IX. CONCLUSION

Fixing the applicable tax system of the country is not the sole responsibility of government. It is equally shared by the citizens as well. The success of this endeavor depends upon the executive and legislative branches of the government as well as the private sector who are called upon to set aside their own interests in favor of the common good. Indeed, this entails making great sacrifices.

This challenge is posed to every Filipino.

Ruiz v. Court of Appeals: A Moral Hazard

*A. Edsel C.F. Tupaz**

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I. INTRODUCTION

The case of *Corazon G. Ruiz v. Court of Appeals and Torres*[1] appears to be the leading case that lays down the doctrine on unreasonable or exorbitant interest rates. In *Ruiz*, a contract of loan was entered into by and between a private lender and a private borrower. It was stipulated therein that the

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1. 401 SCRA 411 (2003).

borrower shall pay three percent (3%) monthly interest or thirty percent (36%) interest per annum until maturity and ten percent (10%) compounded monthly interest on the remaining (unpaid) balance until maturity. The Supreme Court declared these terms null and void. The Court further substituted the original interest rate, as distinguished from the surcharge or penalty rate, with a "reasonable" rate of twelve percent (12%) per annum.

II. Structure of Inquiry

Preliminarily, this essay shall provide for important pointers that the reader has to keep in mind during the discourse to avoid any confusion between two important operational concepts — interest rate proper as opposed to penalty rate, surcharge or liquidated damages. Afterwhich, the facts of the case will be laid down to be followed by a presentation of two principal issues and a demonstration of the holding of the court. Focus shall be given to the bases for the holding. Finally, and most important, after a brief summary, the author shall present at least six problem areas and attempt to resolve the controversies herein.

III. Pointers

Two concepts come into play. The first pertains to the interest rate proper. The legal regime for this includes pertinent provisions of the Civil Code[2] and the Usury Law,[3] whose effectivity has been suspended over a decade ago.[4] The second concept refers to the penalty rate, "surcharge," or liquidated damages.[5] To avoid confusion, it must be noted this early that the

2. An Act to Ordain and Institute the Civil Code of the Philippines [Civil Code of the Philippines] art. 1956: No interest shall be due unless it has been expressly stipulated in writing; art. 1957: Contracts and stipulations, under any cloak or device whatever, intended to circumvent the laws against usury shall be void. The borrower may recover in accordance with the laws on usury; art. 1413: Interest paid in excess of the interest allowed by the usury laws may be recovered by the debtor, with interest thereon from the date of the payment.

3. *See* Act No. 2655, The Usury Law, as amended, § 1-12 (1916).

4. *See* Central Bank of the Philippines, Central Bank Circular No. 905-82, Dec. 3, 1982. (Under the authority granted to it by Sections 1-a, 4-a, and 4-b of the Usury Law, the Monetary Board of the *Bangko Sentral ng Pilipinas* approved this Circular); Hector S. De Leon, Comments and Cases on Credit Transactions 49 (1999).

5. These terms are used interchangeably. *See* Civil Code, arts. 1229 & 2227. *See, e.g.*, Joe's Electrical Supply v. Alto Electronics, 104 Phil 333 (1958) (stating that "liquidated damages" and "penalty clause" are the same); Yulo v. Pe, 101 Phil 134 (1957) (using "penalty clause"); Umali v. Miclat, 105 Phil 1109 (1959) (using "surcharge); Reyes v. Viuda y Hijos de Formoso 46 O.G. No. 5621 (Court of Appeals 1948) (using "penalty clause").

penumbra of rules governing the two concepts operate distinctly or independently. They are not the same.

Ruiz is indoctrinating as to the first concept: this portion of the juridical universe remained amorphous since the suspension of the Usury Law. *Ruiz* tried to fix the rules and end the debate, at least for the interim. (But as shall be discussed, this was not so.) As to the second concept, the regime governing penalty clauses, surcharges, or liquidated damages has already been more or less settled long before *Ruiz*. General principles of law, case law, and pertinent statutory provisions have already boxed this up tightly. Here, there lies no debate.

Ruiz, though a case on micro-economics, is a great case nonetheless. And yet, great cases as Holmes had said, like hard cases, make bad law.[6] For great cases are called great because of some accident of immediate overwhelming interest which appeals to the feelings and distorts the judgment. These immediate interests exercise a kind of hydraulic pressure which makes what was previously clear seem doubtful, and before which even well-settled principles of law will bend.[7]

Nevertheless, Ruiz has its saving points. At the very least, this piece of case law drew the lines and parameters for further discussion. It is quite certain that any future remedial legislation or jurisprudential cure will analyze *Ruiz* further, deepen it, and set better rules. *Ruiz* is simply an exemplar of the historicity of jurisprudence.

IV. Facts of the Case

Ruiz revolves around a classic creditor-debtor relationship where the debtor defaults from fulfilling his contractual obligation to the creditor. The debtor simply refuses to pay, while the creditor seeks to enforce the loan agreement by virtue of foreclosure or collection.[8]

Petitioner Corazon G. Ruiz was engaged in the business of buying and selling jewelry. She obtained loans from private respondent Consuelo Torres on different occasions. Four promissory notes were executed.

The first promissory note principally stipulated the following terms: (1) Amount loaned: Php 750,000.00, dated March 22, 1995, with maturity on April 21, 1996; (2) The loan was secured by a real estate mortgage; (3) Three

6. Oliver Wendell Holmes, Jr., *Path of the Law*, 10 Harv. L. Rev. 457 (1987).

7. Northern Securities Company v. United States, 193 U.S. 197, 400-01 (1904).

8. These remedies, though based on a single cause of action which is the breach of the obligation, cannot be cumulative. The result would otherwise be a splitting up of a single cause of action. *See* Industrial Finance Corp. v. Apostol, 177 SCRA 521 (1989).

percent (3%) monthly interest or 36% p.a. from the signing of the note until its maturity date; (4) Ten percent (10%) compounded monthly interest on the remaining balance at maturity date; (5) One percent (1%) surcharge on the principal loan for every month of default; and (6) Twenty-five percent (25%) attorney's fees.

The second promissory note was similarly written: (1) Amount loaned: Php 100,000.00, dated April 21, 1995, with maturity on August 21, 1995; (2) The loan was secured by a pledge of jewelry; (3) Three (3%) monthly interest or 36% p.a., from the signing of the note until its maturity date; (4) Ten percent (10%) monthly interest on the remaining balance at maturity date; (5) One percent (1%) compounded monthly surcharge on the principal loan for every month of default; and (6) Ten percent (10%) attorney's fees.

The third and fourth notes read: (1) Amount loaned: P100,000.00, dated May 23, 1995, with maturity on November 23, 1995; (2) P100,000.00, dated December 21, 1995 with maturity on March 1, 1996; (3) Both notes were secured by a pledge of jewelry; (4) Three percent (3%) monthly interest or 36% p.a. from the signing of the note until its maturity date; (5) Ten percent (10%) compounded monthly interest on the remaining balance at maturity date; (6) Ten percent (10%) surcharge on the principal loan for every month of default; and (7) Ten percent (10%) attorney's fees.[9]

Ruiz, the debtor, defaulted. Torres, the creditor, attempted to foreclose. Ruiz went to court and pleaded that the interest rates and surcharges were excessive, unreasonable, and unconscionable, and prayed for an injunction to stop the foreclosure. Eventually, the case was elevated to the Supreme Court. It was a classic collection suit.

V. Issues

Ruiz presents two issues: first, whether the stipulations on interest rates are valid; and second, whether the stipulations on surcharges are valid.

VI. The Holding

The Supreme Court did not touch upon the validity of the principal amounts, maturity dates, and the liens by virtue of mortgage or pledge. But the interest rates and the surcharges were altered which the Court even substituted.[10]

9. Ruiz v. Court of Appeals, 401 SCRA 410, 419-20 (2003).

10. *See* Civil Code, art. 1306. (The Freedom to Contract Clause grants the right of persons to enter into lawful contracts; this right cannot be arbitrarily interfered with. The courts should move with all the necessary caution and prudence in holding contracts void); 4 Arturo M. Tolentino, Commentaries and Jurisprudence on the Civil Code of the Philippines 411-12 (1993) (citations omitted).

A. *First Promissory Note*

On the first note, the three percent (3%) monthly interest was reduced to one percent (1%) a month or twelve percent (12%) per annum. It was held that "[a]n interest of 12% p.a. is deemed fair and reasonable."[11]

No other immediate discussion followed.

As to the ten percent (10%) compounded monthly interest on the remaining balance at maturity, this stipulation was struck down and declared void. The underlying reason perhaps may be intuitive for the legal mind. This notwithstanding, no substantive discussion followed.[12]

The one percent (1%) surcharge or penalty rate imposed on the remaining balance for every month of default was retained.

The stipulation as to the twenty-five percent (25%) attorney's fees to be imposed on the total amount recoverable was changed to a fixed amount of Php 50,000.00. Again, no justificatory discussion.

B. *Second Promissory Note*

The second note was of the same fate.

The three percent (3%) monthly interest, imposed from the signing of the note until its maturity date, was reduced by the Court to one percent (1%) per month or twelve percent (12%) per annum. The *Ruiz* Court, in relation to his holding, threw a one-liner: "An interest of 12% p.a. is deemed fair and reasonable."[13] No discussion on this point, however, followed.

The stipulation on the ten percent (10%) monthly interest on the remaining balance at maturity rate was struck down — intuitive, but no stated reasoning nonetheless.

The one percent (1%) compounded monthly surcharge on the principal loan for every month of default was altered to a one percent (1%) a month surcharge without compounding. Here, the Court stated, "[t]he *only*

11. *Ruiz*, 401 SCRA at 421.

12. The want of a substantive justificatory discussion may be construed as a violation of the Constitution. Philippine Const. art. VIII, §14: No decision shall be rendered by any court without expressing therein clearly and distinctly the facts and the law on which it is based.

13. *Ruiz*, 401 SCRA at 421.

permissible rate of surcharge is 1% a month, without compounding."[14] This may amount to a blanket, dangerous statement.[15]

The ten percent (10%) attorney's fees, as with the first promissory note, was altered to a fixed amount of Php 50,000.00. Again, no discussion followed to justify these edicts.

C. *Third and Fourth Notes*

The third and fourth notes essentially followed the fate of its predecessors.

The three percent (3%) monthly interest was changed to one percent (1%) a month or twelve percent (12%) per annum. To the Court, "[a]n interest of 12% p.a. is deemed fair and reasonable."[16] Yet again, the discussion lacked explanatory persuasion.

Similarly, the ten percent (10%) compounded monthly interest on the remaining balance at maturity date was struck down. Likewise intuitive, but no discussion ensued.

The ten percent (10%) surcharge on the principal loan for every month of default was struck down — "[t]he only permissible rate of surcharge is 1% per month, without compounding."[17]

The ten percent (10%) attorney's fees, predictably, was changed to Php 50,000.00. Faithful to its trend, the Supreme Court found no need to explain.

Now comes the *ratio:*

> ... [W]hile the Usury Law ceiling on interest rates was lifted by C.B. Circular No. 905, *nothing in the said circular grants lenders carte blanche*[18] *authority* to raise interest rates to levels which will either enslave their borrowers or lead to a hemorrhaging of their assets. *While not usurious, this*

14. *Id.* at 420 (emphasis supplied).

15. This portion of the ruling may appear to be a blanket statement. However, it may be argued that this ruling may apply strictly and only to those cases whose nature is similar to that of *Ruiz*. Angelito C. Imperio, Partner, SyCip Salazar Hernandez & Gatmaitan, Address at the Monthly Special Projects Meeting (Mar. 26, 2004).

16. *Ruiz*, 401 SCRA at 421.

17. *Id.* at 420.

18. Literally, a white sheet of paper; an instrument signed, but otherwise left blank; a term commonly used to mean unlimited authority or full discretionary power. BLACK'S LAW DICTIONARY 215 (6th ed. 1990).

> *Court held that the same must be equitably reduced for being iniquitous, unconscionable and exorbitant.*[19]

Recall that Section 1 of C.B. Circular No. 905-82 provides that:

> [T]he rate of interest, including commissions, premiums, fees and other charges, on a loan or forbearance of any money, goods, or credits, regardless of maturity and whether secured or unsecured, that may be charged or collected by any person, whether natural or juridical, *shall not be subject to any ceiling prescribed under or pursuant to the Usury Law, as amended.*[20]

VII. BASES OF THE RULING

The Supreme Court in *Ruiz* buttressed its ratio on four cases. The first of which was *Medel v. Court of Appeals*,[21] a case that dealt directly with the interest rate proper as distinguished from the penalty or surcharge. The second case was *Garcia v. Court of Appeals*,[22] which involved the penalty clause under Articles 1229[23] and 2227[24] of the Civil Code. As stated, issues as to these principles of law have long been settled. The other two cases, *Bautista v. Pilar Development Co.*[25] and *Solangon v. Salazar*,[26] like *Garcia*, tackled issues as to the penalty clause. They introduced no new doctrine; they merely affirmed previous ones.

Below is an examination of these four cases.

A. *Medel v. Court of Appeals*[27]

Medel, which was penned by Mr. Justice Bernardo Pardo, is important because, arguably, it was the first case which squarely ruled upon the validity of the interest rate *per se* and not on the penalty rate. Here, the loan involved a principal amount of Php 500,000.00, which was secured by a real estate

19. *Ruiz*, 401 SCRA at 421 (citing Solangon v. Salazar, 360 SCRA 379 (2001); Almeda v. Court of Appeals, 256 SCRA 292 (1996)) (emphasis supplied).

20. *Id.*

21. 299 SCRA 481 (1998).

22. 167 SCRA 815 (1988).

23. 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.

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

25. 312 SCRA 611 (1999).

26. 360 SCRA 379 (2001).

27. 299 SCRA 481 (1998).

mortgage. The loan stipulated an interest of five-and-a-half percent (5.5%) per month or sixty-six percent (66%) per annum. This rate was struck down for being excessive, iniquitous, unconscionable, and exorbitant.

The Court found that: "[t]he interest at 5.5% per month, or 66% per annum, stipulated upon by the parties in the promissory note was iniquitous or unconscionable, and, hence, contrary to morals (*contra bonus mores*), if not against the law."[28] It based its ruling on Article 1306 of the Civil Code,[29] otherwise known as the Freedom to Contract Clause,[30] which states that: "[t]he 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." Finding the 5.5% interest per month contrary to "morals," such was declared void.[31]

However, the Court creates a confusion when it subsequently stated that: "courts shall reduce equitably liquidated damages, whether intended as an indemnity or a penalty if they are iniquitous or unconscionable."[32] It cited as basis Article 2227 of the Civil Code, to wit: "[l]iquidated damages, whether intended as an indemnity or a penalty, shall be equitably reduced if they are iniquitous or unconscionable."

Now, a question hangs: Is this discussion at all relevant? The issue in *Medel* was not the *penalty clause* or *liquidated damages* but the *interest rate* proper. As stated, the set of legal principles governing each concept operate distinctively and independently. They do not even overlap like concentric circles.

The Court does not settle this, but goes on to say that:

> ... However, we can not consider the rate "usurious" because this Court has consistently held that Circular No. 905 of the Central Bank, adopted on December 22, 1982, has expressly removed the interest ceilings prescribed by the Usury Law and that the Usury Law is now "legally inexistent."[33]

Medel admits that the interest rate in that case was not usurious. This is correct in the technical sense. But *Medel* goes around the policy behind the

28. *Id.* at 489.

29. *Id.* (citing CIVIL CODE, art. 1306).

30. TOLENTINO, *supra* note 10, at 411.

31. *Medel*, 299 SCRA at 489-90.

32. *Id.*

33. *Id.* at 489 (citing Liam Law v. Olympic Sawmill Co., 129 SCRA 439, 442 (1984)).

lifting of the effectivity of the Usury Law[34] by saying that excessive rates, though not usurious, are void because they are contrary to morals.

Incidentally, to raise a point of clarification, the Usury Law is technically not *legally inexistent* as stated in *Medel* but rather one whose effectivity has been *suspended*. This was clarified in *Security Bank and Trust Company v. Regional Trial Court of Makati, Branch 61*,[35] a later case. There is a substantial difference between a "legally inexistent" law and a suspended law.

There may be ambiguities and inaccurate statements in *Medel*. But the real point is that this case was the first to declare excessive interest rates void since they are contrary to morals.

What constitutes "excessive," "iniquitous," or "unconscionable," however, is rather relative. The judgment-call is time-space bound. To invoke *Medel*, therefore, the courts of law would have to exercise a sociological function. Plainly stated, the judge must examine existing market conditions, juxtapose this to the stipulated interest as mutually agreed upon by the parties, and then declare whether the differential is simply just too much under existing societal or, as *Medel* put it, "moral" norms.[36]

Medel set the standard. *Ruiz* deepened it.

B. *Garcia v. Court of Appeals*[37]

Garcia, penned by Mr. Justice Hugo Gutierrez, Jr., sustained an interest rate of twenty-four percent (24%) per annum. Like *Medel*, however, *Garcia* did not look into existing market rates and make the comparison. But the penalty rate of thirty-six percent (36%) per annum was struck down for being unconscionable under Article 2227 of the Civil Code.[38]

What is important under *Garcia* is that a ceiling on the interest rate proper had been established. The issue on the penalty clause, for purposes of this discussion, is a secondary issue.

34. *See* DE LEON, *supra* note 4, at 50. (Under Central Bank Circular No. 905-82, the lender and borrower can legally agree on any interest that may be charged on the loan).

35. 263 SCRA 483 (1996).

36. *See* TOLENTINO, *supra* note 10, at 418 (citing 8 MANRESA 620-21). According to Tolentino, morals may be considered as meaning good customs; or those generally accepted principles of morality which have received some kind of social and practical confirmation. What constitutes "generally accepted principles of morality" which have received societal recognition is clearly a relative concept and is a matter of judicial or even sociological perception.

37. 167 SCRA 815 (1988).

38. *Id.* at 831-32.

C. *Bautista v. Pilar Development Co.*[39]

Similar to *Garcia*, this case was penned by Mr. Justice Reynato Puno, set a ceiling of 21% was deemed acceptable. However, the Court failed to cite any basis or make any substantive discussion as to this point other than the statement that the rate was authorized under C.B. Circular Nos. 705 and 712.[40]

The penalty rate of one-and-a-half percent (1.5%) per month was sustained. However, the validity of this rate was not squarely raised.

The ten percent (10%) attorney's fees were sustained. The Court held in simple terms that this obligation was expressly stipulated in the promissory note itself[41] and, hence, should be respected by the parties.[42]

D. *Solangon v. Salazar*[43]

In *Solangon*, which was penned by Mr. Justice Angelina Sandoval-Gutierrez, the note stipulated an interest rate of six percent (6%) per month or seventy-two percent (72%) per annum. The Court struck this down. The legal basis was the *Medel* case, since *Solangon* was decided three years later than the former. To recall, *Medel* laid down the doctrine that, notwithstanding the suspension of the Usury Law, exorbitant, excessive, or unconscionable interest rates are nonetheless *contra bonus mores*.[44]

But the Court went further. It reduced the "immoral" rate to twelve (12%) per annum, stating that "[a]n interest of 12% per annum is deemed fair and reasonable."[45]

VIII. SUMMARY

Bautista sustained a rate of twenty-one percent (21%) per annum. *Garcia* pushed the threshold higher — a rate of twenty-four percent (24%) was deemed reasonable. But *Ruiz* ruled that a rate of thirty-six percent (36%) per annum was "substantially greater than those upheld by the Court in the two

39. 312 SCRA 611 (1999).

40. Bautista v. Pilar Development Co., 312 SCRA 611, 620-21 (1999).

41. *Id.* at 621.

42. Contrast this ruling as to the attorney's fees to the ruling in *Medel v. Court of Appeals* where the latter Court simply fixed the fee instead of allowing for a percentage.

43. 360 SCRA 379 (2001).

44. Medel v. Court of Appeals, 299 SCRA 481, at 489 (1998).

45. *Solangon*, 360 SCRA at 385.

aforecited cases."[46] The pronouncement in *Solangon* was repeated: "[a]n interest of 12% per annum is deemed fair and reasonable."[47]

Consistent with the previous rulings, there was no further justificatory discussion for the imposition of a rate of twelve (12%) per annum.[48] However, it becomes now apparent that this ruling is really one based on equity and fairness. (But the *Ruiz* Court should have expressly invoked the same nonetheless.[49])

Ruiz went further. Not only did it rule upon the validity or reasonableness of the interest rate proper, it also struck down the excessive surcharge or penalty rate:

> [t]he 1% surcharge on the principal loan for every month of default is valid. This surcharge or penalty stipulated in a loan agreement in case of default partakes of the nature of liquidated damages under Art. 2227 of the New Civil Code, and is separate and distinct from interest payment. Also referred to as a penalty clause, it is expressly recognized by law. It is an accessory undertaking to assume greater liability on the part of an obligor in case of breach of an obligation. The obligor would then be bound to pay the stipulated amount of indemnity without the necessity of proof on the existence and on the measure of damages caused by the breach. Although the courts 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 if it is iniquitous or unconscionable. In the instant case, the 10% surcharge per month stipulated in the promissory notes dated May 23, 1995 and December 1, 1995 was properly reduced by the appellate court.[50]

On an earlier page of the decision, the *Ruiz* Court issued a statement that might turn out to be a little problematic: "[t]he *only* permissible rate of surcharge is 1% per month *without compounding*."[51] It may appear that this holding may apply universally regardless of the facts of the case. On the

46. Ruiz v. Court of Appeals, 401 SCRA 410, 422 (2003).

47. *Id.* at 421.

48. Eastern Shipping Lines, Inc. v. Court of Appeals, 234 SCRA 78 (1994). Noteworthy is the rule that the rate of twelve (12%) percent per annum is the legal rate of interest operative in absence of a specific stipulation of interest in writing in a contract of loan or forbearance of money. But this rule does not apply in *Ruiz* since the Court here *substituted* a rate that was deemed "fair and reasonable" with a rate that was declared void.

49. *See* supra note 12.

50. *Ruiz*, 401 SCRA, at 422 (citations omitted).

51. *Id.* at 420 (emphasis supplied).

other hand, this statement may be said to apply only to cases with similar facts or, to be stricter, to the *Ruiz* case and no other.[52]

On the other hand, *Bautista* allowed for a one-and-a-half percent (1.5%) a month surcharge. But the validity of such stipulation was not squarely raised in that case.

The issue therefore is whether the *Ruiz* rule mandating a one percent (1%) a month without compounding is to be strictly enforced regardless of the circumstances. In other words, should the one percent (1%) a month surcharge without compounding be the maximum ceiling for *any and all* penalty rates or surcharges? This question remains unsettled.

IX. Problem Areas

A. *Acceptable Range of Interest Rates*

To reiterate, *Garcia* sustained a rate of twenty-four percent (24%) per annum. *Bautista* sustained a rate of twenty-one percent (21%) per annum. But *Ruiz* says that a rate of thirty-six percent (36%) per annum is "substantially greater than the two abovementioned cases."

There is, therefore, a testing range between twenty-four percent (24%) and thirty-six percent (36%) per annum.

Professor Francis Lim, in his article *The Supreme Court Strikes at Interest Rates — Again!*,[53] raised an important question:

> ... What is the reasonable rate of interest that can be charged by private lenders for a loan? ... Can a 2.5 percent monthly interest or 30 percent annual interest (which is between the 24 percent interest upheld in Garcia and the 36 percent interest struck down in Ruiz) be considered valid?[54]

Of date, this is an unsettled issue.

It is submitted that the Court, as stated, must exercise a socio-economic function in order to determine the reasonableness of the rate. It boils down to a question of relativity. Or, more specifically, a question of morals, as *Ruiz, Medel,* and *Solangon* all hold. The courts of law, when faced with the allegation that a rate is "excessive," "exorbitant," "unconscionable," or "unreasonable," must compare existing market rates with the rates stipulated or mutually agreed upon by the parties at the time of execution of the contract of loan. This should be the jurisprudential test.

52. *See* Imperio, *supra* note 15.

53. Francis Lim, *The Supreme Court Strikes at Interest Rates — Again!* The Phil. Star, Feb. 24, 2004.

54. *Id.* at B-6.

B. *Contra Bonus Mores*

It has been long settled in law and in jurisprudence that the courts may reduce the penalty charge or liquidated damages if it is "iniquitous" or "unconscionable."[55] Here there lies no controversy.

But as to exorbitant interest rates, it is submitted that the legal basis, namely Article 1306 of the Civil Code, for the Supreme Court in *Ruiz* to strike down the same is a little questionable. Article 1306 simply states that "[t]he 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."

Now, to invoke Article 1306, it must be borne in mind that the *policy* of the law is that the freedom of persons to enter into contract *should not be lightly interfered with,* and courts should move with all the necessary caution and prudence in holding contracts, or stipulations therein, void.[56] The policy or intent behind this Civil Code provision is that, to the furthest extent possible, the agreement of the parties, which is the law between them, is not to be lightly tampered; the legislature, and much less, the courts, under the constitution, is not permitted to prescribe the terms of a legal contract and thereby deprive the citizens of the state from entering freely into such contracts according to their own convenience and advantage. The freedom to contract is a liberty guaranteed to the people of the state.[57]

Article 1306, therefore, should be strictly, not liberally, invoked.

As seen in *Ruiz, Medel,* and *Solangon,* the Supreme Court was straightforward. But these cases lacked substantive discourses or justifications. They simply said that the "excessive" rate was against morals and, hence, void.

To invoke *contra bonus mores* as ground under Article 1306, the judge must, as a precondition, study generally accepted principles of morality which have received some kind of social and practical confirmation.[58] This is a difficult task. They may have to resort to expert testimony or, at the very least, judicial notice. Judges, when confronted with an issue involving Article

55. *See* Civil Code, arts. 1229 & 2227; Government v. Punzalan, 7 Phil. 546 (1907); Government v. Amechazura, 10 Phil. 637 (1908); Icaza v. Flores, 7 Phil. 211 (1906); Laureano v. Kilayco, 32 Phil. 194 (1915); Treasurer v. Rodis, 40 Phil. 850 (1920); Kidwell v. Carter, 43 Phil. 953 (1922); Bachrach Motor Co. v. Espiritu, 52 Phil. 346 (1928); Pasay City v. CFI, 132 SCRA 156 (1984); Jison v. CA, 164 SCRA 399 (1988).

56. Tolentino, *supra* note 10, at 412, (citing Ferrazzini v. Gsell, 34 Phil. 697 (1916) & Gabriel v. Monte de Piedad, 71 Phil. 497 (1941) (emphasis supplied)).

57. *Id.* at 411-12; Phil. Const. art. III § 10; People v. Pomar, 46 Phil. 440 (1924).

58. Tolentino, *supra* note 10, at 418 (citing 8 Manresa 620-21).

1306, must look beyond the courtrooms and even everyday experiences. It is an area where the opinions of economists, sociologists, moralists, and philosophers are to be accorded great weight and respect. The courtroom judge, in the exercise of this sociological function, will do social engineering. He must study society. He must be careful in striking down interest rates. And should he do so, he must have basis — a very good, substantive, and justifiable one. Essentially, his decision must be demonstrative of a social fact that the interest rate on the face of the contract has something to do with immorality at the time of execution or, arguably, at the time of performance. Or he must show that the rate is so shocking to the moral sense of the community in which he lives as to strike it down boldly.

There is more.

Recall that Central Bank Circular No. 905-82 suspended the effectivity of the Usury law: "The rate of interest ... that may be charged or collected by any person, whether natural or juridical, shall not be subject to any ceiling prescribed under or pursuant to the Usury Law, as amended."

In effect, C.B. Circular No. 905-82 allowed parties to a contract to stipulate any rate of interest; the purpose — allow a free market. But *Ruiz,* arguably, somewhat abridged that freedom.

Through *Ruiz,* the Supreme Court in effect is able to control the range of interest rates by virtue of Article 1306 of the Civil Code. And the doctrine of the case is simply thus: If the interest rate is against morals, then it shall be struck down.

Now, whether *Ruiz* can be construed as a circumvention of the suspension of the Usury Law is a very delicate question. Is the Supreme Court now acting as the *de facto* Central Bank? May the Supreme Court, apparently without looking into existing market conditions as can be gleaned from the discussions in these cases, control the rates set by the parties? After all, a contract is the *law* between the parties.[59] The reasonableness of interest rates is always a question of relativity. Twenty-four percent (24%) may perhaps be considered too onerous during boom years when the U.S. Federal Reserve inter-bank rates are close to zero, but certainly the same rate might even be a blessing in times of crisis, like the Asian Crisis, when virtually all creditors were afraid to lend.

At any rate, as long as *Garcia* has not been over-ruled, twenty-four percent will always be allowable.

59. *See* CIVIL CODE, art. 1306; TOLENTINO, *supra* note 10, at 412 (declaring that the contract is the law between the parties) (citations omitted).

C. *Deux Ex Machina: 12%*

If the stipulation on the interest rate were declared void due to Article 1306, logically then, although the principal loan survives, there should be no interest chargeable at all. The interest rate is an accessory contract, while the contract of loan is a principal one.[60] Two bases. First, Article 1956 states that "[n]o interest shall be due unless it has been expressly stipulated in writing." If the stipulation is void, then there shall be no interest. Second, there is case law. By analogy, there are a number of Supreme Court cases that declare usurious interest rates void but the validity of the principal loan is nonetheless sustained *without the stipulation to pay interest.*[61]

Medel and *Ruiz* however, imposed a twelve percent (12%) per annum rate. Their basis: "An interest of 12% per annum is deemed fair and reasonable."

In fine, *Medel* and *Ruiz* were decisions based on equity. It was the general principle of the law on *equity* that allowed the *Ruiz* Court to stipulate a twelve percent (12%) rate for and on behalf of the parties.

But had it not been for the principles of equity and fairness which are really common-law doctrines, the result should have been an obligation without a stipulation to pay interest.

D. *Status of the Parties*

From *Garcia* to *Ruiz,* the cases involved a private lender pitted against a private borrower.

In this regard, Professor Lim raises another important question. "What if instead of a private individual as a lender, the lender is a financial institution like a bank? ... [W]ill the Supreme Court prescribe a lower or higher rate of interest for these institutional lenders?"[62]

A re-examination of C.B. Circular No. 905-82 might provide a clue. Section 1 thereof provides: "The rate of interest ... that may be charged or collected *by any person, whether natural or juridical,* shall not be subject to any ceiling prescribed under or pursuant to the Usury Law, as amended." It would follow that the suspension of the effectivity of the Usury Law would apply regardless of the status of the party, whether a banking institution or

60. *See* People v. Concepcion, 44 Phil. 126 (1922); Lopez v. El Hogar Filipino, 47 Phil. 249 (1925) (distinguishing between the principal loan and the interest proper).

61. *See, e.g.,* Briones v. Cammayo, 41 SCRA 404 (1971); Lopez v. El Hogar Filipino, 47 Phil. 249 (1925).

62. Lim, *supra* note 53.

non-bank financial institution, or even non-financial institutions like natural persons or public corporations.

Now, *Ruiz* was intended to put a stop to "exorbitant" (but not "usurious") interest rates. This the Court did without distinction. By implication, *Ruiz* and its precursors, like *Medel,* should also apply to any person without distinction.[63]

E. The Existence of Security

Professor Lim keeps pushing: "[w]hat if, unlike in the Ruiz and Medel cases, the loan is not secured by a real estate mortgage? Will there be a different rule?"[64]

For emphasis's sake, it is submitted again that what constitutes "unconscionable" or "iniquitous" interest rates involves a question of relativity and circumstance. Here, judges and justices must wear the shoes of sociologists and economists. Again, the conclusion of fact and law is time-space bound. Societal and moral norms must be examined, economic conditions, studied.

It is a textbook rule of economics that creditors are willing to assume higher risk with the existence of security in their favor. It would follow that if the loan were unsecured, the Supreme Court should allow for a higher interest rate threshold. If the loan were secured, then the threshold should be lower. But again, it must be emphasized that the setting of this threshold level or "range" of allowable interest rates must be juxtaposed with existing market rates and other economic conditions.

F. Credit Cards

The credit card is an ubiquitous form of leverage for many individuals. There are hundreds and thousands of them in this jurisdiction.

Ruiz was categorical in stating that "[t]he only permissible rate of surcharge is 1% a month without compounding." This statement becomes problematic especially when most, if not all, terms and conditions of credit

63. Recall that the Court in *Medel v. Court of Appeals,* 299 SCRA 481, 489 (1998) said:

> [w]e can not consider the rate usurious because this Court has consistently held that Circular No. 905 of the Central Bank, adopted on December 22, 1982, has expressly removed the interest ceilings prescribed by the Usury Law and that the Usury Law is now 'legally inexistent.'

64. Lim, *supra* note 53.

card service providers exceed this maximum cap.[65] Will these surcharges spread across the globe be declared void *en mass* as well?

X. Conclusion

It can be seen that *Ruiz* presents many difficulties.

First, it did not consider existing market rates in determining the allowable range of interest rates under law. The effectivity of the Usury Law has been suspended, but the Court nonetheless struck down excessive rates by invoking the *contra bonus mores* precept. It is submitted that twenty-four percent (24%) rates during terrorist threats would pose no moral dilemma. Creditors can even argue quite forcibly for higher rates beyond this threshold when global economic activity, which is linked with geo-political security, becomes more precarious. How about a rate of thirty-six percent (36%)? Forty? What if martial law were declared and the Philippines is under threat of international debt default, similar to what happened in recent history? Can an individual simply invoke *Ruiz* in these cases?

Second, the invocation of the *contra bonus mores* principle is a little difficult to accept. To do this, the courts of law must exercise a sociological function. Magistrates may not simply cite Article 1306 in a straightforward manner without a substantive discussitive approach. The answer is this: the Court must establish a strong link between exorbitant rates and immorality. And that is a difficult question. In which case, the judge not only becomes a sociologist but a priest as well.

There had been six problem areas cited which give rise to various issues. Such issues remain ambiguous and unanswered. And as Professor Lim puts it, "[n]o one knows the answers until the issues are brought up to the Supreme Court."

65. Interview with Emmanuel C. Paras, Partner, SyCip Salazar Hernandez & Gatmaitan, in SSHG Law Center, 105 Paseo de Roxas, Makati City (Mar. 24, 2004). *See, e.g.,* Standard Terms and Conditions, Citibank Mastercard/Visa (2004) (providing: "1) Late Payment Penalty Charge: From: 7.5% of the minimum amount due; To: P300 or 7.5% of the minimum amount due, whichever higher; 2) Cash advance fee: 3% of cash advance amount."). The "Late Payment Penalty Charge" stipulates a seven-and-a-half (7.5%) percent surcharge which is well above the one (1%) percent penalty rate allowed under *Ruiz*. Given these, would there be a class suit? The velocity of business and economic activity and investment would drastically slow should *Ruiz* be strictly invoked to the prejudice of all credit card service providers and related financial institutions.