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Republic of the Philippines
Supreme Court
Manila

THIRD DIVISION

SPOUSES JUAN CHUY TAN and MARY TAN (deceased) substituted by the surviving heirs, JOEL TAN and ERIC TAN,
Petitioners,

- versus -

CHINA BANKING CORPORATION,
Respondent.

G.R. No. 200299

Present:

VELASCO, JR., *J.*, *Chairperson,*
PERALTA,
PEREZ,
REYES, and
JARDELEZA, *JJ.*

Promulgated:

August 17, 2016

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DECISION

PEREZ, *J.*:

For resolution of the Court is the instant Petition for Review on *Certiorari*[1] filed by petitioner Spouses Juan Chuy Tan and Mary Tan (deceased) substituted by the surviving heirs, Joel Tan and Eric Tan, seeking to reverse and set aside the Decision[2] dated 14 October 2011 and Resolution[3] dated 24 January 2012 of the Court of Appeals (CA) in CA-G.R. CV. No. 87450. The assailed decision and resolution affirmed with modification the 29 December 2003 Decision[4] of the Regional Trial Court (RTC) of Makati City, Branch 142 by ordering that the penalty surcharge of 24% per annum as stipulated in the contract of loan is reduced to 12% per annum.

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1 *Rollo*, pp. 57-78.
2 Id. at 87-106; penned by Associate Justice Antonio L. Villamor, concurred by Associate Justices Jane Aurora C. Lantion and Ramon A. Cruz.
3 Id. at 107-108.
4 Id. at 166-171; penned by Judge Estela M. Perlas-Bernabe (now a member of this Court).

The Facts

Petitioner Lorenze Realty and Development Corporation (Lorenze Realty) is a domestic corporation duly authorized by Philippine laws to engage in real estate business. It is represented in this action by petitioners Joel Tan and Eric Tan as substitutes for their deceased parents, Spouses Juan Chuy Tan and Mary Tan (Spouses Tan).

Respondent China Banking Corporation (China Bank), on the other hand, is a universal banking corporation duly authorized by *Bangko Sentral ng Pilipinas (BSP)* to engage in banking business.

On several occasions in 1997, Lorenze Realty obtained from China Bank various amounts of loans and credit accommodations in the following amounts:

DATE	PROMISSORY NOTE NOS.	PRINCIPAL AMOUNT
27 June 1997	BDC-0345	₱1,600,000.00
30 July 1997	BDC-0408	1,000,000.00
13 August 1997	BDC-0422	1,100,000.00
18 August 1997	BDC-0432	1,960.000.00
21 August 1997	BDC-0438	1,490.000.00
2 September 1997	BDC-0455	2,200,000.00
1 October 1997	BDC-0506	1,700,000.00
20 November 1997	DLS-0316	2,800,000.00
18 June 1997	DLS-0324	5,500,000.00
18 June 1997	DLS-0325	2,675,000.00
04 July 1997	DLS-0360	7,000,000.00
24 July 1997	DLS-0403	4,000,000.00
28 August 1997	BDC-0449	1,550,000.00
20 November 1997	BDC-0340	1,550,000.00
8 September 1997	BDC-0466	1,262,500.00
31 September 1997	BDC-0479	662,500.00
10 July 1997	DLS 0379	33,000,000.00
TOTAL		**₱71,050,000.00**

It is expressly stipulated in the Promissory Notes that Lorenze Realty agreed to pay the additional amount of ***1/10 of 1% per day of the total amount of obligation due as penalty*** to be computed from the day that the default was incurred up to the time that the loan obligations are fully paid. The debtor also undertook pay ***an additional 10% of the total amount due including interests, surcharges and penalties as attorney's fees.***

As a security for the said obligations, Lorenze Realty executed Real Estate Mortgages (REM) over 11 parcels of land covered by Transfer Certificates of Title (TCT) Nos. B-44428, B-44451, B-44452, V-44275, V-44276, V-44277, V-44278, V-44280, V-44281, V-44283 and V-44284 registered by the Registry of Deeds of Valenzuela City.

Subsequently, Lorenze Realty incurred in default in the payment of its amortization prompting China Bank to cause the extra-judicial foreclosure of the REM constituted on the securities after the latter failed to heed to its demand to settle the entire obligation.

After the notice and publication requirements were complied with, the mortgaged properties were sold at a public auction wherein China Bank emerged as the highest bidder for the amount of ₱85,000,000.00 as evidenced by a certificate of sale.

As shown by the Statement of Account dated 10 August 1998, the indebtedness of Lorenze Realty already reached the amount ₱114,258,179.81, broken down as follows:

Principal Amount	₱71,050,000.00
Interest	13,521,939.31
Penalties	19,763,257.50
Registration Expenses	9,542,013.00
Filing Fee	351,300.00
Publication Fee	25,970.00
Sheriff's Fee	2,000.00
Posting Fee	700.00

After deducting from the total amount of loan obligation the ₱85,000,000.00 proceeds of the public sale, there remains a balance in the amount of ₱29,258,179.81. In its effort to collect the deficiency obligation, China Bank demanded from Lorenze Realty for the payment of the remaining loan but such demand just went to naught.

Consequently, China Bank initiated an action for the collection of sum of money against the Lorenze Realty and its officers, namely, Lawrence Ong, Victoria Ong, Juan Chuy Tan and Mary Tan before the RTC of Makati City, Branch 142. In its Complaint docketed as Civil Case No. 98-3069, China Bank alleged that it is entitled to deficiency judgment because the purchase price of the securities pledged by the debtor is not sufficient to

settle the entire obligation incurred by the latter including the interest, penalties and surcharges that had accrued from the time of default. China Bank thus prayed that defendants be ordered to pay the amount of ₱29,258,179.81, representing the deficiency in its obligation in accordance with the express terms of the promissory notes.

While conceding that they have voluntarily signed the promissory notes, defendants, for their part, disclaim liability by alleging that the surety agreements did not express the true intention of the parties. The officers of the corporation who represented Lorenze Realty below claimed that they just signed the surety contracts without reading the fine terms stipulated therein because they were made to believe by the bank manager that the collaterals they offered to obtain the loans were already sufficient to cover the entire obligation should they incur in default. The collection suit for the deficiency obligation came as a surprise to them after China Bank managed to successfully foreclose the securities of the obligation and purchased for itself the mortgaged properties at the public sale. In addition, defendants averred that the penalty in the amount of 1/10 of 1% per day of the total amount due is usurious and shocking to the conscience and should be nullified by the court. Finally, they prayed that the RTC declare Lorenze Realty's obligation fully settled on account of the sale of the securities.

On 29 December 2003, the RTC found in favor of China Bank declaring the defendants jointly and severally liable for the amount of ₱29,258,179.81 representing the deficiency judgment. It was held by the trial court that Lorenze Realty, "[a]fter having voluntarily signed the surety agreements, cannot be discharged from the consequences of the undertaking because the terms and conditions contained therein is considered to be the law between the parties as long as it is not contrary to law, morals, good customs and public policy. The mistake, misapprehension and ignorance of the defendants as to the legal effects of the obligations are no reason for relieving them of their liabilities." The RTC disposed in this wise:

> WHEREFORE, premises considered, judgment is rendered ordering the defendants to pay [China Bank], jointly and severally, the following:
>
> 1. [T]he amount of ₱29,258,179.81 representing the deficiency claim as of August 10, 1998 plus penalties accruing thereafter at the rate of 2% per month until fully paid;
> 2. 5% of the total amount due as Attorney's [F]ees;
> 3. Expenses of litigation and cost of suit.
>
> SO ORDERED.[5]

[5] Id. at 171.

On appeal, the CA affirmed with modification the judgment of the RTC by reducing the rate of the penalty surcharge from 24% per annum to 12% per annum, and, likewise the award of attorney's fees was reduced from 5% to 2% of the total amount due. The appellate court deemed that the rate of penalty agreed by the parties is unconscionable under the circumstances considering that the obligation was already partially satisfied by the sale of the securities constituted for the loan and resolved to fairly and equitably reduce it to 12% per annum. The decretal portion of the appellate court's decision reads:

> **WHEREFORE**, premises considered, the assailed Decision dated December 29, 2003 of the Regional Trial Court of Makati City, Branch 142 is **AFFIRMED with MODIFICATION** in that the penalty surcharge of 2% per month or 24% per annum is reduced to 12% per annum and, likewise, the award of attorney's fees is reduced from 5% to 2% of the total amount due.
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> No pronouncement as to costs.
>
> **SO ORDERED**.

In a Resolution dated 24 January 2012, the CA refused to reconsider its earlier decision by denying the Motion for Reconsideration interposed by Lorenze Realty.

The Issue

Dissatisfied with the disquisition of the Court of Appeals, Lorenze Realty elevated the matter before the Court by filing a Petition for Review on *Certiorari*. For the resolution of the Court is the sole issue of:

> WHETHER LORENZE REALTY'S OBLIGATION IS FULLY SETTLED WHEN THE REAL PROPERTIES CONSTITUTED AS SECURITIES FOR THE LOAN WERE SOLD AT THE PUBLIC AUCTION FOR ₱85,000,000.00.

The Court's Ruling

In assailing the CA Decision, Lorenze Realty argues that it is no longer liable to pay the deficiency obligation because the proceeds of the sale of the foreclosed properties in the amount of ₱85,000,000.00 is more than enough to cover the principal amount of the loan which is just ₱71,050,000.00. In fact, it further asserted that after applying the proceeds of the public sale to the principal amount of loan, there remains a balance of ₱13,950,000.00 which should more than enough to cover the penalties, interests and surcharges.

For its part, China Bank maintains that the obligation of Lorenze Realty is not extinguished by the foreclosure and sale of real properties constituted as securities citing Article 1253 of the New Civil Code which explicitly states that "If the debt produces interest, payment of the principal shall not be deemed to have been made until the interests have been covered." By first applying the proceeds of the sale to the interest, penalties and expenses of the sale, there yields a balance in the principal obligation in the amount of ₱29,258,179.81.

We resolve to deny the petition.

Obligations are extinguished, among others, by payment or performance, the mode most relevant to the factual situation in the present case.[6] Under Article 1232 of the Civil Code, payment means not only the delivery of money but also the performance, in any other manner, of an obligation.[7] Article 1233 of the Civil Code states that a debt shall not be understood to have been paid unless the thing or service in which the obligation consists has been completely delivered or rendered, as the case may be.[8] In contracts of loan, the debtor is expected to deliver the sum of money due the creditor.[9] These provisions must be read in relation with the other rules on payment under the Civil Code, such as the application of payment, to wit:

> Art. 1252. He who has various debts of the same kind in favor of one and the same creditor, may declare at the time of making the payment, to which of them the same must be applied. Unless the parties so stipulate, or when the application of payment is made by the party for whose benefit the term has been constituted, application shall not be made as to debts which are not yet due.
>
> If the debtor accepts from the creditor a receipt in which an application of the payment is made, the former cannot complain of the same, unless there is a cause for invalidating the contract.

In interpreting the foregoing provision of the statute, the Court in *Premiere Development Bank v. Central Surety & Insurance Company Inc.*[10] held that the right of the debtor to apply payment is merely directory in nature and must be promptly exercised, lest, such right passes to the creditor, *viz:*

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6 *Go Cinco, et al. v. Court of Appeals, et al.*, 618 Phil. 104, 112 (2009).
7 Id.
8 Id. at 112-113.
9 Id.
10 598 Phil. 827, 844-845 (2009).

> "The debtor[']s right to apply payment is not mandatory. This is clear from the use of the word [']may['] rather than the word [']shall['] in the provision which reads: [']He who has various debts of the same kind in favor of one and the same creditor, ***may*** declare at the time of making the payment, to which of the same must be applied.[']
>
> Indeed, the debtor[']s right to apply payment has been considered merely directory, and not mandatory, following this Court[']s earlier pronouncement that [']the ordinary acceptation of the terms [']may['] and [']shall['] may be resorted to as guides in ascertaining the mandatory or directory character of statutory provisions.[']
>
> Article 1252 gives the right to the debtor to choose to which of several obligations to apply a particular payment that he tenders to the creditor. But likewise granted in the same provision is the right of the creditor to apply such payment in case the debtor fails to direct its application. This is obvious in Art. 1252, par. 2, *viz.:* [']If the debtor accepts from the creditor a receipt in which an application of payment is made, the former cannot complain of the same.['] It is the directory nature of this right and the subsidiary right of the creditor to apply payments when the debtor does not elect to do so that make this right, like any other right, waivable.
>
> Rights may be waived, unless the waiver is contrary to law, public order, public policy, morals or good customs, or prejudicial to a third person with a right recognized by law.
>
> A debtor, in making a voluntary payment, may at the time of payment direct an application of it to whatever account he chooses, unless he has assigned or waived that right. **If the debtor does not do so, the right passes to the creditor, who may make such application as he chooses.** But if neither party has exercised its option, the court will apply the payment according to the justice and equity of the case, taking into consideration all its circumstances." [Emphasis supplied, citations omitted.]

In the event that the debtor failed to exercise the right to elect, the creditor may choose to which among the debts the payment is applied as in the case at bar. It is noteworthy that after the sale of the foreclosed properties at the public auction, Lorenze Realty failed to manifest its preference as to which among the obligations that were all due the proceeds of the sale should be applied. Its silence can be construed as acquiescence to China Bank's application of the payment first to the interest and penalties and the remainder to the principal which is sanctioned by Article 1253 of the New Civil Code which provides that:

> Art. 1253. If the debt produces interest, payment of the principal shall not be deemed to have been made until the interests have been covered.

That they assume that the obligation is fully satisfied by the sale of the securities does not hold any water. Nowhere in our statutes and jurisprudence do they provide that the sale of the collaterals constituted as security of the obligation results in the extinguishment of the obligation. The rights and obligations of parties are governed by the terms and conditions of the contract and not by assumptions and presuppositions of the parties. The amount of their entire liability should be computed on the basis of the rate of interest as imposed by the CA minus the proceeds of the sale of the foreclosed properties in public auction.

It is worth mentioning that the appellate court aptly reduced the interest rate to 12% per annum which is in consonance to existing jurisprudence. In *Albos v. Embisan,*[11] *MCMP Construction Corp. v. Monark Equipment Corp.,*[12] *Bognot v. RRI Lending Corporation,*[13] and *Menchavez v. Bermudez,*[14] the Court struck down the stipulated rates of interest for being excessive, iniquitous, unconscionable and exorbitant and uniformly **reduced the rates to 12% per annum.**

Lorenze Realty's plea to further reduce the interest to 3% per annum has no leg to stand on and could not be adopted by this Court. On the other hand, the appellate court, consistent with the ruling of this Court in a number of cases, correctly pegged the rate of interest at 1% per month or 12% per annum. We need not unsettle the principle we had affirmed in a plethora of cases that 12% per annum is the legal rate of interest imposed by this Court on occasions that we nullified the rates stipulated by parties. While the Court has the power to nullify excessive interest rates and impose new rates for the parties, such reduction, however, must always be guided by reason and equity.

WHEREFORE, premises considered, the petition is **DENIED**. The assailed Decision and Resolution of the Court of Appeals are hereby **AFFIRMED.**

SO ORDERED.

JOSE PORTUGAL PEREZ
Associate Justice

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11 G.R. No. 210831, 26 November 2014, 743 SCRA 283, 295- 296.
12 G.R. No. 201001, 10 November 2014, 739 SCRA 432, 442-443.
13 G.R. No. 180144, 24 September 2014, 736 SCRA 357, 379-380.
14 697 Phil. 447, 452 (2012).

WE CONCUR:

PRESBITERO J. VELASCO, JR.
Associate Justice
Chairperson

DIOSDADO M. PERALTA
Associate Justice

BIENVENIDO L. REYES
Associate Justice

FRANCIS H. JARDELEZA
Associate Justice

ATTESTATION

I attest that the conclusions in the above Decision had been reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

PRESBITERO J. VELASCO, JR.
Associate Justice
Third Division, Chairperson

CERTIFICATION

Pursuant to Section 13, Article VIII of the Constitution and the Division Chairperson's Attestation, I certify that the conclusions in the above Decision had been reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

MARIA LOURDES P. A. SERENO
Chief Justice

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Third Division
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