature obligation is often present. I accordingly subscribe to the definition of forbearance provided in *Eastern Shipping Lines* and *Crismina Garments*, which adopted the definition in American jurisprudence that a "'forbearance' in the context of the usury law is a 'contractual obligation of a lender or creditor to refrain, during a given period of time, from requiring the borrower or debtor to repay a loan or debt then due and payable'" as it is the definition that is most in line with the nature and purpose of the Usury Law. Hence, I find that "forbearance" is no different from a loan and that the use of the conjunctive "or" precisely specifies this — meaning the word "loan" is not confined to a forbearance of only money, but also of goods or services. But even if "forbearance" is "separate from a loan" as the *ponencia* suggests, I believe that "forbearance" is or must be understood as akin to a loan and must involve (1) an agreement or contractual obligation (2) to refrain from enforcing payment or to extend the period for the payment of (3) an obligation that has become due and demandable, (4) in return for some compensation, *i.e.*, interest.

> **<u>Based on the foregoing disquisition, I therefore submit that not all obligations constituting the payment of a sum of money may be considered forbearances within the context of the Usury Law and within the authority of the BSP. The mere fact that there is delay or refusal to pay the sums due under a contract of sale, service, employment, lease, or insurance will not constitute a forbearance of money, goods, or credit. In such cases, the obligee or creditor does not actually agree or even acquiesce and is not contractually obliged to refrain from enforcing payment in exchange for interest, but merely fails to exact payment. Hence, the BSP-prescribed rate cannot apply. Instead, the 6% *per annum* interest rate under the Civil Code should apply.</u>**
>
> In like manner, the fact that the payment of interest in case of delay is stipulated in a contract will not automatically transform an obligation into a forbearance. Thus, the presence of a provision on the payment of interest in case of delay in the payment of the purchase price in a contract to sell or of sale, or in the payment of rents under a lease contract, does not transform the sale or lease into a forbearance. In the same vein, a construction contract cannot be deemed a forbearance even if there is a stipulation on the payment of interest in case the party who engaged the services of the contractor does not pay the progress billings on time. The payment of interest in case of delay is in the nature of a penalty clause, which parties may validly stipulate on in agreements involving both loans/forbearances and non-loans/non-forbearances.[45] (Emphasis and underscoring supplied)

Accordingly, I maintain that the guidelines on the imposition of interest must take into account the differential treatment between loans and forbearances on one hand, and all other obligations for payment of a sum of money on the other.

Given the foregoing, and after a careful reexamination of the application of interests with respect to unliquidated damages, I have reconsidered my view with respect thereto. I am now of the view that the delay in the payment of the unliquidated damages should serve as the basis for the application of interest, even though the base amount may be initially unascertained and it is for the courts to determine the exact amount owed. Thus, the application of the interest on the amount, as finally adjudged by the court, should retroact to the point of delay or default, *i.e.*, upon extrajudicial or judicial demand because it is at that point wherein the obligation to pay a sum of money thereby arises. This is akin to just compensation cases wherein the exact amount of just compensation is court-driven but the reckoning point wherein interest is imposed retroacts to the time of taking of the real property, wherein the obligation to pay the just compensation arises, and runs until full payment.

Considering the aforementioned observations, I re-submit the following proposed guidelines which take into comprehensive account the different permutations of applications of interests and their rates across types of obligations consisting of the payment of a sum of money. Given the plurality

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[45] Concurring and Dissenting Opinion of Associate Justice Alfredo Benjamin S. Caguioa in *Lara's Gifts & Decors, Inc. v. Midtown Industrial Sales, Inc.*, supra note 1, at 101-106. Citations omitted.

of the different scenarios wherein impositions of interests may be had, a flow chart reflecting a full rundown of the same is hereto attached to facilitate an overall appreciation of the different conceivable applications of interests at a glance.

At the outset, it must be recognized that interest applies exclusively to obligations consisting of the payment of a sum of money (OCPSM), which may consist of: (1) either loans and forbearances of money, goods, or credit (L/Fs); or (2) non-loans or non-forbearances (NL/NFs). The discourse of interests, the applicable rates and the reckoning points depend on the nature of the subject transactions. The differentiated applicable rates and reckoning points *vis-à-vis* the types of transactions they pertain to are outlined below.

I. Loans and Forbearances of Money, Goods, or Credit

L/Fs may contain a stipulated rate of interest and/or reckoning point (when interest commences to run) and the rate may be upheld as valid or void for being unconscionable and deemed not written. They may also be silent on the rate and/or reckoning point, or without stipulation.

I.A. With stipulated rate and/or reckoning point

I.A.1. Valid stipulation — If the parties stipulate on the payment of regular/conventional compensatory interest (R/CCI) with the rate specified, and the rate is upheld as valid, the R/CCI due shall be based on the stipulated rate, and the reckoning point will be either that which is stipulated or, in the absence of a stipulated reckoning point, the same shall be the time of default or delay from either extrajudicial or judicial demand (EX/JD), as the case may be. From the pertinent reckoning point, the R/CCI shall continue to run until full payment. Such stipulated R/CCI rate shall be controlling and the BSP-prescribed interest rate will not apply.

I.A.1.a. Interest on accrued interest (IOAI) — In addition to the R/CCI as determined in I.A.1., the L/F will also earn IOAI. In case there is a stipulated rate of interest on any unpaid/accrued interest (compounding interest or IOAI rate), and such rate is upheld as valid, the IOAI shall be based on the stipulated rate, and the reckoning point will be either that which is stipulated or, in the absence of a stipulated reckoning point, the same shall be the time of default or delay from either EX/JD.

If the IOAI rate is adjudged as unconscionable or void and deemed not written, the BSP-prescribed interest rate at the time of the execution of the L/F shall be the "surrogate" IOAI rate on the accrued

> interest to be reckoned from the stipulated reckoning point until full payment. In the absence of a stipulated reckoning point, the accrued interest as at judicial demand (JD) shall earn IOAI at the BSP-prescribed interest rate at the time of the execution of the L/F as the "surrogate" IOAI rate until full payment.

I.A.2. Void stipulation — If the stipulated R/CCI rate is adjudged as unconscionable or void and deemed not written, the BSP-prescribed interest rate at the time of the execution of the L/F shall apply as the "surrogate" R/CCI rate, and the reckoning point will be either that which is stipulated; or, in the absence of a stipulated reckoning point, the same shall be at the time of default or delay from either EX/JD until full payment.

> *I.A.2.a.* IOAI — In addition to the R/CCI as determined in I.A.2., the L/F will also earn IOAI. If there is no stipulated IOAI rate, or if such is found to be unconscionable and deemed not written, the prevailing BSP-prescribed rate of interest at the time of the execution of the L/F will apply as the surrogate IOAI rate. The accrued R/CCI as at JD shall earn the said prevailing BSP-prescribed rate until full payment. (Art. 2212)

I.B. Without stipulated rate

I.B.1. R/CCI — If the parties do not stipulate on the payment of interest, the indemnity for damages for delay shall be the payment of interest at the prevailing BSP-prescribed rate at the time of the execution of the L/F to be reckoned from the date of EX/JD and shall continue to run until full payment. (Article 1956 and Article 2209)

I.B.2. IOAI — In addition to the R/CCI as determined in I.B.1., the L/F will also earn IOAI. The accrued R/CCI as at JD shall earn interest at the prevailing BSP-prescribed rate at the time of the execution of the L/F from JD until full payment. (Article 2212)

I.C. Other monetary awards by the court, *e.g.*, moral damages, exemplary damages, temperate damages, attorney's fees — Any other monetary award decreed by the court in relation to the L/Fs shall bear interest at the prevailing BSP-prescribed rate at the time of the finality of the decision/judgment, from such time until full payment.

II. All Other Monetary Obligations Not Constituting Loans or Forbearances (NL/NFs)

The sum of money due in NL/NFs may be liquidated or unliquidated. These NL/NFs cover OCPSM arising from the sources of obligations namely, law, contracts other than L/Fs, quasi-contracts, quasi-delicts and delicts. For example, in a lease contract, the amount of unpaid rentals is generally liquidated. The same holds true in a contract of sale where the seller sues the buyer for the unpaid purchase price. On the other hand, in a just compensation (JC) action based on eminent domain, the exact amount of JC is court-determined, thus the sum due may be considered unliquidated. In a quasi-delict case, the victim may want to proceed to collect from the tortfeasor medical expenses, loss of earning, *etc.*, the exact amount of which is unliquidated.

II.A. NL/NFs with Liquidated Amounts

II.A.1. With valid stipulation — If the parties stipulate on the payment of R/CCI and the rate thereof, and the stipulated rate is deemed as valid, the R/CCI rate shall be that which is stipulated, to be reckoned from the time which is stipulated or, in the absence of a stipulated reckoning point, the same shall be the time of default or delay from either EX/JD, and shall continue to run until full payment.

II.A.1.a. IOAI — In addition to the R/CCI as determined in II.A.1., the R/CCI that has accrued shall itself earn interest at the stipulated IOAI rate, if deemed valid, to be reckoned from either the reckoning point so stipulated or, in the absence of stipulated reckoning point, from EX/JD until full payment. If there is no stipulated IOAI rate, or if such is found to be unconscionable and deemed not written, the legal rate of 6% *per annum* provided in Article 2209 shall apply as the IOAI rate on the accrued R/CCI as at JD from JD until full payment.

II.A.2. With void stipulation — If the stipulated R/CCI rate is void for being unconscionable and deemed not written, the indemnity for damages for delay shall be the payment of legal interest at the rate of 6% *per annum* under Article 2209 reckoned either from the reckoning point so stipulated or, in the absence thereof, from the date of EX/JD until full payment.

II.A.2.a. IOAI — In addition to the R/CCI as determined in II.A.2., the creditor shall be entitled to IOAI pursuant to Article 2212 wherein the accrued R/CCI as at JD shall itself earn legal interest

at the rate of 6% *per annum* from JD until full payment.

II.A.3. Without stipulation — If there is no stipulation as to the R/CCI rate, the indemnity for damages for delay shall be the payment of legal interest at the rate of 6% *per annum* under Article 2209 reckoned either from the date of EX/JD.

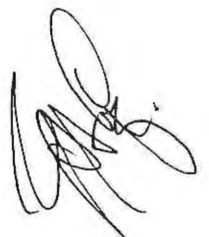
II.A.3.a. IOAI — In addition to the R/CCI as determined in II.A.3., the creditor shall be entitled to IOAI pursuant to Art. 2212 wherein the accrued R/CCI as at JD shall itself earn interest at the legal interest of 6% *per annum* from JD until full payment.

II.B. NL/NFs with Unliquidated Amounts — The amount or sum owed as awarded in the final and executory decision/judgment shall earn legal interest at the rate of 6% *per annum* from default or delay either from EX/JD until full payment.

With regard to unliquidated claims or damages (including obligations arising from law, quasi-delict, quasi-contract, delict, and NL/NFs contracts), the sum of money claimed, being unliquidated, will be subject to the determination of the court, and the exact amount owed will be indicated in the final decision/judgment. Given that the debtor may delay the payment of the sum due through protracted litigation, to compensate the creditor for this delay, legal interest at the rate of 6% *per annum* should be imposed on the amount finally adjudged but given retroactive effect to begin from the reckoning point of default or delay either from EX/JD, until full payment, unless the court orders a bigger amount under the premises. This is akin to JC cases wherein the JC determined with finality is the amount that earns interest from the time of taking of the real property.

II.C. Other monetary awards by the court — Any other monetary award decreed by the court in relation to NL/NFs shall bear legal interest at the rate of 6% *per annum* under Article 2209 from the time the decision/judgment becomes final and executory until full payment.

Finally, with respect to penalty interest, the penal clause will be ascertained as to whether it is to be imposed in its compensatory aspect or punitive aspect. If imposed in its compensatory aspect, the penal clause shall be deemed the indemnity of actual damages and will be subject to the guidelines on R/CCI as formulated above. If imposed in its punitive aspect, the penal clause shall be imposed in addition to actual damages,

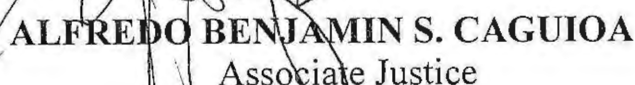


i.e., on top of the R/CCI awarded. However, the penal clause in its punitive aspect may be totally disregarded by reason of unconscionability.

WHEREFORE, based on the foregoing premises, I vote to **DENY** the Motion for Reconsideration filed by petitioner Lara's Gifts & Decors, Inc.

Nevertheless, for the reasons set forth herein, I find that the August 28, 2019 Decision should be **MODIFIED** in that: (1) the guidelines be amended accordingly; and (2) the dispositive portion be restated as follows:

> Petitioner Lara's Gifts & Decors, Inc. is ordered to pay respondent Midtown Industrial Sales, Inc. the following:
>
> 1. ONE MILLION TWO HUNDRED SIXTY-THREE THOUSAND ONE HUNDRED FOUR PESOS and 22/100 (₱1,263,104.22) representing the principal amount plus stipulated interest at 24% *per annum* to be computed from January 22, 2008, the date of extrajudicial demand, until full payment.
>
> 2. The sum of FIFTY THOUSAND PESOS (₱50,000.00) as attorney's fees, plus legal interest thereon at the rate of 6% *per annum* to be computed from the finality of this August 28, 2019 Decision until full payment.
>
> 3. Cost of the suit.



ALFREDO BENJAMIN S. CAGUIOA
Associate Justice

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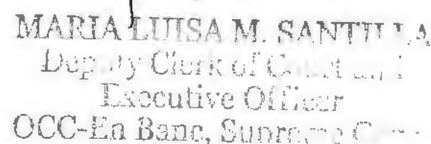

MARIA LUISA M. SANTILLA
Deputy Clerk of Court and
Executive Officer
OCC-En Banc, Supreme Court