G.R. No. 187678 – SPOUSES IGNACIO F. JUICO and ALICE P. JUICO, *Petitioners* v. CHINA BANKING CORPORATION, *Respondent.*

Promulgated:

APR 10 2013

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CONCURRING OPINION

SERENO, *CJ:*

I fully concur with the majority that the increases in interest rates unilaterally imposed by China Bank without petitioners' assent violates the principle of mutuality of contracts. This principle renders void a contract containing a provision that makes its fulfilment exclusively dependent upon the uncontrolled will of one of the contracting parties.[1] In this case, the provision reads:

> I/We hereby authorize the CHINA BANKING CORPORATION to increase or decrease as the case may be, the interest rate/service charge presently stipulated in this note without any advance notice to me/us in the event a law or Central Bank regulation is passed or promulgated by the Central Bank of the Philippines or appropriate government entities, increasing or decreasing such interest rate or service charge.

This Court dealt with a similarly worded provision in *Floirendo, Jr. v. Metropolitan Bank and Trust Company*.[2] It noted that the "provision in the promissory note authorizing respondent bank to increase, decrease or otherwise change from time to time the rate of interest and/or bank charges 'without advance notice' to petitioner, 'in the event of change in the interest rate prescribed by law or the Monetary Board of the Central Bank of the Philippines,' does not give respondent bank unrestrained freedom to charge any rate other than that which was agreed upon."

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[1] See Decision citing *Garcia v. Rita Legarda, Inc.*, 128 Phil. 590, 594-595 (1967).
[2] G.R. No. 148325, 3 September 2007, 532 SCRA 43.

However, I write to clarify that not all escalation clauses in loan agreements are void *per se*.[3] It is actually the rule that "escalation clauses are valid stipulations in commercial contracts to maintain fiscal stability and to retain the value of money in long term contracts."[4] In *The Consolidated Bank and Trust Corporation v. Court of Appeals*,[5] citing *Polotan, Sr. v. Court of Appeals*,[6] this Court already accepted that, given the fluctuating economic conditions, practical reasons allow banks to stipulate that interest rates on a loan will not be fixed and will instead depend on market conditions. In adjudging so, we differentiated a valid escalation clause from an otherwise invalid proviso in this wise:[7]

> Neither do we find error when the lower court and the Court of Appeals set aside as invalid the floating rate of interest exhorted by petitioner to be applicable. The pertinent provision in the trust receipt agreement of the parties fixing the interest rate states:
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> > I, WE jointly and severally agree to any increase or decrease in the interest rate which may occur after July 1, 1981, when the Central Bank floated the interest rate, and to pay additionally the penalty of 1% per month until the amount/s or instalments/s due and unpaid under the trust receipt on the reverse side hereof is/are fully paid.
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> We agree with respondent Court of Appeals that the foregoing stipulation is invalid, there being no reference rate set either by it or by the Central Bank, leaving the determination thereof at the sole will and control of petitioner.
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> While it may be acceptable, for practical reasons given the fluctuating economic conditions, for banks to stipulate that interest rates on a loan not be fixed and instead be made dependent upon prevailing market conditions, there should always be a reference rate upon which to peg such variable interest rates. An example of such a valid variable interest rate was found in *Polotan, Sr. v. Court of Appeals.* [10] In that case, the contractual provision stating that "if there occurs any change in the prevailing market rates, the **new interest rate shall be the guiding rate** in computing the interest due on the outstanding obligation without need of serving notice to the Cardholder other than the required posting on the monthly statement served to the Cardholder" was considered valid. The aforequoted provision was upheld notwithstanding that it may partake of the nature of an escalation clause, because at the same time it provides for the decrease in the interest rate in case the prevailing market rates dictate its reduction. In other words, unlike the stipulation subject of the instant case, the interest rate involved in the *Polotan* case is designed to be based

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[3] *Spouses delos Santos v. Metropolitan Bank and Trust Company,* G.R. No. 153852, 24 October 2012.
[4] *Insular Bank of Asia and America v. Spouses Salazar*, 242 Phil. 757, 761 (1988); *Philippine National Bank v. Spouses Rocamora,* G.R. No. 164549, 18 September 2009, 600 SCRA 395, 406.
[5] 408 Phil. 803 (2001).
[6] 357 Phil. 250 (1998).
[7] Supra note 5, at 811-812.

> on the prevailing market rate. On the other hand, a stipulation ostensibly signifying an agreement to "any increase or decrease in the interest rate," without more, cannot be accepted by this Court as valid for it leaves solely to the creditor the determination of what interest rate to charge against an outstanding loan. (Emphasis in the original and underscoring supplied)

Evidently, the point of difference in the cited escalation clauses lies in the use of the phrase "any increase or decrease in the interest rate" without reference to the **prevailing market rate** actually imposed by the regulations of the Central Bank.[8] It is thus not enough to state, as akin to China Bank's provision, that the bank may *increase or decrease the interest rate in the event a law or a Central Bank regulation is passed.* To adopt that stance will necessarily involve a determination of the interest rate by the creditor since the provision spells a vague condition – it only requires that any change in the imposable interest must conform to the upward or downward movement of borrowing rates.

And if that determination is not subjected to the mutual agreement of the contracting parties, then the resulting interest rates to be imposed by the creditor would be unilaterally determined. Consequently, the escalation clause violates the principle of mutuality of contracts.

Based on jurisprudence, therefore, these points must be considered by creditors and debtors in the drafting of valid escalation clauses. Firstly, as a matter of equity and consistent with P.D. No. 1684, the escalation clause must be paired with a de-escalation clause.[9] Secondly, so as not to violate the principle of mutuality, the escalation must be pegged to the prevailing market rates, and not merely make a generalized reference to "any increase or decrease in the interest rate" in the event a law or a Central Bank regulation is passed. Thirdly, consistent with the nature of contracts, the proposed modification must be the result of an agreement between the parties. In this way, our credit system would be facilitated by firm loan provisions that not only aid fiscal stability, but also avoid numerous disputes and litigations between creditors and debtors.

MARIA LOURDES P. A. SERENO
Chief Justice

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[8] *Lotto Restaurant Corporation v. BPI Family Savings Bank, Inc.*, G.R. No. 177260, 30 March 2011, 646 SCRA 699.

[9] *Banco Filipino Savings and Mortgage Bank v. Judge Navarro*, 236 Phil. 370 (1987); *Equitable PCI Bank v. Ng Sheung Ngor*, G.R. No. 171545, 19 December 2007, 541 SCRA 223, 241.