

EN BANC

G.R. No. 211363 — ESTRELLA PABALAN, *petitioner*, *versus*
VASUDAVE SABNANI, *respondent*.

Promulgated:

February 21, 2023

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CONCURRING OPINION

CAGUIOA, J.:

The *ponencia* grants the Petition¹ and reverses and sets aside the Court of Appeals' (CA) Decision² dated November 28, 2012 and Resolution³ dated February 12, 2014 which reduced the stipulated rates of the loan obligation between petitioner Estrella Pabalan (Pabalan) and respondent Vasudave Sabnani (Sabnani) for being unconscionable, as follows: 1) interest rate of 5% and 8% per month to 1% per month; 2) penalty charge of 20% per month to 1% per month; and 3) the rates of liquidated damages and attorney's fees of 50% and 25% of the amount due, respectively, to 10% each. Consequently, the *ponencia* reinstates the Decision⁴ dated March 28, 2005 of the Regional Trial Court (RTC) upholding the stipulated rates of the parties.

To recall, the transaction here involves a loan entered into between Pabalan and Sabnani on April 30, 1999 for the total amount of ₱7,450,000.00 payable on installment within three (3) months. To secure the loan, Sabnani executed two (2) promissory notes⁵ and a Deed of Real Estate Mortgage⁶ (REM) over his condominium unit located in Skyland Plaza Condominium, Makati City.

As it happened, Sabnani failed to pay the loan obligation resulting in the extrajudicial foreclosure sale of his condominium unit where Pabalan emerged as the sole and highest bidder for the bid amount of ₱17,400,000.00. The bid price was based on an updated Statement of Account submitted by Pabalan during the foreclosure sale which reflected additional interest, penalties, liquidated damages, and attorney's fees agreed upon by the parties.⁷

It is noted that the validity of the REM, promissory notes, and the foreclosure sale is no longer in issue. In her Petition, Pabalan mainly argues

¹ *Rollo*, pp. 13-44.

² *Id.* at 46-72. Penned by Associate Justice Noel G. Tijam (retired member of this Court), with Associate Justices Romeo F. Barza and Ramon A. Cruz concurring.

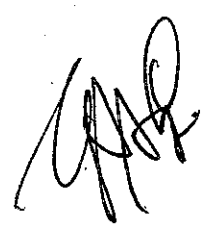
³ *Id.* at 74-78.

⁴ *Id.* at 186-195. Penned by Presiding Judge Winlove M. Dumayas.

⁵ *Id.* at 79-80.

⁶ *Id.* at 81-86.

⁷ *Ponencia*, p. 4.



that, contrary to the ruling of the CA, the interest rates, penalty charges, liquidated damages, and attorney's fees as stipulated by the parties should be upheld since Sabnani voluntarily agreed to the same.⁸ Thus, Pabalan claims that the CA erred in: (1) reducing the stipulated rates of the parties resulting in the reduction of the total liability of Sabnani to the amount of ₱9,517,100.00; and (2) ordering Pabalan to return the excess of the bid price to Sabnani with legal interest from August 3, 1999 (date of foreclosure sale) and cost of sale.

The *ponencia* grants the Rule 45 Petition and consequently reverses and sets aside the CA's Decision dated November 28, 2012 and Resolution dated February 12, 2014, ruling as follows:

1. Contracting parties have a wide latitude to stipulate on interest rates. However, such freedom is not absolute. The stipulated rates must not be contrary to law, morals, good customs, public order, or public policy. The Court has discretionary power to reduce stipulated rates that are found to be iniquitous.
2. Stipulated rates are not inherently conscionable or unconscionable. The determination of this depends on the circumstances of each case. Thus, in *Toledo v. Hyden*,⁹ the interest rate of 6-7% per month was held not to be excessive since the Court found that the debtor therein was making a business on the amount loaned to her and could no longer deny the validity of the stipulated rates after enjoying its benefits.
3. The Court in the recent Resolution on the motion for reconsideration filed in *Lara's Gifts & Decors, Inc. v. Midtown Industrial Sales, Inc.*¹⁰ (*Lara's Gifts*) established the new and prevailing guidelines on conventional and compensatory interest rates. In *Lara's Gifts*, the Court recognized that the standard used in determining the conscionability of a conventional interest rate is twice the legal rate of interest. If the stipulated rate is higher, then the creditor must justify this as necessary under market conditions or show that the parties were on equal footing when they agreed on it.
4. The new rules on interest rate under *Lara's Gifts* will not apply in this case since the parties are on equal footing. Determination of whether the parties stood on equal footing is done on a case-to-case basis and in consideration of relevant factors. This entails looking at personal backgrounds and circumstances, if one of the parties was disadvantaged due to moral dependence, mental

⁸ See *id.* at 8-10.

⁹ 652 Phil. 70 (2010).

¹⁰ G.R. No. 225433, September 20, 2022.



weakness, tender age, their educational attainment, professional employment, financial status and their capacity to understand and consent to the agreement. The history of the relationship of the contracting parties can also be of significance (*i.e.*, isolated transaction or series of transactions). Thus, if the Court finds that the parties are on equal footing the Court must refrain from intervening.

5. Guided by the foregoing rulings, the stipulated rates of the parties in the present case **cannot** be considered iniquitous or illegal. The facts show that the parties herein were on equal footing: (a) neither party was disadvantaged. Pabalan was a businesswoman based in Manila while Sabnani was a British businessman who regularly visited the Philippines to look for investment opportunities; (b) neither party was compelled to enter into the loan transaction. Sabnani was not in financial distress; (c) Sabnani obtained the loan to accommodate his business partner Michael Claparols (Claparols) who would then utilize the loan as investment in Sabnani's projects. Sabnani agreed to the loan in order to obtain the investment money sooner while Claparols waited for his money to be released from the United States; (d) Sabnani's contemporaneous acts during the execution of the loan proved that he had full knowledge of the terms and conditions thereof when he gave consent to it. He was able to determine the risks involved by demanding that Claparols issue in his favor two checks as security. The said checks took into consideration the interest rates imposed by Pabalan and covered the value of his mortgaged property in the event of foreclosure; (e) Sabnani benefitted from the loan and cannot now assail its validity since it was used for investment in his project; and (f) the loan was a short-term undertaking intended to be an accommodation for Claparols.

Accordingly, the *ponencia* holds that the stipulated rates were freely and voluntarily agreed upon resulting in Pabalan's winning bid at the foreclosure sale to be proper. Therefore, the RTC's finding that Pabalan's total bid amount correctly applied the imposed rates should be affirmed and the CA's order requiring her to return the surplus must be reversed and set aside.

I fully concur with the *ponencia* in granting the Petition. The stipulated rates of interest, penalty, liquidated damages and attorney's fees between the parties herein must be upheld.

It is basic that a contract is the law between the parties and they are free to establish such stipulations, clauses, terms and conditions as they may deem convenient provided these are not contrary to law, morals, good customs, public order or public policy, *viz.*:



Art. 1306. 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. (1255a)¹¹

Thus, in accordance with the principle of autonomy of contracts, the parties are free to stipulate on the interest rates, penalties, liquidated damages and attorney's fees which will govern their contractual relations.

As regards interest rates, there are two types: (1) monetary interest or interest as a compensation which is fixed by the parties for the use of forbearance of money; and (2) compensatory interest or interest that may be imposed by the courts as penalty or damage. The present case involves monetary interest or the agreed upon "cost of borrowing money."¹² It arises out of contract for the use or forbearance of money and is the type of interest which is governed by usury laws.

The Usury Law, as amended, prescribed an interest rate of six percent (6%) per annum or such rate as may be prescribed by the Central Bank Monetary Board for loans or forbearance of money, in the absence of express stipulation as to such rate of interest.¹³ The object and purpose of the Usury Law is to penalize the taking of excessive interest¹⁴ in order to protect the needy from those who seek to exploit them. However, in 1982, the Bangko Sentral ng Pilipinas issued Central Bank Circular (CB Circular) No. 905 which removed the interest rate ceiling pursuant to its authority under Section 1-a of the Usury Law.¹⁵ Thus, parties are indeed given latitude to stipulate on interest rates in view of the ceiling suspension granted under CB Circular No. 905.¹⁶ This however does not give creditors "*carte blanche* authority to impose interest rates which would result in the enslavement of their borrowers or to the hemorrhaging of their assets."¹⁷ Courts have the power to equitably reduce the stipulated interest rates when they are found to be contrary to law, morals, good customs, public order or public policy. Thus, similar to the objectives of usury laws, the unconscionability principle is designed to protect helpless borrowers who are induced to sign loan obligations despite burdensome rates imposed by the creditor.

Similarly, courts have the power to reduce stipulated penalty charges, liquidated damages, and attorney's fees when these are found to be iniquitous or unconscionable. The pertinent provisions of the Civil Code are:

Art. 1229. The judge shall equitably reduce the penalty when the principal obligation has been partly or irregularly complied with by the

¹¹ CIVIL CODE.

¹² *Sps. Abella v. Sps. Abella*, 763 Phil. 372, 382, 386 (2015).

¹³ See *Lara's Gifts & Decors, Inc. v. Midtown Industrial Sales, Inc.*, G.R. No. 225433, August 28, 2019, 916 SCRA 1, 43-45.

¹⁴ *United States v. Constantino Tan Quingco Chua*, 39 Phil. 552, 554-556 (1919).

¹⁵ See *Advocates for Truth in Lending, Inc v. Bangko Sentral Monetary Board*, 701 Phil. 483, 488 (2013).

¹⁶ *Rey v. Anson*, 842 Phil. 952, 967-968 (2018).

¹⁷ *Dio v. Sps. Japor*, 501 Phil. 469, 476 (2005); italics in the original and citation omitted.

debtor. Even if there has been no performance, the penalty may also be reduced by the courts if it is iniquitous or unconscionable. (1154a)

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Art. 2208. In the absence of stipulation, attorney's fees and expenses of litigation, other than judicial costs, cannot be recovered, except:

- (1) When exemplary damages are awarded;
- (2) When the defendant's act or omission has compelled the plaintiff to litigate with third persons or to incur expenses to protect his interest;
- (3) In criminal cases of malicious prosecution against the plaintiff;
- (4) In case of a clearly unfounded civil action or proceeding against the plaintiff;
- (5) Where the defendant acted in gross and evident bad faith in refusing to satisfy the plaintiff's plainly valid, just and demandable claim;
- (6) In actions for legal support;
- (7) In actions for the recovery of wages of household helpers, laborers and skilled workers;
- (8) In actions for indemnity under workmen's compensation and employer's liability laws;
- (9) In a separate civil action to recover civil liability arising from a crime;
- (10) When at least double judicial costs are awarded;
- (11) In any other case where the court deems it just and equitable that attorney's fees and expenses of litigation should be recovered.

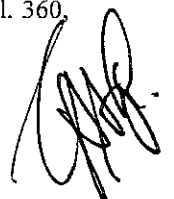
In all cases, the attorney's fees and expenses of litigation must be reasonable.

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

What is considered exorbitant is dependent upon the facts of the case. In exercising the vested power to determine what is iniquitous and unconscionable, courts shall consider the circumstances of each case.¹⁸ Thus, what may be unconscionable in one case, may not necessarily mean the same in another, *viz.*:

¹⁸ *Trade & Investment Dev't. Corp. of the Phil. v. Roblett Industrial Construction Corp.*, 523 Phil. 360, 366 (2006).



Whether an interest rate or penalty charge is reasonable or iniquitous is addressed to the sound discretion of the courts. In determining what is iniquitous and unconscionable, courts must consider the circumstances of each case, for what may be just in one case may be iniquitous and unconscionable in another. Thus, while this Court sustained the validity of a 21% *per annum* interest in *Spouses Bautista v. Pilar Development Corporation*, it reduced an 18% *per annum* interest rate to 12% *per annum* in *Trade & Investment Development Corporation of the Phils. v. Roblett*.[.]¹⁹ (Italics in the original; citations omitted)

Moreover, unconscionable rates are deemed illegal because they violate mutuality of contracts. The principle of mutuality of contracts is embodied in Article 1308 of the Civil Code, *viz.*:

Art. 1308. The contract must bind both contracting parties; its validity or compliance cannot be left to the will of one of them. (1256a)

In *Security Bank Corporation v. Sps. Mercado*,²⁰ the Court aptly explains the principle of mutuality of contracts, to wit:

The principle of mutuality of contracts is found in Article 1308 of the New Civil Code, which states that contracts must bind both contracting parties, and its validity or compliance cannot be left to the will of one of them. **The binding effect of any agreement between parties to a contract is premised on two settled principles: [(1)] that any obligation arising from contract has the force of law between the parties; and (2) that there must be mutuality between the parties based on their essential equality. As such, any contract which appears to be heavily weighed in favor of one of the parties so as to lead to an unconscionable result is void.** Likewise, any stipulation regarding the validity or compliance of the contract that is potestative or is left solely to the will of one of the parties is invalid. This holds true not only as to the original terms of the contract but also to its modifications. Consequently, any change in a contract must be made with the consent of the contracting parties, and must be mutually agreed upon. Otherwise, it has no binding effect.

Stipulations as to the payment of interest are subject to the principle of mutuality of contracts. As a principal condition and an important component in contracts of loan, interest rates are only allowed if agreed upon by express stipulation of the parties, and only when reduced into writing. Any change to it must be mutually agreed upon, or it produces no binding effect:

Basic is the rule that there can be no contract in its true sense without the mutual assent of the parties. If this consent is absent on the part of one who contracts, the act has no more efficacy than if it had been done under duress or by a person of unsound mind. Similarly, contract changes must be made with the consent of the contracting parties. The minds of all the parties must meet as to the proposed modification, especially when it affects an important aspect of the agreement. In the case of loan contracts, the interest rate is undeniably always a vital component, for it can make or break a

¹⁹ *Land Bank of the Phils. v. David*, 585 Phil. 167, 174 (2008).

²⁰ 834 Phil. 286 (2018).



capital venture. Thus, any change must be mutually agreed upon, otherwise, it produces no binding effect.²¹ x x x (Emphasis supplied; citations omitted)

Thus, there can be no contract in the absence of mutual consent of the parties. In order for contractual obligations to have the force of law between the parties, there must be mutuality between them based on their essential equality.²²

Applying the foregoing, the evil sought to be prevented by the unconscionability principle is *not* present in this case. As aptly found by the *ponencia*, the parties herein were on equal footing or, more accurately stated, they were on equal bargaining positions. Sabnani was not an obligor who was in desperate need of money and was constrained to enter into a loan agreement with Pabalan. Rather, both parties were seeking to obtain a financial gain from the loan obligation. Thus, Sabnani cannot claim that the rates he freely agreed to were iniquitous and illegal. To be sure, this claim is completely belied by the fact that Sabnani even covered his exposure by securing from Claparols two checks as security, which checks not only mirrored the interest rates imposed by Pabalan, but also covered the value of his mortgaged property to Pabalan. Consequently, Sabnani is bound by the stipulated rates of interest, penalty charges, liquidated damages, and attorney's fees.

In addition to the extensive discussion of the *ponencia* in upholding the stipulated rates of the contracting parties, I add that the Court should not intervene by reason of the fact that the parties herein are in *pari delicto*. The rule on *pari delicto* is governed by Articles 1411 and 1412 of the Civil Code, to wit:

Art. 1411. When the nullity proceeds from the illegality of the cause or object of the contract, and the act constitutes a criminal offense, both parties being *in pari delicto*, they shall have no action against each other, and both shall be prosecuted. Moreover, the provisions of the Penal Code relative to the disposal of effects or instruments of a crime shall be applicable to the things or the price of the contract.

This rule shall be applicable when only one of the parties is guilty; but the innocent one may claim what he has given, and shall not be bound to comply with his promise. (1305)

Art. 1412. If the act in which the unlawful or forbidden cause consists does not constitute a criminal offense, the following rules shall be observed:

(1) When the fault is on the part of both contracting parties, neither may recover what he has given by virtue of the contract, or demand the performance of the other's undertaking;

(2) When only one of the contracting parties is at fault, he cannot recover what he has given by reason of the contract, or ask for the

²¹ Id. at 305-306.

²² *Philippine National Bank v. Court of Appeals*, 308 Phil. 18, 24 (1994).



fulfillment of what has been promised him. The other, who is not at fault, may demand the return of what he has given without any obligation to comply with his promise. (1306) (*Italics in the original*)

Under the *pari delicto* doctrine, if the parties to a controversy are equally culpable or guilty, they shall have no action, in equity or law, against each other, and the court shall leave the parties where it finds them, *viz.*:

Latin for “in equal fault,” *in pari delicto* connotes that two or more people are at fault or are guilty of a crime. Neither courts of law nor equity will interpose to grant relief to the parties, when an illegal agreement has been made, and both parties stand *in pari delicto*. Under the *pari delicto* doctrine, the parties to a controversy are equally culpable or guilty, they shall have no action against each other, and it shall leave the parties where it finds them. This doctrine finds expression in the maxims “*ex dolo malo non oritur actio*” and “*in pari delicto potior est conditio defendentis*.”²³ (*Italics in the original; citations omitted*)

As discussed, Sabnani was fully aware of the rates imposed on the loan agreement. Again, when he re-lent the amount to Claparols, he asked for and obtained sufficient securities in the form of checks to cover his risk (*i.e.*, one BPI check for ₱8,282,000.00 to cover the loan and another BPI check for ₱21,718,000.00 to cover the value of his condominium unit). Meanwhile, Pabalan, at the risk of not being able to collect the debt, ensured that her financial exposure would be covered by the stipulated rates, as well as the REM over Sabnani’s condominium unit. Stated otherwise, both parties were seeking a business advantage from the transaction and ensured sufficient securities in their favor to protect against any financial loss.

Now that Sabnani’s venture did not push through, he cannot then seek recourse from the courts for what he knowingly and willingly agreed to. As a businessman, he was well aware of the effects of the stipulations in the promissory notes and the REM. All told, neither one of the parties herein may seek remedy from the courts of justice or equity. The courts will leave them as they were at the time the case was filed.²⁴

In summary, “[i]t is a long-established doctrine that the law does not relieve a party from the effects of an unwise, foolish or disastrous contract, entered into with all the required formalities and with full awareness of what he was doing. Courts have no power to relieve parties from obligations voluntarily assumed, simply because their contracts turned out to be disastrous deals or unwise investments.”²⁵ The parties here were not legally incompetent to understand the terms and conditions of the loan contract they freely and voluntarily entered. Thus, they are bound by the consequences of their agreement.

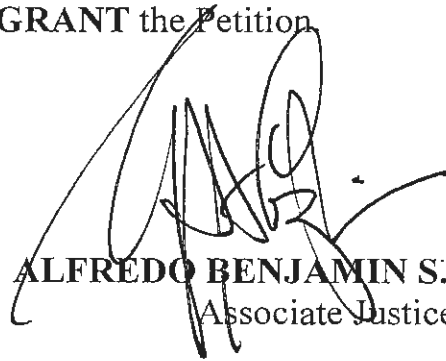
²³ *Constantino v. Heirs of Pedro Constantino, Jr.*, 718 Phil. 575, 584-585 (2013).

²⁴ *Id.*

²⁵ *Esguerra v. CA*, 335 Phil. 58, 69 (1997); citation omitted.



For these reasons, I vote to **GRANT** the Petition.



ALFREDO BENJAMIN S. CAGUIOA
Associate Justice