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A CRITICAL STUDY OF THE USURY LAW (ACT 2655)

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PREFATORY NOTE

About a year ago when the writer of this monograph first thought of making a critical study of the Usury Law, he was entirely unaware of the hard task that he would have before him. The all-powerful influence of the Usury Law on our economic life, as well as the increasing attention devoted to it by our government officials day by day, confirm the author's belief that the limited time at his command coupled with his still more limited knowledge and experience will make it impossible for him to do justice to the magnitude of the subject and the exigencies of existing conditions.

The fact that there has not been published so far an analytic study of a law of this kind in the Philippines prompted the writing of this thesis. The author has several objects in view:—First of all, it is his intention to show the rôle which a law of this kind has been playing from the dawn of legal history up to the present time. Second, to give the reader a view of the subject more comprehensive than that which could be gathered from a mere reading of the provisions of the law itself, by citing the opinion of the most important authorities on the subject in the plainest words and in a most convenient manner. Third, to express the varied means known to the author by which the provisions of the law are evaded. And, last, but not least, to help untie the Gordian-knot which oppresses the poor in their dealings with the wealthy class, by proposing a remedy which may help to bring about the total suppression of usury.

The materials found in this work are a conglomeration of the existing law on the subject, of the miscellaneous provisions regarding interest found in the Civil Code and the Code of Commerce, of the decisions of our Supreme Court and of the opinion of American authorities on the matter fortified by leading cases, and added to all these, as a supplement, is the humble opinion of the author himself.

PART I

CHAPTER I

HISTORY

Antiquity. The writer is of the opinion that at least a very brief history of the law on the subject is necessary in order to trace from the past the roots of the present ideas about usury. It should be understood that in early times, there was no distinction between "interest" and "usury." The taking of interest was considered usury; it was looked upon with great disfavor, regarded with abhorrence, and severely punished. The church uttered its anathema against those who took interest, whether great or small, in amount. Such kind of usury was prohibited by the primitive laws of the Chinese, the Hindus, and also by the Koran. The Mosaic Laws forbade the Jews from exacting interest upon loans to brethren but permitted it as to loans made to aliens. Moses said: "Thou shalt not lend upon usury to thy brethren; usury of money, of victuals, usury of anything lent upon usury. Unto a stranger, thou mayest lend upon usury, but unto thy brother, thou shalt not lend upon usury." The Athenians allowed moderate charges of interest; custom fixing the maximum rate of 12%.

The Romans were also allowed to take reasonable rate of interest, the current rate being about 8⅓%.

During those early times, it was difficult to find profitable investments for money, so the lending thereof was considered an act of charity. However, in the course of time, the idea that "money is barren" passed away and the increasing profit that may be derived from the use of money gradually gave rise to the universal belief that the taking of a reasonable rate of interest is justifiable before the law and consistent with the precepts of morality.

In Spain. Very little is known about the usury law of Spain. It seems that the Spanish Legislature paid a little attention to this question. It is known, however, that on or about the middle of the 13th century, king Alfonso X allowed interest as high as 25% to be charged in Castile; while in Aragon, the rate was lower, being 20% at first and later 12%. Webb, a famous commentator on the law of usury, classifies the Spanish Law on the subject into two kinds: legal rate which is applicable to contracts in case the parties have not agreed upon a fixed rate, and the conventional or customary rate which is the one sanctioned by custom in a given place at a given time. It is to be noted that the same classification may be applied to our present usury law. In Spain, as in England, all restrictions upon interest charges were removed about 1850. The history of usury from 1850 will find its place under the next heading.

In America. The underlying principles of the early colonial usury acts of the United States were borrowed from England, which in turn borrowed hers from the

more ancient and learned nations. To some extent, the exact laws which have been long experimented on and tested in England found a place in the statute of some of the states. The first enactment made all usurious contracts wholly void, as in England; but the repeated assaults made upon these early enactments by additional statutes and by the decisions of courts gave rise to the present tendency of mitigating the punishment inflicted upon the usurer. The usury laws of the United States at present are much more liberal than those of England. In most of the American states, the statute only allows the forfeiture of the interest, either wholly or as to the illegal excess.

In the Philippines. The history of the usury law in the Philippines does not, strictly speaking, go back very far into the past. Before the arrival of the Spaniards, Filipino customs and traditions, as recorded in our history, are silent about usury. Neither the conquest of the Philippines by Spain nor the subsequent introduction of Spanish laws into our country had led to the introduction into our legal system of any principles of usury as they are now generally accepted. This fact is easily explained; as Spain herself paid very little attention to this matter, she could not be expected to introduce into the Philippines what she hardly had. It is true that the Spanish Code of Commerce and the Civil Code now in force here touch incidentally upon the subject of interest; but it should be understood that "interest" and "usury", are by no means synonimous as will be explained later. In truth and in fact, therefore, the history of the usury law in this country dates back only from the passage of the usury act for the Department of Mindanao and Sulu, Mountain Province' and the provinces of Agusan and Nueva Vizcaya which took place on August 19, 1907. It was followed by Act 2655 entitled "An Act Fixing Rates of Interest Upon Loans and Declaring the effect of receiving usurious rates, and for other purposes." This act which has been in force from May 1st, 1916, is the central theme of this treatise. The drafters of the Philippine usury law are unanimous in their opinion that usury is a social cancer, the prejudicial effect of which are felt in our industrial, commercial and agricultural life.

After reading the legislative records the writer has arrived at the conclusion that our usury law is one of the most complete and most elaborate of all the laws of its kind; it is American in essence and in spirit but changed in such a way as to suit Philippine local conditions. As it was originally drafted by the Philippine Commission the first bill contained fewer sections than the present usury law and hence embraced a much more limited field. The fact is shown by the explanatory statement to the law found in the legislative records which runs as follows: "considering the brevity of the original bill, many cases which should be covered would have escaped, and for this reason we submit the substitute bill (referring to Act 2655 as it is) intended to cover all." The modifications which the first bill has suffered will be mentioned in connection with the discussion of each section of the law.

CHAPTER II

ECONOMIC BASIS OF THE LAW

The history of the usury law has given birth to two antagonistic views regarding its workings:—one maintaining that usury laws are arbitrary and unwise, the other advocating the justice and the necessity of the law.

Those who maintain that usury laws are arbitrary and unwise allege the following grounds in support of their contention:

(1) It is a natural law that all abundant things in this world are cheap and all rare things, dear. Since capital is subject to the economic law of supply and demand as all other commodities are, it is therefore apparent that interest must necessarily vary from time to time, thereby making it impossible for human laws to suit themselves to changing conditions.

(2) To limit the rate of interest, one should be acquainted first with the normal rate, but the normal rate depends upon the uniformity of the economic conditions in a country, which conditions are very hard if not impossible to determine; hence, it follows that any fixed law regulating interest, is arbitrary.

(3) One borrows money for two reasons: (*a*) to pay for the use of money borrowed, (*b*) to get profit for himself. Consequently, the fact that the debtor agrees to pay a high rate of interest simply shows that the services rendered him by the capital are not dear as compared with the benefits received.

(4) It may be true that abuses incident to the loan of money are inevitable, but the use of money is very common while abuses are rare.

(5) Since the element of risk is present in all kinds of transactions, hence, the taking of high rate of interest is justified.

(6) The existence of a law fixing the rate of interest which may be paid by borrowers induce the lenders to charge a higher rate in order to compensate the penalty which may be imposed upon them.

(7) The last result is the enhancement of the difficulty of obtaining loans from capitalists who would not be willing to lend their money at low rates.

On the other hand, those who advocate and maintain the justice of the laws allege the following grounds in support of their argument:—

(1) Although the rate of interest depends upon the amount of capital available and although the latter in turn is dependent upon the law of supply and demand, yet, it cannot be doubted that lawmakers are usually possessed of enough foresight and wisdom to fix such a rate of interest as is best suited to the existing conditions in a country at a given time—rates which may be altered from time to time as circumstances vary.

(2) The agreement on the part of the borrower to pay a high rate of interest does not necessarily show that the debtor is benefitted, for an urgent need may compel the needy to borrow money at the highest rate of interest; hence, it is in cases of this nature that the law must step in to protect the oppressed.

(3) Even admitting that abuses in connection with the loan of money are rare, yet it cannot be denied that a law regulating interest will surely diminish, if not totally exterminate the existing abuses.

(4) It cannot be questioned that the element of risk is present in all kinds of transaction. It is likewise true that risks differ in different transactions; hence, the necessity for the law fixing the compensation for the use of money in proportion to the degree of risk or danger to which it is subjected.

(5) The idea that the existence of a usury law induces lenders to charge greater interest because of fear of the law is true to a certain extent only; these violators of the law will sooner or later be discovered and punished accordingly.

(6) It is further contended that usury law makes it more difficult to obtain loans; because the capitalists will not always be willing to loan money at no lucrative interest. This argument can be answered by saying that it is a poor economic policy to keep surplus capital stagnant rather than to make it earn something.

To tell definitely which of the two antagonistic views as above set forth, is correct, is difficult; but the weight of authority seems to be inclined towards the idea that justice and equity demand a law regulating interest charges.

The writer is of the opinion that however urgent the economic reasons necessitating the non-regulation of the rate of interest may be, they must yield to public necessity. The interests of the people demand laws which will safeguard the rights of the poor and put a stop to certain abuses to which the needy are constantly subjected.

CHAPTER III

DEFINITIONS

After consulting the various treatises defining each and every one of the following terms, the writer has come to the conclusion that those which are hereinbelow given are the best for the purposes of this thesis. Hence, whenever the terms given below appear in the subsequent pages they should be accorded the meaning herein given them:

"Usury or unlawful interest is the reserving and taking, or contracting to reserve and take, either directly or by indirection, a greater sum for the use of money than the lawful interest." (Rosenstein *v.* Fox, 150 N. Y. 354.)

"Interest is the compensation allowed by law, or fixed by the parties, for the use or forbearance of money, or as damages for its detention." (Brown *v.* Hiatt, 15 Wall. 177.)

"Conventional interest is interest at the rate agreed upon and fixed by the parties themselves, as distinguished from that which the law would prescribe in the absence of an explicit agreement." (Fowler *v.* Smith, 2 Cal. 568.)

"Legal interest is that rate of interest prescribed by the laws of the particular state or country as the highest which may be lawfully contracted for or exacted, and which must be paid in all cases where the law allows interest without the assent of the debtor." (Fowslee *v.* Durkee, 12 Wis. 485.)

"Lawful interest." The term "lawful interest" as distinguished from "legal interest" means any rate of interest charges up to that fixed by

law as the maximum rate at which interest can be contracted for. Where, however, there is no stipulation as to a named rate, the term "lawful interest" is synonimous with "legal interest." (Daniel *v.* Gibson, 72 Ga. 267.)

"Moratory interest" or interest by way of damages is interest allowed in actions for breach of contract or tort as damages for the unlawful detention of money found to be due. (Close *v.* Riddle, 40 Ore. 592.)

"Simple interest" is that which is paid for the principal or sum lent, at a certain rate or allowance, made by law or agreement of parties. (Black's Law Dictionary, p. 647.)

"Compound interest" is interest upon interest, where accrued interest is added to the principal sum, and the whole treated as a new principal, for the calculation of the interest for the next period. (Black's Law Dictionary, p. 647.)

CHAPTER IV

ESSENTIAL ELEMENTS OF USURY

All authorities are agreed that certain indispensable elements must be present in order that a contract or transaction may be considered as one tainted with usury. These elements are the following:—

(1) *A loan or forbearance of money, either express or implied, is needed.* If there be a loan, however disguised, the contract will be usurious, if it be so in other respects. Loan and forbearance are correlative terms. Loan or debt is indispensable in order to prove usury, for a usurious transaction cannot be established unless a loan of money or its equivalent was contemplated by the parties. (Goodrich *v.* Rogers, 101 Ill. 523.) To forbear is to allow one to retain a loan of money after it has become due and payable; that is, to give an extention of time for the return of money after the date in which it became due is over. (Kendigg *v.* Linn, 47 Iowa 62.)

(2) *There must be an agreement that the principal shall be or may be returned and this agreement must be absolute;* for if the return of the principal with interest, or of the principal only, depend upon a contingency, there can be no usury. The payment of interest may not be certain and this fact will not affect the contract unless the rate of interest contracted for is unlawful. In the latter case, the contract will be considered usurious. (Dowdall *v.* Lenox, 2 Edw. Ch. 266.) But if a loan is made for an indefinite period, the mere fact that the compensation agreed to be paid for the use of money exceeded the lawful rate of interest, does not make the contract usurious. (City of Phil. *v.* Kelly, 166 Pa. St. 207.) The lender is not at liberty to stipulate even for a contingent benefit beyond the lawful rate of interest, if according to the terms of the agreement he is entitled to the return of the principal with the lawful interest, at all events. (Buttrick *v.* Harris, 1 Bus. 442.)

(3) *Agreement to pay more than lawful interest is necessary.* Generally, an agreement to pay excessive interest or reservation of same are essential to constitute usury; and this agreement must be so far completed as to become obligatory upon the parties. In civil cases, no actual payment of usurious interest is needed in order to avoid a contract. "In determining whether usury exists in a particular case, the proper inquiry is not necessary whether the borrower is to pay for the use or forbearance, but what is the lender to receive for the loan or forbearance of his money." (Webb on Usury, r 30.)

The test of usury in a contract is whether it would, if performed, result in obtaining a higher rate of interest on the subject matter than is sanctioned by law. (Smith *v.* Parsons, 55 Minn. 520.) But the payment of a premium, less in amount than the lawful interest, in consideration of a loan is not usurious. (Oyster *v.* Longnecker, 16 Pa. St. 269.)

(4) *The intent to violate the law must be apparent;* such evil intent may be implied if all the other elements are expressed on the face of the contract. Another way of determining unlawful intent, is by examining the surrounding circumstances and the subsequent acts of the parties; such as the situation and object of the parties at the time when the loan took place, the nature of the funds, the use to which such funds are to be devoted, and the place and manner of repaying same. "To constitute usury within the prohibition of the law, there must be an intention knowingly to contract for or take usurious interest, for if neither party intend it, but act bona fide and innocently, the law will not infer a corrupt agreement. Where, indeed, the contract is, upon its very face, imports usury, as by an express reservation of more than legal interest, there is no room for presumption, for the intent is apparent, *res ipsa loquitur*. But where the contract on its face is for legal interest only, then it must be proved, that there was some corrupt agreement, or device, or shift to cover usury; and that it was in full contemplation of the parties." (U. S. Bank *v.* Waggener, 9 Pet. 378.)

Mistakes of law. The weight of authority seems to be that once the existence of the agreement to pay usurious interest is proven, it is unnecessary to prove further an actual intention to violate the law. "The nature and terms of the contract determine its character and purpose; and if usurious in itself, it must be understood to have been so intended by the parties, and they cannot be heard to the contrary." (Burwell *v.* Burzwyn, 100 N. C. 389.)

Mistakes of fact. An actual receipt of an amount more than that allowed by law as interest, is not necessary to brand a contract with usury. "The true test depends upon whether there was a purpose in the mind of the lender to take more than the lawful interest; and whether, by the terms of the transaction, and the means used to effect the loan, he may, by its enforcement, be able to get more than the lawful rates. If so, the transaction is usurious." (Miller *v.* Life Ins. Co., 118 N. C. 612.)

(5) It is to be noted that all the essential elements enumerated above are only applicable to civil cases. In order to sustain a criminal prosecution for the crime of usury, one more essential element must be present, that is, the *actual receipt* of the unlawful interest.

PART II

ACT 2655

AN ACT FIXING RATES OF INTEREST UPON LOANS AND DECLARING THE EFFECT OF RECEIVING OR TAKING USURIOUS RATES, AND FOR OTHER PURPOSES.

SEC. I. 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 SIX PER CENTUM PER ANNUM

Rate of interest as to loan or forbearance in the absence of express contract. If at the time of an agreement for a loan nothing is said as to the rate of interest, the law assumes it to be that fixed by the statute. (Guggenheiner *v.* Geiszler, 31 N. Y. 293.)

An unqualified agreement to pay interest generally, means the payment of the legal rate of interest (Archibald *v.* Thomas, 3 Conn. 284.) It should be noted that the two cases above cited refer only to contracts specifying the payment of interest but which do not state the rates. There are cases, however, which support the theory that where there is a contract, express or implied, to pay money, even though such contract is silent as to interest, yet interest will be allowed upon its breach in the way of damages. Interest in such cases is clearly the measure of damages, and this measure is a fixed and invariable one, not subject to be varied because of peculiar or unusual damages sustained in any particular case, as the law contemplates no damages beyond the interest on such money. (Place *v.* Dodge, 54 Ill. App. 167.)

However, before damages will be allowed for breach of a contract for the payment of money, there must first be a default in the payment of the principal debt. Interest will only be allowed from the date of such default. (Rogers *v.* Yarnell, 51 Ark. 198.) In many cases before interest can be allowed as damages for default in the payment of debt, a demand is a prerequisite to fix the default. (State *v.* Milwaukee, 158 Wis. 564.) But where a person wrongfully detains money, no demand is necessary to charge him with interest. (Cooper *v.* Coates, 21 Wall. 105.)

Where money has been paid by mutual mistake of fact and no fraud can be imputed to the party receiving the same, interest will not be allowed except from the time when the mistake was discovered and demand made. (Northrop *v.* Graves, 19 Conn. 548.) A party cannot be in default in the payment of a debt until the amount thereof has been ascertained, or unless it is capable of ascertainment. And not only that; there must also be certainty as to the time of payment, before there can be default in payment, for which interest as damages will be allowed. (Still *v.* Hall, 20 Wend. 51.) Although there is no fixed time for the payment of a debt, if it appears to be payable within a reasonable time and there is unreasonable and vexatious delay in the payment of the same, interest will be allowed for such delay. In order to bring a case within this rule, there must be more than a mere delay in the payment: the debtor must have put some obstacles in the way of the collection, or must have induced the creditor to delay collection by some contrivance or circumvention as shown by the circumstances of each case. (Young *v.* Godle, 15 Wall. 562; Hitt *v.* Allen, 13 Ill. 592.)

Where the amount of the demand is sufficiently certain to warrant the allowance of interest thereon, the existence of a set-off or counterclaim which is unliquidated, will not bar the recovery of interest on the balance of the debt found due and payable. (Healy *v.* Fallon, 69 Conn. 228.) However, it is often held that where the amount of the demand is disputed in good faith on reasonable grounds, or when the right for its recovery is, in good faith, denied, interest will not be allowed until after its final determination by judgment or otherwise. (Isaac Newton Fed. Cas. No. 7090.)

According to one line of decisions, the conventional rate of interest will continue after maturity, as before, in the absence of any stipulation of the parties. (Thomp-

son *v.* Gerner, 104 Cal. 168.) On the other hand, the courts in a number of states have held that under such circumstances, the legal rate of interest and not the conventional rate will be allowed after maturity. (Brewster *v.* Wakefield, 22 Haw. 118.) There is much soundness in the theory that where the contract is silent as to the rate of interest after maturity, the legal rate should be allowed. Those who maintain the opposite view hold it to be a presumption of the parties that the rate stipulated before should continue after maturity; but this is opposed to the rule that after a failure to pay, the interest that is given is not founded on contract, but is in the nature of damages. (6 Am. Dec. 191.)

The writer is of the opinion, however, that the first view should be followed as being more consistent with the provision of our Civil Code, and with practice and custom.

Interest on Judgments. The theory upon which interest on judgment is based is that it is a measure of damages fixed by the legislature; it is not interest in its strict sense; nor is it founded on any contract, express or implied, as a judgment is not a contract except in a very recondite and remote sense.

Interest on judgments is now universally allowed under the law as a matter of right. As a general rule, the fact that a judgment is silent as to interest, will not prevent the recovery of interest thereon by proper action or by execution where the law allows interest on judgments. (Amis *v.* Smith, 16 Pet. 303.) Some courts hold that even though the obligation upon which a judgment is recovered was not interest-bearing in its character, interest will generally be recoverable on the judgment.

It has also been held that interest as incident to a judgment may be collected as long as the execution remains unsatisfied, notwithstanding the payment of the amount of the judgment. (Am. Cases 1913, E. 586.)

The legislature may change the rate of interest on judgments and the same will apply retroactively to judgments already rendered without impairing the obligation of contract. (Morley *v.* Lake Shore, etc., Ry. Co., 146 U. S. 162); for, as it has already been said, interest on judgment not being founded on contract, is an obligation implied by law which it can alter from time to time.

A judgment rendered for a fine (*) does not ordinarily bear interest. It is often held that when a judgment has been rendered for a specific sum and for the costs of the suit, interest is not recoverable on that portion of the judgment representing the costs, even though the allowance of interest upon judgments generally is provided by statute, unless the party recovering costs has actually paid them, in which case interest is allowed, but only from the time of such payment. (*People *v.* Sutter, 129 Cal. 545; Rogers *v.* Burns, 27 Pa. St. 527.)

Most states of the Union fix the legal rate of interest to 8% and the same rate was fixed by the original usury bill already referred to, on the ground that the National Bank and the Philippine Postal Savings Bank charge the same rate; but it was later changed to 6% for reasons which the drafter of the law failed to express. The writer

is, however, of the opinion that it is the spirit of conservatism that has guided the legislature to adopt the last named rate, it being the one fixed by our Civil Code and to which rate we have been accustomed.

The provision of this section corresponds in substance and in essence with Art. 1108 of the Civil Code which says, "When the obligation consists in the payment of money, and the debtor is in default, the indemnity for damages and injuries, when there is no stipulation to the contrary, shall consist in the payment of the interest agreed upon, and when there is no agreement, the legal interest shall be paid.

"While another rate is not fixed by the agreement, interest at the rate of 6% per year shall be considered as the legal."

Likewise, Art. 316 of the Code of Commerce says, "Debtors who delay the payment of their debts after same became due, must pay from the day on which it became due, the interest agreed upon in such case, or in the absence of such agreement, the legal interest (6%); the rules, therefore, which are applicable to these articles are equally applicable to the interpretation of this section and vice versa." It is to be noted however, that this section is more comprehensive than the articles above cited because it includes not only money but also "goods or credits." Bearing this difference in mind, we will proceed to the discussion of the rules which may be applied in common to these provisions of law.

Manresa in his commentaries on the Civil Code, Vol. 8 pages 102-104, speaking of Art. 1108 enumerates the following as its requisites:—

(1) There must be delay or default; but to fix the time for default there must be demand, either judicial or extrajudicial.
(2) Obligation must consist in the payment of money (goods or credits).
(3) Debt must be certain and demandable or declared to be due by court.

(1) There must be delay or default as well as demand, either judicial or extrajudicial for Art. 1100 of Civil Code provides:—

> "Persons obliged to deliver or to do something are in default from the moment on which the creditor exacts judicially or extrajudicially the compliance with their obligation."

However, the intimation of the creditor, in order that default may exist, shall not be necessary;

(*a*) When the law or obligation declares it expressly.
(*b*) When from its nature and circumstances it may appear that the fixing of the time on which the thing was to be delivered or the service was to be done, was a determinate cause to constitute the obligation.

Demand is generally needed in order to make it known to the debtor the damages which the creditor sustains by reason of the default.

Since the law is silent as to the form in which the demand is to be made, Manresa is of the opinion that it can be made in any form, provided it produces the desired

effect, but of course, an extrajudicial demand is harder to prove and the burden of proving the same lies upon the creditor. Among the many cases decided by our Supreme Court regarding this point are the following:—

(*a*) Interest as damages is only payable when there is demand judicial or extrajudicial, except in those cases specified in Art. 1100; the rate of interest being that agreed upon or the legal one. (De la Peña *v.* Hidalgo, 16 P. R. 452.)

(*b*) Where a contract, not being mercantile loan, does not provide for interest nor expressly say that failure to pay the debt when due constitutes a default, no interest can be recovered until a demand for payment is made. (Co. Gen. de Tabacos *v.* Araza, 7 Phil. 455.)

(2) Obligation must consist in the payment of money, (goods or credits), in support of this principle our Supreme Court held that the measure of damages for the nonfulfillment to pay money at the time stipulated, in the absence of express contract as to the rate of interest, is the legal rate. (Tin Fian *v.* Tan, 14 Phil. 126.)

(3) Debt must be demandable or declared due by the court. The following decision which supports this doctrine, holds that the obligation to pay interest on a sum fixed on a judgment exists from the date of the sentence, when so declared; for until the net amount of the debtor's liability has been determined, he cannot be considered delinquent in the payment of a debt with interest thereon. This principle is also supported by the decision of the Supreme Court of Spain of July 13, 1904.

SEC. 2. NO PERSON OR CORPORATION SHALL DIRECTLY OR INDIRECTLY TAKE OR RECEIVE IN MONEY OR OTHER PROPERTY, REAL OR PERSONAL, A HIGHER RATE OR GREATER SUM OR VALUE FOR THE LOAN OR FORBEARANCE OF MONEY, GOODS, OR CREDITS, WHERE SUCH LOAN OR FORBEARANCE IS SECURED IN WHOLE OR IN PART BY A MORTGAGE UPON REAL ESTATE THE TITLE TO WHICH IS DULY REGISTERED, OR BY ANY DOCUMENT CONVEYING SUCH REAL ESTATE OR AN INTEREST THEREIN, THAN TWELVE PER CENTUM PER ANNUM. MUTUAL BUILDING AND LOAN SOCIETIES INCORPORATED UNDER THE CORPORATION ACT MAY, HOWEVER, CHARGE EIGHTEEN PER CENTUM PER ANNUM BUT NOT MORE, DIRECTLY OR INDIRECTLY, INCLUDING PREMIUMS, INTEREST AND FINES.

This section allows 12% interest in case a debt is secured in whole or in part by real estate the title to which is duly registered. The reason for this provision is obvious; since the economic basis of the right to charge interest is the degree of risk to which the capital or the money of the lender is subjected, it is but just that where there is good security, a reasonable rate should be allowed. Another reason which might have induced the legislator in enacting this section is the fact that most of the lands in the Philippines of private ownership are not yet registered under the Land Registration Act; since money lenders are generally reluctant to give loans which are not secured by Torrens Title, it therefore serves as an incentive to landowners

to have their land registered as soon as possible, for by so doing they will not only find the borrowing of money easier but they will also find it easier to obtain a loan with a lower rate of interest.

The law is so carefully worded so as to include any contract of loan which may be resorted to by Philippine Shylocks to conceal usury. The most important opinion known regarding this point is that given by Attorney-General Paredes in compliance with a request of the provincial fiscal of Misamis, in which he said: "An agreement or transaction may be usurious if money is lent, the loan being secured by any document conveying real estate, and interest higher than 12 per cent. is indirectly taken or received. It is not, therefore, necessary that the loan be secured by a mortgage or that excessive interest be charged directly. Numerous are the devices resorted to by money lenders to hide under the cloak of legality transactions which, in fact, are usurious, thus evading the provisions of usury laws. As regards sales with *pacto de retro*, the Supreme Court of the Philippine Islands, in the case of Rosales *vs.* Reyes and Ordoveza (25 Phil. Rep. 497), said: 'It might be added that there are many characteristics of these sales with *pacto de retro* which stamp them as being in the nature of usurious loans. The property is usually sold for a much smaller sum than it is actually worth, as witness the present case, where Rivera sold the property to the defendants for ₱800, and then sold his right to repurchase for a considerably larger amount. During the time the right to repurchase lasts the purchaser either takes possession of the fruits thereof, or the vendor becomes his tenant and pays him rent for the use of the property. The chief inducement for purchasing property under such conditions is either the hope that the vendor will not be able to raise the amount of the redemption price within the time allowed, or else the prospect of enjoying the products of a property acquired at less than its market value.'

"In several cases decided in the United States it has also been held that 'when a vendor sells property at a clearly inadequate price, reserving the option to repurchase at a price greater than the original price with lawful interest, such contract will be regarded, not as an absolute sale, but as in effect a mortgage to secure a usurious loan.' (39 Cyc., 930.) In the case of Starweather *vs.* Prince (1 MacArthur, 144), the court said:

> " 'Where chattels are conveyed on an agreement that the owner may repurchase the same within six months on paying the amount advanced with 2½ per cent. per month for the use thereof, the contract is usurious on on its face.' "

The rest of the opinion will be cited under Section 10 as it has a more direct bearing on it.

The second part of the same section allows mutual building and loan societies incorporated under the Corporation Act to charge as high as 18% including premiums, interest and fines. The inquiry which naturally presents itself is the reason for the existing difference between an ordinary loan and that furnished by a mutual building

and loan society. The difference is explained by the peculiar nature of the latter; loan in case of mutual building and loan associations, is not essentially a loan, but a form of advancement, by way of discount, of the share the member would otherwise be entitled at the expiration of the society, coupled with the idea that it is a dealing with what is virtually a co-partnership fund. It is therefore this peculiar business which they carry on and the mutual participation in the profits arising from it which make this class of lenders distinct from others as to warrant a special grant of power to charge higher rate. In many states they are even exempted from the operation of the usury law.

According to the doctrine rightly laid down by the great weight of authority, if the so called payment of dues on stock or the exaction of a premium is a mere device to cover a payment for the use of money which is greater than what the law recognises as legal interest, the contract is an usurious one. (Mobile Bldg. Ass'n. *v.* Robertson, 65 Ala. 382.)

Where the statute does not authorize building associations to collect a premium for priority in receiving loans, the association cannot exact such a premium of a borrower; and all charges in addition to the lawful interest are usurious. (Burlington Mut. Loan Ass'n. *v.* Heider, 55 Iowa 424.)

Whether or not a loan made by a loan society is usurious, depends upon the amount agreed upon in good faith to be paid as interest on the sum loaned or advanced on the stock. (Howe Mut. Bldg. Ass'n. *v.* Thursby, 58 Md. 284.)

American and Spanish authorities are agreed that stipulation to the effect that if the debt be not paid at maturity it shall draw interest thereafter at a rate greater than the statutory one, is valid and cannot be considered as tainted with usury; for the excess rate is regarded as a penalty to induce prompt payment and the debtor can easily avoid same by discharging the debt when due. The test of usury in such cases is whether the debtor has the absolute and unconditional right to discharge his obligation by the prescribed and lawful interest. Whenever the debtor, by the terms of his contract, can avoid the payment of the excess rate of interest, by paying his debt at an earlier date, the contract is not usurious, but the difference between the sums is a penalty. (Cullen *v.* Howe, 8 Mass. 257.) But if the circumstances show that the transaction, although apparently an agreement for the payment of a penalty, was in fact a device for obtaining more than the lawful interest, it will be held usurious (Davis *v.* Rider, 53 Ill. 416); an example of this is where a note payable one day after date, bears interest at the rate of 20% after maturity. (Osborn *v.* McCowen, 25 Ill. 201.)

Another kind of contract which under ordinary circumstance cannot be considered as usurious, is where the payment of the principal sum depends upon the happening of any contingent event or is put at hazard in any manner, or in cases where the capital is placed in jeopardy. (Waite *v.* Windham, 37 Vt. 608.) Bottomry bonds and respondentia loans are very good examples of this kind of contracts

which are usually exempted from the operation of the usury law because of the perils of maritime navigations. But, again, to bring the case beyond the reach of usury statute or law, the contingency or hazard must be bona fide and not a mere color of a risk or such possibilities of unexpected loss as might occur in ordinary borrowing and lending of money.

With due respect to the author of the law, the writer believes that this section is not free from criticism; the first line speaks of "person or corporation" which means natural person or corporation, thus excluding by implication partnership, both commercial and civil, which are a juridical person distinct and different and not included under either "person or corporation." If the lawmaker intends to include both natural and juridical persons under the word "person," then, it follows that the use of the word "corporation" is a surplusage. In either case therefore, the wording of the law is either defective or not comprehensive enough so as to include partnership. It might be contended that a reasonable interpretation should include partnership, for it cannot be the legislative intent to endow favors, but to this contention the writer simply answers that the law gives room for doubt and hence, it should be made clearer.

SEC. 3. NO PERSON OR CORPORATION SHALL DIRECTLY OR INDIRECTLY TAKE OR RECEIVE IN MONEY OR OTHER PROPERTY, REAL OR PERSONAL, A HIGHER RATE OR GREATER SUM OR VALUE FOR THE LOAN OR FORBEARANCE OF MONEY, GOODS, OR CREDITS, WHERE SUCH LOAN OR FORBEARANCE IS NOT SECURED AS PROVIDED IN SECTION TWO HEREOF, THAN FOURTEEN PER CENTUM PER ANNUM.

This section allows a higher rate of interest in case a loan is not secured with duly registered title to real estate for the simple reason that a loan with no security or with a security other than real estate duly registered, runs a greater risk of being lost. The writer believes, that under this section comes loans secured by real estates other than that mentioned in Section 2, and those secured by personalty other than those that come under the following section regarding pawnshop. A very common example of a contract secured by personalty is that in vogue in the provinces in which the document of large cattle, usually that of a carabao, is pledged as security. It is to be noted that a contract of this nature commonly denominated as pledge or chattle mortgage is neither of the two, for in order to have a valid mortgage or pledge there must be either the delivery of the thing pledged to the pledgor or to a third person agreed upon by the parties or the registry of the lien in the proper registry of deeds. Strictly and legally speaking therefore, the mere delivery of the document of cattle to the lender gives the latter no security at all and the contract is equivalent to a pure loan and nothing more; hence, a loan of this kind subjects the capital to a risk which is disproportionate to the rate allowed by law, or rather 14%, if we are to follow strictly the law. The writer therefore is of the opinion that this article should

be interpreted so as to include only those loans validly secured by some kind of property, real or personal. In other words, those loans which are not secured at all, or secured by a chattel, or real estate mortgage which are invalid and therefore non-existing before the eye of the law, should be allowed a higher rate than 14%, the risk to which the capital is subjected being greater than other loans with security. Consequently, a rate of 16% is deemed reasonable by the writer in case of loans without security.

A discussion of some of the articles of the Civil Code in this connection will serve as a supplement to the proper interpretation of the law. Art. 1755 of the Civil Code provides that interest shall only be paid when they have been expressly stipulated. By the words *"expressly" "stipulated"* as used here is meant that it need not be written; it is sufficient if the borrower consents to the payment of interest, either orally or in writing, for it is only the express consent which is needed. (11 Manresa, 635.) American authorities are in accord with the above opinion of Manresa. It has been held that where the obligation does not show any interest agreed upon, a creditor cannot lawfully apply sums received by him as rent from a property owned by the debtor, to the payment of interest nor to any other purpose except to pay the indebtedness for Art. 1755 of the Civil Code provides that interest shall only be payable when it has been expressly stipulated, that is, when the debtor has expressly consented thereto, without prejudice to 1108 Civil Code, relating to legal interest in case of delay. (Guzman *v.* Balarag, 11 Phil. 503.) Our Supreme Court held also that when there is stipulation for the payment of interest until the expiration of the contract, other sums subsequently received by the debtor, independent of the loan, do not bear such rate of interest, but simply the legal rate, in the absence of express covenant or agreement, inasmuch as, however general the terms of a contract, it is unlawful to include therein, terms and conditions not intended by the contracting parties. (Nolan *v.* Majinay, 12 Phil. 559.) On the other hand, when there is express stipulation for the payment of interest, it must be paid from the day fixed in the contract, and the obligation to pay is not interrupted by any suit between the parties, for until the capital or principal shall have been paid, the obligation to pay interest subsists whatever be the amount to which the debt may have been reduced by payments made on account of the principal; the said continuous obligation must be complied with until the total reimbursement of the principal sum. (Banal *v.* Safont, 19 Phil. 372.)

Another important provision of the Civil Code which will serve an important purpose in the proper interpretation of the usury law is Art. 1756 which provides that a borrower who has paid interests without it being stipulated, cannot impute them for the payment of the capital. Different authors give different reasons for this article; Manresa believes that this is an exception to the universal rule of "payment of what is not due," in quasi-contract. The law presumes the existence of an implied agreement to pay interest, but such implication becomes an express stipula-

tion by virtue of the act of the contracting parties where one gives, while the other accepts. Other authors interpret the act to mean that the borrower in order not to owe favor to the lender pays the interest. Belgian authors, however, contend that the payment of interest by the borrower is a kind of donation given in return for the good will of the lender; his feeling of gratitude being the motive power of his act, and it is a principle in case of donation that once the thing donated is accepted by the donee, it becomes irrevocable. (11 Manresa, 635-638.) The writer believes in the soundness of all the foregoing reasons, but he is more inclined to agree with the view of Belgian authors as being more consistent with law and sound reasoning.

As to the question, whether or not partial payments made in case of an interest bearing debt will be applied to the payment of the principal, our Supreme Court held in applying Art. 1173 of the Civil Code that once an interest bearing obligation payable in installments is admitted, it is presumed that partial payments made are to be applied first to the payment of interest and then for the reduction of the principal. (San Jose et al., *v.* Ortega, 11 Phil. 442.)

SEC. 4. NO PAWNBROKER OR PAWNBROKER'S AGENT SHALL DIRECTLY OR INDIRECTLY TAKE OR RECEIVE ANY HIGHER OR GREATER SUM OR VALUE FOR ANY LOAN OR FORBEARANCE THAN THREE PER CENTUM PER MONTH WHEN THE SUM LENT IS LESS THAN ONE HUNDRED PESOS; TWO PER CENTUM PER MONTH WHEN THE SUM LENT IS ONE HUNDRED PESOS OR MORE, BUT NOT EXCEEDING FIVE HUNDRED PESOS, AND FOURTEEN PER CENTUM PER ANNUM WHEN IT IS MORE THAN THE AMOUNT LAST MENTIONED A PAWNBROKER OR PAWNBROKER'S AGENT SHALL BE CONSIDERED SUCH, FOR THE BENEFITS OF THIS ACT ONLY IF HE BE DULY LICENSED AND HAS FURTHER AN ESTABLISHMENT OPEN TO THE PUBLIC.

Laws in all countries accord a special privilege to pawnshops allowing them always to charge a higher rate of interest than ordinary lenders. There are special reasons which justify this privilege enjoyed by pawnshops and among them are the following:—

(1) Usually pawnshops are engaged in short time loans, so that there is great danger of not being able to lend again their capital immediately after its return by first borrowers.

(2) They are usually paying higher license than an ordinary lender.

(3) They are directly in contact with those that urgently need money and hence they render greater service to the public.

(4) They pay more for employees for the nature of their business involve greater trouble.

(5) They are sometimes the victim of deceit and fraud due to misrepresentation as to the real nature and ownership of the property pledged to them.

But it should be understood that only those who comply with the provision of this section can claim the privilege granted by it, for to allow those which are not

duly licensed to charge the rates allowed by law, would be, not only to tolerate and encourage unlawful acts but also to sanction inequality before the law.

The 3% rate of monthly interest to which pawnshops are entitled in cases of loans not in excess of ₱100.00 are a result of the compromise between the petition of the pawnbrokers and the desire of the legislators as is shown by the following quotation taken from an official record: "On occasion of the public hearing held, several of the pawnbrokers and pawnbroker's agents confessed that they could reduce the rate of interest to 4%. We, however, believed that it could be reduced still further to 3%. The schedule which we propose is in accordance with that hearing and is a compromise statements of pawnbrokers and what we believe can be done in the interest of the customers of the pawnshops." The decrease in the rate of interest as the amount loaned increases, is in accord with reason and with the other provisions of the law.

A pawnshop is strictly limited to charge only the interest fixed by law for a pawner who agrees to pay interest in excess of the legal rate is entitled to the possession of the pledges, if he tenders the principal and the lawful interest (Jackson *v.* Shawl, 29 Cal. 267.)

In another case it was held that a pawnbroker cannot acquire the right to charge interest in excess of the maximum rate charged by statute by treating a loan for a longer period as a monthly contract. (Reg. *v.* Goodburn, 2 Jur. 857.)

Te render a pawnbroker amenable to the penalty provided by law for taking or receiving directly or indirectly, usurious interest, the excessive interest must have been actually received by him. (Hallenbeck *v.* Getz, 63 Conn. 385.) It should be understood that this case is applicable only to a criminal and not to a civil action.

SEC. 5. IN COMPUTING THE INTEREST ON ANY OBLIGATION, PROMISSORY NOTE OR OTHER INSTRUMENT OR CONTRACT, COMPOUND INTEREST SHALL NOT BE RECKONED, EXCEPT BY AGREEMENT, OR, IN DEFAULT THEREOF, WHENEVER THE DEBT IS JUDICIALLY CLAIMED, IN WHICH LAST CASE IT SHALL DRAW SIX PER CENTUM PER ANNUM INTEREST.

The provision of this section is an embodiment of the existing legislation on the subject; the contents of Art. 317 of the Code of Commerce which provides that interest due shall not earn interest unless there is an agreement to that effect, that of Art. 1109 of the Civil Code which allows compound interest from the date of the judicial demand and last of all that of Sec. 510 of the Code of Civil Procedure which says, "When the Supreme Court will affirm a judgment below for the recovery of money, or shall reverse a judgment below, and award a sum of money as debt or damages, it shall direct that interest be added to the original judgment or sum determined to be due, from the date of the former judgment to the date of the final judgment, at the rate of 6% per annum." The reason for this unanimous opinion of the

different authorities as to the manner of charging compound interest is based upon the common belief which questions the propriety and justice of interest upon unpaid interest. It is often contended by moralists that there is a distinction between principal money and interest money; the former fruitful, the latter, barren; the one is a proper foundation of a contract, the other not; the profit of one is legal, while that of the other illegal and unrighteous to the debtor class who, through misfortune or calamity, may be unable to satisfy their debt at maturity. But to the lawyer it does not mean that the taking of compound interest is never justified; it simply means that it must be charged according to law. Although courts of both England and the United States have always been quoted from the earliest times to the allowance of compound interest on the ground of public policy, yet this rule has always been subjected to certain limitations and exceptions. (Young *v.* Hill, 67 N. Y. 162.)

For the sake of convenience, compound interest may be divided into compound interest by agreement and compound interest by judgment. Again, compound interest by agreement may be subdivided into those agreed upon contemporaneously with the execution of the loan and those agreed upon at the time of the maturity of the loan contract or subsequent thereto. As to the first, that is, agreement to pay compound interest at the time of the execution of the contract, it has been held by a great majority of cases to be usurious and unenforceable being done in bad faith, oppressive and actuated by corrupt motives.

On the other hand, it seems to be universally admitted that after interest becomes due, the parties may make a valid agreement whereby, in consideration of the lender's forbearance to compel payment, the borrower may bind himself to pay interest thereon; the debtor should no more retain the interest due, without paying interest upon it, then he should retain the principal without compensation for it. Not only that, the debtor is at least, morally obliged to make good his default by paying interest on interest due because the creditor is entitled to receive it, inasmuch as he is entitled to receive the capital.

An agreement to pay interest, either simple or compound, may be implied or express; implied are those originating from usuage or from an established course of dealing between the parties. (Young *v.* Hill, 67 N. Y. 162.)

It is likewise undisputed that it is perfectly competent for the creditor to recover interest from the date of the judicial demand, for interest on interest is allowed only after judicial demand, although the obligation is silent about it. (Salvador *v.* Palencia, 25 Phil. 661.) Again, it has been held that in the absence of an express agreement between the parties, judgment will not be rendered for interest upon interest, save in those cases under Article 1109 of the Civil Code which permits the recovery of compound interest from the date of judicial demand. (Sunico *v.* Ramirez, 14 Phil. 501.) Our Supreme Court in interpreting Sec. 510 of Act 190, relating to interest on judgments, enunciated the doctrine that it does not apply to a case where the obligation sued on bears interest; in such a case, a judgment which provides for

interest from the date of the maturity of the obligation until payment is proper. (Pepperel *v.* Taylor, 5 Phil. 536.) The American doctrine regarding this point is practically the same as the above, for it is to the effect that compound interest is not recoverable unless there has been settlement between the parties, or a judgment, whereby the aggregate amount of principal, or whenever there is a special agreement to do so, in such form as to be valid. (Conn. *v.* Jackson, 1 Johns Ch. (N.Y.) 13.)

The acceptance of a simple interest upon a debt, will constitute a waiver of a claim for compound interest thereon. (Henry *v.* Flagg, 13 Mete. Mass. 64.)

(To be continued)