

## FIRST DIVISION

[ G.R. No. 159709, June 27, 2012 ]

### HEIRS OF SERVANDO FRANCO, PETITIONERS, VS. SPOUSES VERONICA AND DANILO GONZALES, RESPONDENTS.

#### DECISION

##### **BERSAMIN, J.:**

There is novation when there is an irreconcilable incompatibility between the old and the new obligations. There is no novation in case of only slight modifications; hence, the old obligation prevails.

The petitioners challenge the decision promulgated on March 19, 2003,<sup>[1]</sup> whereby the Court of Appeals (CA) upheld the issuance of a writ of execution by the Regional Trial Court (RTC), Branch 16, in Malolos, Bulacan.

#### **Antecedents**

The Court adopts the following summary of the antecedents rendered by the Court in *Medel v. Court of Appeals*,<sup>[2]</sup> the case from which this case originated, to wit:

On November 7, 1985, Servando Franco and Leticia Medel (hereafter Servando and Leticia) obtained a loan from Veronica R. Gonzales (hereafter Veronica), who was engaged in the money lending business under the name "Gonzales Credit Enterprises", in the amount of P50,000.00, payable in two months. Veronica gave only the amount of P47,000.00, to the borrowers, as she retained P3,000.00, as advance interest for one month at 6% per month. Servando and Leticia executed a promissory note for P50,000.00, to evidence the loan, payable on January 7, 1986.

On November 19, 1985, Servando and Leticia obtained from Veronica another loan in the amount of P90,000.00, payable in two months, at 6% interest per month. They executed a promissory note to evidence the loan, maturing on January 19, 1986. They received only P84,000.00, out of the proceeds of the loan.

On maturity of the two promissory notes, the borrowers failed to pay the indebtedness.

On June 11, 1986, Servando and Leticia secured from Veronica still another loan in the amount of P300,000.00, maturing in one month, secured by a real estate mortgage over a property belonging to Leticia Makalintal Yaptinchay, who issued a special power of attorney in favor of

Leticia Medel, authorizing her to execute the mortgage. Servando and Leticia executed a promissory note in favor of Veronica to pay the sum of P300,000.00, after a month, or on July 11, 1986. However, only the sum of P275,000.00, was given to them out of the proceeds of the loan.

Like the previous loans, Servando and Medel failed to pay the third loan on maturity.

On July 23, 1986, Servando and Leticia with the latter's husband, Dr. Rafael Medel, consolidated all their previous unpaid loans totaling P440,000.00, and sought from Veronica another loan in the amount of P60,000.00, bringing their indebtedness to a total of P500,000.00, payable on August 23, 1986. They executed a promissory note, reading as follows:

"Baliwag, Bulacan July 23, 1986

"Maturity Date August 23, 1986

"P500,000.00

"FOR VALUE RECEIVED, I/WE jointly and severally promise to pay to the order of VERONICA R. GONZALES doing business in the business style of GONZALES CREDIT ENTERPRISES, Filipino, of legal age, married to Danilo G. Gonzales, Jr., of Baliwag Bulacan, the sum of PESOS ..... FIVE HUNDRED THOUSAND ..... (P500,000.00) Philippine Currency with interest thereon at the rate of 5.5 PER CENT per month plus 2% service charge per annum from date hereof until fully paid according to the amortization schedule contained herein. (Underscoring supplied)

"Payment will be made in full at the maturity date.

"Should I/WE fail to pay any amortization or portion hereof when due, all the other installments together with all interest accrued shall immediately be due and payable and I/WE hereby agree to pay an additional amount equivalent to one per cent (1%) per month of the amount due and demandable as penalty charges in the form of liquidated damages until fully paid; and the further sum of TWENTY FIVE PER CENT (25%) thereof in full, without deductions as Attorney's Fee whether actually incurred or not, of the total amount due and demandable, exclusive of costs and judicial or extra judicial expenses. (Underscoring supplied)

"I, WE further agree that in the event the present rate of interest on loan is increased by law or the Central Bank of the Philippines, the holder shall have the option to apply and collect the increased interest charges without notice although the original interest have already been collected wholly or

partially unless the contrary is required by law.

"It is also a special condition of this contract that the parties herein agree that the amount of peso-obligation under this agreement is based on the present value of peso, and if there be any change in the value thereof, due to extraordinary inflation or deflation, or any other cause or reason, then the peso-obligation herein contracted shall be adjusted in accordance with the value of the peso then prevailing at the time of the complete fulfillment of obligation.

"Demand and notice of dishonor waived. Holder may accept partial payments and grant renewals of this note or extension of payments, reserving rights against each and all indorsers and all parties to this note.

"IN CASE OF JUDICIAL Execution of this obligation, or any part of it, the debtors waive all his/their rights under the provisions of Section 12, Rule 39, of the Revised Rules of Court."

On maturity of the loan, the borrowers failed to pay the indebtedness of P500,000.00, plus interests and penalties, evidenced by the above-quoted promissory note.

On February 20, 1990, Veronica R. Gonzales, joined by her husband Danilo G. Gonzales, filed with the Regional Trial Court of Bulacan, Branch 16, at Malolos, Bulacan, a complaint for collection of the full amount of the loan including interests and other charges.

In his answer to the complaint filed with the trial court on April 5, 1990, defendant Servando alleged that he did not obtain any loan from the plaintiffs; that it was defendants Leticia and Dr. Rafael Medel who borrowed from the plaintiffs the sum of P500,000.00, and actually received the amount and benefited therefrom; that the loan was secured by a real estate mortgage executed in favor of the plaintiffs, and that he (Servando Franco) signed the promissory note only as a witness.

In their separate answer filed on April 10, 1990, defendants Leticia and Rafael Medel alleged that the loan was the transaction of Leticia Yaptinchay, who executed a mortgage in favor of the plaintiffs over a parcel of real estate situated in San Juan, Batangas; that the interest rate is excessive at 5.5% per month with additional service charge of 2% per annum, and penalty charge of 1% per month; that the stipulation for attorney's fees of 25% of the amount due is unconscionable, illegal and excessive, and that substantial payments made were applied to interest, penalties and other charges.

After due trial, the lower court declared that the due execution and genuineness of the four promissory notes had been duly proved, and ruled that although the Usury Law had been repealed, the interest

charged by the plaintiffs on the loans was unconscionable and "revolting to the conscience". Hence, the trial court applied "the provision of the New [Civil] Code" that the "legal rate of interest for loan or forbearance of money, goods or credit is 12% per annum."

Accordingly, on December 9, 1991, the trial court rendered judgment, the dispositive portion of which reads as follows:

"WHEREFORE, premises considered, judgment is hereby rendered, as follows:

"1. Ordering the defendants Servando Franco and Leticia Medel, jointly and severally, to pay plaintiffs the amount of P47,000.00 plus 12% interest per annum from November 7, 1985 and 1% per month as penalty, until the entire amount is paid in full.

"2. Ordering the defendants Servando Franco and Leticia Y. Medel to plaintiffs, jointly and severally the amount of P84,000.00 with 12% interest per annum and 1% per cent per month as penalty from November 19, 1985 until the whole amount is fully paid;

"3. Ordering the defendants to pay the plaintiffs, jointly and severally, the amount of P285,000.00 plus 12% interest per annum and 1% per month as penalty from July 11, 1986, until the whole amount is fully paid;

"4. Ordering the defendants to pay plaintiffs, jointly and severally, the amount of P50,000.00 as attorney's fees;

"5. All counterclaims are hereby dismissed.

"With costs against the defendants."

In due time, both plaintiffs and defendants appealed to the Court of Appeals.

In their appeal, plaintiffs-appellants argued that the promissory note, which consolidated all the unpaid loans of the defendants, is the law that governs the parties. They further argued that Circular No. 416 of the Central Bank prescribing the rate of interest for loans or forbearance of money, goods or credit at 12% per annum, applies only in the absence of a stipulation on interest rate, but not when the parties agreed thereon.

The Court of Appeals sustained the plaintiffs-appellants' contention. It ruled that "the Usury Law having become 'legally inexistent' with the promulgation by the Central Bank in 1982 of Circular No. 905, the lender and borrower could agree on any interest that may be charged on the loan". The Court of Appeals further held that "the imposition of 'an

additional amount equivalent to 1% per month of the amount due and demandable as penalty charges in the form of liquidated damages until fully paid' was allowed by law".

Accordingly, on March 21, 1997, the Court of Appeals promulgated its decision reversing that of the Regional Trial Court, disposing as follows:

"WHEREFORE, the appealed judgment is hereby MODIFIED such that defendants are hereby ordered to pay the plaintiffs the sum of P500,000.00, plus 5.5% per month interest and 2% service charge per annum effective July 23, 1986, plus 1% per month of the total amount due and demandable as penalty charges effective August 24, 1986, until the entire amount is fully paid.

"The award to the plaintiffs of P50,000.00 as attorney's fees is affirmed. And so is the imposition of costs against the defendants.

"SO ORDERED."

On April 15, 1997, defendants-appellants filed a motion for reconsideration of the said decision. By resolution dated November 25, 1997, the Court of Appeals denied the motion.<sup>[3]</sup>

On review, the Court in *Medel v. Court of Appeals* struck down as void the stipulation on the interest for being iniquitous or unconscionable, and revived the judgment of the RTC rendered on December 9, 1991, viz:

WHEREFORE, the Court hereby REVERSES and SETS ASIDE the decision of the Court of Appeals promulgated on March 21, 1997, and its resolution dated November 25, 1997. Instead, we render judgment REVIVING and AFFIRMING the decision dated December 9, 1991, of the Regional Trial Court of Bulacan, Branch 16, Malolos, Bulacan, in Civil Case No. 134-M-90, involving the same parties.

No pronouncement as to costs in this instance.

SO ORDERED.<sup>[4]</sup>

Upon the finality of the decision in *Medel v. Court of Appeals*, the respondents moved for execution.<sup>[5]</sup> Servando Franco opposed,<sup>[6]</sup> claiming that he and the respondents had agreed to fix the entire obligation at P775,000.00.<sup>[7]</sup> According to Servando, their agreement, which was allegedly embodied in a receipt dated February 5, 1992,<sup>[8]</sup> whereby he made an initial payment of P400,000.00 and promised to pay the balance of P375,000.00 on February 29, 1992, superseded the July 23, 1986 promissory note.