

## PENAL CLAUSE AND USURY LAW

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Section 2 of Act No. 2655 as amended otherwise known as the Usury Law, provides that —

No person or corporation shall directly or indirectly take or receive in money or other property, real or personal, or choses in action, a higher rate of interest or greater sum or value, including commissions, premiums, fines and *penalties*, for the loan or renewal thereof or forbearance of money, goods, or credits, where such loan or renewal or forbearance is secured. x x x

Section 3 of the same Act, on the other hand, states that:

No person or corporation shall directly or indirectly demand, take, receive or agree to charge in money or other property, real or personal, a higher rate or greater sum or value, for the loan or forbearance of money, goods, or credits, where such loan or forbearance is not secured. x x x

When an excessive rate of interest is made payable only in case of default in payment of the principal, the higher rate is not for the use of the money, but imposed as a penalty for non-performance of the contract x x x There is no policy and nowhere in Act No. 2655 is there a provision preventing the stipulation and enforcement of a penalty in case of a violation of the contract.<sup>1</sup> While this doctrine holds true under section 3 of the Usury Law, it does not so hold under section 2 of the same law. Or should it?

The resolution of the question is material to the determination of the proper scope of application of Act No. 2655. Stated otherwise, the issue is: Whether or not, in determining a transaction to be usurious or otherwise, penal clause should be considered. It is submitted that it should not.

### THE USURY LAW, ACT NO. 2655

In 1916, Act No. 2655 or the Usury Law was enacted to afford protection to those who, in their financial difficulties, may desperately agree to pay exorbitant interests on loans contracted by them, thus lessening their chance to live with dig-

<sup>1</sup> Lopez and Javelona vs. El Hogar Filipino, 47 Phil. 249; Bachrach Motor Co. vs. Espiritu, 52 Phil. 346; Go Chico vs. Martinez, 45 Phil. 256.

nity in a society of free men, making them sink deeper in poverty, and to punish unscrupulous individuals who take advantage of the misfortunes of others.<sup>2</sup> It is an act fixing rates of interest upon loans and declaring the effect of receiving or taking usurious rate and for other purposes.<sup>3</sup> It is intended to protect the borrower from undue and oppressive imposition of unscrupulous lenders by preventing excessive charges by way of compensation for the loan of money by the latter.<sup>4</sup>

#### "DEMANDING OR AGREEING vs. ACTUAL TAKING OR RECEIVING"

Under section 3 of the Usury Law, the mere *demanding* or *agreeing* "to charge in money or other property, real or personal, a higher rate or greater sum or value, for the loan or forbearance" is usury. Meanwhile, under the circumstances of section 2 of the same act, *actual taking* or *receiving* of compensation for the use of money over the legally allowed rate is the gesture constitutive of usury. Under section 6<sup>5</sup> of the same law, the right to recover the entire<sup>6</sup> usurious interest paid is granted only to one who "shall have paid or delivered a higher rate or greater sum or value than is hereinbefore allowed to be taken or received." The last cited section and a list of Philippine jurisprudence on usury points to the *actual taking* or *receiving* as the proper ambience in which the Usury Law finds its full efficacy. Merely *agreeing* or *demanding* is not a significant consideration in usurious transactions. This latter proposition finds support in that contracts formerly usurious

<sup>2</sup> Agbayani, *Commentaries and Jurisprudence on the Commercial Laws of the Philippines*, vol. 1, 1978 edition (AFA Publications: Quezon City), p. 503.

<sup>3</sup> Arevalo vs. Dimayuga, 49 Phil. 894.

<sup>4</sup> 91 C.J.S. 570.

<sup>5</sup> See also the case of Go Chico vs. Martinez, 45 Phil. 256.

Also a debtor who promises to pay 22% interest on the principal but pays only 12% cannot recover the 12% paid by him. (Garcia and Buencamino vs. Matias and Policarpio, 49 Phil. 257.)

<sup>6</sup> The issue on how much interest a debtor may recover on a usurious transaction has been clinched in the Supreme Court decision of 1968 in the case of Angel Jose Merchandising vs. Chelda Enterprises and Syjueco (23 SCRA 119). Accordingly, the person paying usurious interest can recover not only the interest in excess of that which the law allows, but the entire interest paid. This is because the stipulation for the payment of usurious interest is void.

in character may become legal upon the passing of usury statutes sanctioning the formers' usurious stipulations.<sup>7</sup> On the other hand, that *actual taking* or *receiving* is the critical considerations in the Usury Law is confirmed by the recent Central Bank Circular No. 721 which amends sections 2 and 3 of the Usury Law. In prescribing the interest rate ceilings for the loan or forbearance of any money, goods, or credits, said circular used the *effective rate of interest* as measure, said rate being defined as "the price paid for the use of money expressed as a percentage, on an annual basis, of the amount actually received."

#### PENALTY, DEFINED, ITS NATURE, PURPOSE AND LIMITATIONS

Where a borrower has agreed to pay a rate of interest not forbidden by law, but has stipulated that *in the event of his not making payment* at the time specified, the obligation shall bear a higher rate of interest, either from default or from the date of its execution, or that some specific sum shall be paid in addition to the principal and interest contracted for, the increased rate is generally regarded as a penalty.<sup>9</sup> A penalty stipulation is a coercive means to obtain from the debtor compliance with the obligation and is an accessory undertaking to assume liability in case of breach of the principal obligation.<sup>10</sup> As such, it is of a contingent character, and its demandability accrues only upon the breach of the principal obligation.

Among others, the purpose of the penalty is to provide a motivation for the prompt fulfillment of an obligation and/or to insure the performance of the same.<sup>11</sup>

<sup>7</sup> Usury statutes which do not impair the obligation of contracts by making contracts legal which were illegal at their inception may constitutionally be made retrospective. Thus, the right of a debtor under a usurious contract to refuse to pay interest or to recover usury has been held not to be a vested constitutional right secured against legislative innovation but that it constitutes a mere privilege within the legislative power to take away. Statutes which take away an existing defense of usury are generally held not to affect the obligation of the contract, but to pertain to the remedy only. The effect of such legislation is not to change the contract of the parties, but only to remove a bar to its enforcement, and where the legislature so intends, it will operate retrospectively. As a general rule, the legislature has the power to validate any or all parts of pre-existing usurious contracts. (91 C.J.S. 576-577 and U.S. vs. Tan Quingco Chua, 39 Phil. 552, both as cited in de Leon, *Comments and Cases on Credit Transactions*, 1978 [Rex Printing Co., Inc.: Quezon City], pp. 41-42.)

<sup>8</sup> Under the Usury Law, the Monetary Board of the Central Bank of the Philippines has the power to amend said law.

<sup>9</sup> R.C.L. 232 as cited in de Leon, *Comments and Notes on Credit Transactions*, p. 46.

<sup>10</sup> Georgi and Manresa as cited in Paras, *Civil Code of the Philippines Annotated*, vol. IV, 9th edition, 1978 (Rex Printing Co., Inc.: Quezon City), p. 246.

<sup>11</sup> Manresa as cited in Paras, *Civil Code*, vol. IV, p. 246.

The penalty stipulation is subject only to the limitations imposed by the Civil Code<sup>12</sup> namely, that it be *not* inequitous and unconscionable.<sup>13</sup>

#### CENTRAL BANK CIRCULAR NO. 721

Par. 1 and 2 of the Central Bank Circular No. 721 prescribing ceilings on the rates of interest for the loan or forbearance of any money, goods or credits read:

1. The effective rate of interest, excluding *commissions, premiums, fees and other charges* for the loan or forbearance of any money, goods, or credits, where such loan or renewal thereof, or forbearance has a maturity of 730 days or less, shall not exceed fourteen per cent (14%) per annum for secured loans and sixteen per cent (16%) per annum for unsecured loans, as defined respectively by sections 2 and 3 of the Usury Law, as amended.
2. The effective rate of interest, including commissions, premiums, fees and other charges for the loan or forbearance of any money, goods, or credits, where such loan, or renewal thereof, or forbearance has a maturity of more than 730 days, shall not exceed twenty-one percent (21%) per annum for both secured and unsecured loans, as defined respectively by sections 2 and 3 of the Usury Law, as amended.

The cited paragraphs amend sections 2 and 3 of the Usury Law to the effect, among others, that the term *penalties* in the earlier section is omitted, indicative, it seems, of an intention to definitely exclude the same from the scope of the Usury Law, thus resolving the controversy centering on the said term. Note that the term cannot be said to be subsumed in the catch all phrase "and other charges" following the principle of *ejusdem generis* in statutory construction. The specific enumerations are incident to the granting of loan, while "penalties" are consequent of its non-payment.

#### PREMISES THUS CONSIDERED x x x

x x x Penalty rates are not subject to the provisions of the Usury Law, notwithstanding section 2 of the said law.

(1) The Usury Law contemplates *actual taking* or *receiving* of usurious interests. It considers that interest which is taken or received *by way of compensation for the use of money*. Said interest forms an integral part of the principal obligation and demandable concurrently with the latter.

(2) Penalty, on the other hand, is by its very nature, a contingency measure which is *not* actually taken or received unless there is a breach of the loan obliga-

<sup>12</sup>Article 1226, *New Civil Code of the Philippines*.

<sup>13</sup>Article 1229, *New Civil Code of the Philippines*.

tion. And when it is actually taken or received, it is taken or received *not by way of compensation for the use of money*, but as *indemnity* for the breach of the loan obligation. When it is not taken or received, or during the pendency of the loan, the penalty serves only as a motivation to the debtor to comply with his obligation. While a penalty stipulation may be inserted in a loan obligation, the former's demandability is *not concurrent* with that of the latter, but contingent upon said latter's breach.

(3) That the application of the Usury Law does not extend to penalties and penalty stipulations in loans or forbearance is further supported by the amendment effected by Central Bank Circular No. 721 on the former. More specifically, the omission of the term *penalties* in paragraphs 2 and 3 of the circular effect the term's deletion from section 2 of the Usury Law.

Penalties and penalty stipulations should not be considered in determining whether a transaction is usurious or otherwise.