



Republic of the Philippines  
**Supreme Court**  
 Manila

EN BANC

**LARA’S GIFTS & DECORS, INC.,**      **G.R. No. 225433**  
 Petitioner,

Present:

GESMUNDO\*, *Chief Justice*,  
 LEONEN\*\*, *Acting Chief Justice*  
 CAGUIOA,  
 HERNANDO,  
 LAZARO-JAVIER,  
 INTING,  
 ZALAMEDA,  
 LOPEZ, M. \*,  
 GAERLAN,  
 ROSARIO,  
 LOPEZ, J.,  
 DIMAAMPAO,  
 MARQUEZ,  
 KHO, JR., and  
 SINGH, JJ.

-versus-

**MIDTOWN INDUSTRIAL SALES,**  
**INC.**

Respondent.

**Promulgated:**  
September 20, 2022

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**RESOLUTION**

**LEONEN, J.:**

For resolution is respondents’ Motion for Reconsideration<sup>1</sup> of this Court’s August 28, 2019 Decision,<sup>2</sup> which denied the Petition of Lara’s Gifts

\* On official business.

\*\* Per Special Order No. 2914 dated September 15, 2022.

<sup>1</sup> *Rollo*, pp. 379–396.

<sup>2</sup> *Lara’s Gifts & Decors, Inc. v. Midtown Industrial Sales, Inc.*, G.R. No. 225433, August 28, 2019, <<https://elibrary.judiciary.gov.ph/thebookshelf/showdocs/1/65527>> [Per J. Carpio, En banc].

& Decors, Inc. and affirmed the Court of Appeals' Decision<sup>3</sup> with modification as to damages.

As recalled from the facts of the Petition,<sup>4</sup> Lara's Gifts & Decors, Inc. (Lara's Gifts) purchased from Midtown Industrial Sales, Inc. (Midtown) various industrial and construction materials, from January to December 2007, in the total amount of ₱1,263,104.22.

The purchases were on a 60-day credit term, subject to the condition that 24% per annum would be charged on all accounts overdue. Lara's Gifts issued post-dated checks to pay for its purchases. However, these checks were later dishonored due to "insufficiency of funds" or "account closed." Midtown informed Lara's Gifts of the bounced checks and demanded the settlement of its accounts, through a demand letter dated January 21, 2008. However, Lara's Gifts still failed to pay. Thus, on February 5, 2008, Midtown filed a Complaint for Sum of Money with Prayer for Attachment.<sup>5</sup>

Lara's Gifts admitted its purchases, but claimed that most of the deliveries were substandard and of poor quality. As such, the finished products, using those raw materials, were rejected by U.S. buyers. Lara's Gifts added that due to the economic recession, some of the orders made by its U.S. buyers were cancelled. Also, on February 19, 2008, a fire razed its factory destroying its equipment, machineries, and inventories.

On January 27, 2014, the Regional Trial Court, Branch 128, Caloocan City rendered a decision<sup>6</sup> in favor of Midtown. It found insufficient evidence to prove Lara's Gifts' claim that the products were substandard. On the other hand, it found the amount claimed by Midtown to be supported by the sales invoices and checks. It also found the 24% interest not unconscionable. The dispositive of the Decision reads:

WHEREFORE, premises considered, judgment is hereby rendered in favor of the plaintiff MIDTOWN INDUSTRIAL SALES, INC. and against the defendant LARA'S GIFTS [&] DECORS, INC. ordering the latter to pay the former the following amount:

1. ONE MILLION TWO HUNDRED SIXTY THREE THOUSAND ONE HUNDRED FOUR PESOS and 22/100 (Php1,263,104.22) plus interest fixed at 24% per annum to be computed from February 5, 2008, the date of judicial demand, until the judgment obligation is fully paid.

<sup>3</sup> *Rollo*, pp. 44–58. The Court of Appeals' Decision dated April 21, 2016 was penned by Associate Justice Stephen C. Cruz and concurred in by Associate Justices Jose C. Reyes, Jr. (retired Supreme Court Justice) and Ramon Paul L. Hernando (now a Member of this Court) of the Fifth Division, Court of Appeals, Manila.

<sup>4</sup> As narrated in *Lara's Gifts & Decors, Inc. v. Midtown Industrial Sales, Inc.*, G.R. No. 225433, August 28, 2019, <<https://elibrary.judiciary.gov.ph/thebookshelf/showdocs/1/65527>> [Per J. Carpio, En banc].

<sup>5</sup> *Id.*

<sup>6</sup> *Rollo*, pp. 62–71.

2. The sum of FIFTY THOUSAND PESOS (Php50,000.00) as and by way of attorney's fees.

Finally, defendant is ordered to pay the cost of suit.

SO ORDERED.

On appeal, the Court of Appeals upheld the Regional Trial Court's decision<sup>7</sup> which prompted Lara's Gifts to file a Petition for Review<sup>8</sup> before this Court.

In an August 28, 2019 Decision,<sup>9</sup> this Court denied Lara's Gifts' Petition, and affirmed the Court of Appeals' Decision with modification as to damages. This Court held that: (1) petitioner's general denial amounts to an admission of the genuineness and due execution of the sales invoices; (2) petitioner failed to prove its claim that the materials delivered did not comply with the specifications or were substandard or of poor quality; and (3) the 24% stipulated interest is valid and binding on petitioner, which is reckoned from date of extrajudicial demand on January 22, 2008 until full payment.

This Court further applied legal interest on the 24% interest, at the rate of: (i) 12%, reckoned from date of judicial demand on February 5, 2008 until June 30, 2013; and (ii) 6%, from July 1, 2013 until full payment. The Decision disposed thus:

**WHEREFORE**, the Decision dated 21 April 2016 of the Court of Appeals in CA-G.R. CV No. 102465, affirming the 27 January 2014 Decision of the Regional Trial Court, Branch 128, Caloocan City, is **AFFIRMED** with **MODIFICATION**, as follows:

Petitioner Lara's Gifts & Decors, Inc. is ordered to pay respondent Midtown Industrial Sales, Inc. the following:

1. ONE MILLION TWO HUNDRED SIXTY THREE THOUSAND ONE HUNDRED FOUR PESOS and 22/100 (P1,263,104.22) representing the principal amount plus stipulated interest at 24% *per annum* to be computed from 22 January 2008, the date of extrajudicial demand, until full payment.
2. Legal interest on the 24% *per annum* interest due on the principal amount accruing as of judicial demand, at the rate of 12% *per annum* from the date of judicial demand on 5 February 2008 until 30 June 2013, and thereafter at the rate of 6% *per annum* from 1 July 2013 until full payment.
3. The sum of FIFTY THOUSAND PESOS (P50,000.00) as attorney's fees, plus legal interest thereon at the rate of

<sup>7</sup> Id. at 57.

<sup>8</sup> Id. at 13-43. Filed under Rule 45.

<sup>9</sup> *Lara's Gifts & Decors, Inc. v. Midtown Industrial Sales, Inc.*, G.R. No. 225433, August 28, 2019, <<https://elibrary.judiciary.gov.ph/thebookshelf/showdocs/1/65527>> [Per J. Carpio, En banc].

- 6% *per annum* to be computed from the finality of this Decision until full payment.
4. Cost of the suit.<sup>10</sup> (Emphasis in the original)

Petitioner filed a Motion for Reconsideration.<sup>11</sup> It argues that: (1) the due execution of the sales invoices was specifically denied in its Answer;<sup>12</sup> (2) it cannot be considered in default of its obligation since it did not receive any demand;<sup>13</sup> (3) it had sufficiently established that the materials delivered by respondent were substandard and of poor quality;<sup>14</sup> (4) the 24% interest stated in the sales invoices is null and void for being excessive, unconscionable, and exorbitant,<sup>15</sup> and was unilaterally imposed by respondent without petitioner's consent;<sup>16</sup> and (5) the imposition of legal interest on the 24% compensatory interest is excessive.<sup>17</sup>

In its Comment/Opposition,<sup>18</sup> respondent asserts that the Motion for Reconsideration must be denied outright as no new matters have been raised therein by the petitioner.

This Court partially grants the Motion for Reconsideration.

Petitioner's first to fourth arguments have already been sufficiently passed upon and discussed by this Court in the assailed Decision. We have held that petitioner's general denial in its Answer amounts to an admission of the genuineness and due execution of the sales invoices:

In this case, petitioner did not state the facts or substance of the matters relied upon to support its denial of the due execution of the sales invoices. As held in *Sy-Quia v. Marsman*, "the Rules require that besides specifying the allegations of fact not admitted, the answer should set forth the matters relied upon in support of the denial; so that, in effect, the Rules are no longer satisfied with mere denials, even if specific, but demand that defendant manifest what he considers to be the true facts." The purpose of the specific denial is to compel the defendant to specify the allegations which he or she intends to disprove and disclose the matters relied upon to support such denial, thereby limiting the issues and avoiding unnecessary delays and surprises. Petitioner's general denial amounts to an admission of the genuineness and due execution of the sales invoices.<sup>19</sup> (Citations omitted)

<sup>10</sup> Id.

<sup>11</sup> *Rollo*, pp. 379–396.

<sup>12</sup> Id. at 381.

<sup>13</sup> Id. at 384–385.

<sup>14</sup> Id. at 386.

<sup>15</sup> Id. at 390.

<sup>16</sup> Id. at 389 and 391.

<sup>17</sup> Id. at 391.

<sup>18</sup> Id. at 405–412.

<sup>19</sup> *Lara's Gifts & Decors, Inc. v. Midtown Industrial Sales, Inc.*, G.R. No. 225433, August 28, 2019, <<https://elibrary.judiciary.gov.ph/thebookshelf/showdocs/1/65527>> [Per J. Carpio, En banc].

As to the poor quality of delivered products, this Court held that “other than its bare allegation that the materials delivered were substandard and of poor quality, petitioner failed to prove or substantiate its claims. As found by the trial court, none of petitioner’s witnesses was able to present proof that the materials delivered were substandard or of poor quality.”<sup>20</sup>

Moreover, in upholding the validity of the 24% per annum interest, we ruled:

In the present case, petitioner, which has been doing business since 1990 and has been purchasing various materials from respondent since 2004, cannot claim to have been misled into agreeing to the 24% interest rate which was expressly stated in the sales invoices. Besides, this Court has already ruled in several cases that an interest rate of 24% *per annum* agreed upon between the parties is valid and binding and not excessive and unconscionable. Thus, the stipulated 24% interest *per annum* is binding on petitioner.<sup>21</sup> (Citations omitted)

We find no valid justification to compel a modification or reversal of our Decision as to those issues.

The only matter left for this Court to resolve is whether or not the imposition of legal interest on the compensatory interest of 24% per annum is excessive.

To answer this, an elucidation of the concept and functions of interest is first appropriate.

## I

Interest is of *two major kinds*—*conventional interest*, on one hand, and *compensatory interest* on the other.<sup>22</sup> These two kinds of interest are conceptually different, subsume the other types and kinds of interest, and are governed by different rules that must be consistently applied, otherwise the computation of interest “present[s] intricate situations.”<sup>23</sup>

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<sup>20</sup> Id.

<sup>21</sup> Id.

<sup>22</sup> This dichotomy goes back to *Banal v. Safont & Puig*, 19 Phil. 372 (1911) [Per CJ Arellano, En banc], but it should be noted that in *Reinsurance Company of the Orient, Inc. v. Court of Appeals, et al.*, 275 Phil. 20 (1991) [Per J. Feliciano, Third Division], *Siga-an v. Villanueva*, 596 Phil. 760 (2009) [Per J. Chico-Nazario, Third Division], *Asiatrust Development Bank v. Tuble*, 691 Phil. 732 (2012) [Per J. Sereno, Second Division] and *Sun Life of Canada (Phils.) v. Tan Kit*, 745 Phil. 482 (2014), and several other cases, the Supreme Court established the dichotomy as *monetary interest*, on one hand, and *compensatory interest*, on the other. Nevertheless, the *Banal* dichotomy is used here as *conventional interest* subsumes monetary interest, and therefore, allows a broader understanding of the concept.

<sup>23</sup> *Robinson v. Macleod & Postal Savings Bank of the Philippine Islands*, 46 Phil. 539, 540 (1924) [Per J. Malcolm, Second Division]. In this section, we adopt and share the views on this topic in Stephanie V. Gomez-Somera’s book, *Credit Transactions: Notes and Cases*, Vol. 1 (2<sup>nd</sup> ed., 2015).

## I (A)

“A *simple loan*, whether the object is money or other consumable thing, may be *gratuitous or onerous*.<sup>24</sup> If it is *onerous*, the *compensation* to be paid by the borrower is referred to as *conventional interest*, as it is the interest agreed to by the parties themselves as distinguished from that prescribed by law.”<sup>25</sup>

Conventional interest is therefore paid not as a consequence of default, nor is it compensatory or a result of a provision of law. It is “rigorously lucrative,” and the result of the express will of the parties in a contract.<sup>26</sup> In onerous simple loans, the payment of conventional interest is a principal condition, if not the most important condition, of the loan. In that case, “any modification must be mutually agreed upon; otherwise, it has no binding effect.”<sup>27</sup> As it is a stipulation covenanted in a valid and effective contract, conventional interest continues to run from the date stipulated, with no break in the continuity of the obligation to pay it.<sup>28</sup>

However, payment of conventional interest is allowed only if the following conditions concur:

- “1) There is an *express stipulation* for the payment of interest, **and**
- 2) The stipulation for the payment of interest is *in writing*.”<sup>29</sup>

The most common type of conventional interest is *monetary interest*, also referred to as *regular interest*. It is “the conventional interest in a simple loan of money . . . The payment of both principal and interest is made in money (an amortization, literally, to deaden) gradually extinguishing<sup>30</sup> the loan of money. Monetary interest is, therefore, generally viewed as the ‘*cost of the use of money*.’”<sup>31</sup>

<sup>24</sup> CIVIL CODE, art. 1933 provides:

ARTICLE 1933. By the contract of loan, one of the parties delivers to another, . . . money or other consumable thing, upon the condition that the same amount of the same kind and quality shall be paid, in which case the contract is simply called a loan or mutuum.

. . . .

Simple loan may be gratuitous or with a stipulation to pay interest. . . .

<sup>25</sup> I STEPHANIE V. GOMEZ-SOMERA, CREDIT TRANSACTIONS: NOTES AND CASES 95 (2<sup>nd</sup> ed., 2015). See also BLACK’S LAW DICTIONARY (9<sup>th</sup> ed., 2009).

<sup>26</sup> *Banal v. Safont & Puig*, 19 Phil. 372, 374 (1911) [Per CJ Arellano, En banc].

<sup>27</sup> *Spouses Silos v. Philippine National Bank*, 738 Phil. 156, 160 (2014) [Per J. Del Castillo, Second Division].

<sup>28</sup> *Banal v. Safont & Puig*, 19 Phil. 372 (1911) [Per CJ Arellano, En banc].

<sup>29</sup> CIVIL CODE, art. 1956 provides:

ARTICLE 1956. No interest shall be due unless it has been expressly stipulated in writing.

See also *De la Paz v. L & J Development Co.*, 742 Phil. 420 (2014) [Per J. Del Castillo, Second Division]; *Siga-an v. Villanueva*, 596 Phil. 760 (2009) [Per J. Chico-Nazario, Third Division]; and I STEPHANIE V. GOMEZ-SOMERA, CREDIT TRANSACTIONS: NOTES AND CASES 95 (2<sup>nd</sup> ed., 2015).

<sup>30</sup> BLACK’S LAW DICTIONARY (9<sup>th</sup> ed., 2009).

<sup>31</sup> *State Investment House, Inc. v. Court of Appeals*, 275 Phil. 433, 444 (1991) [Per J. Feliciano, Third Division]. See I STEPHANIE V. GOMEZ-SOMERA, CREDIT TRANSACTIONS: NOTES AND CASES 96 (2<sup>nd</sup> ed., 2015).

P

“The payment of regular interest constitutes the price or cost of the use of money and thus, until the principal sum due is returned to the creditor, regular interest continues to accrue since the debtor continues to use such principal amount.”<sup>32</sup> It has been held that “[f]or [a debtor] to continue in possession of the principal of the loan. . . and to continue to use the same after maturity of the loan without payment of regular or monetary interest, would constitute unjust enrichment on the part of the [debtor] at the expense of [the creditor][.]”<sup>33</sup>

Pursuant to the *Usury Law*,<sup>34</sup> “the *applicable interest rate* in the *loan of money, goods, or credits (simple loans)*, shall be determined as follows:

(1) If there is an interest rate stipulated, then the interest rate as stipulated shall be applicable.

(2) If there is no stipulation on the interest rate, then the interest rate prescribed by statute (or *legal interest*<sup>35</sup>) shall be applicable.”<sup>36</sup>

But insofar as simple loans are concerned, this rule on legal interest applies only if in the first place, *conventional interest was expressly stipulated in writing* and only the *rate* of interest was left unstipulated.

With regard to interest on interest, the following provisions are pertinent:

Civil Code

ARTICLE 1959. Without prejudice to the provisions of Article 2212, interest due and unpaid shall not earn interest.

However, the contracting parties may by stipulation capitalize the interest due and unpaid, which as added principal, shall earn new interest.

ARTICLE 2212. Interest due shall earn legal interest from the time it is judicially demanded, although the obligation may be silent upon this point.

<sup>32</sup> Id.

<sup>33</sup> Id. at 445.

<sup>34</sup> Act No. 2655 (1916), An Act Fixing Rates of Interest Upon Loans and Declaring the Effect of Receiving or Taking Usurious Rates and for Other Purposes, as amended by Presidential Decrees No. 116, 858, and 1684, is generally known as the Usury Law.

<sup>35</sup> Currently 6% for loans and forbearance of money, goods, or credits pursuant to Bangko Sentral ng Pilipinas Circular No. 799, series of 2013, effective July 1, 2013, which was issued and promulgated by the Monetary Board pursuant to the authority granted to the Bangko Sentral ng Pilipinas by P.D. No. 116, which amended the Usury Law.

<sup>36</sup> Usury Law, sec. 1 provides:

SECTION 1. The rate of interest for the loan. . . of any money, goods, or credits. . . in the absence of express contract as to such rate of interest, shall be six per centum per annum or such rate as may be prescribed by the Monetary Board of the Central Bank of the Philippines for that purpose in accordance with the authority hereby granted. *See* I STEPHANIE V. GOMEZ-SOMERA, CREDIT TRANSACTIONS: NOTES AND CASES 109 (2<sup>nd</sup> ed., 2015).

Usury Law

SECTION 5. In computing the interest on any obligation, promissory note or other instrument or contract, compound interest shall not be reckoned, except by agreement; Provided, That whenever compound interest is agreed upon, the effective rate of interest charged by the creditor shall not exceed the equivalent of the maximum rate<sup>37</sup> prescribed by the Monetary Board, or, in default thereof, whenever the debt is judicially claimed, in which last case it shall draw six per centum per annum interest or such rate as may be prescribed by the Monetary Board.<sup>38</sup>

“For *conventional interest*, the general rule is that interest is paid on the *principal only (simple interest)*.<sup>39</sup>

Consequently, *interest on interest*, that is, the compensation for interest that is due and unpaid, is generally not demandable.

It is only demandable if, in the first place, there is conventional interest—that is, an express stipulation in writing to pay interest in a contract of loan—*and* any or both of the following instances are applicable:

(1) When *by stipulation* of the parties, compounding or capitalizing of interest is agreed upon, in which case previously accumulated interest is added as principal and earns interest as such (*compound interest*).<sup>40</sup>

(2) When interest that is due and unpaid is *judicially demanded, whether or not there is an agreement or stipulation to this effect*. Judicial demand is reckoned from the date of filing of a complaint in court. The rate of interest shall be the legal rate applicable to loans or forbearance of money.”<sup>41</sup>

**I (B)**

“*Compensatory interest*, also referred to as *penalty interest, indemnity, or moratory interest*,<sup>42</sup> is the *indemnity for damages* arising from *delay* on the part of the debtor in an obligation consisting in the payment of a sum of money. It is interest allowed by law in the absence of a promise to pay interest, as compensation for delay in paying a fixed sum or a delay in assessing and paying damages.<sup>43</sup>

<sup>37</sup> Central Bank Circular No. 905, Series of 1982, effectively lifted the ceiling on interest rates.

<sup>38</sup> Currently 6% pursuant to Bangko Sentral ng Pilipinas Circular No. 799, series of 2013.

<sup>39</sup> BLACK'S LAW DICTIONARY (9<sup>th</sup> ed., 2009).

<sup>40</sup> *Central Bank of the Philippines v. Cloribel*, 150-A Phil. 86 (1972) [Per J. Concepcion, Second Division]. See I STEPHANIE V. GOMEZ-SOMERA, CREDIT TRANSACTIONS: NOTES AND CASES 142 (2<sup>nd</sup> ed., 2015).

<sup>41</sup> Currently 6% pursuant to Bangko Sentral ng Pilipinas Circular No. 799, series of 2013. See I STEPHANIE V. GOMEZ-SOMERA, CREDIT TRANSACTIONS: NOTES AND CASES 142 (2<sup>nd</sup> ed., 2015).

<sup>42</sup> *National Marketing Corp. v. Marquez, et al.*, 136 Phil. 143 (1969) [Per J. JBL Reyes, En banc]; and *Mendoza & Lim v. Spouses Gomez*, 736 Phil. 460 (2014) [Per J. Perez, Second Division].

<sup>43</sup> BLACK'S LAW DICTIONARY (9<sup>th</sup> ed. 2009).



Since a simple loan of money is necessarily an obligation consisting in the payment of a sum of money, then compensatory interest is always demandable in case the borrower in a simple loan of money incurs delay.

However, a simple loan of money is not the only obligation that consists in the payment of a sum of money.<sup>44</sup> Moreover, not every obligation consists in the payment of a sum of money.<sup>45</sup>

“Although compensatory interest, unlike conventional interest, *need not be expressly stipulated in writing*, the parties may freely stipulate on compensatory interest through a *penalty or penal clause*.”<sup>46</sup> The nature of a penal clause was expounded in *Ligutan v. Court of Appeals*:<sup>47</sup>

A penalty clause, expressly recognized by law, 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 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. 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.<sup>48</sup> (Citations omitted)

In distinguishing between *conventional interest* and *compensatory interest*, this Court has explained that if the debtor is not in delay, it is properly liable only for the principal of the loan and conventional interest. Even if the debtor is not liable for compensatory interest, this does not mean that it is, as a matter of law, relieved from the payment of conventional interest. The conventional interest continues to accrue under the terms of the loan until actual payment is effected. The payment of conventional interest, specifically monetary interest, constitutes the price or cost of the use of money and thus, continues to accrue until the principal sum due is returned to the creditor.<sup>49</sup> Corollary to this, if the debtor *were in delay*, then *compensatory interest*, as a matter of law, will accrue *in addition to conventional interest*.

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<sup>44</sup> 1 STEPHANIE V. GOMEZ-SOMERA, CREDIT TRANSACTIONS: NOTES AND CASES 144–145 (2<sup>nd</sup> ed., 2015).

<sup>45</sup> *Id.*

<sup>46</sup> *Id.*

<sup>47</sup> 427 Phil. 42 (2002) [Per J. Vitug, Third Division].

<sup>48</sup> *Id.* at 51.

<sup>49</sup> *See State Investment House, Inc. v. Court of Appeals*, 275 Phil. 433 (1991) [Per J. Feliciano, Third Division], which involved the application of monetary interest.

The “rules of thumb” for the rate of *compensatory interest* were established in *Eastern Shipping Lines, Inc. v. Court of Appeals*,<sup>50</sup> and restated<sup>51</sup> in *Nacar v. Gallery Frames*:<sup>52</sup>

- I. When an obligation, regardless of its source, *i.e.*, law, contracts, quasi-contracts, delicts or quasi-delicts,<sup>53</sup> is breached, the contravenor can be held liable for damages.<sup>54</sup> The provisions under Title XVIII on “Damages” of the Civil Code govern in determining the measure of recoverable damages.<sup>55</sup>
- II. With regard particularly to an *award of interest in the concept of actual and compensatory damages*, the rate of interest, as well as the accrual thereof, is imposed, as follows:
  1. When the obligation is breached, and it consists in the *payment of a sum of money, i.e., a loan or forbearance of money*, the interest due should be that which may have been stipulated in writing.<sup>56</sup> Furthermore, the interest due shall itself earn legal interest from the time it is judicially demanded.<sup>57</sup> In the absence of stipulation,<sup>58</sup> the rate of interest shall be 6% per annum to be computed from default, *i.e.*, from judicial or extrajudicial demand under and subject to the provisions of Article 1169 of the Civil Code.
  2. When an obligation, *not constituting a loan or forbearance of money*, is breached, an *interest on the amount of damages* awarded may be imposed at the discretion of the court<sup>59</sup> at the rate of 6% per annum.<sup>60</sup> No interest, however, shall be adjudged on unliquidated claims or damages, except when or until the demand can be established with reasonable certainty.<sup>61</sup> Accordingly, where the demand is established with reasonable

<sup>50</sup> 304 Phil. 236 (1994) [Per J. Vitug, En banc].

<sup>51</sup> Taking into account Bangko Sentral ng Pilipinas Circular No. 799, Series of 2013, effective July 1, 2013.

<sup>52</sup> 716 Phil. 267, 282–283 (2013) [Per J. Peralta, En banc].

<sup>53</sup> CIVIL CODE, art. 1157.

<sup>54</sup> CIVIL CODE, art. 1170 provides:

ARTICLE 1170. Those who in the performance of their obligations are guilty of fraud, negligence, or delay, and those who in any manner contravene the tenor thereof, are liable for damages.

<sup>55</sup> CIVIL CODE, art. 2195 provides:

ARTICLE 2195. The provisions of this Title (on Damages) shall be respectively applicable to all obligations mentioned in article 1157.

<sup>56</sup> CIVIL CODE, art. 1956 provides:

ARTICLE 1956. No interest shall be due unless it has been expressly stipulated in writing.

<sup>57</sup> CIVIL CODE, art. 2212 provides:

ARTICLE 2212. Interest due shall earn legal interest from the time it is judicially demanded, although the obligation may be silent upon this point.

<sup>58</sup> As explained in *State Investment House, Inc. v. Court of Appeals*, 275 Phil. 433 (1991) [Per J. Feliciano, Third Division]: “. . . in the absence of a stipulation of a particular rate of *penalty interest*, then the payment of *additional interest* at a rate equal to the regular monetary interest; and if no regular interest had been agreed upon, then payment of *legal interest*. . .” (Emphasis supplied)

<sup>59</sup> CIVIL CODE, art. 2210 provides:

ARTICLE 2210. Interest may, in the discretion of the court, be allowed upon damages awarded for breach of contract.

<sup>60</sup> CIVIL CODE, art. 2209 provides:

ARTICLE 2209. If the obligation consists in the payment of a sum of money, and the debtor incurs in delay, the indemnity for damages, there being no stipulation to the contrary, shall be the payment of the interest agreed upon, and in the absence of stipulation, the legal interest, which is six percent per annum.

<sup>61</sup> CIVIL CODE, art. 2213 provides:

ARTICLE 2213. Interest cannot be recovered upon unliquidated claims or damages, except when the demand can be established with reasonable certainty.

certainty, the interest shall begin to run from the time the claim is made judicially or extrajudicially (Art. 1169, Civil Code), but when such certainty cannot be so reasonably established at the time the demand is made, the interest shall begin to run only from the date the judgment of the court is made (at which time the quantification of damages may be deemed to have been reasonably ascertained). The actual base for the computation of legal interest shall, in any case, be on the amount finally adjudged.

3. When the *judgment of the court* awarding a sum of money becomes final and executory, the rate of legal interest, whether the case falls under paragraph 1 or paragraph 2, above, shall be 6% per annum from such finality until its satisfaction, this interim period being deemed to be by then an equivalent to a forbearance of credit.

And, in addition to the above, judgments that have become final and executory prior to July 1, 2013, shall not be disturbed and shall continue to be implemented applying the rate of interest fixed therein. (Emphasis supplied)

It should be stressed that the *Eastern Shipping Lines* and *Nacar* rules govern only *compensatory interest*, not conventional interest,<sup>62</sup> and should be read in conjunction with the provisions of Articles 2209 and 1226 of the Civil Code.

ARTICLE 2209. If the obligation consists in the payment of a sum of money, and *the debtor incurs in delay, the indemnity for damages*, there being no stipulation to the contrary, shall be the payment of the interest agreed upon, and in the absence of stipulation, the legal interest, which is six per cent per annum.

ARTICLE 1226. In obligations with a *penal clause, the penalty shall substitute the indemnity for damages and the payment of interests in case of noncompliance*, if there is no stipulation to the contrary. . . . (Emphasis supplied)

Thus, “the applicable *compensatory interest* in contracts *consisting in the payment of a sum of money* should be determined as follows:<sup>63</sup>

- (1) If there is a penal clause that stipulates the penalty or indemnity, then the *stipulated penalty or indemnity* shall be applicable.

<sup>62</sup> It should be noted, however, that several cases (*see for example: Cuaton v. Salud*, 465 Phil. 999 (2004) [Per J. Ynares-Santiago, First Division], *Rizal Commercial Banking Corporation v. Court of Appeals*, 352 Phil. 101 (1998) [Per J. Melo, Second Division]) consider *Eastern Shipping Lines, Inc.* as a comprehensive summary of existing rules on the computation of interest, without distinguishing between conventional and compensatory interest.

<sup>63</sup> *See Reinsurance Company of the Orient, Inc. v. Court of Appeals*, 275 Phil. 20 (1991) [Per J. Feliciano, Third Division] and *State Investment House, Inc. v. Court of Appeals*, 275 Phil. 433 (1991) [Per J. Feliciano, Third Division].

- (2) If there is no penal clause, but there is a stipulation on conventional or monetary interest, then the *conventional or monetary interest* shall be applicable.
- (3) If there is no stipulation on the penalty or on conventional interest, then the *legal interest rate* shall be applicable. In contracts of simple loan of money, the legal interest rate is currently 6%.<sup>64</sup>

A question arises on whether interest on interest is applicable to compensatory interest. Jurisprudence supports its application as shown in the following cases.

In *Philippine American Accident Insurance Company, Inc. v. Flores & Navalta*,<sup>65</sup> this Court stated that Article 2212<sup>66</sup> of the Civil Code “contemplate[s] the presence of stipulated or conventional interest which had accrued when demand was judicially made.”<sup>67</sup> Although the statement was made as basis for ruling that Article 2212 cannot be invoked to justify the payment of compound interest if the judgment only involves the payment of simple interest, it also raised the issue of whether Article 2212 can serve as basis for the payment of interest on compensatory interest.

*Eastern Shipping Lines, Inc.*, as restated in *Nacar*, provides:

II. With regard particularly to an award of *interest in the concept of actual and compensatory damages*, the rate of interest, as well as the accrual thereof, is imposed, as follows:

1. When the obligation is breached, and it consists in the payment of a sum of money, *i.e.*, a loan or forbearance of money, the interest due should be that which may have been stipulated in writing. ***Furthermore, the interest due shall itself earn legal interest from the time it is judicially demanded.*** In the absence of stipulation, the rate of interest shall be 6% per annum to be computed from default, *i.e.*, from judicial or extrajudicial demand under and subject to the provisions of Article 1169 of the Civil Code.<sup>68</sup> (Emphasis supplied)

In *Tan v. Court of Appeals & Cultural Center of the Philippines*,<sup>69</sup> this Court ruled that Articles 1959<sup>70</sup> and 2212 of the Civil Code sanction the compounding of penalty charges in the parties' contract.

<sup>64</sup> Bangko Sentral ng Pilipinas Circular No. 799, series of 2013. See I STEPHANIE V. GOMEZ-SOMERA, CREDIT TRANSACTIONS: NOTES AND CASES 154 (2<sup>nd</sup> ed., 2015).

<sup>65</sup> 186 Phil. 563 (1980) [Per J. Abad Santos, Second Division] as cited in *David v. Court of Appeals et al.* 375 Phil. 177 (1999) [Per J. Quisumbing, Second Division].

<sup>66</sup> ARTICLE 2212. Interest due shall earn legal interest from the time it is judicially demanded, although the obligation may be silent upon this point.

<sup>67</sup> *Philippine American Accident Insurance Company, Inc. v. Flores & Navalta*, 186 Phil. 563, 566 (1980) [Per J. Abad Santos, Second Division].

<sup>68</sup> *Nacar v. Gallery Frames*, 716 Phil. 267, 282 (2013) [Per J. Peralta, En banc].

<sup>69</sup> 419 Phil. 857 (2001) [Per J. De Leon, Jr., Second Division].

<sup>70</sup> However, Article 1959 of the Civil Code should only be invoked in cases involving conventional interest. It provides:

*Isla v. Estorga*,<sup>71</sup> reiterated that Article 2212 applies to “stipulated or conventional interest, *i.e.*, monetary interest[.]”

In addition, not only the principal amount but also the monetary interest due to respondent as discussed above shall itself earn compensatory interest at the legal rate, pursuant to Article 2212 of the Civil Code, which states that “[i]nterest due shall earn legal interest from the time it is judicially demanded, although the obligation may be silent upon this point. To be sure, Article 2212 contemplates the presence of stipulated or conventional interest, *i.e.*, monetary interest, which has accrued when demand was *judicially* made. In cases where no monetary interest had been stipulated by the parties, no accrued monetary interest could further earn compensatory interest upon judicial demand. Thus, the principal amount and monetary interest due to respondent shall earn compensatory interest of twelve percent (12%) per annum from judicial demand, *i.e.*, the date of the filing of the complaint on July 24, 2007, to June 30, 2013, and thereafter, at the rate of six percent (6%) per annum from July 1, 2013 until fully paid.”<sup>72</sup> (Emphasis in the original, citations omitted)

## II

*Stipulated* interest rates, whether conventional or compensatory, are subject to the “unconscionability” standard. The concept of unconscionability is a matter of law and equity. Jurisprudence empowers courts to equitably reduce interest rates; and the law<sup>73</sup> empowers them to reduce penalty charges.<sup>74</sup> *Eastern Shipping Lines* recognized that “factual circumstances [of a case] may [call] for different applications, guided by the rule that the courts are vested with discretion, depending on the equities of each case, on the award of interest.”<sup>75</sup>

### II (A)

“Central Bank Circular No. 905 issued by the Monetary Board of the Central Bank, pursuant to the powers granted by the Usury Law, effectively lifted the ceilings on interest rates. Consequently, usury, although illegal, is *legally non-existent* and interest can be charged as agreed upon by creditor

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ARTICLE 1959. Without prejudice to the provisions of Article 2212, interest due and unpaid shall not earn interest. However, the contracting parties may by stipulation capitalize the interest due and unpaid, which as added principal shall earn new interest.

<sup>71</sup> 834 Phil. 884 (2018) [Per J. Perlas-Bernabe, Second Division].

<sup>72</sup> *Id.* at 894 citing *David v. Court of Appeals, et al.*, 375 Phil. 177 (1999) [Per J. Quisumbing, Third Division], which in turn cited *Philippine American Accident Insurance Co., Inc. v. Flores*, 186 Phil. 563 (1980) [Per J. Abad Santos, Second Division].

<sup>73</sup> CIVIL CODE, art. 1229 provides:

ARTICLE 1229. The judge shall equitably reduce the penalty when the principal obligation has been partly or irregularly complied with by the debtor. Even if there has been no partial performance, the penalty may also be reduced by the courts if it is iniquitous or unconscionable.

<sup>74</sup> *Land Bank of the Phils. v. David*, 585 Phil. 167 (2008) [Per J. Carpio-Morales, Second Division].

<sup>75</sup> *Eastern Shipping Lines, Inc. v. Court of Appeals*, 304 Phil. 236, 252 (1994) [Per J. Vitug, En banc].

and borrower<sup>76</sup> pursuant to the freedom of contract principle<sup>77</sup> under Article 1306 of the Civil Code, viz:

ARTICLE 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.

However, courts have not hesitated to void *conventional interest* that is “*excessive, iniquitous, unconscionable and exorbitant,*” for being violative of the same provision of Article 1306 of the Civil Code. As held in *Carpo v. Chua & Dy Ng*:<sup>78</sup>

In a long line of cases, this Court has invalidated similar stipulations on interest rates for being excessive, iniquitous, unconscionable and exorbitant. In *Solangon v. Salazar*<sup>79</sup> we annulled the stipulation of 6% per month or 72% per annum interest on a P60,000.00 loan. In *Imperial v. Jaucian*,<sup>80</sup> we reduced the interest rate from 16% to 1.167% per month or 14% per annum. In *Ruiz v. Court of Appeals*,<sup>81</sup> we equitably reduced the agreed 3% per month or 36% per annum interest to 1% per month or 12% per annum interest. The 10% and 8% interest rates per month on a P1,000,000.00 loan were reduced to 12% per annum in *Cuaton v. Salud*.<sup>82</sup> Recently, this Court, in *Arrofo v. Quiño*,<sup>83</sup> reduced the 7% interest per month on a P15,000.00 loan amounting to 84% interest per annum to 18% per annum.

There is no need to unsettle the principle affirmed in *Medel* and like cases. From that perspective, it is apparent that the stipulated interest in the subject loan is excessive, iniquitous, unconscionable and exorbitant. Pursuant to the freedom of contract principle embodied in Article 1306 of the Civil Code, 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. In the ordinary course, the codal provision may be invoked to annul the excessive stipulated interest.

Conventional interest rates that are unconscionable are deemed unjust, immoral, and contrary to public policy. In *Sps. Castro v. Tan et al.*:<sup>84</sup>

The imposition of an unconscionable rate of interest on a money debt, even if knowingly and voluntarily assumed, is immoral and unjust. It is tantamount to a repugnant spoliation and an iniquitous deprivation of property, repulsive to the common sense of man. It has no support in law, in principles of justice, or in the human conscience nor is there any reason whatsoever which may justify such imposition as righteous and as one that

<sup>76</sup> *Liam Law v. Olympic Sawmill Co. & Chi*, 214 Phil. 385 (1984) [Per J. Melencio-Herrera, First Division].

<sup>77</sup> 1 STEPHANIE V. GOMEZ-SOMERA, CREDIT TRANSACTIONS: NOTES AND CASES 181–182 (2<sup>nd</sup> ed., 2015).

<sup>78</sup> 508 Phil. 462, 468–469 (2005) [Per J. Tinga, Second Division].

<sup>79</sup> 412 Phil. 816 (2001) [Per J. Sandoval-Gutierrez, Third Division].

<sup>80</sup> 471 Phil. 484 (2004) [Per J. Panganiban, First Division].

<sup>81</sup> 449 Phil. 419 (2003) [Per J. Puno, Third Division].

<sup>82</sup> 465 Phil. 999 (2004) [Per J. Ynares-Santiago, First Division].

<sup>83</sup> 490 Phil. 179 (2005) [Per J. Carpio, First Division].

<sup>84</sup> 620 Phil. 239 (2009) [Per J. Del Castillo, Second Division].

may be sustained within the sphere of public or private morals.<sup>85</sup> (Citation omitted)

In *Vitug v. Abuda*,<sup>86</sup> we held that while parties are free, in view of the suspension of the Usury Law, to set interest rates in their loan contract, they must ensure that their stipulated interest rates are neither iniquitous nor unconscionable. Otherwise, the same would be void for being against public morals. We emphasized that “[t]he lifting of the ceiling on interest rates may not be read as ‘grant[ing] lenders *carte blanche* to raise interest rates to levels which will either enslave their borrowers or lead to a hemorrhaging of their assets.’”<sup>87</sup> Thus, when stipulated interest rates are later found to be iniquitous or unconscionable, courts have the discretionary power to equitably reduce them, approximating the prevailing market rate “under the circumstances had the parties had equal bargaining power.”<sup>88</sup>

The reduction of interest rates is not limited to monetary interest. It is not dependent on the type of interest imposed on the party, but on whether the interest rate was unconscionable or not. Thus, compensatory interest, when found to be unconscionable, may also be reduced.

Articles 1229 and 2227 of the Civil Code allow the reduction of penalty charges or damages that are unconscionable:

ARTICLE 1229. The judge shall equitably reduce the penalty when the principal obligation has been partly or irregularly complied with by the debtor. Even if there has been no performance, the penalty may also be reduced by the courts if it is iniquitous or unconscionable.

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

In *Ibarra v. Aveyro*,<sup>89</sup> this Court even held that if a penalty clause is so unconscionable that its enforcement constitutes “a repugnant spoliation and an iniquitous deprivation of property,”<sup>90</sup> it can be struck down for being invalid.

Accordingly, in several cases,<sup>91</sup> this Court reduced or removed altogether penalty interests or charges that were unconscionable.

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<sup>85</sup> Id. at 242–243.

<sup>86</sup> 776 Phil. 540 (2016) [Per J. Leonen, Second Division].

<sup>87</sup> Id. at 568–569.

<sup>88</sup> Id. at 569.

<sup>89</sup> 37 Phil. 273 (1917) [Per J. Torres, First Division].

<sup>90</sup> Id. at 282.

<sup>91</sup> See *Macalinao v. Bank of the Philippine Islands*, 616 Phil. 60 (2009) [Per J. Velasco, Jr., Third Division]; *State Investment House, Inc. v. Court of Appeals*, 413 Phil. 518 (2001) [Per J. Kapunan, First Division]; *Palmares v. Court of Appeals*, 351 Phil. 664 (1998) [Per J. Regalado, Second Division]; and *Rizal Commercial Banking Corporation v. Court of Appeals*, 352 Phil. 101 (1998) [Per J. Melo, Second Division].

## II (B)

“Interest rates become unconscionable in light of the context in which they were imposed or applied.”<sup>92</sup> Thus, the determination of whether an interest rate or penalty charge is reasonable or iniquitous rests on the sound discretion of the courts based on the established facts of a particular case.<sup>93</sup>

This Court had struck down stipulated monthly interest rates of 2.5%,<sup>94</sup> 5%,<sup>95</sup> 6%,<sup>96</sup> and 10%<sup>97</sup> for being unconscionable. Meanwhile, in *Toledo v. Hyden*,<sup>98</sup> a monthly interest rate of 6% to 7% was deemed valid. In that case, this Court noted that the borrower was not in dire need of money when she obtained a loan, and it was the borrower herself who was guilty of inequitable acts:

*In this case, there was no urgency of the need for money on the part of Jocelyn, the debtor, which compelled her to enter into said loan transactions. She used the money from the loans to make advance payments for prospective clients of educational plans offered by her employer. In this way, her sales production would increase, thereby entitling her to 50% rebate on her sales. This is the reason why she did not mind the 6% to 7% monthly interest. Notably too, a business transaction of this nature between Jocelyn and Marilou continued for more than five years. Jocelyn religiously paid the agreed amount of interest until she ordered for stop payment on some of the checks issued to Marilou. The checks were in fact sufficiently funded when she ordered the stop payment and then filed a case questioning the imposition of a 6% to 7% interest rate for being allegedly iniquitous or unconscionable and, hence, contrary to morals.*

*It was clearly shown that before Jocelyn availed of said loans, she knew fully well that the same carried with it an interest rate of 6% to 7% per month, yet she did not complain. In fact, when she availed of said loans, an advance interest of 6% to 7% was already deducted from the loan amount, yet she never uttered a word of protest.*

After years of benefiting from the proceeds of the loans bearing an interest rate of 6% to 7% per month and paying for the same, Jocelyn cannot now go to court to have the said interest rate annulled on the ground that it is excessive, iniquitous, unconscionable, exorbitant, and absolutely revolting to the conscience of man.<sup>99</sup> (Emphasis supplied, citations omitted)

<sup>92</sup> *Vitug v. Abuda*, 776 Phil. 540, 569 (2016) [Per J. Leonen, Second Division].

<sup>93</sup> *Land Bank of the Phils. v. David*, 585 Phil. 167 (2008) [Per J. Carpio Morales, Second Division].

<sup>94</sup> *Spouses Abella v. Spouses Abella*, 763 Phil. 372, 388 (2015) [Per J. Leonen, Second Division].

<sup>95</sup> *Spouses Castro v. Tan*, 620 Phil. 239 (2009) [Per J. Del Castillo, Second Division].

<sup>96</sup> *De La Paz v. L & J Development Company, Inc.*, 742 Phil. 420, 430–432 (2014) [Per J. Del Castillo, Second Division] and *Spouses Solangon v. Salazar*, 412 Phil. 816, 823 (2001) [Per J. Sandoval-Gutierrez, Third Division].

<sup>97</sup> *Isla v. Estorga*, G.R. No. 233974, July 2, 2018, <<http://elibrary.judiciary.gov.ph/thebookshelf/showdocs/1/64438>> [Per J. Perlas-Bernabe, Second Division].

<sup>98</sup> 652 Phil. 70 (2010) [Per J. Del Castillo, First Division].

<sup>99</sup> *Id.* at 79–80.



Furthermore, while we have sustained the validity of a 21% per annum interest in one case,<sup>100</sup> we have also reduced an 18% per annum interest rate to 12% per annum in another,<sup>101</sup> after finding that “the resulting interest charge has turned out to be excessive in the context of its base computation period, and hence, unwarranted[.]”<sup>102</sup> In *Land Bank of the Phils. v. David*,<sup>103</sup> we upheld the reduction of the interest rate of 17% per annum and the penalty charge of 12% per annum to 12% and 5% per annum, respectively, on equitable grounds. This was because the loan extended to respondent was part of the social assistance program to farmers and this Court considered respondent’s efforts to pay even after she had suffered business losses.

In *Vitug*, the stipulated interest rates of 5% to 10% per month were found iniquitous considering the “extreme necessity” which compelled petitioner to obtain the loan and the possibility of his property being foreclosed if not for the loan. This Court further said that “it would be unjust to impose a heavier burden upon petitioner, who would already be losing his and his family’s home. Respondent would not be unjustly deprived if the interest rate is reduced. After all, respondent still has the right to foreclose the property.”<sup>104</sup>

Also, in another case,<sup>105</sup> this Court noted that the payment of the principal loan of ₱500,000 and interest of ₱425,000, computed at a monthly interest rate of 5% already “sufficiently compensated for the loan and the interest earned, and [the creditor] cannot be allowed to further recover on an interest rate which is unconscionable.”<sup>106</sup>

To determine whether an interest rate is unconscionable, we are guided by the following pronouncements in *Sps. Abella v. Sps. Abella*:<sup>107</sup>

In determining whether the rate of interest is unconscionable, the mechanical application of pre-established floors would be wanting. The lowest rates that have previously been considered unconscionable need not be an impenetrable minimum. What is more crucial is a consideration of the parties’ contexts. Moreover, interest rates must be appreciated in light of the fundamental nature of interest as compensation to the creditor for money lent to another, which he or she could otherwise have used for his or her own purposes at the time it was lent. It is not the default vehicle for predatory gain. As such, interest need only be reasonable. It ought not be a supine mechanism for the creditor’s unjust enrichment at the expense of another.<sup>108</sup>

<sup>100</sup> *Spouses Bautista v. Pilar Development Corporation*, 371 Phil. 533, 543 (1999) [Per J. Puno, First Division].

<sup>101</sup> *Trade & Investment Development Corporation of the Phils. v. Roblett*, 523 Phil. 360 (2006) [Per J. Tinga, Special Second Division].

<sup>102</sup> *Id.* at 367.

<sup>103</sup> *Land Bank of the Phils. v. David*, 585 Phil. 167 (2008) [Per J. Carpio-Morales, Second Division].

<sup>104</sup> *Vitug v. Abuda*, 776 Phil. 540, 572 (2016) [Per J. Leonen, Second Division].

<sup>105</sup> *Menchavez v. Bermudez*, 697 Phil. 447 (2012) [Per J. Velasco, Jr., Third Division].

<sup>106</sup> *Id.* at 458.

<sup>107</sup> 763 Phil. 372 (2015) [Per J. Leonen, Second Division].

<sup>108</sup> *Id.* at 389.

Hence, this guiding parameter:

The legal rate of interest is the presumptive reasonable compensation for borrowed money. While parties are free to deviate from this, any deviation must be reasonable and fair. Any deviation that is far-removed is suspect. *Thus, in cases where stipulated interest is more than twice the prevailing legal rate of interest, it is for the creditor to prove that this rate is required by prevailing market conditions.*<sup>109</sup> (Emphasis supplied)

Conformable to the foregoing pronouncements, “[t]he maximum interest rate that will not cross the line of conscionability is ‘not more than twice the prevailing legal rate of interest.’ If the stipulated interest exceeds this standard, the creditor must show that the rate is necessary under current market conditions.”<sup>110</sup> The creditor must also show that the parties were on an equal footing when they stipulated on the interest rate.<sup>111</sup>

Furthermore, where the monetary interest rate is found to be unconscionable, only the rate is nullified and deemed not written into the contract; the parties’ agreement on the payment of interest remains. In such instance, “the legal rate of interest prevailing at the time the agreement was entered into”<sup>112</sup> is applied by the courts.

As for compensatory interest, this Court in *Ligutan v. Court of Appeals*<sup>113</sup> held:

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.<sup>114</sup> (Citations omitted)

In *Palmares v. Court of Appeals*,<sup>115</sup> this Court removed the monthly 3% penalty charge for being highly inequitable and unreasonable. *Palmares* involved a ₱30,000.00 loan, payable in two months with interest at 6% per annum that would be compounded every month. *Palmares* held:

<sup>109</sup> Id.

<sup>110</sup> *Lara's Gifts & Decors, Inc. v. Midtown Industrial Sales, Inc.*, G.R. No. 225433, August 28, 2019, <<https://elibrary.judiciary.gov.ph/thebookshelf/showdocs/1/65527>> [Per J. Carpio, En banc].

<sup>111</sup> See *Philippine National Bank v. Court of Appeals*, 308 Phil. 18, 24 (1994) [Per J. Puno, Second Division].

<sup>112</sup> *Isla v. Estorga*, 834 Phil. 884, 891 (2018) [Per J. Perlas-Bernabe, Second Division].

<sup>113</sup> 427 Phil. 42 (2002) [Per J. Vitug, Third Division].

<sup>114</sup> Id. at 52.

<sup>115</sup> 351 Phil. 664 (1998) [Per J. Regalado, Second Division].

In a case previously decided by this Court which likewise involved private respondent M.B. Lending Corporation, and which is substantially on all fours with the one at bar, we decided to eliminate altogether the penalty interest for being excessive and unwarranted under the following rationalization:

Upon the matter of penalty interest, we agree with the Court of Appeals that the economic impact of the penalty interest of three percent (3%) per month on total amount due but unpaid should be equitably reduced. *The purpose for which the penalty interest is intended — that is, to punish the obligor — will have been sufficiently served by the effects of compounded interest.* Under the exceptional circumstances in the case at bar, e.g., the original amount loaned was only P15,000.00; partial payment of P8,600.00 was made on due date; and the heavy (albeit still lawful) regular compensatory interest, the penalty interest stipulated in the parties' promissory note is iniquitous and unconscionable and may be equitably reduced further by eliminating such penalty interest altogether.<sup>116</sup> (Emphasis supplied, citation omitted)

In *Barons Marketing Corp. v. Court of Appeals*,<sup>117</sup> this Court reduced the 25% penalty charge to cover the attorney's fees and collection fees, which was in addition to the 12% annual interest, to 10% for being manifestly exorbitant. Also, in *Tan v. Court of Appeals*,<sup>118</sup> the continued monthly accrual of the 2% penalty on the total amount due of about ₱7.996 million was held to be unconscionable. Considering the debtor's partial payments and offer to settle his outstanding loan in good faith, this Court found it fair and equitable in that case to reduce the 2% penalty charge, compounded monthly, to a straight 12% per annum.

## II (C)

However, the standards of unconscionability cannot apply to interest on interest under Article 2212 of the Civil Code, viz:

ARTICLE 2212. *Interest due shall earn legal interest* from the time it is judicially demanded, although the obligation may be silent upon this point. (Emphasis supplied)

As Justice Alfredo Benjamin S. Caguioa elucidated, "interest on interest" is fixed by law. In the absence of a contractual stipulation between the parties on the rate of interest on accrued interest, the legal rate shall apply by operation of law. Its imposition is not subject to the court's discretionary power.<sup>119</sup>

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<sup>116</sup> Id. at 693-691.

<sup>117</sup> 349 Phil. 769 (1998) [Per J. Kapunan, Third Division].

<sup>118</sup> 419 Phil. 857 (2001) [Per J. De Leon, Jr., Second Division].

<sup>119</sup> J. Caguioa, Reflections, p. 2.

Article 2212's interest on interest is penalty or indemnity for delay in the payment of stipulated interest.<sup>120</sup> It is expressly prescribed by law, and deemed written into every contract. This, all contracting parties should be aware of when they stipulate on the payment of interest.

In view of the foregoing discussions, and taking into consideration the viewpoints of Justice Caguioa, the summary of rules on the imposition of interest, as provided in *Eastern Shipping Lines* and *Nacar*, are amended as follows:

With regard to an award of interest in the concept of actual and compensatory damages, the rate of interest, as well as the accrual thereof, is imposed, as follows:

A. In obligations consisting of loans or forbearances of money, goods or credit:

1. The compensatory interest due shall be that which is stipulated by the parties in writing as the penalty or compensatory interest rate,<sup>121</sup> provided it is not unconscionable.<sup>122</sup> In the absence of a stipulated penalty or compensatory interest rate, the compensatory interest due shall be that which is stipulated by the parties in writing as the conventional interest rate,<sup>123</sup> provided it is not unconscionable.<sup>124</sup> In the absence of a stipulated penalty or a stipulated conventional interest rate, or if these rates are unconscionable, the compensatory interest shall be the prevailing legal interest rate prescribed by the Bangko Sentral ng Pilipinas.<sup>125</sup> Compensatory interest, in the absence of a stipulated reckoning date, shall be computed from default, i.e., from extrajudicial or judicial demand, *until full payment*.<sup>126</sup>

2. Interest on conventional/monetary interest and stipulated compensatory interest shall accrue at the stipulated interest rate (compounded interest) from the stipulated reckoning point or, in the absence thereof, from extrajudicial or judicial demand *until full payment*, provided it is not unconscionable. In the absence of a stipulated compounded interest rate or if this rate is unconscionable, the prevailing legal interest rate prescribed by the Bangko Sentral ng Pilipinas shall apply from the time of judicial demand *until full payment*.<sup>127</sup>

B. In obligations not consisting of loans or forbearances of money, goods or credit:

1. For liquidated claims:

The compensatory interest due shall be that which is stipulated by the parties in writing as the penalty or compensatory interest rate,<sup>128</sup>

<sup>120</sup> Article 2212 is within Title XVIII, Chapter 2 of the Civil Code, on "Actual or Compensatory Damages."

<sup>121</sup> CIVIL CODE, arts. 1226 and 2209.

<sup>122</sup> CIVIL CODE, art. 1306.

<sup>123</sup> CIVIL CODE, art. 2209.

<sup>124</sup> CIVIL CODE, art. 1306.

<sup>125</sup> CIVIL CODE, art. 2209 and Usury Law, sec. 1.

<sup>126</sup> CIVIL CODE, art. 1169.

<sup>127</sup> CIVIL CODE, art. 2212.

<sup>128</sup> CIVIL CODE, art. 1226 and 2209.

provided it is not unconscionable.<sup>129</sup> In the absence of a stipulated penalty or compensatory interest rate, or if these rates are unconscionable, the compensatory interest shall be at the rate of 6%.<sup>130</sup> Compensatory interest, in the absence of a stipulated reckoning date, shall be computed from default, i.e., from extrajudicial or judicial demand, *until full payment*.<sup>131</sup>

- a. Interest on stipulated compensatory interest shall accrue at the stipulated interest rate (compounded interest) from the stipulated reckoning point or in the absence thereof, from extrajudicial or judicial demand *until full payment*, provided it is not unconscionable. In the absence of a stipulated compounded interest rate or if this rate is unconscionable, legal interest at the rate of 6% shall apply from the time of judicial demand *until full payment*.<sup>132</sup>

2. For unliquidated claims:

Compensatory interest on the amount of damages awarded may be imposed in the discretion of the court at the rate of 6% per annum.<sup>133</sup> No compensatory interest, however, shall be adjudged on unliquidated claims or damages until the demand can be established with reasonable certainty.<sup>134</sup> Thus, when such certainty cannot be so reasonably established at the time the demand is made, the interest shall begin to run only from the date of the judgment of the trial court (at which time the quantification of damages may be deemed to have been reasonably ascertained) *until full payment*.<sup>135</sup> The actual base for the computation of the interest shall, in any case, be on the principal amount finally adjudged.

The foregoing guidelines are illustrated in the table below:

**Rules on the Imposition of Compensatory Interest**

| <b>When obligation consists in:</b> | <b>Compensatory interest (scenario)</b>                                       | <b>Interest rate</b>                        | <b>Interest Accrual</b>   |
|-------------------------------------|---|---|---|
|                                     | ⇒ If the penalty or compensatory interest rate is stipulated                  | Stipulated penalty or compensatory interest | ⇒ As stipulated<br>⇒ If not stipulated, from judicial or extrajudicial demand |
|                                     | ⇒ If the penalty or compensatory interest is not stipulated or unconscionable | Stipulated conventional interest            | ⇒ As stipulated<br>⇒ If not stipulated, from judicial or extrajudicial demand |

<sup>129</sup> CIVIL CODE, art. 1306.

<sup>130</sup> CIVIL CODE, art. 2209.

<sup>131</sup> CIVIL CODE, art. 1169.

<sup>132</sup> CIVIL CODE, art. 2212.

<sup>133</sup> CIVIL CODE, art. 2209.

<sup>134</sup> CIVIL CODE, art. 2213.

<sup>135</sup> CIVIL CODE, art. 2213.

|  |  |   |   |
|--|--|---|---|
| <b>LOANS OR FORBEARANCE OF MONEY, GOODS OR CREDIT</b>        | ⇒ If conventional interest is not stipulated or unconscionable | BSP-prescribed legal rate   | From judicial demand  |
|  | <i>Interest on Interest</i>                                    | <i>Interest rate</i>  | <i>Interest Accrual</i>   |
|  | (i) Interest on conventional interest                          | Stipulated rate (compound interest rate)  | ⇒ As stipulated<br>⇒ If not stipulated, from judicial or extrajudicial demand |
|  |  | BSP-prescribed legal rate, if not stipulated or unconscionable.   | From judicial demand  |
|  | (ii) Interest on compensatory interest                         | Stipulated rate (compound interest rate)  | ⇒ As stipulated<br>⇒ If not stipulated, from judicial or extrajudicial demand |
|  |  | BSP-prescribed legal rate, if not unconscionable  | From judicial demand  |
| <b>NON-LOAN OR NON-FORBEARANCE OF MONEY, GOODS OR CREDIT</b> | <i>Is demand established with reasonable certainty?</i>        | <i>Compensatory interest rate</i>   | <i>Interest Accrual</i>   |
|  | Yes  | Stipulated penalty or compensatory interest<br><br>Legal rate at 6%, if not stipulated or unconscionable. | ⇒ As stipulated<br>⇒ If not stipulated, from judicial or extrajudicial demand |
|  |  | Interest on interest at 6%  | From judicial demand  |
|  | No   | Discretionary at 6%   | From date of judgment   |

### III

Now to this case, we modify our earlier Decision and hold that the contract involved is not a loan or forbearance of money, goods, or credit,<sup>136</sup> but a sale of goods on credit. From January to December 2007, petitioner Lara's Gifts purchased from respondent Midtown various industrial and construction materials totaling ₱1,263,104.22. The purchases were on a 60-day credit term, with the condition that a 24% interest rate per annum would be charged on *all accounts overdue*. This means that the 24% interest rate per annum would run only upon petitioner's failure to pay on the due date.

<sup>136</sup> *Estores v. Spouses Supangan*, 686 Phil. 86, 96 (2012) [Per J. Del Castillo, First Division], defined forbearance as an arrangement other than a loan where a person agrees to the temporary use of his money, goods, or credits subject to the fulfilment of certain conditions.

Thus, the 24% interest rate is a *compensatory interest*, imposed as indemnity for damages caused by the delay in the payment of the raw materials' purchase price, pursuant to Article 2209.

By the express provision of Article 2212, the 24% compensatory interest, which have accrued at the time of judicial demand, may be subject to "interest on interest."

However, as Justice Amy C. Lazaro-Javier pointed out, the Regional Trial Court adjudged in favor of Midtown Industrial Sales only ₱1,263,104.22 plus interest at 24% per annum, computed from February 5, 2008 until fully paid; and ₱50,000.00 as attorney's fees. This judgment award became final and executory as to Midtown Industrial Sales as it did not appeal. Thus, the additional award of legal interest on the 24% interest, in an appeal brought by Lara's Gifts, is *ultra vires*.<sup>137</sup>

**ACCORDINGLY**, the Motion for Reconsideration is **PARTIALLY GRANTED**. This Court's August 28, 2019 Decision is **MODIFIED** in that the award of legal interest on the 24% per annum compensatory interest is hereby **DELETED**.

Petitioner Lara's Gifts & Decors, Inc. is ordered to **PAY** respondent Midtown Industrial Sales, Inc. the following:

- (1) ONE MILLION TWO HUNDRED SIXTY-THREE THOUSAND ONE HUNDRED FOUR PESOS and 22/100 (₱1,263,104.22) representing the principal amount plus stipulated interest at 24% *per annum* to be computed from January 22, 2008, the date of extrajudicial demand, until full payment;
- (2) The sum of FIFTY THOUSAND PESOS (₱50,000.00) as attorney's fees; and
- (3) Cost of the suit.

The total monetary award shall bear legal interest at the rate of 6% *per annum* from finality of this Resolution until full payment.<sup>138</sup>

**SO ORDERED.**

  
MARVIC M.V.F. LEONEN  
Acting Chief Justice

<sup>137</sup> J. Lazaro-Javier, Reflections, pp. 2-3.

<sup>138</sup> *Nacar v. Gallery Frames*, 716 Phil. 267 (2013) [Per J. Peralta, En Banc].

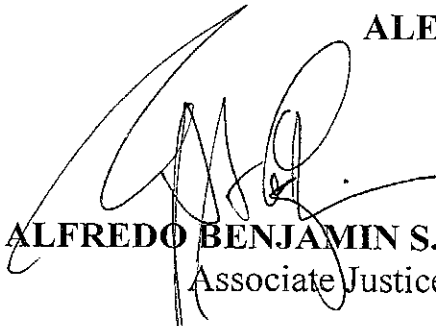
WE CONCUR:

On official business

**ALEXANDER G. GESMUNDO**

Chief Justice

*See  
Concurring  
Opinion*



**ALFREDO BENJAMIN S. CAGUIOA**

Associate Justice



**RAMON PAUL L. HERNANDO**

Associate Justice

*I concur in the result.  
See Separate Opinions  
of Justices*

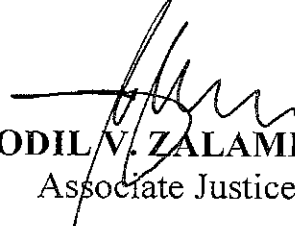
**AMY C. LAZARO-JAVIER**

Associate Justice



**HENRI JEAN PAUL B. INTING**

Associate Justice



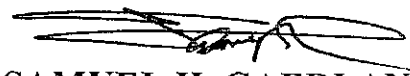
**RODIL V. ZALAMEDA**

Associate Justice

On official business

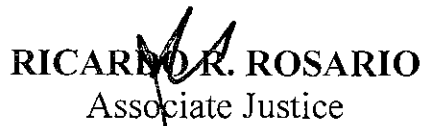
**MARIO V. LOPEZ**

Associate Justice



**SAMUEL H. GAERLAN**

Associate Justice



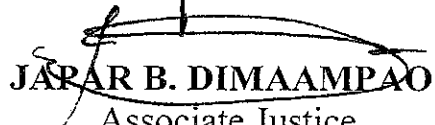
**RICARDO R. ROSARIO**

Associate Justice



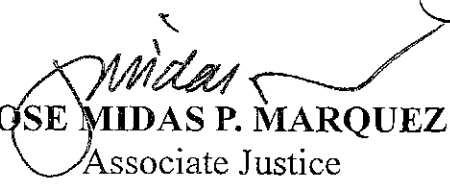
**JHOSEP V. LOPEZ**

Associate Justice



**JAPAR B. DIMAAMPAO**

Associate Justice



**JOSE MIDAS P. MARQUEZ**

Associate Justice



**ANTONIO T. KHO, JR.**

Associate Justice



**MARIA FILOMENA D. SINGH**

Associate Justice



**CERTIFICATION**

I certify that the conclusions in the above Resolution had been reached in consultation before the case was assigned to the writer of the opinion of the court.

A handwritten signature in black ink, appearing to read 'Marvic M.V.F. Leonen', with a long horizontal flourish extending to the right.

**MARVIC M.V.F. LEONEN**  
Acting Chief Justice