

## THIRD DIVISION

[ G.R. No. 197861, June 05, 2013 ]

**SPOUSES FLORENTINO T. MALLARI AND AUREA V. MALLARI,  
PETITIONERS, VS. PRUDENTIAL BANK (NOW BANK OF THE  
PHILIPPINE ISLANDS), RESPONDENT.**

### D E C I S I O N

**PERALTA, J.:**

Before us is a Petition for Review on *Certiorari* under Rule 45, assailing the Decision<sup>[1]</sup> dated June 17, 2010 and the Resolution<sup>[2]</sup> dated July 20, 2011 of the Court of Appeals (CA) in CA-G.R. CV No. 65993.

The antecedent facts are as follows:

On December 11, 1984, petitioner Florentino T. Mallari (Florentino) obtained from respondent Prudential Bank-Tarlac Branch (respondent bank), a loan in the amount of P300,000.00 as evidenced by Promissory Note (PN) No. BD 84-055.<sup>[3]</sup> Under the promissory note, the loan was subject to an interest rate of 21% per annum (p.a.), attorney's fees equivalent to 15% of the total amount due but not less than P200.00 and, in case of default, a penalty and collection charges of 12% p.a. of the total amount due. The loan had a maturity date of January 10, 1985, but was renewed up to February 17, 1985. Petitioner Florentino executed a Deed of Assignment<sup>[4]</sup> wherein he authorized the respondent bank to pay his loan with his time deposit with the latter in the amount of P300,000.00.

On December 22, 1989, petitioners spouses Florentino and Aurea Mallari (petitioners) obtained again from respondent bank another loan of P1.7 million as evidenced by PN No. BDS 606-89<sup>[5]</sup> with a maturity date of March 22, 1990. They stipulated that the loan will bear 23% interest p.a., attorney's fees equivalent to 15% p.a. of the total amount due, but not less than P200.00, and penalty and collection charges of 12% p.a. Petitioners executed a Deed of Real Estate Mortgage<sup>[6]</sup> in favor of respondent bank covering petitioners' property under Transfer Certificate of Title (TCT) No. T-215175 of the Register of Deeds of Tarlac to answer for the said loan.

Petitioners failed to settle their loan obligations with respondent bank, thus, the latter, through its lawyer, sent a demand letter to the former for them to pay their obligations, which when computed up to January 31, 1992, amounted to P571,218.54 for PN No. BD 84-055 and P2,991,294.82 for PN No. BDS 606-89.

On February 25, 1992, respondent bank filed with the Regional Trial Court (RTC) of Tarlac, a petition for the extrajudicial foreclosure of petitioners' mortgaged property for the satisfaction of the latter's obligation of P1,700,000.00 secured by such

mortgage, thus, the auction sale was set by the Provincial Sheriff on April 23, 1992.  
[7]

On April 10, 1992, respondent bank's Assistant Manager sent petitioners two (2) separate Statements of Account as of April 23, 1992, i.e., the loan of P300,000.00 was increased to P594,043.54, while the P1,700,000.00 loan was already P3,171,836.18.

On April 20, 1992, petitioners filed a complaint for annulment of mortgage, deeds, injunction, preliminary injunction, temporary restraining order and damages claiming, among others, that: (1) the P300,000.00 loan obligation should have been considered paid, because the time deposit with the same amount under Certificate of Time Deposit No. 284051 had already been assigned to respondent bank; (2) respondent bank still added the P300,000.00 loan to the P1.7 million loan obligation for purposes of applying the proceeds of the auction sale; and (3) they realized that there were onerous terms and conditions imposed by respondent bank when it tried to unilaterally increase the charges and interest over and above those stipulated. Petitioners asked the court to restrain respondent bank from proceeding with the scheduled foreclosure sale.

Respondent bank filed its Answer with counterclaim arguing that: (1) the interest rates were clearly provided in the promissory notes, which were used in computing for interest charges; (2) as early as January 1986, petitioners' time deposit was made to apply for the payment of interest of their P300,000.00 loan; and (3) the statement of account as of April 10, 1992 provided for a computation of interest and penalty charges only from May 26, 1989, since the proceeds of petitioners' time deposit was applied to the payment of interest and penalty charges for the preceding period. Respondent bank also claimed that petitioners were fully apprised of the bank's terms and conditions; and that the extrajudicial foreclosure was sought for the satisfaction of the second loan in the amount of P1.7 million covered by PN No. BDS 606-89 and the real estate mortgage, and not the P300,000.00 loan covered by another PN No. 84-055.

In an Order<sup>[8]</sup> dated November 10, 1992, the RTC denied the Application for a Writ of Preliminary Injunction. However, in petitioners' Supplemental Motion for Issuance of a Restraining Order and/or Preliminary Injunction to enjoin respondent bank and the Provincial Sheriff from effecting or conducting the auction sale, the RTC reversed itself and issued the restraining order in its Order<sup>[9]</sup> dated January 14, 1993.

Respondent bank filed its Motion to Lift Restraining Order, which the RTC granted in its Order<sup>[10]</sup> dated March 9, 1993. Respondent bank then proceeded with the extrajudicial foreclosure of the mortgaged property. On July 7, 1993, a Certificate of Sale was issued to respondent bank being the highest bidder in the amount of P3,500,000.00.

Subsequently, respondent bank filed a Motion to Dismiss Complaint<sup>[11]</sup> for failure to prosecute action for unreasonable length of time to which petitioners filed their Opposition.<sup>[12]</sup> On November 19, 1998, the RTC issued its Order<sup>[13]</sup> denying respondent bank's Motion to Dismiss Complaint.

Trial thereafter ensued. Petitioner Florentino was presented as the lone witness for the plaintiffs. Subsequently, respondent bank filed a Demurrer to Evidence.

On November 15, 1999, the RTC issued its Order<sup>[14]</sup> granting respondent's demurrer to evidence, the dispositive portion of which reads:

WHEREFORE, this case is hereby ordered DISMISSED. Considering there is no evidence of bad faith, the Court need not order the plaintiffs to pay damages under the general concept that there should be no premium on the right to litigate.

NO COSTS.

SO ORDERED.<sup>[15]</sup>

The RTC found that as to the P300,000.00 loan, petitioners had assigned petitioner Florentino's time deposit in the amount of P300,000.00 in favor of respondent bank, which maturity coincided with petitioners' loan maturity. Thus, if the loan was unpaid, which was later extended to February 17, 1985, respondent bank should have just applied the time deposit to the loan. However, respondent bank did not, and allowed the loan interest to accumulate reaching the amount of P594,043.54 as of April 10, 1992, hence, the amount of P292,600.00 as penalty charges was unjust and without basis.

As to the P1.7 million loan which petitioners obtained from respondent bank after the P300,000.00 loan, it had reached the amount of P3,171,836.18 per Statement of Account dated April 27, 1993, which was computed based on the 23% interest rate and 12% penalty charge agreed upon by the parties; and that contrary to petitioners' claim, respondent bank did not add the P300,000.00 loan to the P1.7 million loan obligation for purposes of applying the proceeds of the auction sale.

The RTC found no legal basis for petitioners' claim that since the total obligation was P1.7 million and respondent bank's bid price was P3.5 million, the latter should return to petitioners the difference of P1.8 million. It found that since petitioners' obligation had reached P2,991,294.82 as of January 31, 1992, but the certificate of sale was executed by the sheriff only on July 7, 1993, after the restraining order was lifted, the stipulated interest and penalty charges from January 31, 1992 to July 7, 1993 added to the loan already amounted to P3.5 million as of the auction sale.

The RTC found that the 23% interest rate p.a., which was then the prevailing loan rate of interest could not be considered unconscionable, since banks are not hospitable or equitable institutions but are entities formed primarily for profit. It also found that Article 1229 of the Civil Code invoked by petitioners for the reduction of the interest was not applicable, since petitioners had not paid any single centavo of the P1.7 million loan which showed they had not complied with any part of the obligation.

Petitioners appealed the RTC decision to the CA. A Comment was filed by respondent bank and petitioners filed their Reply thereto.

On June 17, 2010, the CA issued its assailed Decision, the dispositive portion of which reads:

**WHEREFORE**, the instant appeal is hereby **DENIED**. The Order dated November 15, 1999 issued by the Regional Trial Court (RTC), Branch 64, Tarlac City, in Civil Case No. 7550 is hereby **AFFIRMED**.<sup>[16]</sup>

The CA found that the time deposit of P300,000.00 was equivalent only to the principal amount of the loan of P300,000.00 and would not be sufficient to cover the interest, penalty, collection charges and attorney's fees agreed upon, thus, in the Statement of Account dated April 10, 1992, the outstanding balance of petitioners' loan was P594,043.54. It also found not persuasive petitioners' claim that the P300,000.00 loan was added to the P1.7 million loan. The CA, likewise, found that the interest rates and penalty charges imposed were not unconscionable and adopted *in toto* the findings of the RTC on the matter.

Petitioners filed their Motion for Reconsideration, which the CA denied in a Resolution dated July 20, 2011.

Hence, petitioners filed this petition for review arguing that:

THE HON. COURT OF APPEALS ERRED IN AFFIRMING THE ORDER OF THE RTC-BRANCH 64, TARLAC CITY, DATED NOVEMBER 15, 1999, DESPITE THE FACT THAT THE SAME IS CONTRARY TO SETTLED JURISPRUDENCE ON THE MATTER.<sup>[17]</sup>

The issue for resolution is whether the 23% p.a. interest rate and the 12% p.a. penalty charge on petitioners' P1,700,000.00 loan to which they agreed upon is excessive or unconscionable under the circumstances.

Parties are free to enter into agreements and stipulate as to the terms and conditions of their contract, but such freedom is not absolute. As Article 1306 of the Civil Code provides, "The contracting parties may establish such stipulations, clauses, terms and conditions as they may deem convenient, provided they are not contrary to law, morals, good customs, public order, or public policy." Hence, if the stipulations in the contract are valid, the parties thereto are bound to comply with them, since such contract is the law between the parties. In this case, petitioners and respondent bank agreed upon on a 23% p.a. interest rate on the P1.7 million loan. However, petitioners now contend that the interest rate of 23% p.a. imposed by respondent bank is excessive or unconscionable, invoking our ruling in *Medel v. Court of Appeals*,<sup>[18]</sup> *Toring v. Spouses Ganzon-Olan*,<sup>[19]</sup> and *Chua v. Timan*.<sup>[20]</sup>

We are not persuaded.

In *Medel v. Court of Appeals*,<sup>[21]</sup> we found the stipulated interest rate of 66% p.a. or a 5.5% per month on a P500,000.00 loan excessive, unconscionable and exorbitant, hence, contrary to morals if not against the law and declared such stipulation void. In *Toring v. Spouses Ganzon-Olan*,<sup>[22]</sup> the stipulated interest rates