Republic of the Philippines
Supreme Court
Baguio City

**SECOND DIVISION**

**NUNELON R. MARQUEZ,**
Petitioner,

- versus -

**ELISAN CREDIT CORPORATION,**
Respondents.

**G.R. No. 194642**

Present:

CARPIO, *J., Chairperson,*
BRION,
DEL CASTILLO,
MENDOZA, and
LEONEN, *JJ.*

Promulgated:

06 APR 2015

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# DECISION

**BRION, *J.*:**

We resolve the present petition for review on *certiorari*[1] assailing the May 17, 2010 decision[2] and the November 25, 2010 resolution[3] of the Court of Appeals *(CA)* in CA- G.R. SP No. 102144.[4]

## The Factual Antecedents

On December 16, 1991, Nunelon R. Marquez (*petitioner*) obtained a loan (*first loan*) from Elisan Credit Corporation (*respondent*) for fifty-three thousand pesos (Php 53,000.00) payable in one-hundred eighty (180) days.[5]

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1 *Rollo*, pp. 10-30. The petition is filed under Rule 45 of the Rules of Court.

2 Id. at 32-42. Penned by Associate Justice Rodil V. Zalameda and concurred in by Associate Justice Mario L. Guariña III and Associate Justice Apolinario D. Bruselas, Jr.

3 Id. at 44-45. Penned by Associate Justice Rodil V. Zalameda and concurred in by Associate Justice Mario L. Guariña III and Associate Justice Apolinario D. Bruselas, Jr.

4 The CA affirmed the May 7, 2007 order of the Regional Trial Court (RTC) Branch 222 - Quezon City, which reversed and set aside the February 20, 2004 decision of the Metropolitan Trial Court (MTC), Branch 43 - Quezon City.

5 *Supra* note 1, at 2.

The petitioner signed a promissory note which provided that it is payable in weekly installments and subject to twenty-six percent (26%) annual interest. In case of non-payment, the petitioner agreed to pay ten percent (10%) monthly penalty based on the total amount unpaid and another twenty-five percent (25%) of such amount for attorney's fees exclusive of costs, and judicial and extrajudicial expenses.[6]

To further secure payment of the loan, the petitioner executed a chattel mortgage[7] over a motor vehicle. The contract of chattel mortgage provided among others, that the motor vehicle shall stand as a security for the first loan and "all other obligations of every kind already incurred or *which may hereafter be incurred.*"[8]

Both the petitioner and respondent acknowledged the full payment of the first loan.[9]

Subsequently, the petitioner obtained another loan (*second loan*) from the respondent for fifty-five thousand pesos (₱55,000.00) evidenced by a promissory note[10] and a cash voucher[11] both dated June 15, 1992.

The promissory note covering the second loan contained *exactly the same* terms and conditions as the first promissory note.

When the second loan matured on December 15, 1992, the petitioner had *only* paid twenty-nine thousand nine hundred sixty pesos (₱29,960.00), leaving an unpaid balance of twenty five thousand forty pesos (₱25,040.00).[12]

Due to liquidity problems, the petitioner asked the respondent if he could pay in daily installments (*daily payments*) until the second loan is paid. The respondent granted the petitioner's request. Thus, as of September 1994 or twenty-one (21) months *after* the second loan's maturity, the petitioner had already paid a total of fifty-six thousand four-hundred forty pesos (₱56,440.00), an amount greater than the principal.[13]

Despite the receipt of more than the amount of the principal, the respondent filed a complaint for judicial foreclosure of the chattel mortgage because the petitioner allegedly failed to settle the balance of the second loan despite demand.[14]

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6 *Rollo*, p.79.
7 Id. at 81. The chattel mortgage was duly registered in the Office of the Registry of Deeds in Novaliches, Quezon City.
8 *Supra* note 1, at 12. Emphasis supplied.
9 *Rollo*, pp. 12, 168.
10 Id. at 82.
11 Id. at 83.
12 Id. at 13, 169.
13 Id. at 14, 168.
14 Id. at 71-77.

The respondent further alleged that pursuant to the terms of the promissory note, the petitioner's failure to fully pay upon maturity triggered the imposition of the ten percent (10%) monthly penalty and twenty-five percent (25%) attorney's fees.

The respondent prayed that the petitioner be ordered to pay the balance of the second loan plus accrued penalties and interest.[15]

Before the petitioner could file an answer, the respondent applied for the issuance of a writ of replevin. The MTC issued the writ and by virtue of which, the motor vehicle covered by the chattel mortgage was seized from the petitioner and delivered to the respondent.[16]

Trial on the merits thereafter ensued.

## **The MTC Ruling**[17]

The MTC found for the petitioner and held that the second loan was fully extinguished as of September 1994.

It held that when an obligee accepts the performance or payment of an obligation, knowing its incompleteness or irregularity and without expressing any protest or objection, the obligation is deemed fully complied with.[18] The MTC noted that the respondent accepted the daily payments made by the petitioner without protest. The second loan having been fully extinguished, the MTC ruled that respondent's claim for interests and penalties plus the alleged unpaid portion of the principal is without legal basis.

The MTC ordered:

1. "the plaintiff Elisan Credit Corporation to return/deliver the seized motor vehicle with Plate No. UV-TDF-193 to the possession of the defendant and in the event its delivery is no longer possible, to pay the defendant the amount of ₱30,000.00 corresponding to the value of the said vehicle;"

2. "the bonding company People's Trans-East Asia Insurance Corporation to pay the defendant the amounts of ₱20,000.00 and ₱5,000.00 representing the damages and attorney's fees under P.T.E.A.I.C Bond No. JCL (13)-00984;"

3. "the plaintiff is likewise directed to surrender to the defendant the originals of the documents evidencing indebtedness in this case so as to prevent further use of the same in another proceeding."

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15 Id. at 171.
16 *Supra* note 2, at 34.
17 *Rollo*, pp. 57-61.
18 Id. at 60. Article 1235, Civil Code.

## The RTC Ruling[19]

Except for the MTC's order directed to the bonding company, the RTC initially affirmed the ruling of the MTC.

Acting on the respondent's motion for reconsideration, the RTC reversed itself. Citing Article 1253 of the Civil Code, it held that "if the debt produces interest, payment of the principal shall not be deemed to have been made until the interests have been covered." It also sustained the contention of the respondent that the chattel mortgage was revived when the petitioner executed the promissory note covering the second loan.

The RTC ordered:

1. "the defendant to pay the plaintiff the following: a) ₱25,040.00, plus interest thereon at the rate of 26% per annum and penalties of 10% per month thereon from due date of the second promissory note until fully paid, b) 25% of the defendant's outstanding obligation as and for attorney's fees, c) costs of this suit;"

2. "the foreclosure of the chattel mortgage dated December 16, 1991 and the sale of the mortgaged property at a public auction, with the proceeds thereof to be applied as and in payment of the amounts awarded in a and b above."

## The CA Ruling[20]

The CA affirmed the RTC's ruling with modification.

The CA observed that the disparity in the amount loaned and the amount paid by the petitioner supports the respondent's view that the daily payments were properly applied first for the payment of interests and not for the principal.

According to the CA, if the respondent truly condoned the payment of interests as claimed by the petitioner, the latter did not have to pay an amount in excess of the principal. The CA believed the petitioner knew his payments were first applied to the interests due.

The CA held that Article 1253 of the Civil Code is clear that if debt produces interest, payment of the principal shall not be deemed made until the interests have been covered. It ruled that even if the official receipts issued by the respondent did not mention that the payments were for the interests, the omission is irrelevant as it is deemed by law to be for the payment of interests first, if any, and then for the payment of the principal amount.

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19 Id. at 62-70.

20 *Supra* note 2.

The CA, however, reduced the monthly penalty from ten percent (10%) to two percent (2%) pursuant to Article 1229 of the Civil Code which gives the courts the power to decrease the penalty when the principal obligation has been partly or irregularly complied with by the debtor.

The dispositive portion of the CA decision provides:

> "WHEREFORE, premises considered, the Petition is hereby **DENIED** for lack of merit. The Order dated 07 May 2007 of the Regional Trial Court, Branch 222, Quezon City is hereby **AFFIRMED** with **MODIFICATION** that the penalty charge should only be two (2%) per month until fully paid."

The CA denied the petitioner's Motion for Reconsideration dated May 17, 2010 on November 25, 2010 for failing to raise new matters. Hence, this present petition.

## The Petition

The petitioner seeks the reversal of the CA's decision and resolution. He argues that he has fully paid his obligation. Thus, the respondent has no right to foreclose the chattel mortgage.

The petitioner insists that his daily payments should be deemed to have been credited against the principal, as the official receipts issued by the respondent were silent with respect to the payment of interest and penalties. He cites Article 1176 of the Civil Code which ordains that "[t]he receipt of the principal by the creditor without reservation with respect to the interest, shall give rise to the presumption that the interest has been paid. The petitioner invokes Article 1235 of the Civil Code which states that "[w]hen the obligee accepts the performance of an obligation, knowing its incompleteness or irregularity, and without expressing any protest or objection, the obligation is deemed fully complied with."

The petitioner denies having stipulated upon and consented to the twenty-six per cent (26%) per annum interest charge, ten percent (10%) monthly penalty and twenty-five percent (25%) attorney's fees. According to the petitioner, he signed the promissory note in blank.

The petitioner likewise disclaims receiving any demand letter from the respondent for the alleged balance of the second loan after he had paid fifty-six thousand four-hundred forty pesos (Php 56,440.00) as of September 1994, and further argues that the chattel mortgage could not cover the second loan as it was annulled and voided upon full payment of the first loan.

## The Respondent's Case[21]

The respondent claims that the daily payments were properly credited against the interest and not against the principal because the petitioner incurred delay in the full payment of the second loan.

It argues that pursuant to the terms and conditions of the promissory note, the interest and penalties became due and demandable when the petitioner failed to pay in full upon maturity. The respondent relies on Article 1253 of the Civil Code which provides that if the debt produces interest, payment of the principal shall not be deemed to have been made until the interests have been covered.

The respondent likewise maintains that the chattel mortgage could validly secure the second loan invoking its provision which provided that it covers "*obligations…which may hereafter be incurred*."

## Issues

The petitioner raises the following issues for our resolution:

I. "WHETHER THE HONORABLE COURT OF APPEALS ERRED IN AFFIRMING THE DECISION OF THE REGIONAL TRIAL COURT ORDERING THE PETITIONER TO PAY THE RESPONDENT THE AMOUNT OF PHP24,040.00 PLUS INTEREST AND PENALTY FROM DUE DATE UNTIL FULLY PAID; AND

II. "WHETHER THE HONORABLE COURT OF APPEALS ERRED IN AFFIRMING THE DECISION OF THE REGIONAL TRIAL COURT ORDERING THE FORECLOSURE AND SALE OF THE MORTGAGED PROPERTY."[22]

In simpler terms, did the respondent act lawfully when it credited the daily payments against the interest instead of the principal? Could the chattel mortgage cover the second loan?

## The Court's Ruling

**We find the petition partly meritorious**.

We rule that: (1) the respondent acted pursuant to law and jurisprudence when it credited the daily payments against the interest instead of the principal; and (2) the chattel mortgage could not cover the second loan.

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21 *Rollo*, pp. 164-172.

22 *Supra* note 1, at 19.

***Rebuttable presumptions; Article 1176 vis-à-vis Article 1253***

There is a need to analyze and harmonize Article 1176 and Article 1253 of the Civil Code to determine whether the daily payments made after the second loan's maturity should be credited against the interest or against the principal.

Article 1176 provides that:

> "**The receipt of the principal by the creditor, without reservation with respect to the interest, shall give rise to the presumption that said interest has been paid**.
>
> xxx."

On the other hand, Article 1253 states:

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

The above provisions appear to be contradictory but they in fact support, and are in conformity with, each other. Both provisions are also presumptions and, as such, lose their legal efficacy in the face of proof or evidence to the contrary.

Thus, the settlement of the first issue depends on which of these presumptions prevails under the given facts of the case.

There are two undisputed facts crucial in resolving the first issue: (1) the petitioner failed to pay the full amount of the second loan upon maturity; and (2) the second loan was subject to interest, and in case of default, to penalty and attorney's fees.

But before proceeding any further, we first tackle the petitioner's denial of the genuineness and due execution of the second promissory note. He denies that he stipulated upon and consented to the interest, penalty and attorney's fees because he purportedly signed the promissory note in blank.[23]

This allegation deserves scant consideration. It is self-serving and unsupported by evidence.

As aptly observed by the RTC and the CA, the promissory notes securing the first and second loan contained exactly the same terms and conditions. They were mirror-image of each other except for the date and amount of principal. Thus, we see sufficient basis to believe that the petitioner knew or was aware of such terms and conditions even assuming

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[23] *Supra* note 1, at 13.

that the entries on the interest and penalty charges were in blank when he signed the promissory note.

Moreover, we find it significant that the petitioner does not deny the genuineness and due execution of the first promissory note. Only when he failed to pay the second loan did he impugn the validity of the interest, penalty and attorney's fees. The CA and the RTC also noted that the petitioner is a schooled individual, an engineer by profession, who, because of these credentials, will not just sign a document in blank without appreciating the import of his action.[24]

These considerations strongly militate against the petitioner's claim that he did not consent to and stipulated on the interest and penalty charges of the second loan. Thus, he did not only fail to fully pay the second loan upon maturity; the loan was also subject to interest, penalty and attorney's fees.

*Article 1176 in relation to Article 1253*

Article 1176 falls under Chapter I (**Nature and Effect of Obligations**) while Article 1253 falls under Subsection I (**Application of Payments**), Chapter IV (**Extinguishment of Obligations**) of Book IV (*Obligations and Contracts*) of the Civil Code.

The structuring of these provisions, properly taken into account, means that Article 1176 should be treated as a general presumption subject to the more specific presumption under Article 1253. Article 1176 is relevant on questions pertaining to the effects and nature of obligations in general, while Article 1253 is specifically pertinent on questions involving application of payments and extinguishment of obligations.

A textual analysis of the above provisions yields the results we discuss at length below:

The presumption under Article 1176 does *not* resolve the question of whether the amount received by the creditor is a payment for the principal or interest. Under this article the amount received by the creditor is the payment for the principal, but a doubt arises on whether or not the interest is waived because the creditor accepts the payment for the principal without reservation with respect to the interest. Article 1176 resolves this doubt by presuming that the creditor waives the payment of interest because he accepts payment for the principal without any reservation.

On the other hand, the presumption under Article 1253 resolves doubts involving payment of interest-bearing debts. It is a given under this Article that the debt produces interest. The doubt pertains to the application of payment; the uncertainty is on whether the amount received by the

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[24] *Supra* note 2, at 39.

creditor is payment for the principal or the interest. Article 1253 resolves this doubt by providing a hierarchy: payments shall *first* be applied to the interest; payment shall then be applied to the principal *only after* the interest has been *fully-paid*.

Correlating the two provisions, the rule under Article 1253 that payments shall first be applied to the interest and not to the principal shall govern if two facts exist: (1) the debt produces interest (*e.g.*, the payment of interest is expressly stipulated) and (2) the principal remains unpaid.

The exception is a situation covered under Article 1176, *i.e.*, when the creditor waives payment of the interest despite the presence of (1) and (2) above. In such case, the payments shall obviously be credited to the principal.

Since the doubt in the present case pertains to the application of the daily payments, Article 1253 shall apply. Only when there is a waiver of interest shall Article 1176 become relevant.

Under this analysis, we rule that the respondent properly credited the daily payments to the interest and not to the principal because: (1) the debt produces interest, *i.e.*, the promissory note securing the second loan provided for payment of interest; (2) a portion of the second loan remained unpaid upon maturity; and (3) the respondent did not waive the payment of interest.

*There was no waiver of interest*

The fact that the official receipts did not indicate whether the payments were made for the principal or the interest does not prove that the respondent waived the interest.

We reiterate that the petitioner made the daily payments *after* the second loan had already matured and a portion of the principal remained unpaid. As stipulated, the principal is subject to 26% annual interest.

All these show that the petitioner was already in default of the principal when he started making the daily payments. The stipulations providing for the 10% monthly penalty and the additional 25% attorney's fees on the unpaid amount also became effective as a result of the petitioner's failure to pay in full upon maturity.

In other words, the so-called *interest for default*[25] (as distinguished from the *stipulated monetary interest* of 26% per annum) in the form of the 10% monthly penalty accrued and became due and demandable. Thus, when the petitioner started making the daily payments, two types of interest were

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[25] ARTURO M. TOLENTINO, CIVIL CODE OF THE PHILIPPINES Vol. IV, 313 (1960).

at the same time accruing, the 26% *stipulated monetary interest* and the *interest for default* in the form of the 10% monthly penalty.

Article 1253 covers both types of interest. As noted by learned civilist, Arturo M. Tolentino, no distinction should be made because the law makes no such distinction. He explained:

> "Furthermore, the interest for default arises because of non-performance by the debtor, and **to allow him to apply payment to the capital without first satisfying such interest, would be to place him in a better position than a debtor who has not incurred in delay**. The delay should worsen, not improve, the position of a debtor."[26] [Emphasis supplied.]

The petitioner failed to specify which of the two types of interest the respondent allegedly waived. The respondent waived neither.

In *Swagman Hotels and Travel Inc. v. Court of Appeals*,[27] we applied Article 1253 of the Civil Code in resolving whether the debtor has waived the payments of interest when he issued receipts describing the payments as "capital repayment." We held that,

> "Under Article 1253 of the Civil Code, if the debt produces interest, payment of the principal shall not be deemed to have been made until the interest has been covered. In this case, **the private respondent would not have signed the receipts describing the payments made by the petitioner as "capital repayment" if the obligation to pay the interest was still subsisting**.
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> "There was therefore a novation of the terms of the three promissory notes in that **the interest was waived**…"[28] [Emphasis supplied.]

The same ruling was made in an older case[29] where the creditor issued a receipt which specifically identified the payment as referring to the principal. We held that the interest allegedly due cannot be recovered, in conformity with Article 1110 of the Old Civil Code, a *receipt from the creditor for the principal*, that *contains no stipulation regarding interest*, extinguishes the obligation of the debtor with regard thereto when the receipt issued by the creditor showed that no reservation whatever was made with respect to the interest.

In both of these cases, it was clearly established that the creditors accepted the payment of the principal. The creditors were deemed to have waived the payment of interest because they issued receipts expressly referring to the payment of the principal without any reservation with respect to the interest. As a result, the interests due were deemed waived. It was

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26 Id.
27 495 Phil. 161 (2005).
28 Id. at 175. Emphasis supplied.
29 *Hill v. Veloso*, 31 Phil. 160 (1915).

immaterial whether the creditors intended to waive the interest or not. The law presumed such waiver because the creditors *accepted the payment of the principal without reservation with respect to the interest*.

In the present case, it was not proven that the respondent accepted the payment of the principal. The silence of the receipts on whether the daily payments were credited against the unpaid balance of the principal or the accrued interest does not mean that the respondent waived the payment of interest. There is no presumption of waiver of interest without any evidence showing that the respondent accepted the daily installments as payments for the principal.

Ideally, the respondent could have been more specific by indicating on the receipts that the daily payments were being credited against the interest. Its failure to do so, however, should not be taken against it. The respondent had the right to credit the daily payments against the interest applying Article 1253.

It bears stressing that the petitioner was already in default. Under the promissory note, the petitioner waived demand in case of non-payment upon due date.[30] The stipulated interest and interest for default have both accrued. The only logical result, following Article 1253 of the Civil Code, is that the daily payments were first applied against either or both the stipulated interest and interest for default.

Moreover, Article 1253 is viewed as having an obligatory character and not merely suppletory. It cannot be dispensed with except by *mutual agreement*. The creditor may oppose an application of payment made by the debtor contrary to this rule.[31]

In any case, the promissory note provided that "interest not paid when due shall be added to, and become part of the principal and shall likewise bear interest at the same rate, compounded monthly."[32]

Hence, even if we assume that the daily payments were applied against the principal, the principal had also increased by the amount of unpaid interest and the interest on such unpaid interest. Even under this assumption, it is doubtful whether the petitioner had indeed fully paid the second loan.

***Excessive interest, penalty and attorney's fees***

Notwithstanding the foregoing, we find the stipulated rates of interest, penalty and attorney's fees to be exorbitant, iniquitous, unconscionable and

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30 *Supra* note 10.
31 *Supra* note 25, citing Manresa.
32 *Supra* note 10.

excessive. The courts can and should reduce such astronomical rates as reason and equity demand.

Article 1229 of the Civil Code provides:

> "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 of the Civil Code ordains:

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

More importantly, Article 1306 of the Civil Code is emphatic:

> "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."

Thus, stipulations imposing excessive rates of interest and penalty are void for being contrary to morals, if not against the law.[33]

Further, we have repeatedly held that while *Central Bank Circular No. 905-82*, which took effect on January 1, 1983, effectively removed the ceiling on interest rates for both secured and unsecured loans, regardless of maturity, nothing in the said circular could possibly be read as granting *carte blanche* authority to lenders to raise interest rates to levels that would be unduly burdensome, to the point of oppression on their borrowers.[34]

In exercising this power to determine what is iniquitous and unconscionable, courts must consider the circumstances of each case since what may be iniquitous and unconscionable in one may be totally just and equitable in another.[35]

In the recent case of *MCMP Construction Corp. v. Monark Equipment Corp.*,[36] we reduced the interest rate of twenty-four percent (24%) per annum to twelve percent (12%) per annum; the penalty and collection charge of three percent (3%) per month, or thirty-six percent (36%) per annum, to six percent (6%) per annum; and the amount of attorney's fees from twenty-five percent (25%) of the total amount due to five percent (5%).

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33 *Planters Development Bank v. Spouses Lopez*, G.R. No. 186332, October 23, 2013, 708 SCRA 481, citing *Imperial v. Jaucian*, 471 Phil. 484, 494-495 (2004); and *Castro v. Tan*, G.R. No. 168940, November 24, 2009, 605 SCRA 231, 237-238.

34 *Macalinao v. Bank of the Philippine Islands*, G.R. No. 175490, September 17, 2009, 600 SCRA 67, 76-78, citing *Imperial v. Jaucian*, G.R. 149004, April 14, 2004, 427 SCRA 517, *Tongoy v. Court of Appeals*, No. L-45645, June 28, 1983, 123 SCRA 99.

35 Id.

36 G.R. No. 201001, November 10, 2014.

Applying the foregoing principles, we hereby reduce the stipulated rates as follows: the interest of twenty-six percent (26%) per annum is reduced to two percent (2%) per annum; the penalty charge of ten percent (10%) per month, or one-hundred twenty percent (120%) per annum is reduced to two percent (2%) per annum; and the amount of attorney's fees from twenty-five percent (25%) of the total amount due to two percent (2%) of the total amount due.

We believe the markedly reduced rates are reasonable, equitable and just under the circumstances.

It is not entirely the petitioner's fault that he honestly, albeit wrongly, believed that the second loan had been fully paid. The respondent is partly to blame for issuing receipts not indicating that the daily payments were being applied against the interest.

Moreover, the reduction of the rates is justified in the context of its computation period. In *Trade & Investment Dev't Corp. of the Phil. v. Roblett Industrial Construction Corp.*,[37] we equitably reduced the interest rate because the case was decided with finality sixteen years after the filing of the complaint. We noted that the amount of the loan swelled to a considerably disproportionate sum, far exceeding the principal debt.

It is the same in the present case where the complaint was filed almost twenty-years ago.[38]

***The Chattel Mortgage could not cover the second loan***

The chattel mortgage could not validly cover the second loan. The order for foreclosure was without legal and factual basis.

In *Acme Shoe, Rubber and Plastic Corp. v. Court of Appeals*,[39] the debtor executed a chattel mortgage, which had a provision to this effect:

> "In case the MORTGAGOR executes subsequent promissory note or notes either as a renewal of the former note, as an extension thereof, or as a new loan, or is given any other kind of accommodations such as overdrafts, letters of credit, acceptances and bills of exchange, releases of import shipments on Trust Receipts, etc., **this mortgage shall also stand as security for the payment of the said promissory note or notes and/or accommodations without the necessity of executing a new contract and this mortgage shall have the same force and effect as if the said promissory note or notes and/or accommodations were existing on the date thereof**."[40] [Emphasis supplied.]

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37 523 Phil. 362, 367 (2006), cited in *Planters Development Bank v. Spouses Lopez*, *supra* note 33.
38 *Supra* note 14. The complaint was filed on August 16, 1995.
39 329 Phil 531 (1996).
40 Id. at 536.

In due time, the debtor settled the loan covered by the chattel mortgage. Subsequently, the debtor again borrowed from the creditor. Due to financial constraints, the subsequent loan was not settled at maturity.

On the issue whether the chattel mortgage could be foreclosed due to the debtor's failure to settle the subsequent loan, we held that,

> "[c]ontracts of security are either personal or real. x x x In contracts of real security, such as a pledge, a mortgage or an antichresis, that fulfillment is secured by an encumbrance of property — in pledge, the placing of movable property in the possession of the creditor; in chattel mortgage, by the execution of the corresponding deed substantially in the form prescribed by law; x x x — upon the essential condition that if the principal obligation becomes due and the debtor defaults, then the property encumbered can be alienated for the payment of the obligation, but that **should the obligation be duly paid, then the contract is automatically extinguished proceeding from the accessory character of the agreement**. **As the law so puts it, once the obligation is complied with, then the contract of security becomes, ipso facto, null and void**."[41]

> While a pledge, real estate mortgage, or antichresis may exceptionally secure after-incurred obligations so long as these future debts are accurately described, a chattel mortgage, however, can only cover obligations **existing at the time the mortgage** is constituted. **Although a promise expressed in a chattel mortgage to include debts that are yet to be contracted can be a binding commitment that can be compelled upon, the security itself, however, does not come into existence or arise until after a chattel mortgage agreement covering the newly contracted debt is executed either by concluding a fresh chattel mortgage or by amending the old contract conformably with the form prescribed by the Chattel Mortgage Law**. Refusal on the part of the borrower to execute the agreement so as to cover the after-incurred obligation can constitute an act of default on the part of the borrower of the financing agreement whereon the promise is written but, of course, the remedy of foreclosure can only cover the debts extant at the time of constitution and during the life of the chattel mortgage sought to be foreclosed."[42] [Emphasis supplied.]

We noted that the Chattel Mortgage Law[43] requires the parties to the contract to attach an affidavit of good faith and execute an oath that –

> " x x x (the) mortgage is made for the purpose of securing the **obligation specified in the conditions thereof**, and for **no other purposes**, and that the same is a just and valid obligation, and one not entered into for the purposes of fraud."[44]

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41 Id. at 538-539.
42 Id. at 539.
43 Act 1508 as amended dated July 2, 1906.
44 *Supra* note 39, at p. 540.

It is obvious therefore that the debt referred in the law is a **current**, **not an obligation that is yet merely contemplated**.[45]

The chattel mortgage in the present case had the following provision:

> "x x x in consideration of the credit accommodation granted by the MORTGAGEE to the MORTGAGOR(S) in the amount of FIFTY-THREE THOUSAND ONLY PESOS (P 53,000.00) xxx and all other obligations of every kind already incurred **or which may hereafter be incurred, for or accommodation of the MORTGAGOR(S)**, as well as the faithful performance of the terms and conditions of this mortgage x x x"[46] [Emphasis supplied.]

The *only* obligation specified in the chattel mortgage contract was the first loan which the petitioner later fully paid. By virtue of Section 3 of the Chattel Mortgage Law,[47] the payment of the obligation automatically rendered the chattel mortgage terminated; the chattel mortgage had ceased to exist upon full payment of the first loan. Being merely an accessory in nature, it cannot exist independently of the principal obligation.

The parties did not execute a fresh chattel mortgage nor did they amend the chattel mortgage to comply with the Chattel Mortgage Law which requires that the obligation must be *specified* in the affidavit of good faith. Simply put, there no longer was any chattel mortgage that could cover the second loan upon full payment of the first loan. The order to foreclose the motor vehicle therefore had no legal basis.

**WHEREFORE**, in view of the foregoing findings and legal premises, we **PARTIALLY GRANT** the petition. We **MODIFY** the May 17, 2010 Decision and the November 25, 2010 Resolution of the Court of Appeals in CA G.R. SP No. 102144.

**ACCORDINGLY**, petitioner Nunelon R. Marquez is **ORDERED** to pay:

1. Twenty-five thousand forty pesos (₱25,040.00) representing the amount of the unpaid balance of the second loan;

2. Interest of two percent (2%) per annum on the unpaid balance to be computed from December 15, 1992[48] until full payment;

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45 Id.

46 *Supra* note 7.

47 *Sec. 3. Chattel mortgage defined.* — A chattel mortgage is a conditional sale of personal property as security for the payment of a debt, or the performance of some other obligation specified therein, the condition being that the sale shall be void upon the seller paying to the purchaser a sum of money or doing some other act named. **If the condition is performed according to its terms the mortgage and sale immediately become void,** and the mortgagee is thereby divested of his title. [Emphasis supplied.]

48 The maturity date of the second loan.

3. Penalty of two percent (2%) per annum on the unpaid balance to be computed from December 15, 1992;

4. Attorney's Fees of two percent (2%) of the total amount to be recovered.

The total amount to be recovered shall further be subject to the legal interest rate of six percent (6 %) per annum from the finality of this Decision until fully paid.[49]

Respondent Elisan Credit Corporation, on the other hand, is **ORDERED** to return/deliver the seized motor vehicle with Plate No. UV-TDF-193, subject of the chattel mortgage, to the possession of the petitioner; in the event its delivery is no longer possible, to pay the petitioner the amount of ₱30,000.00 corresponding to the value of the said vehicle.

No pronouncement as to costs.

**SO ORDERED.**

**ARTURO D. BRION**
Associate Justice

**WE CONCUR:**

**ANTONIO T. CARPIO**
Associate Justice
Chairperson

**MARIANO C. DEL CASTILLO**
Associate Justice

**JOSE CATRAL MENDOZA**
Associate Justice

**MARVIC M.V.F. LEONEN**
Associate Justice

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49 Section 1 of BSP Circular No. 799 dated July 1, 2013.

## ATTESTATION

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

**ANTONIO T. CARPIO**
Associate Justice
Chairperson, Second Division

## CERTIFICATION

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

**MARIA LOURDES P. A. SERENO**
Chief Justice