

SUPREME COURT OF THE PHILIPPINES  
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Republic of the Philippines  
**Supreme Court**  
Manila

**FIRST DIVISION**

**RUBY SHELTER BUILDERS  
and REALTY DEVELOPMENT  
CORPORATION, represented  
by its President, Ruben Sia,**  
Petitioner,

**G.R. No. 217368\***

Present:

GESMUNDO, *C.J.*, Chairperson  
HERNANDO,  
ZALAMEDA,  
ROSARIO, and  
MARQUEZ, *JJ.*

-versus-

**ROMEO Y. TAN, ROBERTO L.  
OBIEDO and ATTY. TOMAS A.  
REYES,**  
Respondents.

Promulgated:

AUG 05 2024

*Signatures*

X ----- X

**DECISION**

**GESMUNDO, C.J.:**

Not all instances of alienation of mortgaged property by the debtor in favor of the creditor in the event of failure to timely pay the obligation will be declared void for being *pactum commissorium*. The prohibition does not extend to a mutual agreement between the debtor and the creditor that the property subject of the mortgage is sold to the latter to extinguish the obligation.

Before the Court is a Petition for Review on *Certiorari*<sup>1</sup> under Rule 45 of the Rules of Court assailing the Amended Decision<sup>2</sup> of the Court of Appeals

\* Part of the Supreme Court Decongestion Program.

<sup>1</sup> *Rollo*, pp. 13–151.

<sup>2</sup> *Id.* at 195–209. The February 18, 2015 Amended Decision in CA-G.R. CV No. 101180 was penned by Associate Justice Noel G. Tijam (now a retired Member of the Court) and concurred in by Associate Justices Priscilla J. Baltazar-Padilla<sup>+</sup> (former Member of the Court) and Agnes Reyes-Carpio of the Former Sixth Division, Court of Appeals, Manila.

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(CA), which reversed its earlier Decision<sup>3</sup> rendered on October 20, 2014. In the Amended Decision, the CA affirmed the Decision<sup>4</sup> and Order<sup>5</sup> of the Regional Trial Court (RTC) which dismissed petitioner's complaint for annulment of deed of sale and declared that the parties had agreed to novate their earlier real estate mortgage.

### Antecedents

Petitioner Ruby Shelter Builders and Realty Development Corporation (Ruby Shelter) obtained a loan from respondents Romeo Y. Tan and Roberto L. Obiedo (Tan and Obiedo), which was secured by a Real Estate Mortgage covering five parcels of land with Transfer Certificate of Title (TCT) Nos. 29918, 38374, 38376, 39225 and 39232 located at Concepcion Pequeña, Naga City. As of March 2005, Ruby Shelter's outstanding debt amounted to PHP 95,700,620.00. In order to secure an extension for the re-payment of the loan, the parties executed a Memorandum of Agreement (MOA) dated March 17, 2005, the pertinent portions of which are hereby reproduced:

1. That the FIRST PARTY is indebted to the SECOND PARTY in the aggregate sum of NINETY[-]FIVE MILLION SEVEN HUNDRED THOUSAND SIX HUNDRED TWENTY PESOS [(PHP 95,700,620.00)], Philippine currency, covered by Real Estate Mortgages over five (5) parcels of land enumerated in paragraph 3 hereof.

2. That because of the FIRST PARTY's corporate offer to simultaneously execute Deeds of Absolute Sale over the properties as provided for and listed in paragraph 3 hereof, the SECOND PARTY here allows the FIRST PARTY to pay the said indebtedness, on or before [December 31, 2005]. Moreover, the SECOND PARTY hereby agrees to condone and/or write off the interests, penalties and surcharges from October 1, 2004 to December 31, 2005, or a total period of fifteen (15) months, amounting to SEVENTY[-]FOUR MILLION SIX HUNDRED SEVENTY[-]EIGHT THOUSAND SIX HUNDRED FORTY[-]SEVEN PESOS [(PHP 74,678,647.00)].

3. Upon the execution hereof, and, by way of dacion en pago, the FIRST PARTY shall execute deeds of absolute sale to be uniformly dated January 2, 2006, over the following properties in favor of the SECOND PARTY, with the corresponding purchase prices, thus:

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<sup>3</sup> *Id.* at 153-184. The October 20, 2014 Decision in CA-G.R. CV No. 101180 was penned by Associate Justice Noel G. Tijam (now a retired Member of the Court) and concurred in by Associate Justices Priscilla J. Baltazar-Padilla\* (former Member of the Court) and Agnes Reyes-Carpio of the Sixth Division, Court of Appeals, Manila.

<sup>4</sup> *Id.* at 410-432. The January 30, 2013 Decision in Civil Case No. RTC 2006-0030 was penned by Presiding Judge Efren G. Santos of Branch 22, Regional Trial Court, Naga City.

<sup>5</sup> *Id.* at 437-440. The April 25, 2013 Order in Civil Case No. RTC 2006-0030 was penned by Presiding Judge Efren G. Santos of Branch 22, Regional Trial Court, Naga City.

4. The FIRST PARTY is here allowed to pay off the indebtedness covered by the Real Estate Mortgage, either by individual lots or the entire five (5) parcels of land as described in the immediately preceding paragraph, provided that the corresponding payment shall consider the earned and accrued interest and penalties, according to the following schedule: for parcel (a), the redemption sum shall be [PHP 25,328,939.00]; for parcel (b) the redemption money shall be [PHP 35,660,800.00]; for parcel (c) the redemption sum shall be [PHP 28,477,600.00]; for parcels (d) and (e) shall be [PHP 6,233,281.00].

5. If and when the FIRST PARTY is able to effect redemption of any of the property listed and enumerated in paragraph 3 hereof, the Deed of Absolute Sale dated [January 02, 2006] for the corresponding parcel of land shall be nullified and will have no force and effect and the SECOND PARTY shall then return the owner's duplicate copy of the certificate of title and shall likewise execute a Deed of Discharge of Mortgage.

6. In the event though that the FIRST PARTY shall not be able to tender any amount for the payment of the indebtedness corresponding to any of the parcel of land, then, the SECOND PARTY is hereby allowed to present the Deeds of Absolute Sale over the properties enumerated in paragraph 3 hereof, for registration with the Office of the Register of Deeds for Naga City so that the corresponding certificates of title in the name of the SECOND PARTY shall then be issued by the said Register of Deeds, after payment of necessary fees and taxes.

7. The parties hereby agree, if only to finally settle everything, to faithfully comply with and abide by their respective covenants; provided that if the FIRST PARTY shall contest, judicially or otherwise, any act, transaction, or event, related to or necessarily connected with this memorandum of agreement as well as the Deeds of Absolute Sale over the properties listed in paragraph 3 hereof, it hereby undertakes to indemnify the SECOND PARTY the amount of not less than TEN MILLION [PHP 10,000,000.00], Philippine currency, as liquidated damages, inclusive of costs and attorney's fees; provided still further that in the event that the FIRST PARTY shall contest the transaction, it shall obligate itself to pay off the condoned interests, surcharges and penalties in the amount of [PHP 55,167,000.00] (as stated in paragraph 2 hereof); provided finally, that should a contest be effected on this agreement, Mr. RUBEN SIA, obligates himself, jointly and severally with the FIRST PARTY, to assume personal obligation to effect the payments of the entire monetary obligations herein cited together with the FIRST PARTY.

8. In the alternative, the FIRST PARTY here agrees to execute deeds of sale over the five parcels of land listed in par. 3 hereof upon the execution of this agreement, in consideration for the receipt of FIVE MILLION PESOS [(PHP 5,000,000.00)] from the SECOND PARTY, in which case, the said sale shall constitute full payment (dacion en pago) and the FIRST PARTY'S entire liability is written off[.]<sup>6</sup>

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<sup>6</sup> *Id.* at 344-346.

As a result, Ruby Shelter immediately executed separate Deeds of Absolute Sale, all dated January 3, 2006, covering the mortgaged properties in favor of Tan and Obiedo.<sup>7</sup>

On December 27, 2005, Ruby Shelter, through its president Ruben Sia (Sia), wrote a Letter<sup>8</sup> to Tan and Obiedo intimating its intention to redeem the properties and requesting for a meeting to discuss its concerns on the interests, surcharges, and penalties imposed on its original obligation. The parties met, but despite several dialogues, the parties failed to arrive at a mutually acceptable computation of the final amount.

Ruby Shelter claimed that on January 3, 2006, Tan and Obiedo prematurely caused the notarization of the deeds of absolute sale by respondent Atty. Tomas A. Reyes (Atty. Reyes). Tan and Obiedo allegedly made it appear that Sia personally appeared and ratified the instruments before Atty. Reyes.

Aggrieved by the premature notarization, Ruby Shelter filed a Complaint<sup>9</sup> mainly to annul the deeds of absolute sale, against Tan and Obiedo and Atty. Reyes (Tan et al.). Ruby Shelter averred therein that the deeds of sale are null and void for being *pactum commissorium*.

Tan et al. denied that the MOA constitutes a *pactum commissorium* and instead argued that Ruby Shelter voluntarily offered to execute the deeds of sale to ask for additional time to pay its outstanding debt and condonation of interest, penalties, and surcharges.

On March 23, 2006, Ruby Shelter filed an Amended Complaint<sup>10</sup> alleging that the titles of the mortgaged properties were already canceled, and new TCTs<sup>11</sup> were issued in the names of Tan and Obiedo.

### **Ruling of the RTC**

On January 30, 2013, the RTC issued a Decision<sup>12</sup> dismissing the complaint for lack of merit. It opined that the mortgage was effectively novated by the deeds of sale over the mortgaged properties which were offered as payment in *dacion en pago*. The *dacion en pago* was legally binding considering that the conditions under which a dation in payment would be

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<sup>7</sup> *Id.* at 314–323.

<sup>8</sup> *Id.* at 324.

<sup>9</sup> *Id.* at 333–343.

<sup>10</sup> *Id.* at 388–399.

<sup>11</sup> *Id.* at 328–332.

<sup>12</sup> *Id.* at 410–432.

valid were all present.<sup>13</sup> Hence, the RTC ordered Tan and Obiedo to pay Ruby Shelter the stipulated amount of PHP 5,000,000.00 as full payment pursuant to paragraph 8 of the MOA.

The RTC further held that the stipulations in the MOA with respect to the execution of the deeds of absolute sale did not constitute *pactum commissorium* since Ruby Shelter agreed to sell the properties to Tan and Obiedo in the event of default.<sup>14</sup>

On April 25, 2013, the RTC issued an Order<sup>15</sup> modifying its earlier Decision by deleting the portion which ordered Tan and Obiedo to pay PHP 5,000,000.00, thus:

WHEREFORE, viewed in the light of the foregoing premises, the "Motion for Partial Reconsideration" filed by TAN and OBIEDO is hereby GRANTED and the DECISION dated January 30, 2013 is PARTIALLY RECONSIDERED and MODIFIED. Accordingly, a new DECISION is hereby rendered:

- a) UPHOLDING the LEGALITY and VALIDITY of the MEMORANDUM OF AGREEMENT dated March 17, 2005, and the five (5) DEEDS OF ABSOLUTE SALE all dated January 3, 2006 and notarized by Atty. Tomas A. Reyes on even date and therefore, of FULL FORCE and EFFECT;
- b) DISMISSING the COMPLAINT for lack of merit;
- c) DISMISSING the claims for DAMAGES of the Plaintiffs;
- d) ORDERING the PLAINTIFF and RUBEN SIA, to jointly and severally pay Defendants ROMEO Y. TAN and ROBERTO L. OBIEDO, the amount of [PHP 10,000,000.00] as liquidated damages inclusive of costs and Attorney's fees; and
- e) All other CLAIMS and COUNTERCLAIMS are hereby ordered DISMISSED for lack of merit.

No pronouncement as to costs.

SO ORDERED.<sup>16</sup>

Aggrieved, Ruby Shelter appealed the case before the CA.

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<sup>13</sup> *Id.* at 426-427.

<sup>14</sup> *Id.* at 427-428.

<sup>15</sup> *Id.* at 437-440.

<sup>16</sup> *Id.* at 439-440.

### Ruling of the CA

On October 20, 2014, the CA rendered a Decision<sup>17</sup> in favor of Ruby Shelter, viz.:

**WHEREFORE**, the *Appeal* is hereby partially **GRANTED**, and the assailed Decision dated January 30, 2013, and Order dated April 25, 2013 of the Regional Trial Court (RTC), Naga City, Branch 22, in RTC Case No. 2006-0030 are hereby partially **REVERSED** and **SET ASIDE**.

Judgment is hereby rendered, as follows:

1. declaring the MOA partially VOID only insofar as the automatic appropriation of the subject properties to Defendants-Appellees Tan and Obiedo upon failure of Plaintiff-Appellant to pay its obligations;
2. declaring the remaining provisions in the MOA VALID and ENFORCEABLE between the parties;
3. annulling the 5 Deeds of Sale, all dated January 3, 2006, covering TCT Nos. 29918, 38374, 38376, 39225 and 39232;
4. holding Plaintiff-Appellant liable for the amount of [PHP 95,700,620.00] as principal obligation, plus [PHP 74,678,647.00] as condoned interest, penalties and surcharges, pursuant to pars. 1 and 2 of the MOA, as of the date of execution of the MOA on March 17, 2005, subject to 12% per annum interest from the filing of Tan and Obiedo's Answer, on March 17, 2006, and, thereafter, at the rate of 12% per annum from the finality of this Decision until the same is fully paid;
5. holding Plaintiff-Appellant liable for liquidated damages in the amount of [PHP 10,000,000.00], pursuant to par. 7 of the MOA, subject to 6% per annum interest from the filing of Tan and Obiedo's Answer, on March 17, 2006, and, thereafter, at the rate of 12% per annum from the finality of this Decision until the same is fully paid;
6. holding Ruben Sia jointly and severally liable with Plaintiff-Appellant for the latter's entire monetary obligation, pursuant to par. 7 of the MOA; and,
7. the subsisting real estate mortgage on the properties subject of the 5 Deeds of Sale, all dated January 3, 2006, be FORECLOSED and the properties subject thereof be SOLD at a public auction in the event Plaintiff-Appellant fails to pay its obligations to Defendants-Appellees Tan

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<sup>17</sup> *Id.* at 153-184.

and Obiedo within ninety (90) days from entry of judgment.

**SO ORDERED.**<sup>18</sup> (Emphasis in the original)

The CA found that the MOA did not novate the loan agreement,<sup>19</sup> that instead of novation, the parties intended to supplement its prior mortgage agreement toward the same end of making the subject properties stand as security for Ruby Shelter's obligation;<sup>20</sup> that despite the use of the words "*dacion en pago*" in the MOA, the intention of the parties was to forge a conditional sale in consideration of the condonation of interest and penalties,<sup>21</sup> and that there can be no dation in payment because the creditor's possession of the properties is merely by way of security.<sup>22</sup>

Both parties filed their respective Motions for Reconsideration.<sup>23</sup>

On February 18, 2015, the CA promulgated the now challenged Amended Decision, reversing its earlier decision and affirming the RTC. The CA decreed:

**WHEREFORE**, premises considered, Defendants-Appellees' Motion for Reconsideration is hereby **GRANTED**. Our Decision dated October 20, 2014, is hereby **REVERSED** and **SET ASIDE** and a new judgment is rendered **affirming in toto** the Decision dated January 30, 2013 and Order dated April 25, 2013 of the Regional Trial Court (RTC), Naga City, Branch 22, in RTC Case No. 2006-0030.

Plaintiff-Appellant's Motion for Partial Reconsideration is **DENIED** for lack of merit.

**SO ORDERED.**<sup>24</sup> (Emphasis in the original)

The CA held that the provisions of the MOA novated the loan agreement with real estate mortgage.<sup>25</sup> Applying the test of incompatibility, the CA found that the MOA contains stipulations which are incompatible with the real estate mortgage, which was executed by the parties. Also, the extension of the period to pay is inconsistent with the status of the obligation in the real estate mortgage, which already matured.<sup>26</sup> The MOA constitutes a conscious and deliberate effort on the part of the parties to novate the

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<sup>18</sup> *Id.* at 182–183.

<sup>19</sup> *Id.* at 163–165.

<sup>20</sup> *Id.* at 167.

<sup>21</sup> *Id.* at 169.

<sup>22</sup> *Id.* at 169–170.

<sup>23</sup> *Id.* at 499–539.

<sup>24</sup> *Id.* at 208–209.

<sup>25</sup> *Id.* at 199.

<sup>26</sup> *Id.* at 200.

agreement from one of mortgage to a *dacion en pago*.<sup>27</sup>

As regards the issue on *pactum commissorium*, the CA changed its stance and held that the premise for the application of the aforesaid principle is not present in this case. The law aims to protect persons who, out of dire circumstances, are compelled to part with their properties. The CA opined that, in this case, it was petitioner Ruby Shelter who offered the subject properties to Tan and Obiedo as payment for its obligation. Sia, who is an educated man and a noted businessman, cannot be deemed to have been coerced to offer Ruby Shelter's properties to its creditor.<sup>28</sup>

Undaunted, Ruby Shelter elevated the case before this Court *via* a Petition for Review on *Certiorari* under Rule 45 of the Rules of Court praying for the reversal of the Amended CA Decision.

### Issues

The core issues boil down to: (a) whether the CA erred in ruling that the parties novated the real estate mortgage and entered into a *dacion en pago*; and (b) whether the MOA is void for being a *pactum commissorium*.

### *Petitioner's Arguments*

Ruby Shelter insists that the MOA did not alter the essence of the original obligation but only modified the terms of the payment thereof.<sup>29</sup> The circumstance in this case is the very situation contemplated by the provisions on *pactum commissorium* because it enables the creditor to acquire ownership over the mortgaged properties without need of any foreclosure proceedings.<sup>30</sup> It also maintains that the condoned interest, penalties and surcharges amounting to PHP 74,678,647.00 are already included in the total amount of the obligation pegged at PHP 95,700,620.00 as of December 31, 2005.<sup>31</sup> Since Tan and Obiedo have enjoyed beneficial use over the subject properties as of January 2006, Ruby Shelter argues that it is no longer liable to pay legal interest.<sup>32</sup> Finally, it prays for the deletion of the liquidated damages for being unconscionable, unjust, and in violation of its right to free access to the court to air legitimate grievances.<sup>33</sup>

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<sup>27</sup> *Id.* at 201.

<sup>28</sup> *Id.* at 205–206.

<sup>29</sup> *Id.* at 132–135.

<sup>30</sup> *Id.* at 136.

<sup>31</sup> *Id.* at 137–138.

<sup>32</sup> *Id.* at 138–139.

<sup>33</sup> *Id.* at 139.



### *Respondents' Arguments*

In their Comment, Tan et al. interpose that the petition deserves an outright dismissal for primarily assailing the existence of a novation, which is a question of fact;<sup>34</sup> that the CA correctly held that the parties agreed to a *dacion en pago* and not a *pactum commissorium*; that the contemporaneous and subsequent acts of Ruby Shelter showed that the mortgaged realty was used as payment for and equivalent to its entire loan obligation;<sup>35</sup> that Ruby Shelter is estopped and barred from assailing the sale of the subject properties since the loan obligation has already been extinguished through *dacion en pago*;<sup>36</sup> that the MOA clearly provides that the principal amount of PHP 95,700,620.00 and the interest of PHP 74,678,647.00, are separate amounts for which Ruby Shelter is liable;<sup>37</sup> and that the liquidated damages in the amount of PHP 10,000,000.00 under paragraph 7 of the MOA is valid under Articles 1226 and 2226 of the Civil Code.<sup>38</sup>

### **Ruling of the Court**

The petition fails.

Tan et al. correctly argued that this case deserves outright dismissal for raising factual issues. In a petition for review on *certiorari* under Rule 45 of the Rules of Court, the Court's scope of review is limited to questions of law. Factual issues are not within the province of the Court, as it is not a trier of facts<sup>39</sup> and is not required to reassess and recalibrate the oral and documentary evidence anew. The interpretation and construction of contracts are beyond the ambit of a petition for review on *certiorari*.<sup>40</sup> However, the Court, in exceptional circumstances, has the authority to review, and in proper cases, reverse the findings of the trial courts and appellate courts, viz.:

(1) when the findings are grounded entirely on speculation, surmises or conjectures; (2) when the inference made is manifestly mistaken, absurd or impossible; (3) when there is grave abuse of discretion; (4) when the judgment is based on a misapprehension of facts; (5) when the findings of facts are conflicting; (6) when in making its findings the Court of Appeals went beyond the issues of the case, or its findings are contrary to the admissions of both the appellant and the appellee; (7) when the findings are contrary to the trial court; (8) when the findings are conclusions without

<sup>34</sup> *Id.* at 271–279.

<sup>35</sup> *Id.* at 279–290.

<sup>36</sup> *Id.* at 290–299.

<sup>37</sup> *Id.* at 300–306.

<sup>38</sup> *Id.* at 306–308.

<sup>39</sup> *Gatan v. Vinarao*, 820 Phil. 257, 265 (2017) [Per J. Leonardo-De Castro, First Division].

<sup>40</sup> *Richardson Steel Corporation v. Union Bank of the Philippines*, G.R. No. 224235, June 28, 2021 [Per J. Delos Santos, Third Division] at 8. This pinpoint citation refers to the copy of the Decision uploaded to the Supreme Court website.

citation of specific evidence on which they are based; (9) when the facts set forth in the petition as well as in the petitioner's main and reply briefs are not disputed by the respondent; (10) when the findings of fact are premised on the supposed absence of evidence and contradicted by the evidence on record; and (11) when the Court of Appeals manifestly overlooked certain relevant facts not disputed by the parties, which, if properly considered, would justify a different conclusion.<sup>41</sup> (Citation omitted)

The rule is settled that findings of the CA are conclusive on the parties and on this Court, and carry even more weight when the appellate court affirms the factual findings of the trial court.<sup>42</sup> The determination of the existence of *pactum commissorium* is a question of fact as it requires the court to look into contractual stipulations, and the intent of the parties.<sup>43</sup> Since Ruby Shelter raises arguments consisting mainly of factual matters, including questions on whether *pactum commissorium* is present, and because the findings of the courts *a quo* are supported by the evidence on record, the Court is not convinced that the instant petition merits exemption from the rule.

Regardless of the procedural defect inherent in this petition, the Court shall proceed to write *finis* on the substantive issues raised by Ruby Shelter.

*The parties agreed to novate the earlier loan agreement which resulted in extinguishing the obligation by way of dacion en pago*

Article 1231 of the Civil Code provides the methods by which all civil obligations may be extinguished.<sup>44</sup> One of these modes is novation, which is defined as the extinguishment of an obligation by the substitution or change of the obligation by a subsequent one which terminates it, either by changing its objects or principal conditions, or by substituting a new debtor in place of the old one, or by subrogating a third person to the rights of the creditor.<sup>45</sup>

<sup>41</sup> *Prudential Bank v. Rapanot*, 803 Phil. 294, 306 (2017) [Per J. Caguioa, First Division].

<sup>42</sup> *Ocampo-Paule v. Court of Appeals*, 426 Phil. 463, 469 (2002) [Per J. Kapunan, First Division]. Citation omitted.

<sup>43</sup> *Aljem's Credit Investors Corp. v. Spouses Bautista*, G.R. No. 215175, April 25, 2022 [Per J. Hernando, Second Division] at 8–9. This pinpoint citation refers to the copy of the Decision uploaded to the Supreme Court website. Citations omitted.

<sup>44</sup> CIVIL CODE, art. 1231. Obligations are extinguished:

- (1) By payment or performance;
- (2) By the loss of the thing due;
- (3) By the condonation or remission of the debt;
- (4) By the confusion or merger of the rights of creditor and debtor;
- (5) By compensation;
- (6) By novation.

Other causes of extinguishment of obligations, such as annulment, rescission, fulfillment of a resolutive condition, and prescription, are governed elsewhere in this Code.

<sup>45</sup> *St. James College of Parañaque v. Equitable PCI Bank*, 641 Phil. 452, 461 (2010) [Per J. Velasco, Jr., First Division]. Citations omitted.

For novation to exist, the following elements must concur: (1) a previous valid obligation; (2) the agreement of all the parties to the new contract; (3) the extinguishment of the old contract; and (4) the validity of the new one. It is essential that there is consent of all the parties to the substitution, resulting in the extinction of the old obligation and the creation of a valid new one.<sup>46</sup>

As to essence, novation is classified as: (a) objective or real, where there is change in the cause, object or principal conditions of the obligation; (b) subjective or personal, where there is a substitution in the person of the debtor or a subrogation of the third person to the rights of the creditor; or (c) mixed, where there is a combination of objective and subjective novation.<sup>47</sup> As to form, novation may be expressed or implied as provided under Article 1292 of the Civil Code. As to extent, novation may be: (a) extinctive or total, where there is absolute extinguishment of the old obligation; or (b) partial or modified, where there is merely a modification of the old obligation.<sup>48</sup>

To gain proper perspective on the challenges raised by Ruby Shelter, We again quote the pertinent portions of the subject MOA:

1. That the FIRST PARTY is indebted to the SECOND PARTY in the aggregate sum of NINETY[-]FIVE MILLION SEVEN HUNDRED THOUSAND SIX HUNDRED TWENTY PESOS [(PHP 95,700,620.00)], Philippine currency, covered by Real Estate Mortgages over five (5) parcels of land enumerated in paragraph 3 hereof[.]

2. That because of the FIRST PARTY's corporate offer to simultaneously execute Deeds of Absolute Sale over the properties as provided for and listed in paragraph 3, hereof, the SECOND PARTY here allows the FIRST PARTY to pay the said indebtedness, on or before [December 31, 2005]. Moreover, the SECOND PARTY hereby agrees to condone and/or write off the interests, penalties and surcharges from October 1, 2004 to December 31, 2005, or a total period of fifteen (15) months, amounting to SEVENTY[-]FOUR MILLION SIX HUNDRED SEVENTY[-]EIGHT THOUSAND SIX HUNDRED FORTY[-]SEVEN PESOS [(PHP 74,678,647.00)].

3. Upon the execution hereof, and, by way of dacion en pago, the FIRST PARTY shall execute deeds of absolute sale to be uniformly dated January 2, 2006, over the following properties in favor of the SECOND PARTY, . . .

....

<sup>46</sup> *Spouses Reyes v. BPI Family Savings Bank, Inc.*, 520 Phil. 801, 807 (2006) [Per J. Corona, Second Division] citing *Garcia v. Court of Appeals*, 269 Phil. 523, 535-536 (1990) [Per J. Cruz, First Division].

<sup>47</sup> *Yujuico v. Far East Bank and Trust Co.*, 838 Phil. 688, 705 (2018) [Per J. Caguioa, Second Division].

<sup>48</sup> *Id.*

4. The FIRST PARTY is here allowed to pay off the indebtedness covered by the Real Estate Mortgage, either by individual lots or the entire five (5) parcels of land as described in the immediately preceding paragraph, provided that the corresponding payment shall consider the earned and accrued interest and penalties, according to the following schedule . . .

5. If and when the FIRST PARTY is able to effect redemption of any of the property listed and enumerated in paragraph 3 hereof, the Deed of Absolute Sale dated [January 2, 2006] for the corresponding parcel of land shall be nullified and will have no force and effect and the SECOND PARTY shall then return the owner's duplicate copy of the certificate of title and shall likewise execute a Deed of Discharge of Mortgage.

6. In the event though that the FIRST PARTY shall not be able to tender any amount for the payment of the indebtedness corresponding to any of the parcel of land, then, the SECOND PARTY is hereby allowed to present the Deeds of Absolute Sale over the properties enumerated in paragraph 3 hereof, for registration with the Office of the Register of Deeds for Naga City so that the corresponding certificates of title in the name of the SECOND PARTY shall then be issued by the said Register of Deeds, after payment of [the] necessary fees and taxes.<sup>49</sup>

The parties disagree on how the MOA novated their previous loan agreement. For Ruby Shelter, the stipulations in the MOA merely changed the terms or mode of payment of the principal obligation; the immediate sale of the mortgaged realty only secured the payment of the principal obligation. On the other hand, Tan and Obiedo believe that there was an extinctive novation, in that Ruby Shelter's debt was extinguished by way of *dacion en pago*.

Both arguments are partially correct. We explain.

The effect of novation may either be partial or total.<sup>50</sup> The distinction between them was well-explained in *Iloilo Traders Finance Inc. v. Heirs of Sps. Soriano*,<sup>51</sup> to wit:

Novation may either be extinctive or modificatory, much being dependent on the nature of the change and the intention of the parties. Extinctive novation is never presumed; there must be an express intention to novate; . . .

An extinctive novation would thus have the twin effects of, *first*, extinguishing an existing obligation and, *second*, creating a new one in its stead. This kind of novation presupposes a confluence of four essential requisites: (1) a previous valid obligation; (2) an agreement of all parties concerned to a new contract; (3) the extinguishment of the old obligation; and (4) the birth of a valid new obligation. *Novation is merely modificatory*

<sup>49</sup> *Rollo*, pp. 344–345.

<sup>50</sup> *Ong v. Bogñalbal*, 533 Phil. 139, 156 (2006) [Per J. Chico-Nazario, First Division].

<sup>51</sup> 452 Phil. 82 (2003) [Per J. Vitug, First Division].

where the change brought about by any subsequent agreement is merely incidental to the main obligation (e.g., a change in interest rates or an extension of time to pay); in this instance, the new agreement will not have the effect of extinguishing the first but would merely supplement it or supplant some but not all of its provisions.<sup>52</sup> (Emphasis supplied, citations omitted)

Thus, for total or extinctive novation to exist, the old obligation must be totally and absolutely extinguished giving birth to a new obligation. Whereas, in partial novation, only the terms and conditions are modified while the main obligation remains in force.<sup>53</sup> Novation is merely modificatory when the old obligation subsists to the extent that it remains compatible with the amendatory agreement.<sup>54</sup> *Yujuico v. Far East Bank and Trust Company*<sup>55</sup> explained that the novation contemplated under Article 1215<sup>56</sup> is that of an extinctive novation,<sup>57</sup> while it also pointed out that an imperfect or modificatory novation is allowed under Article 1291<sup>58</sup> of the Civil Code.<sup>59</sup>

A modification in the principal conditions may include adjustments in the period to comply with the obligation. Such change would only be a partial novation because the period merely affects the performance, not the creation of the obligation.<sup>60</sup> There is also modificatory novation when the parties had a subsequent agreement lowering the monthly rental fee,<sup>61</sup> but if such reduction in the rental is merely temporary, novation does not avail.<sup>62</sup>

Alterations of the terms and conditions of the obligation would generally result only in modificatory novation unless such terms and conditions are considered to be the essence of the obligation itself. Hence, there is modificatory novation when the interest was waived and the principal

<sup>52</sup> *Id.* at 89–90.

<sup>53</sup> *Tomimbang v. Tomimbang*, 612 Phil. 447, 458 (2009) [Per J. Peralta, Third Division].

<sup>54</sup> *Republic Glass Corp. v. Qua*, 479 Phil. 393, 413 (2004) [Per J. Carpio, First Division]. Citations omitted.

<sup>55</sup> 838 Phil. 688 (2018) [Per J. Caguioa, Second Division].

<sup>56</sup> CIVIL CODE, article 1215. Novation, compensation, confusion or remission of the debt, made by any of the solidary creditors or with any of the solidary debtors, shall extinguish the obligation, without prejudice to the provisions of article 1219.

<sup>57</sup> *Yujuico v. Far East Bank and Trust Co.*, 838 Phil. 688, 709–710 (2018) [Per J. Caguioa, Second Division].

<sup>58</sup> CIVIL CODE, article 1291. Obligations may be modified by:

- (1) Changing their object or principal conditions;
- (2) Substituting the person of the debtor;
- (3) Subrogating a third person in the rights of the creditor.

<sup>59</sup> *Yujuico v. Far East Bank and Trust Co.*, 838 Phil. 688, 704 (2018) [Per J. Caguioa, Second Division], citing 4 EDUARDO P. CAGUIOA, COMMENTS AND CASES ON CIVIL LAW, CIVIL CODE OF THE PHILIPPINES, 410 (2<sup>nd</sup> ed., 1983).

<sup>60</sup> *Ong v. Bogñalbal*, 533 Phil. 139, 156–157 [Per J. Chico-Nazario, First Division], citing *Inchausti & Co. v. Yulo*, 34 Phil. 978, 986 (1914) [Per J. Arellano] and *Zapanta v. de Rotaeche*, 21 Phil. 154, 159 (1912) [Per J. Johnson].

<sup>61</sup> See *Spouses Modomo v. Spouses Layug*, 859 Phil. 214, 225 (2019) [Per J. Caguioa, Second Division].

<sup>62</sup> See *Broadway Centrum Condominium, Corp. v. Tropical Hut Food Market*, 296 Phil. 141, 159–162 (1993) [Per J. Feliciano, Third Division].

obligation was made payable in monthly installments because the obligation to pay a sum of money remains in force.<sup>63</sup> The execution of a Partial Compromise Agreement wherein the creditor agreed to suspend all actions accruing to it by virtue of the old obligation, also constitutes a modificatory novation.<sup>64</sup> There is also partial novation when the parties execute a Restructuring Agreement which merely modified certain terms in the previous contract of loan pertaining to waiver of penalties, reduction of interest rates, renewal of payment periods, and fixing of payable principal amounts.<sup>65</sup>

Regardless of whether novation is partial or extinctive, the will to novate must appear by express agreement of the parties, by their acts which are too clear and unequivocal to be mistaken.<sup>66</sup> Renowned civilist Arturo M. Tolentino noted that the sufficiency of the changes in the obligation which may bring about novation, depends upon the facts and circumstances of each case.<sup>67</sup> As such, he reminded the courts to consider not only the nature of the clause that is modified, but also the intention of the parties and the economic significance of the modification.<sup>68</sup>

A scrutiny of the stipulations in the MOA reveals the intention of the parties to modify the previous loan obligation.

The MOA may be condensed into three agreements. *First*, the interests, penalties, and surcharges from October 1, 2004 until December 31, 2005 imposed on Ruby Shelter's original loan are condoned by Tan and Obiedo. *Second*, Ruby Shelter had until December 31, 2005 to pay its remaining obligation either in full, or partially by individual lots based on their stipulated values. *Third*, in case of failure to pay the remaining balance, payment shall be made by selling the mortgaged properties covered by the deeds of absolute sale executed by Ruby Shelter. Evident from these agreements that the MOA contemplates two situations that would result in the extinguishment of Ruby Shelter's debt: (1) payment by Ruby Shelter of the remaining obligation either in full or partially by lots, and (2) sale of the mortgaged properties to Tan and Obiedo.

In the first situation, the MOA could not have completely novated Ruby Shelter's obligation. No new obligation arose from this option considering

<sup>63</sup> See *Swagman Hotels and Travel, Inc. v. Court of Appeals*, 495 Phil. 161, 175 (2005) [Per C.J. Davide, First Division].

<sup>64</sup> See *Adriatico Consortium, Inc. v. Land Bank of the Philippines*, 623 Phil. 1027, 1043 (2009) [Per J. Velasco, Jr., Third Division].

<sup>65</sup> See *Rizal Commercial Banking Corp. v. Plast-Print Industries, Inc.*, 854 Phil. 46, 65 (2019) [Per J. Caguioa, Second Division].

<sup>66</sup> *Broadway Centrum Condominium, Corp. v. Tropical Hut Food Market*, 296 Phil. 141, 157 (1993) [Per J. Feliciano, Third Division].

<sup>67</sup> 4 ARTURO M. TOLENTINO, CIVIL CODE OF THE PHILIPPINES, 389 (1991).

<sup>68</sup> *Id.*

that the agreement consisted only of waiving the interest, penalties, and surcharges that accrued on the principal obligation for 15 months. The parties only agreed to modify the terms and conditions of the original obligation by reducing the amount of the existing debt and fixing the period of its payment. In this regard, Ruby Shelter accurately argued that the MOA merely changed the terms of its obligation, hence, modificatory or partial, instead of a total or extinctive novation.

However, the second situation bears a different outcome. It contemplates a situation where Ruby Shelter fails to pay the modified obligation. In such instance, Tan and Obiedo are now allowed to have the previously executed deeds of absolute sale notarized. Tan and Obiedo perceive this transaction as *dacion en pago*.

The Court agrees.

Among other modes, an obligation is extinguished by payment or performance.<sup>69</sup> There is payment when there is delivery of money or performance of an obligation. Article 1245 of the Civil Code provides for a special mode of payment called dation in payment or *dacion en pago*.<sup>70</sup>

*Dacion en pago* or the delivery and transmission of a thing by the debtor to the creditor is deemed as an accepted equivalent to the performance of the obligation.<sup>71</sup> Dation in payment extinguishes the obligation to the extent of the value of the thing delivered, either as agreed upon by the parties or as may be proved, unless the parties by agreement — express or implied, or by their silence — consider the thing as equivalent to the obligation, in which case the obligation is totally extinguished.<sup>72</sup>

The requisites for a valid *dacion en pago* are: (1) there must be a performance of the prestation in lieu of payment (*animo solvendi*) which may consist in the delivery of a corporeal thing or a real right or a credit against the third person; (2) there must be some difference between the prestation due and that which is given in substitution (*aliud pro alio*); and (3) there must be an agreement between the creditor and debtor that the obligation is immediately extinguished by reason of the performance of a prestation different from that due.<sup>73</sup> *Filinvest Credit Corporation v. Philippine Acetylene*,

<sup>69</sup> *Desiderio Dalisay Investments, Inc. v. Social Security System*, 829 Phil. 341, 356 (2018) [Per J. Velasco, Third Division].

<sup>70</sup> *Id.* at 356–357; *Tan Shuy v. Spouses Maulawin*, 681 Phil. 599, 608 (2012) [Per J. Sereno, Second Division].

<sup>71</sup> *Spouses Hofer v. Yu*, 875 Phil. 878, 895 (2020) [Per J. Carandang, Third Division]; *Philippine National Bank v. Dee*, 727 Phil. 473, 485 (2014) [Per J. Reyes, First Division].

<sup>72</sup> *Spouses Villaluz v. Land Bank of the Philippines*, 803 Phil. 407, 417 (2017) [Per J. Jardeleza, Third Division]; *id.*

<sup>73</sup> *Aquintey v. Spouses Tibong*, 540 Phil. 422, 447 (2006) [Per J. Callejo, Sr., First Division]; *Lo v. KJS Eco-*

*Co., Inc.*<sup>74</sup> also adds that common consent by the parties remains an essential prerequisite.

The Court further explained in *Filinvest Credit* that the modern concept of dation in payment is that of an objective novation where the thing offered by the debtor as payment is the object of the contract of sale, while the debt is treated as the purchase price:

Dacion en pago, according to Manresa, is the transmission of the ownership of a thing by the debtor to the creditor as an accepted equivalent of the performance of an obligation. In dacion en pago, as a special mode of payment, the debtor offers another thing to the creditor who accepts it as equivalent of payment of an outstanding debt. The undertaking really partakes in one sense of the nature of sale, that is, the creditor is really buying the thing or property of the debtor, payment for which is to be charged against the debtor's debt. As such, the essential elements of a contract of sale, namely, consent, object certain, and cause or consideration must be present. In its modern concept, what actually takes place in dacion en pago is an objective novation of the obligation where the thing offered as an accepted equivalent of the performance of an obligation is considered as the object of the contract of sale, while the debt is considered as the purchase price. In any case, common consent is an essential prerequisite, be it sale or novation, to have the effect of totally extinguishing the debt or obligation.<sup>75</sup> (Citations omitted)

Accordingly, Article 1245<sup>76</sup> of the Civil Code expressly provides that dation in payment is governed by the law on sales. In dation in payment, the debtor delivers and transmits to the creditor the former's ownership over a thing as an accepted equivalent of the payment or performance of an outstanding debt.<sup>77</sup>

On the other hand, the law on sales provides that a contract of sale is perfected when the seller obligates himself, for a price certain, to deliver and to transfer ownership of a thing or right to the buyer, over which the latter agrees. From that moment, the parties may demand reciprocal performance.<sup>78</sup>

Here, the sale of the mortgaged lands was deemed perfected. Ruby Shelter, as the vendor, obligated itself to deliver ownership of the mortgaged properties by agreeing to (1) execute deeds of absolute sale on the mortgaged properties, and (2) allowing the notarization of the deeds of absolute sale after

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*Formwork System Phil., Inc.*, 459 Phil. 532, 539 (2003) [Per J. Ynares-Santiago, First Division].

<sup>74</sup> 197 Phil. 394 (1982) [Per J. De Castro, Second Division].

<sup>75</sup> *Id.* at 402-403.

<sup>76</sup> CIVIL CODE, art. 1245. Dation in payment, whereby property is alienated to the creditor in satisfaction of a debt in money, shall be governed by the law of sales.

<sup>77</sup> *Tan Shuy v. Spouses Maulawin*, 681 Phil. 599, 608 (2012) [Per J. Sereno, Second Division]. Citations omitted.

<sup>78</sup> *Starbright Sales Enterprises, Inc. v. Philippine Realty Corp.*, 679 Phil. 330, 335 (2012) [Per J. Abad, Third Division]. Citations omitted.



its failure to satisfy the debt. The delivery and transfer of ownership becomes effective upon failure to satisfy the obligation as it prompts Tan and Obiedo to notarize the deeds of absolute sale. As regards the purchase price, the same was certain since the MOA made express reference to Ruby Shelter's outstanding obligation less interests, penalties, and surcharges. Finally, the consent of both parties was manifest not only from the wording of paragraph 6, but also in voluntarily affixing their signatures on the MOA.

Despite a clear perfected sale of the properties, Ruby Shelter argues in the main that its obligation continued despite the MOA because the deeds of absolute sale only served as security for its loan. It relies on the ruling in *Spouses Ong v. Roban Lending Corporation*<sup>79</sup> and *Rockville Excel International Exim Corporation v. Spouses Culla*<sup>80</sup> where the Court held that the extension provided to the purported vendors to pay the obligation negated the claim of *dacion en pago*.

The argument fails to convince.

*First*, there was nothing from the MOA that carried, either expressly or impliedly, any stipulation that the deeds of absolute sale will be treated as security until Ruby Shelter has the capacity to pay its obligation. As previously discussed, the final intention of the parties was to totally extinguish the obligation by way of *dacion en pago*, hence, the execution of the deeds of absolute sale.

*Second*, Ruby Shelter limited its interpretation of the MOA by focusing only on paragraphs 3 and 6. This restricted construction failed to consider the other stipulations, particularly paragraph 2 from which the succeeding terms originated. It is basic rule in construing a contract or an instrument, that construction must be adopted as will give effect to all.<sup>81</sup> Article 1374 of the Civil Code also instructs that the clauses in the contract cannot be interpreted by parts, but various stipulations must be read together to give effect to the whole.<sup>82</sup>

Accordingly, in construing paragraphs 3 and 6 of the MOA, the other parts of the MOA should also be considered, particularly paragraph 2. Notably, paragraph 2 provided the context which led the parties to enter into a MOA – the offer coming from Ruby Shelter to execute deeds of absolute sale in exchange for (1) a condonation of interests, penalties and surcharges

<sup>79</sup> 579 Phil. 769 (2008) [Per J. Carpio Morales, Second Division].

<sup>80</sup> 617 Phil. 328 (2009) [Per J. Brion, Second Division].

<sup>81</sup> *Rivera v. Espiritu*, 425 Phil. 169, 184 (2002) [Per J. Quisumbing, Second Division].

<sup>82</sup> CIVIL CODE, art. 1374. The various stipulations of a contract shall be interpreted together, attributing to the doubtful ones that sense which may result from all of them taken jointly.

accruing to the obligation from October 1, 2004 to December 31, 2005, and (2) an opportunity to pay the remaining balance until December 31, 2005. Indubitably, Tan and Obiedo would not have agreed to the MOA if not for Ruby Shelter's offer to execute simultaneous deeds of absolute sale.

Furthermore, the said offer may be traced from Board Resolution No. 08, series of 2005 dated February 12, 2005, by the board members of Ruby Shelter. The resolution reads:


BOARD RESOLUTION NO. 08, SERIES OF 2005

Upon motion duly made and seconded, be it resolved as it is hereby resolved to (a) authorize the corporate president, RUBEN SIA, to negotiate with the mortgagees, of the parcels of land hereunder enumerated, ROBERTO L. OBIEDO and ROMEO Y. TAN, for the settlement of the entire corporate indebtedness in the aggregate sum of FIFTY[-]TWO MILLION FIVE HUNDRED THOUSAND PESOS [(PHP 52,500,000.00)], Philippine currency, covered by corresponding Real Estate Mortgages, by *requesting for the condonation of the interests, penalties and surcharges for the period covering October 1, 2004 to December 31, 2005, or a total period of fifteen (15) months;* (b) *sell, transfer, and convey, by way of dacion en pago the properties hereunder listed in favor of the said ROMEO Y. TAN and ROBERTO L. OBIEDO, for the price of [PHP 52,500,000.00];* (c) *enter into a memorandum of agreement with the said mortgagees whereby the Corporation shall be allowed to pay off the entire indebtedness on or before December 31, 2005, either by individual lots or the entire parcels of land put up by way of mortgages as hereunder listed and enumerated, and;* (d) empower the corporate president, RUBEN SIA, to *execute a deed of absolute sale, simultaneously with the execution of a memorandum of agreement over the properties hereunder listed in favor of ROBERTO L. OBIEDO and ROMEO Y. TAN, which shall be dated January 2, 2006, conditioned upon the understanding that should the Corporation be unable to pay off the indebtedness, then the said January 2, 2006 Deeds of Absolute Sale shall forthwith be presented for registration with the Office of the Register of Deeds of Naga City, or, in the alternative, for the Corporation to sell outright the said parcels of land hereunder enumerated for the total purchase price of [PHP 52,500,000.00] immediately and will not wait till after January 1, 2006. The parcels of land involved are the following:*

.....  
Unanimously approved.<sup>83</sup> (Emphasis supplied)

Significantly, the authority given to Sia in the said board resolution was identical to the stipulations contained in the MOA. Hence, Ruby Shelter cannot validly renounce the stipulations contained thereon considering that the same were lifted from the board resolution which vested Sia with the specific authority to act in its behalf and negotiate for better terms to meet its loan obligation.

<sup>83</sup> Rollo, pp. 529-530.



*Third*, the rulings in *Spouses Ong* and *Rockville* cannot be applied herein.

In *Spouses Ong*, the parties executed an Amendment to Amended Real Estate Mortgage consolidating the debtors' loans. On even date, the parties entered a MOA and a Dation in Payment Agreement. Under the MOA, the debtors signed a promissory note indicating their promise to pay their obligation within one year. Should they fail to pay, the Dation in Payment Agreement wherein the debtors assigned their property in favor of the creditor to settle the obligation, will be enforced.<sup>84</sup>

The Court declared in *Spouses Ong* that the MOA and Dation in Payment Agreement are void for being *pactum commissorium*. It noted that both instruments did not contain any provisions for foreclosure proceedings or redemption, and the Dation in Payment Agreement provided for an automatic transfer of ownership of the property upon the debtors' failure to pay the loan. The Court also observed that the purported alienation of property was only meant to secure and not to satisfy the loan.<sup>85</sup>

On the other hand, *Rockville* involved a PHP 2,000,000.00 loan which the debtors had difficulty paying the creditor. The debtors allegedly offered their property as payment, which the creditor accepted for a purchase price of PHP 3,500,000.00. However, only one of the debtor spouses signed the deed of absolute sale which prevented the creditor from transferring and registering the property under its name. This prompted the creditor to file a complaint for specific performance and damages. However, the Court sided with the debtors and declared that the real intention of the parties was to execute an equitable mortgage. It noted that if the parties had truly intended a *dacion en pago*, the creditor would not have granted the debtors' requests for extension to pay the obligation.<sup>86</sup>

Noteworthy in both *Spouses Ong* and *Rockville* that the Court deemed the extension of the period to pay the original obligation negated a *dacion in pago* transaction. This, however, does not obtain in the case at bar. The period to pay until December 31, 2005 that was accorded to Ruby Shelter, did not pertain to its payment of the original obligation. To be clear, the period provided to Ruby Shelter pertained to its payment of the modified obligation, and not the original loan.

Also, contrary to what happened in *Rockville* and as previously explained, the deeds of absolute sale executed by Ruby Shelter did not

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<sup>84</sup> 579 Phil. 769, 777 (2008) [Per J. Carpio Morales, Second Division].

<sup>85</sup> *Id.*

<sup>86</sup> 617 Phil. 328, 335 (2009) [Per J. Brion, Second Division].

constitute as security to pay its loan.

It bears emphasizing that the intention of the parties is the most important decisive factor in the evaluation of agreements. Intent is shown not only by the terminology used in the contracts or agreements but also by the parties' conduct, words, actions, and deeds prior to, during and immediately after executing the agreement.<sup>87</sup>

In here, both the stipulations in the MOA and the circumstances surrounding its execution reveal the true intention of the parties to treat the subject properties as payment for the outstanding obligation instead of a security. As there was delivery and transmission of the properties by Ruby Shelter to Tan and Obiedo who accepted the same as equivalent to the performance of the former's obligation, a *dacion en pago* was validly executed. Hence, Ruby Shelter's obligation is already deemed extinguished.

*The MOA is not void for being pactum commissorium*

Ruby Shelter attributes another error on the part of the CA for its failure to declare the MOA as void for being *pactum commissorium*. Allegedly, the acquisition of ownership of the mortgaged properties by Tan and Obiedo upon failure to pay the loan, is *pactum commissorium* and therefore prohibited and unlawful.

The instant petition does not present a valid case of *pactum commissorium*.

To be sure, not all alienation of properties by the debtor in favor of the creditor in the event of default are void for being *pactum commissorium*. Such view will render inoperable Article 1245 of the Civil Code which allows the parties to enter a dation in payment to extinguish an obligation.

The concept of *pactum commissorium* essentially prohibits the automatic appropriation by the creditor of the subject properties upon default of the debtor.<sup>88</sup> Article 2088 of the Civil Code provides that:

The creditor cannot appropriate the things given by way of pledge or mortgage, or dispose of them. Any stipulation to the contrary is null and void.

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<sup>87</sup> *Rockville Excel International Exim Corp. v. Spouses Culla*, 617 Phil. 328, 335 (2019) [Per J. Brion, Second Division].

<sup>88</sup> *Spouses Solitarios v. Spouses Jaque*, 746 Phil. 852, 877-878 (2014) [Per J. Velasco, Jr., Third Division].

From the foregoing, two elements of *pactum commissorium* are derived, viz.: (1) there should be a property mortgaged by way of security for the payment of the principal obligation, and (2) there should be a stipulation for automatic appropriation by the creditor of the thing mortgaged in case of default or non-payment of the principal obligation within the stipulated period.<sup>89</sup>

In the early case of *Alcantara v. Alinea*,<sup>90</sup> the Court emphasized that the prohibition against *pactum commissorium* contemplates a prior mortgage, pledge, or antichresis. Thus, in *Guerrero v. Yñigo*,<sup>91</sup> the clause in a “mortgage with conditional sale” which provided that the title to the mortgaged property shall pass to the mortgagee after the period of redemption has lapsed, was struck down by the Court as illegal. The provision was construed as giving the mortgagees immediate right to own the property upon default of the mortgagor, therefore, a *pactum commissorium* which is unlawful and void.<sup>92</sup> The same will also be the result where a stipulation in a promissory note conferred ownership of the mortgaged property to the creditor upon default of the debtor.<sup>93</sup>

*Pactum commissorium* condemns the situation where upon failure to pay or to redeem the mortgage, the land automatically passes to the mortgagee.<sup>94</sup> It is a stipulation empowering the creditor to appropriate the thing given as guaranty for the fulfillment of the obligation in the event the obligor fails to live up to his undertakings, without further formality, such as foreclosure proceedings, and a public sale.<sup>95</sup> Even the loss of the right to redeem the property and consequent transfer of ownership to the mortgagee despite a prior judgment that the agreement constitutes an equitable mortgage, would produce the same effect as a *pactum commissorium* – a forfeiture clause which has traditionally been held as contrary to good morals and public policy, and therefore, void.<sup>96</sup> Before perfect title over a mortgaged property may thus be secured by the mortgagee, they must, in case of non-payment of the debt, foreclose the mortgage first and thereafter purchase the mortgaged property at the foreclosure sale.<sup>97</sup>

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<sup>89</sup> *Home Guaranty Corp. v. La Savoie Development Corp.*, 752 Phil. 123, 161 (2015) [Per J. Leonen, Second Division]. Citation omitted.

<sup>90</sup> 8 Phil. 111 (1907) [Per J. Torres].

<sup>91</sup> 96 Phil. 37 (1954) [Per J. Padilla].

<sup>92</sup> *Id.* at 41-42.

<sup>93</sup> *A. Francisco Realty and Development Corp. v. Court of Appeals*, 358 Phil. 833, 847-848 (1998) [Per J. Mendoza, Second Division].

<sup>94</sup> *Lopez Reyes v. Nebrija*, 98 Phil. 639, 640-641 (1956) [Per J. Bautista Angelo]; *Reyes v. Sierra*, 182 Phil. 51, 59 (1979) [Per J. De Castro, First Division].

<sup>95</sup> *Philnico Industrial Corp. v. Privatization and Management Office*, 742 Phil. 49, 76 (2014) [Per J. Leonardo-De Castro, First Division]; *Spouses Martires v. Chua*, 707 Phil. 34, 49 (2013) [Per J. Peralta, Third Division].

<sup>96</sup> *Montevirgen v. Court of Appeals*, 198 Phil. 338, 346 (1982) [Per J. De Castro, First Division].

<sup>97</sup> *Ramirez v. Court of Appeals*, 456 Phil. 345, 353 (2003) [Per J. Carpio Morales, Third Division].

On the other hand, *pactum commissorium* does not exist where the debtor only promised to sell its property not subject to a mortgage in the event of default,<sup>98</sup> or when the earlier agreement was already that of a sale and purchase, and not a mortgage,<sup>99</sup> or the condition in the deed of assignment merely provided for the appointment of the creditor as attorney-in-fact with authority to sell the mortgaged property upon default and to apply the proceeds to the outstanding loan.<sup>100</sup> *Esguerra v. Court of Appeals*<sup>101</sup> made it clear that there is nothing unlawful when the mortgagee only took possession of the chattel for the purpose of foreclosure, either judicially or extrajudicially and thereby, liquidate the indebtedness in accordance with law.<sup>102</sup>

Fittingly, in the 1930 case of *Tan Chun Tic v. West Coast Life Insurance Co.*,<sup>103</sup> the Court determined whether a *pactum commissorium* occurred by distinguishing between an assignment in favor of the creditor covering the mortgaged property, and an agreement to sell the secured property in the event of default.<sup>104</sup>

*Tan Chun Tic* arose from a mortgage contract, the terms of which authorized the mortgagee to take over the mortgaged parcels of land and to dispose them after the obligation matured and remained unsatisfied. The Court illustrated that such assignment is void for being *pactum commissorium*, and is different from an agreement where the debtor sold the secured property to satisfy the unpaid obligation, viz.:

The fundamental difference between the two may be easily understood, and consists in that in one case the mortgagee may take over and dispose of the property mortgaged for the nonpayment of the debt, and in the other, in case of nonpayment, the debtor sells to the creditor the same property mortgaged, for the value of the mortgage.

The doctrines invoked by the plaintiff in support of the judgment appealed from were rendered in cases where the question in dispute was whether a mortgagor could validly sell the thing mortgaged to the mortgagee for the amount of the mortgage, when the latter became due. The most interesting case expounded by Manresa in his commentaries upon article 1872 of the Civil Code, contained the following stipulation: "If upon the lapse of one year from this date, the amount loaned has not been returned, the borrower promises to execute a public deed of sale transferring to the lender the two parcels of land described in numbers 2 and 3, for the price of

<sup>98</sup> *Id.*

<sup>99</sup> *See Sps. Uy Tong v. Court of Appeals*, 244 Phil. 403 (1988) [Per J. Cortes, Third Division].

<sup>100</sup> *See Garcia v. Villar*, 689 Phil. 363, 374 (2012) [Per J. Leonardo-De Castro, First Division]; *Development Bank of the Philippines v. Court of Appeals*, 348 Phil. 15, 30-31 (1998) [Per J. Davide, Jr., First Division].

<sup>101</sup> 255 Phil. 1 (1989) [Per J. Bidin, Third Division].

<sup>102</sup> *Id.* at 9-10.

<sup>103</sup> 54 Phil. 361 (1930) [Per J. Villamor].

<sup>104</sup> *Id.* at 368-370.

4,000 pesetas; and in case of the non-fulfillment of this obligation, the parties may be compelled to do so by the courts.”

The board of registration in its resolution dated November 16, 1902, held that such an instrument, (containing the stipulation quoted) can be registered, holding, among other grounds for such a resolution, that “what the law forbids is the appropriation or disposition of the mortgaged property by the mortgagee, and that if the debtor may legally sell to his creditor the mortgaged property for such price and subject to such conditions as he may deem fit, which had never been doubted, there is no reason whatsoever why he should not be able in like manner to make a promise to sell.”

And Manresa concludes: “That is to say, that *if said parties agree in the mortgage deed upon the sale, or mere promise to sell, of the property mortgaged to the creditor, should the obligation secured by it not be complied with in time, stipulating the conditions of the alienation, the latter may be effectuated without any juridical objection upon the mere default in the payment, without the necessity of a prior auction sale, or any other requisite or formality; but, if instead of agreeing upon the alienation the agreement merely states that upon non-fulfillment of the obligation secured by the mortgage, the mortgagee may, when the mortgage falls due, sell the encumbered property, then the provisions of the law for the sale of the thing pledged, as given in the article under consideration, must be observed.*”

But the doctrines which recognize the right of owners of mortgaged property to transmit freely the ownership thereof to the mortgagee in payment of his credit, are not applicable to the case at bar, where the additional stipulation in question is entirely different from that which the judge took into consideration as the ground of the judgment appealed from. This being so, it is held that the court below erred in upholding the validity of the additional stipulation in question, and in ordering the cancellation of the annotation of the preliminary attachment upon said lots in favor of the defendant West Coast Life Insurance Company.

It is true that by Exhibit B, Genoveva Gamboa de Jayme assigned her rights and actions to the plaintiff Tan Chun Tic, but such an assignment does not extend to the ownership of the mortgaged property, for, the additional stipulation in question, being void, the assignor could not have appropriated said property to herself. And as it is evident that the assignee Tan Chun Chic could not have acquired more rights to the mortgaged property than his assignor Genoveva Gamboa de Jayme had, it follows that neither could he have acquired the ownership of said lots, and hence, he had no right to ask for the cancellation of the annotation of the preliminary attachment levied thereon.<sup>105</sup> (Emphasis supplied)

Verily, *pactum commissorium* does not extend to a mutual agreement between the debtor and the creditor that the property subject of the mortgage is sold to the latter to extinguish the obligation. When the parties entered into a separate Deed of Absolute Sale, it proves that there was no automatic transfer of ownership, and therefore, no *pactum commissorium*.<sup>106</sup>

<sup>105</sup> *Id.* at 368–370.

<sup>106</sup> *Solidstate Multi-Products Corporation v. Spouses Villaverde*, 581 Phil. 179, 187 (2008) [Per J. Tinga,

It must be emphasized that the evil that is sought to be avoided in a *pactum commissorium* is not the alienation of the mortgaged properties to the creditor upon default of the debtor *per se*. *Pactum commissorium* is a stipulation for automatic vesting of title over the security in the creditor in case of the debtor's default.<sup>107</sup> The prohibition is intended to protect the obligor, pledgor, or mortgagor against being overreached by their creditor who holds a pledge or mortgage over property whose value is much more than the debt.<sup>108</sup> It includes a situation where the deed of sale with *pacto de retro* allowed the conveyance of ownership of the mortgaged property without the necessity of drawing another deed of absolute sale.<sup>109</sup> Clearly, what is being prevented, is the unilateral and instant arrogation by the creditor of ownership over the mortgaged property, to the prejudice of the debtor's interest who may have only consented to an assignment of rights, and without releasing the property from the mortgage contract.

Here, the ownership of the properties which initially secured Ruby Shelter's obligation were not instantly transferred in favor of Tan and Obiedo upon its default. Ruby Shelter, through its own offer, voluntarily executed a deed of absolute sale as dation in payment which could not have given rise to a *pactum commissorium*. Tan and Obiedo did not instantly acquire ownership over the mortgaged properties, as the parties had agreed to free them from the mortgage by executing a deed of absolute sale as dation in payment.

Prescinding from the above discussion, the Court fails to find error on the part of the CA in holding that the premise for the application of *pactum commissorium* is not present in this case. The CA correctly opined that the prohibition on *pactum commissorium* is primarily designed to protect the persons who, out of dire circumstances, are compelled to part with their properties. Aside from the fact that it voluntarily offered the sale of the subject properties, Ruby Shelter and Sia, as its president, cannot be considered hapless and powerless borrowers, which the law seeks to protect.<sup>110</sup> There was no evidence presented to prove that Ruby Shelter was at a disadvantage, and did not deal with Tan and Obiedo on equal footing.

Finally, Ruby Shelter cannot deny the eventuality of transferring ownership over the subject lands as a means to satisfy its debt. The Court is inclined to believe the allegation of Tan and Obiedo that Ruby Shelter resorted to veiled attempts to prevent notarization of the deeds of absolute sale by challenging the interest imposed on its obligation. Although Ruby Shelter made manifestations that it was interested in paying its debt, Tan and Obiedo

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Second Division].

<sup>107</sup> *Vda. de Zulueta v. Octaviano*, 206 Phil. 247, 258 (1983) [Per J. Melencio-Herrera, First Division].

<sup>108</sup> *Yau Chu v. Court of Appeals*, 258 Phil. 591, 594 (1989) [Per J. Griño-Aquino, First Division].

<sup>109</sup> *See Lumayag v. Heirs of Nemeño*, 553 Phil. 293, 306 (2007) [Per J. Garcia, First Division].

<sup>110</sup> *Rollo*, pp. 203-204.



accurately observed that it did not make any overt act of offering any amount to cover its obligation, whether fully or even partially. Based on Tan and Obiedo's recollection of the meetings requested by Ruby Shelter, the latter – through Sia – repeatedly failed to present its own computation to clearly make known to Tan and Obiedo its “concerns” on Tan and Obiedo's assessment of the appurtenant interests and penalties. This conduct of Ruby Shelter negates any allegation of interest in satisfying its debt, and only proved that it was aware of the consequences of its offer of selling the subject properties to extinguish its obligation.

It also does not escape the attention of the Court that while Ruby Shelter claimed that Tan et al. had fraudulently notarized the deeds of absolute sale, it failed to present proof of such allegation. On the other hand, Tan et al. were able to explain that Sia was present when the deeds were notarized. They also narrated that before notarizing the instrument, Atty. Reyes personally ascertained Sia's knowledge and voluntariness in signing the said documents. In *Sia v. Atty. Reyes*,<sup>111</sup> a disbarment case filed by Sia involving the alleged spurious notarization of the deeds of absolute sale, the Court noted that he admitted his physical presence before Atty. Reyes on January 3, 2006. Indubitably, the apparent knowledge and consent of Ruby Shelter regarding the appropriation of the mortgaged property in favor of Tan and Obiedo to satisfy its obligation, are antithetical to its claim of *pactum commissorium*.

#### *Propriety of liquidated damages*

Finally, petitioner Ruby Shelter questions the imposition of liquidated damages in the amount of PHP 10,000,000.00 under paragraph 7 of the MOA for being unconscionable. The amount in effect, deprives Ruby Shelter of its right to seek remedy before the courts.

The Court is not moved by the argument.

Under Article 2226 of the Civil Code, liquidated damages are those agreed upon by the parties to a contract, to be paid in case of breach thereof. Essentially, liquidated damages are attached to an obligation to strengthen the coercive force of the obligation by the threat of greater responsibility in the event of breach.<sup>112</sup>

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<sup>111</sup> 852 Phil. 676 (2019) [Per J. Del Castillo, First Division].

<sup>112</sup> *Atlantic Erectors, Inc. v. Court of Appeals*, 697 Phil. 342, 352 (2012) [Per J. Peralta, Third Division]. Citation omitted.

However, the courts are empowered to reduce liquidated damages, where intended as an indemnity or a penalty, if they are iniquitous or unconscionable.<sup>113</sup> *Ligutan v. Court of Appeals*<sup>114</sup> explained that determination of whether a penalty is reasonable or iniquitous would depend on factors such as the type, extent, and purpose of the penalty, the nature of the obligation, the mode of breach and its consequences, the supervening realities, relationship of the parties, among others, all of which are addressed to the sound discretion of the court.<sup>115</sup>

Thus, in equitably reducing the liquidated damages in *Urban Consolidated Constructors Phil., Inc. v. Insular Life Assurance Co., Inc.*,<sup>116</sup> the Court did not only consider the iniquity of the penalty imposed, but also took note the substantial performance by the contractor, as well as the principal's failure to timely pay the former based on their agreement.<sup>117</sup> Hence, when the other party was also at fault, the liquidated damages may be reduced to an amount deemed adequate for the purpose intended.<sup>118</sup>

Reduction of the liquidated damages may also avail if the debt by itself, is already staggering, that in imposing an additional interest thereon would be cumbersome to the debtor.<sup>119</sup> The Court may also consider the financial difficulties experienced by the debtor which prevented it from fulfilling its obligations, coupled with the creditor's delay in complying with its reciprocal obligation.<sup>120</sup>

The above circumstances do not avail in the case at bar.

The liquidated damages awarded to Tan and Obiedo are not iniquitous and unconscionable, considering that under paragraph 7, it already includes attorney's fees and costs. The amount is also almost equal to 10% of Ruby Shelter's outstanding obligation as of March 2005, which it failed to pay despite negotiating for the condonation of interests. Moreover, the amount that Ruby Shelter was ordered to pay, was only fixed at PHP 10,000,000.00 despite

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<sup>113</sup> CIVIL CODE, art. 2227.

<sup>114</sup> 427 Phil. 42 (2005) [Per J. Vitug, Third Division].

<sup>115</sup> *Id.* at 52.

<sup>116</sup> 614 Phil. 95 (2009) [Per J. Ynares-Santiago, Third Division].

<sup>117</sup> See also *Ka Kuen Chua v. Colorite Marketing Corp.*, 813 Phil. 73 (2017) [Per J. Reyes, Third Division].

<sup>118</sup> See *Sy v. Court of Appeals*, 209 Phil. 151, 154 (1983) [Per J. Melencio-Herrera, First Division].

<sup>119</sup> See *Virata v. Ng Wee*, 813 Phil. 252, 352 (2017) [Per J. Velasco, Jr., Third Division]; *Ka Kuen Chua v. Colorite Marketing Corp.*, 813 Phil. 73, 120–121 (2017) [Per J. Reyes, Third Division].

<sup>120</sup> See *Vil-Rey Planners and Builders v. Lexber, Inc.*, 787 Phil. 199, 218 (2016) [Per C.J. Sereno, First Division].

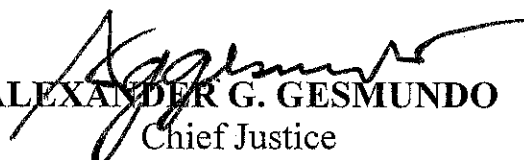
the wording of paragraph 7<sup>121</sup> that it may also be liable to pay the condoned interests, penalties, and surcharges in the amount of PHP 55,167,000.00 if it contests the deeds of absolute sale. Ruby Shelter cannot likewise question the reasonability of the said amount since it had freely agreed to the same when it executed the MOA. There is no indication from the parties' averments and the available evidence, that it was forced to agree to this amount.

The Court also finds that Ruby Shelter shrewdly resorted to delaying tactics and even deceitful conduct in preventing the consummation of its valid agreement with Tan and Obiedo. Notable likewise that Ruby Shelter had earlier caused delay in the proceedings of this case by questioning the order of the RTC to pay additional docket fees.<sup>122</sup> The Court also took into consideration that Sia, as president of Ruby Shelter, had frivolously filed a disbarment case against respondent Atty. Reyes involving the subject deeds of sale. For these reasons, Ruby Shelter does not deserve to be exonerated from paying liquidated damages even at a reduced sum.

Finally, in view of our ruling in *Nacar v. Gallery Frames*,<sup>123</sup> the said damages shall earn interest of 6% per annum from finality of this Decision, until fully paid.

**ACCORDINGLY**, the Petition is **DENIED**. The February 18, 2015 Amended Decision of the Court of Appeals in CA-G.R. CV No. 101180 is **AFFIRMED WITH MODIFICATION**. Ruby Shelter Builders and Realty Development Corporation, is **ORDERED** to **PAY** liquidated damages in the amount of PHP 10,000,000.00 with 6% interest per annum from the date of finality of this Decision until its full satisfaction.

**SO ORDERED.**

  
ALEXANDER G. GESMUNDO  
Chief Justice

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<sup>121</sup> Paragraph 7 states:

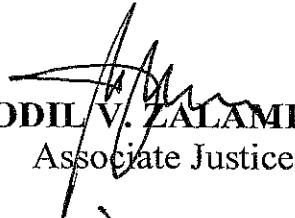
"7. The parties hereby agree, if only to finally settle everything, to faithfully comply with and abide by their respective covenants; provided that if the FIRST PARTY shall contest, judicially or otherwise, any act, transaction, or event, related to or necessarily connected with this memorandum of agreement as well as the Deeds of Absolute Sale over the properties listed in paragraph 3 hereof, it hereby undertakes to indemnify the SECOND PARTY the amount of not less than TEN MILLION [(PHP 10,000,000.00)], Philippine currency, as liquidated damages, inclusive of costs and attorney's fees; provided still further that in the event that the FIRST PARTY shall contest the transaction, it shall obligate itself to pay off the condoned interests, surcharges and penalties in the amount of [PHP 55,167,000.00] . . . (Rollo, p. 346)


<sup>122</sup> See *Ruby Shelter Builders and Realty Development Corporation v. Formaran III*, 598 Phil. 105, 130 (2009) [Per Chico-Nazario, Third Division].

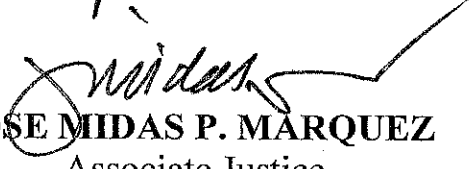
<sup>123</sup> 716 Phil. 267 (2013) [Per J. Peralta, *En Banc*].

**WE CONCUR:**

  
**RAMON PAUL L. HERNANDO**  
Associate Justice

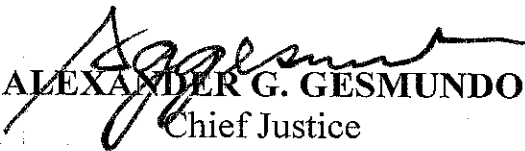
  
**RODIL V. ZALAMEDA**  
Associate Justice

  
**RICARDO R. ROSARIO**  
Associate Justice

  
**JOSE MIDAS P. MARQUEZ**  
Associate Justice

**CERTIFICATION**

Pursuant to Article VIII, Section 13 of the Constitution, 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.

  
**ALEXANDER G. GESMUNDO**  
Chief Justice