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# THIRD DIVISION

# [ G.R. No. 138677, February 12, 2002 ]

## TOLOMEO LIGUTAN AND LEONIDAS DE LA LLANA, PETITIONERS, VS. HON. COURT OF APPEALS & SECURITY BANK & TRUST COMPANY, RESPONDENTS.

## D E C I S I O N

**VITUG, J.:**

Before the Court is a petition for review on *certiorari* under Rule 45 of the Rules of Court, assailing the decision and resolutions of the Court of Appeals in CA-G.R. CV No. 34594, entitled "Security Bank and Trust Co. vs. Tolomeo Ligutan, et al."

Petitioners Tolomeo Ligutan and Leonidas dela Llana obtained on 11 May 1981 a loan in the amount of P120,000.00 from respondent Security Bank and Trust Company. Petitioners executed a promissory note binding themselves, jointly and severally, to pay the sum borrowed with an interest of 15.189% per annum upon maturity and to pay a penalty of 5% every month on the outstanding principal and interest in case of default. In addition, petitioners agreed to pay 10% of the total amount due by way of attorney's fees if the matter were indorsed to a lawyer for collection or if a suit were instituted to enforce payment. The obligation matured on 8 September 1981; the bank, however, granted an extension but only up until 29 December 1981.

Despite several demands from the bank, petitioners failed to settle the debt which, as of 20 May 1982, amounted to P114,416.10. On 30 September 1982, the bank sent a final demand letter to petitioners informing them that they had five days within which to make full payment. Since petitioners still defaulted on their obligation, the bank filed on 3 November 1982, with the Regional Trial Court of Makati, Branch 143, a complaint for recovery of the due amount.

After petitioners had filed a joint answer to the complaint, the bank presented its evidence and, on 27 March 1985, rested its case. Petitioners, instead of introducing their own evidence, had the hearing of the case reset on two consecutive occasions. In view of the absence of petitioners and their counsel on 28 August 1985, the third hearing date, the bank moved, and the trial court resolved, to consider the case submitted for decision.

Two years later, or on 23 October 1987, petitioners filed a motion for reconsideration of the order of the trial court declaring them as having waived their right to present evidence and prayed that they be allowed to prove their case. The court *a quo* denied the motion in an order, dated 5 September 1988, and on 20 October 1989, it rendered its decision,[1] the dispositive portion of which read:

"WHEREFORE, judgment is hereby rendered in favor of the plaintiff and against the defendants, ordering the latter to pay, jointly and severally, to the plaintiff, as follows:

"1. The sum of P114,416.00 with interest thereon at the rate of 15.189% per annum, 2% service charge and 5% per month penalty charge, commencing on 20 May 1982 until fully paid;

"2. To pay the further sum equivalent to 10% of the total amount of indebtedness for and as attorney's fees; and

"3. To pay the costs of the suit."[2]

Petitioners interposed an appeal with the Court of Appeals, questioning the rejection by the trial court of their motion to present evidence and assailing the imposition of the 2% service charge, the 5% per month penalty charge and 10% attorney's fees. In its decision[3] of 7 March 1996, the appellate court affirmed the judgment of the trial court except on the matter of the 2% service charge which was deleted pursuant to Central Bank Circular No. 783. Not fully satisfied with the decision of the appellate court, both parties filed their respective motions for reconsideration.[4] Petitioners prayed for the reduction of the 5% stipulated penalty for being unconscionable. The bank, on the other hand, asked that the payment of interest and penalty be commenced not from the date of filing of complaint but from the time of default as so stipulated in the contract of the parties.

On 28 October 1998, the Court of Appeals resolved the two motions thusly:

"We find merit in plaintiff-appellee's claim that the principal sum of P114,416.00 with interest thereon must commence not on the date of filing of the complaint as we have previously held in our decision but on the date when the obligation became due.

"Default generally begins from the moment the creditor demands the performance of the obligation. However, demand is not necessary to render the obligor in default when the obligation or the law so provides.

"In the case at bar, defendants-appellants executed a promissory note where they undertook to pay the obligation on its maturity date 'without necessity of demand.' They also agreed to pay the interest in case of non-payment from the date of default.

"x x x x x x x x x

"While we maintain that defendants-appellants must be bound by the contract which they acknowledged and signed, we take cognizance of their plea for the application of the provisions of Article 1229 x x x.

"Considering that defendants-appellants partially complied with their obligation under the promissory note by the reduction of the original amount of P120,000.00 to P114,416.00 and in order that they will finally

settle their obligation, it is our view and we so hold that in the interest of justice and public policy, a penalty of 3% per month or 36% per annum would suffice.

"x x x x x x x x x

"WHEREFORE, the decision sought to be reconsidered is hereby MODIFIED. The defendants-appellants Tolomeo Ligutan and Leonidas dela Llana are hereby ordered to pay the plaintiff-appellee Security Bank and Trust Company the following:

"1. The sum of P114,416.00 with interest thereon at the rate of 15.189% per annum and 3% per month penalty charge commencing May 20, 1982 until fully paid;

"2. The sum equivalent to 10% of the total amount of the indebtedness as and for attorney's fees."[5]

On 16 November 1998, petitioners filed an omnibus motion for reconsideration and to admit newly discovered evidence,[6] alleging that while the case was pending before the trial court, petitioner Tolomeo Ligutan and his wife Bienvenida Ligutan executed a real estate mortgage on 18 January 1984 to secure the existing indebtedness of petitioners Ligutan and dela Llana with the bank. Petitioners contended that the execution of the real estate mortgage had the effect of novating the contract between them and the bank. Petitioners further averred that the mortgage was extrajudicially foreclosed on 26 August 1986, that they were not informed about it, and the bank did not credit them with the proceeds of the sale. The appellate court denied the omnibus motion for reconsideration and to admit newly discovered evidence, ratiocinating that such a second motion for reconsideration cannot be entertained under Section 2, Rule 52, of the 1997 Rules of Civil Procedure. Furthermore, the appellate court said, the newly-discovered evidence being invoked by petitioners had actually been known to them when the case was brought on appeal and when the first motion for reconsideration was filed. [7]

Aggrieved by the decision and resolutions of the Court of Appeals, petitioners elevated their case to this Court on 9 July 1999 *via* a petition for review on *certiorari* under Rule 45 of the Rules of Court, submitting thusly -

"I. The respondent Court of Appeals seriously erred in not holding that the 15.189% interest and the penalty of three (3%) percent per month or thirty-six (36%) percent per annum imposed by private respondent bank on petitioners' loan obligation are still manifestly exorbitant, iniquitous and unconscionable.

"II. The respondent Court of Appeals gravely erred in not reducing to a reasonable level the ten (10%) percent award of attorney's fees which is highly and grossly excessive, unreasonable and unconscionable.

"III. The respondent Court of Appeals gravely erred in not

admitting petitioners' newly discovered evidence which could not have been timely produced during the trial of this case.

"IV. The respondent Court of Appeals seriously erred in not holding that there was a novation of the cause of action of private respondent's complaint in the instant case due to the subsequent execution of the real estate mortgage during the pendency of this case and the subsequent foreclosure of the mortgage."[8]

Respondent bank, which did not take an appeal, would, however, have it that the penalty sought to be deleted by petitioners was even insufficient to fully cover and compensate for the cost of money brought about by the radical devaluation and decrease in the purchasing power of the peso, particularly *vis-a-vis* the U.S. dollar, taking into account the time frame of its occurrence. The Bank would stress that only the amount of P5,584.00 had been remitted out of the entire loan of P120,000.00.[9]

A penalty clause, expressly recognized by law,[10] 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[11] 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.[12] 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.[13]

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*,[14] 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.[15] The stipulated penalty might even be deleted such as when there has been substantial performance in good faith by the obligor,[16] when the penalty clause itself suffers from fatal infirmity, or when exceptional circumstances so exist as to warrant it.[17]

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