

Of Interest Rates and the New 6% per Annum Legal Interest Rate

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Money is something generally accepted as a medium of exchange, a measure of value, or a means of payment.² Indeed, it is a tool of exchange right in the heart of every commercial transaction, including a contract of loan.

By the contract of loan, one of the parties delivers to another, either something not consumable so that the latter may use the same for a certain time and return it, in which case the contract is called a *commodatum*, or money or other consumable thing, upon the condition that the same amount of the same kind and quality shall be paid, in which case the contract is simply called a loan or a *mutuum*.³ A simple loan may be gratuitous or with a stipulation to pay interest.⁴

It is not uncommon for parties entering into a contract of *mutuum* or simple loan to agree for the payment of interest. Interest refers to the compensation allowed by law or fixed by the parties for the loan or forbearance of money, goods, or credits.⁵

Philippine law and jurisprudence provide for these kinds of interest: (1) Simple interest, which is paid for the principal at a certain

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² <http://www.merriam-webster.com/dictionary/money>

³ Article 1933, paragraph 1, of the New Civil Code of the Philippines.

⁴ *Ibid*, paragraph 3.

⁵ Hector S. De Leon and Hector M. De Leon, Jr. *Comments and Cases on Credit Transactions* p. 59 (Rex Book Store, Inc. 2010).

rate fixed or stipulated by the parties,⁶ and (2) Compound interest, which is imposed upon interest due and unpaid. The accrued interest is added to the principal sum and the whole (principal and accrued interest) is treated as new principal upon which the interest for the next period is stipulated.⁷ Accrued interest refers to interest earned but not yet received.⁸

As a general rule, interest due and unpaid shall not earn interest. However, the contracting parties may by stipulation capitalize the interest due and unpaid, which as added principal should earn new interest.⁹ In other words, a lender cannot demand compounded interest from the borrower, unless otherwise agreed by both parties. Article 2212 of the New Civil Code also states, “Interest due shall earn legal interest from the time it is judicially demanded, although the obligation may be silent upon this point.”

The Supreme Court in Mambulao vs. PNB emphasized the two instances when compound interest may be collected.¹⁰

This is also the clear mandate of Article 2212 of the new Civil Code which provides that interest due shall earn legal interest only from the time it is judicially demanded, and of Article 1959 of the same code which ordains that interest due and unpaid shall not earn interest. Of course, the parties may, by stipulation, capitalize the interest due and unpaid, which as added principal shall earn new interest.

Legal interest is an interest that the law directs to be charged in the absence of any agreement as to the rate between the parties.¹¹ Lawful interest, on the other hand, is one that the law allows or does

⁶ Ibid, page 60.

⁷ Ibid, page 61.

⁸ <http://www.businessdictionary.com/definition/accrued-interest.html>

⁹ Article 1959 of the New Civil Code of the Philippines.

¹⁰ G.R. No. L-29973 (1968).

¹¹ Hector S. De Leon and Hector M. De Leon, Jr. *Comments and Cases on Credit Transactions* p. 61 (Rex Book Store, Inc. 2010).

not prohibit; it is an interest within the maximum prescribed by law.¹² An unlawful or usurious interest, however, is paid or stipulated to be paid beyond the maximum fixed by law.¹³

When is an interest due? No interest is due unless it has been expressly stipulated in writing.¹⁴ This applies to simple loan or mutuum. If a simple interest or a particular rate of interest has been expressly stipulated by the parties, that interest, not the legal rate of interest, shall be applied.¹⁵ If payment of interest has been expressly stipulated in writing but the specific rate of the interest is not mentioned, the legal rate of interest shall be payable.

Under our law, there are several instances wherein the interest may be demanded even if such was not expressly stipulated in writing. First, in the absence of a stipulated interest, there exists legal interest pursuant to Article 2209¹⁶ of the Civil Code. In other words, interest may be paid either as compensation for the use of money (monetary interest) referred to in Article 1956 or imposed by law or by the courts as penalty or indemnity for damages (compensatory interest).¹⁷

Second, a debtor in delay is liable to pay legal interest as indemnity for damages even in the absence of stipulation for the payment of interest. Those obliged to deliver or to do something incur in delay from the time the obligee judicially or extrajudicially demands from them the fulfillment of their obligation.¹⁸ Article 1169 of the

¹² Ibid.

¹³ Ibid.

¹⁴ Article 1956, the New Civil Code of the Philippines.

¹⁵ *Casa Filipina Development Corp. vs. The Deputy Executive Secretary*, G.R. No. 96494 (1992).

¹⁶ Article 2209. If the obligation consists in the payment of a sum of money, and the debtor incurs in delay, the indemnity for damages there being no stipulation to the contrary, shall be the payment of the interest agreed upon, and in the absence of stipulation, the legal interest, which is six percent per annum.

¹⁷ Hector S. De Leon and Hector M. De Leon, Jr. *Comments and Cases on Credit Transactions* p. 37 (Rex Book Store, Inc. 2010).

¹⁸ Article 1169 of the New Civil Code of the Philippines.

New Civil Code provides for the instances wherein demand by the creditor shall not be necessary in order that delay may exist.¹⁹

The obligation consisting of the payment of a sum of money referred to in Article 2209 is not confined to a loan or forbearance in money.²⁰ In a line of cases including that of *Costelo vs Court of Appeals* the Supreme Court used Article 2209 to resolve issues involving default in the payment of price or consideration under a contract of sale, an action for damages for injury to persons and loss of property, and an action for damages arising from unpaid insurance claims.²¹

When is an interest unlawful and usurious? Usury, generally speaking, may be defined as contracting for or receiving something in excess of the amount allowed by law for the loan or forbearance of money.²² There can be no usury if there is no loan or forbearance of money to speak of.

Forbearance in the context of usury law is a contractual obligation of a lender or creditor to refrain, during a given period of time, from requiring the borrower or debtor to repay a loan or debt then due and payable.²³

Usurious interest was therefore considered as unlawful and illegal. The Philippine Legislature condemned the collection of a rate of interest higher than that allowed by law.²⁴

¹⁹ Article 1169: xxx

(1) When the obligation or the law expressly so declare; or (2) When from the nature and the circumstances of the obligation it appears that the designation of the time when the thing is to be delivered or the service is to be rendered was a controlling motive for the establishment of the contract; or (3) When demand would be useless, as when the obligor has rendered it beyond his power to perform.

²⁰ Hector S. De Leon and Hector M. De Leon, Jr. *Comments and Cases on Credit Transactions* p. 40 (Rex Book Store, Inc. 2010).

²¹ *Ibid.*

²² *Tolentino vs. Gonzales*, G.R. No. 26085 (1927).

²³ *International Container vs. FGU Insurance Corp.*, G.R. No. 161539 (2009).

²⁴ *Ibid.*

Act No. 2655, otherwise known as the Usury Law, was enacted on 4 February 1916 and took effect on 1 May 1916. It aimed to protect the borrowers from the imposition of unscrupulous lenders who take undue advantage of the necessities of others.²⁵ Under the Usury Law, the Monetary Board was authorized to prescribe the maximum rate of interest for the loan or renewal thereof or the forbearance of any money, goods, or credits.²⁶ The Monetary Board, in Resolution No. 1622 dated 29 July 1974, prescribed that the rate of interest for the loan or forbearance of any money, goods, or credits and the rate allowed in judgments, in the absence of express contract as to such rate of interest, shall be twelve per cent (12%) per annum.²⁷ With Central Bank Circular No. 410-74, the legal interest of 12% per annum was therefore fixed and applied to the following: (1) loans, (2) forbearance of any money, goods, or credits and (3) judgments involving such loans or forbearance in the absence of express agreement as to such rate of interest.²⁸

Thereafter, the Monetary Board of the Central Bank issued Resolution No. 224, dated 3 December 1982, which states, among others, that in the absence of express contract as to the rate of interest for the loan or forbearance of any money, goods, or credit and the rate allowed in judgments, shall continue to be at 12% per annum. In the same resolution, which took effect on 1 January 1983 per Central Bank of the Philippines Circular No. 905-82 dated 10 December 1982, it was resolved that the rate of interest that may be charged or collected by any person shall not be subject to any ceiling prescribed under the Usury Law.

Hence, even if the legal interest rate continued to be at 12% per annum in case of loans or forbearances of money, the effectivity of

²⁵ Hector S. De Leon and Hector M. De Leon, Jr. *Comments and Cases on Credit Transactions* p. 54 (Rex Book Store, Inc. 2010)

²⁶ Section 1-A, Act No. 2655.

²⁷ CBP Circular No. 416-74, dated 29 July 1974.

²⁸ Hector S. De Leon and Hector M. De Leon, Jr. *Comments and Cases on Credit Transactions* p. 41 (Rex Book Store, Inc. 2010).

the Usury Law was suspended and as such, no ceiling was imposed upon the interest rates that the parties may agree. According to the Supreme Court, the said Circular did not repeal nor in any way amend the Usury Law but simply suspended the latter's effectivity²⁹ because a Central Bank Circular cannot repeal a law as only a law can repeal another law.³⁰

In the 2013 case of Advocates for Truth in Lending, Inc. and Olaguer vs. Bangko Sentral Monetary Board³¹, the Supreme Court stated that

Thus, according to the Court, by lifting the interest ceiling, CB Circular No. 905 merely upheld the parties' freedom of contract to agree freely on the rate of interest. It cited Article 1306 of the New Civil Code, under which 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.

With the suspension of the effectivity of the Usury Law, the parties were now given the freedom to stipulate the interest to be paid on monetary obligations. Absent any evidence of fraud, undue influence, or any vice of consent exercised by one party against the other, the interest rate agreed upon is binding upon them.³² But while interest rates are no longer subject to any ceiling, the Supreme Court emphasized in several cases, including the case of Imperial vs. Jaucian³³, citing Spouses Solangon vs. Salazar³⁴ that

While the Usury Law ceiling on interest rates was lifted by C.B. Circular No. 905, nothing in the said circular grants

²⁹ *First Metro Development Corp. vs. Este Del Sol Mountain Reserve, Inc. et al*, G.R. No. 141811 (2001); *Medel vs. Court of Appeals*, G.R. No. 131622 (1998); *Security Bank and Trust Company vs. Regional Trial Court of Makati*, G.R. No. 113926 (1996).

³⁰ *Ibid.*

³¹ G.R. No. 192986 (2013).

³² Hector S. De Leon and Hector M. De Leon, Jr. *Comments and Cases on Credit Transactions* p. 50 (Rex Book Store, Inc. 2010).

³³ G.R. No. 149004 (2004).

³⁴ G.R. No. 1259004 (2001).

lenders carte blanche authority to raise interest rates to levels which will either enslave their borrowers or lead to a hemorrhaging of their assets.

The same principle was reiterated by the Supreme Court in the earlier mentioned case of Advocates for Truth in Lending, Inc.³⁵ In the case of Svensden vs. People of the Philippines³⁶, the Court held that

Stipulations authorizing such interest are contra bonos mores, if not against the law. They are, under Article 1409 of the New Civil Code, inexistent and void from the beginning.

The Supreme Court held in the case of Macalinao vs. Bank of the Philippine Islands³⁷ that the interest rate and penalty charge of 3% per month should be equitably reduced to 2% per month or 24% per annum. The Supreme Court ruled that an interest rate of 4% per month or 48% per annum is highly unconscionable and inordinate and was thus reduced to 12% per annum.³⁸ In Medel vs. Court of Appeals³⁹, the stipulated rate of interest at 5.5% per month was considered excessive, iniquitous, unconscionable, and exorbitant but was not considered usurious since C.B. Circular 905 has expressly removed the interest ceilings prescribed by the Usury Law. In this case, the Supreme Court agreed with the trial court in the imposition of interest at 12% interest per annum, and an additional 1% per month penalty charge as liquidated damages.

An interest rate of 6% per month or 72% per month was likewise found outrageous and inordinate and the Supreme Court deemed an interest of 12% per annum fair and reasonable.⁴⁰ In Svensden⁴¹,

³⁵ G.R. No. 192986 (2013).

³⁶ G.R. No. 175381 (2008).

³⁷ G.R. No. 175490 (2009).

³⁸ *Bulos vs. Yasuma*, G.R. No. 164159 (2007).

³⁹ G.R. No. 131622 (1998).

⁴⁰ G.R. No. 1259004 (2001).

⁴¹ G.R. No. 175381 (2008).

an interest rate of 10% per month agreed upon by the parties was held as excessive, iniquitous, and unconscionable and was reduced as 12% per annum.

In the case of Imperial⁴², the Supreme Court upheld the finding of the Court of Appeals and the Regional Trial Court reducing the interest rate from 16% to 1.167 % per month or 14% per annum and in Spouses Bacolor vs. Banco Filipino⁴³, the interest rate of 24% per annum agreed upon by the parties is not unconscionable or excessive.

A careful perusal of the various decisions of the Supreme Court indicate that there is no exact rule as to what specific interest rate is unconscionable, iniquitous, or excessive. The Supreme Court emphasized this in the case of Macalinao⁴⁴, to wit:

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.

What were the applicable legal interest rates prior to 1 July 2013? The rule that was applied by the Supreme Court prior to 1 July 2013 was summarized in the landmark case of Eastern Shipping Lines, Inc. vs. Court of Appeals.⁴⁵

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

1. When the obligation is breached, and it consists in the payment of a sum of money, i.e., a loan or forbearance of money, the interest due should be that which may have been stipulated in writing. Furthermore, the interest due shall itself earn legal

interest from the time it is judicially demanded. In the absence of stipulation, the rate of interest shall be 12% per annum to be computed from default, i.e., from judicial or extrajudicial demand under and subject to the provisions of Article 1169 of the Civil Code.

2. When an obligation, not constituting a loan or forbearance of money, is breached, an interest on the amount of damages awarded may be imposed at the discretion of the court at the rate of 6% per annum. No interest, however, shall be adjudged on unliquidated claims or damages except when or until the demand can be established with reasonable certainty. Accordingly, where the demand is established with reasonable certainty, the interest shall begin to run from the time the claim is made judicially or extrajudicially (Art. 1169, Civil Code) but when such certainty cannot be so reasonably established at the time the demand is made, the interest shall begin to run only from the date the judgment of the court is made (at which time the quantification of damages may be deemed to have been reasonably ascertained). The actual base for the computation of legal interest shall, in any case, be on the amount finally adjudged.
3. When the judgment of the court awarding a sum of money becomes final and executory, the rate of legal interest, whether the case falls under paragraph 1 or paragraph 2, above, shall be 12% per annum from such finality until its satisfaction, this interim period being deemed to be by then an equivalent to a forbearance of credit.

In its Resolution No. 796 dated 16 May 2013, the Monetary Board approved the revisions governing the rate of interest in the absence of stipulation in loan contracts, thereby amending Section 2 of Circular No. 905, Series of 1982.

⁴² G.R. No. 149004 (2004).

⁴³ G.R. No. 148491 (2007).

⁴⁴ G.R. No. 175490 (2009).

⁴⁵ G.R. No. 97412 (1994).

Section 1 of the Bangko Sentral ng Pilipinas Circular No. 299, Series of 2013, which took effect on 1 July 2013, now states

The rate of interest for the loan or forbearance of any money, goods, or credits and the rate allowed in judgments, in the absence of an express contract as to such rate of interest, shall be six percent (6%) per annum.

The Supreme Court applied this in the case of Nacar vs. Gallery Frames.⁴⁶

Thus, from the foregoing, in the absence of an express stipulation as to the rate of interest that would govern the parties, the rate of legal interest for loans or forbearance of any money, goods or credits and the rate allowed in judgments shall no longer be twelve percent (12%) per annum – as reflected in the case of Eastern Shipping Lines and Subsection X305.1 of the Manual of Regulations for Banks and Sections 4305Q.1, 4305S.3 and 4303P.1 of the Manual of Regulations for Non-Bank Financial Institutions, before its amendment by BSP-MB Circular No. 799 – but will now be six percent (6%) per annum effective July 1, 2013.

Supreme Court, however, emphasized that as to the applicability of the new legal interest rate

...it should be noted, nonetheless, that the new rate could only be applied prospectively and not retroactively. Consequently, the twelve percent (12%) per annum legal interest shall apply only until June 30, 2013. Come July 1, 2013 the new rate of six percent (6%) per annum shall be the prevailing rate of interest when applicable.

In conclusion, the guidelines laid down in the case of Eastern Shipping Lines were modified accordingly to embody Circular No. 799, as follows:

⁴⁶ G.R. No. 189871 (2013).

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

1. When the obligation is breached, and it consists in the payment of a sum of money, i.e., a loan or forbearance of money, the interest due should be that which may have been stipulated in writing. Furthermore, the interest due shall itself earn legal interest from the time it is judicially demanded. In the absence of stipulation, the rate of interest shall be 6% per annum to be computed from default, i.e., from judicial or extrajudicial demand under and subject to the provisions of Article 1169 of the Civil Code.
2. When an obligation, not constituting a loan or forbearance of money, is breached, an interest on the amount of damages awarded may be imposed at the discretion of the court at the rate of 6% per annum. No interest, however, shall be adjudged on unliquidated claims or damages, except when or until the demand can be established with reasonable certainty. Accordingly, where the demand is established with reasonable certainty, the interest shall begin to run from the time the claim is made judicially or extrajudicially (Art. 1169, Civil Code), but when such certainty cannot be so reasonably established at the time the demand is made, the interest shall begin to run only from the date the judgment of the court is made (at which time the quantification of damages may be deemed to have been reasonably ascertained). The actual base for the computation of legal interest shall, in any case, be on the amount finally adjudged.
3. When the judgment of the court awarding a sum of money becomes final and executory, the rate of legal interest, whether the case falls under paragraph 1 or paragraph 2, above, shall be 6% per annum

from such finality until its satisfaction, this interim period being deemed to be by then an equivalent to a forbearance of credit.

And, in addition to the above, judgments that have become final and executory prior to July 1, 2013, shall not be disturbed and shall continue to be implemented applying the rate of interest fixed therein.⁴⁷

⁴⁷ Ibid.