

THE PHILIPPINE MONEY MARKET AND THE USURY LAW

By

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The question of the applicability of the Usury Law¹ to the activities of the money market is a problem whose implication and effects could greatly affect the interests of the commercial community in this country. The problem can be crucial, at least insofar as banking firms and investment houses engaged in the money market are concerned. The relevancy of the problem is even more felt today in view of the rather rapid growth of these institutions within our country's economic structure.

Notwithstanding the significance of the problem, it is a surprise that to date almost nothing at all has been expressed on the subject by commercial law commentators. The likely reason for this silence, in a country where there is no dearth of legal writers, is not difficult to discern. After all, the money market device, although ancient in itself, is still a relatively novel institution on the Philippine commercial scene. Thus, it may not have as yet caught the scrutinizing eyes of our legal luminaries.

However, the more basic reason for the absence of discussion on the point may be explained by the silence of the persons offended by a particular money market transaction who dare not bring the matter before the courts. It is interesting to note that, to date, no case has been filed in court raising the issue of usury in connection with a money market transaction. Needless to say, since courts are without authority to settle issues not raised in a proper litigation between real parties in interest, the absence of an actual case raising this precise issue precludes the courts from settling the question once and for all.

It is, therefore, the task of this paper to anticipate a situation which involves the problem of the money market and how it relates to the Usury Law. The methodology sought to be followed is to break down the problem into its most basic analyzable premises and to present the possible arguments that would be used in support of and against the legality of the money market. The final objective, however, is to arouse

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¹ Act No. 2655 (1916), as amended.

the interest of the reader sufficiently to elicit comments and debate on the matter.

The Money Market Device

Before a satisfactory presentation and a clear understanding of the problem may be had, a brief note on the concept, the nature and the history of the money market is in order.²

Ronald Robinson, a leading American economist, defines the money market as "the market for riskless loans in large amounts for one day or for a short period of time." A more comprehensive definition is offered by Lawrence Smith: "the money market is a market dealing in standardized short-term credit instruments (involving large amounts) where lenders and borrowers do not deal directly with each other but through a middle man or dealer in the open market." Both definitions contain three basic elements, namely: (1) riskless loans, (2) large amounts and (3) short-term maturity. A possible fourth element present in Smith's definition is the "middleman" or money market dealer. The presence of this fourth, however, is not absolutely indispensable as there are instances where in order to save on the commissions which dealers charge, money market borrowers directly conduct their borrowing operations by maintaining their own selling force which looks for buyers of their notes.³

The fundamental function of the money market device in its operation is to match and bring together in a most impersonal manner both the "fund-users" and the "fund-suppliers." Thus, a money market transaction includes the participation of three main parties, namely:

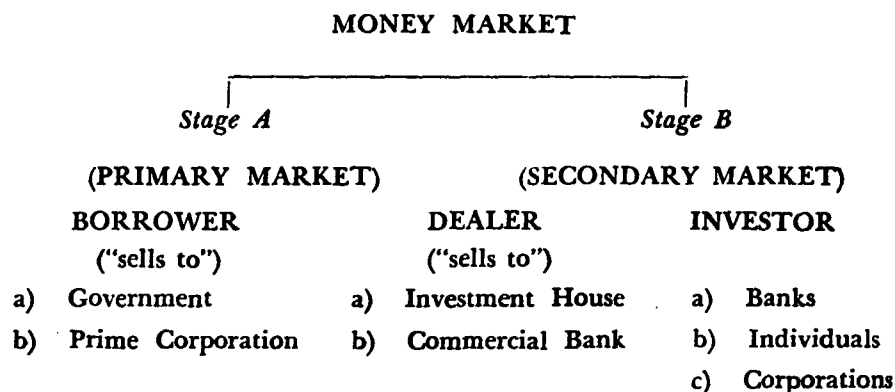
- (1) the money market investor who may be a corporation, a bank or an individual;
- (2) the money market dealer who may be an investment house or a commercial bank; and
- (3) the money market borrower who may be the Government or a private corporation.

In a complete money market transaction involving these participants, two stages are undergone, which are referred to as the "primary market stage" and the "secondary market stage." The former denotes the "lending activities" of the money market dealer, and the latter denotes the "borrowing activities" of such dealer.

² This section leans heavily on "The Philippine Money Market", an unpublished exposition prepared by the officers and staff of the Rizal Commercial Banking Corporation.

³ BAXTER, *THE COMMERCIAL PAPER MARKET*, 37 (1966 ed.).

The relationships created among the participants in these two stages may be diagrammed as follows:



In the entire operation of the money market, various modes and commercial instruments are utilized. Some of those presently availed of are:

(1) *Treasury Bills* — short-term, direct and unconditional general obligations of the Government of the Philippines. These are auctioned off by the Central Bank⁴ every Monday in case of 49-day, 13-day, 91-day, 147-day, 192-day and 273-day bills. The bills are non-interest bearing and are available in denominations of ₱1,000, ₱5,000, ₱10,000, ₱50,000 and ₱100,000. They are issued to bearer on a discount basis under either competitive or non-competitive bidding. They are in turn negotiated by the acquirer to investors in the money market for a consideration based on the face value plus a rate of interest determined by the relationship of supply and demand in the market.

(2) *Commercial Papers* — short-term, unsecured promissory notes of an individual or trading concern in the possession of the money

⁴ The authority of the Central Bank to auction off the Treasury Bills is based on Rep. Act No. 265:

SEC. 97. *Purchases and sales of Government securities.* — In order to achieve the objectives of the national monetary policy, the Central Bank may, in accordance with the principles stated in section 96 of this Act and with such rules and regulations as may be prescribed by the Monetary Board, buy and sell in the open market for its own account:

(a) Evidences of indebtedness issued directly by the Government of the Philippines or by its political subdivisions, and

(b) Evidences of indebtedness issued by Government instrumentalities and fully guaranteed by the Government.

The evidences of indebtedness acquired under the provisions of this section must be freely negotiable and regularly serviced.

SEC. 98. *Issue and negotiation of Central Bank obligations.* — In order to provide the Central Bank with effective instruments for open market operations, the Bank may, subject to such rules and regulations

market dealer which, like the treasury bill, are sold to an investor and the proceeds thereof used as working capital to be lent to a money market borrower. These notes are sold on discount yield basis, the amount being determined again by the market itself.

(3) *Banker's Acceptances* — negotiable time bills of exchange drawn on and accepted by the bank selling them. These are generated out of international or domestic transactions covering movement or storage of merchandise. Like the previous commercial papers described, these are sold on discount yield basis.

(4) *Repurchase Agreement* — a firm undertaking to buy back a pre-existing instrument at a pre-agreed price on a specified future date. The investor's profit is the difference between the purchase price and the repurchase price. (As will be seen later, this instrument goes hand in hand with the promissory notes earlier described.)

(5) *Interbank Call Market* — essentially a market in which the commodity traded is the excess legal issues in the form of clearing account balances maintained by commercial banks with the Central Bank. This device comes in handy when a bank finds itself with reserve deficiencies at the close of the banking day and, in order that such deficiencies may be corrected, borrows the excess reserves of other banks for the same day.

(6) *Intercompany Market* — this enables a firm short of funds to refinance its position by borrowing the seasonally excess funds of other firms. The instrument used is the unsecured promissory note through an intermediary which may be an investment bank or a commercial bank. This device is more commonly known to and exploited by universities and colleges upon the opening of each school season. Since they do not immediately need all the tuition fees collected from their

as the Monetary Board may prescribe and in accordance with the principles stated in section 96 of this Act, issue, place, buy and sell freely negotiable evidences of indebtedness of the Bank. Said evidences of indebtedness may be issued directly against the international reserve of the Bank or against the securities which it has acquired under the provisions of section 97 of this Act, or may be issued without relation to specific types of assets of the Bank.

The Monetary Board shall determine the interest rates, maturities and other characteristics of said obligations of the Bank, and may, if it deems it advisable, denominate the obligations in gold or foreign currencies.

Subject to the principles stated in section 96 of this Act, the evidences of indebtedness of the Central Bank to which this section refers may be acquired by the Bank before their maturity, either through purchases in the open market or through redemptions at par or by lot if the Bank has reserved the right to make such redemptions. The evidences of indebtedness acquired or redeemed by the Central Bank shall not be included among its assets, and shall be immediately retired and cancelled.

students, they deem it wise to invest the excess funds in the money market rather than maintain a low-income-earning savings account with the bank. The promissory notes used are made payable to one designated by the dealer such that the user of the funds does not know personally who the supplier is.

(7) *Certificate of Assignment* — involves an assignment of a bank's specific borrower's promissory note in said bank's loan portfolio, in favor of the buyer. This, however, is rarely used today.

The rate of interest in the money market is as variable as price in all other markets. The determinative factor is the availability of supply of money in relation to the extent of the demand for it. Thus, where the supply of money is low and the demand for it is high, the rate of interest is also high; and conversely, if the supply of money is high and the demand for it is low, the rate of interest is also low.⁵ Theoretically, there is no limit to the rate of interest that the market may determine and consequently the rate may, in a given season, rise to as high as 50% *per annum* or higher, or drop to as low as 10% *per annum* or even less.

As stated earlier, the money market is still a novel institution in Philippine commercial circles. In fact, it was only early in 1961 that the device was transformed from pure theory into actual practice in this country upon the introduction of the "interbank call market." A bank that finds itself with a reserve deficiency for the day would send what was known as a "call slip" to borrow from another bank the latter's excess reserves for the day in order to comply with the minimum-reserve requirements of our banking laws.⁶ In 1965, the Banc-com Development Corporation, then a newly established investment house, organized the first inter-company sub-market in the Philippines. It played the comfortable role of match-maker or intermediary in the matching of "fund-users" and "fund-suppliers" for a commission without disclosing to either party the identity of the other.

The Money Market — Characterized

The characterization of a "money market" transaction into its proper legal category is, at this juncture, primordial for purposes of this analysis. As in all cases, the necessity of individuating a transaction from all others is not only apparent but convenient. The need is felt even more greatly in view of the confusion created by both the proponents of the "money market" as a perfectly legal venture regard-

⁵ BAXTER, *supra*, note 3.

⁶ See Republic Act No. 377 (1949), secs. 22 & 23; Rep. Act No. 265 (1948), secs. 100, 101, 102, 103, 104, 105 & 106.

less of rate of interest and its opponents who condemn it as usurious whenever the rate of interest charged exceeds the limits set by law. The former attempt to solve the problem by simply denominating the entire transaction as a "sale and purchase" of negotiable paper and ignoring as without application the provisions of the Usury Law. The latter, on the other hand, label the transaction as a "loan" of a sum of money and nothing else. And, to compound the issue, some writers refer to a "money market" transaction on the one hand with such terms as "purchase" and "sale," or "buying" and "selling" of commercial paper and, on the other, with the words "loan", "borrowing," "lending," and so on.⁷

In order to characterize a money market transaction into its proper legal category, take the following model:⁸

Given: A—a money market investor

B—a money market dealer

C—a money market borrower

Step I. Assume B to be in possession of a promissory note (hereinafter p.n.) of X Corporation obtained by B in the regular bank-lending operation in order to secure X's indebtedness to B. The p.n. covers the amount of ₱100,000 payable in 90 days at 14 percent interest *per annum* (hereinafter p.a.). B negotiates this note to A for a consideration of ₱100,000 in cash to generate funds to be used in money market. A "Repurchase Agreement" is entered into between A and B whereby B engages to buy back the same note upon maturity for ₱100,000 plus 15 percent interest p.a. (assuming 15 percent p.a. to be the money market rate of interest on the date of the transaction).⁹

Step II. C, a prime corporation,¹⁰ needs ₱100,000 immediately and consequently sells to B its own p.n.¹¹ for ₱100,000. B, however, does not deliver to C the full ₱100,000 but pre-deducts 17 percent interest p.a., (assuming 17% p.a. to be the current money market rate of

⁷ BAXTER, *supra*, note 3.

⁸ The model does not purport to show all the possible modes of operation in the money market. It contains and sufficiently emphasizes, through the use of the promissory note and purchase agreement, the basic elements of and the common denominators found in a regular money market transaction.

⁹ This is the "secondary market" stage of a money market transaction.

¹⁰ A prime corporation is one whose credit standing in the business world is so well recognized that its promissory notes are treated as good as cash. The calibration of a corporation into a prime category is the result of very strict and rigid credit investigation conducted by the banks with which it carries on business. Examples of such corporations are: the San Miguel Corporation, and Dole Philippines Inc. These are considered prime because they have certain future collectibles with assets far exceeding liabilities.

¹¹ C's promissory note may again be negotiated by B to some other investor in the money market for B to raise funds anew to be lent to some other borrower.

interest for the day), or if B acquired the ₱100,000 from A at 15 percent interest *per annum* and the rates remain the same on the date that C sells its p.n. to B, B charges an additional 2 or 3 percent on top of the 15 percent as commission and pre-deducts the same amount from the sum given to C.¹²

From this model appear two distinct transactions, each one being complete in itself and independent of the other. The first is the contract between A and B, and the second is that between B and C. Note that there is no privity whatsoever between A and C and therefore the rules on agency¹³ cannot come into play. As a rule, the dealer, B, does not disclose to C the identity of A. B is thus deemed to act solely for and on his own behalf.¹⁴ Neither is there a hint of the existence of a trust¹⁵ relationship where A becomes trustor and at the same time *cestui que trust* with B as trustee in the contract with C, since A is not concerned with what B does with his ₱100,000, the obligation of the latter being to buy back the p.n. at the agreed amount. Neither has B any concern for A in giving the amount to C since B's only interest is to profit from C without intending to share such profits with A. Thus, there are left only the two aforementioned possible interpretations as to the character of either transaction. Either the contract is a simple loan¹⁶ of a sum of money, or one of sale¹⁷ and purchase of commercial paper.

Money Market — A Simple Loan

Those who lean towards the proposition that the Usury Law applies to a money market transaction are necessarily confronted from the very

¹² This operation is the "primary market" stage of a money market transaction. Refer to diagram, *supra*.

¹³ CIVIL CODE, art. 1868: By the contract of agency, a person binds himself to render some service or to do something in representation or on behalf of another, with the consent or authority of the latter.

¹⁴ CIVIL CODE, art. 1883: If an agent acts in his own name, the principal has no right of action against the person with whom the agent has contracted; neither have such persons against the principal.

In such case the agent is the one directly bound in favor of the person with whom he has contracted, as if the transaction were his own, except when the contract involves things belonging to the principal.

¹⁵ CIVIL CODE, art. 1440: A person who establishes a trust is called the trustor; one in whom confidence is reposed as regards property for the benefit of another person is known as the trustee; and the person for whose benefit the trust has been created is referred to as the beneficiary.

¹⁶ CIVIL CODE, art. 1933: By the contract of loan, one of the parties delivers to another, either something not consumable so that the latter may use the same for a certain time and return it, in which case, the contract is called a *commodatum*; or money or other consumable thing, upon the condition that the same amount of the same kind and quality shall be paid, in which case, the contract is simply called a loan or *mutuum*.

¹⁷ Understood in the light of the Negotiable Instruments Law (Act No. 2031).

outset with the problem of proving the existence of a simple loan and that the rate of interest charged, received, taken or demanded exceeds the limits provided by law.¹⁸ That there exists such a loan is, however, not difficult to show. It is enough for this purpose that there be an agreement to the effect that "one of the parties delivers to another . . . money upon the condition that the same amount . . . shall be paid . . .";¹⁹ and that there is a stipulation in writing²⁰ providing for the payment of usurious interest, or even if there is no such stipulation in writing, that the lender has "directly or indirectly demand[ed], take[n] receive[d] or charge[d] in money or other property real or personal,"²¹ a higher rate or greater sum or value than fourteen percent *per annum* for the loan of money, goods, or credits, where such loan is not secured as provided in Sec. 2 of the Usury Law.

In this connection, the form of the contract is of no moment. Art. 1957 of the new Civil Code plugs all formal loopholes which the loan-shark may take advantage of by declaring that "[c] ontracts and stipulations, under any cloak or device whatever, intended to circumvent the laws against usury shall be void. . . ." The insertion of this provision in our usury laws was motivated by the desire to "defeat the cunning devices of usurers"²² that the law has encountered in the past. In application of this provision, the Supreme Court in a case²³ categorically declared the form of the contract as "not conclusive," and that even if the contract is made to appear on its face as a valid and legal sale with a repurchase agreement (*pacto de retro*), rules of evidence shall not prevent the courts from looking into other circumstances to determine whether or not usury exists and the document is a sham to cover a "usurious financial manipulation."²⁴ The cardinal inquiry is: Did the parties resort to the transaction for the purpose of disguising usury? The law will not permit a usurious loan to hide itself behind a legal form. Parol evidence is admissible to show that a written document, though legal in form, was in fact a device to conceal usury. If from an interpretation of the entire transaction it is apparent that there exists a corrupt intention to violate the Usury Law, the courts should permit no scheme, however ingenious, to conceal the crime of usury.²⁵ "The

¹⁸ Act No. 2655 (1916), Sec. 3, *infra*.

¹⁹ *Supra*, note 16.

²⁰ CIVIL CODE, art. 1956: No interest shall be due unless it has been expressly stipulated in writing.

²¹ Act No. 2655 (1916), Sec. 3, *infra*.

²² REPORT OF THE CODE COMMISSION, p. 152.

²³ *United States v. Diaz Conde*, 42 Phil. 766 (1922).

²⁴ *United States v. Constantino Tan Quingco Chua*, 39 Phil. 552 (1919); *People v. Hodges*, 46 Phil. 502 (1924).

²⁵ *Ibid.*; See also ABAD SANTOS, NOTES ON CREDIT TRANSACTIONS, 20-40 (1961 ed.).

test of usury in a contract is whether it would, if performed, result in securing a greater rate of profit on the subject matter than is allowed by law. . . .²⁶

Neither is it an argument for the proponents of the money market to invoke for its validity, regardless of the rate of interest, Circular No. 387, series of 1973 as the enabling authorization for commercial banks and investment houses to engage in open market operations. The Central Bank, through the Monetary Board, expressly permits, even encourages, through the use of the treasury bills, commercial banks and investment houses to avail themselves of the benefits of the open market for commercial paper, that is, by "borrowing," which refers to "all forms of obtaining or raising funds through any of the methods and for any of the purposes provided in Section 1" of the Circular; or by "relending," which refers to "the extension of loans . . . with antecedent borrowing transactions". The pertinent provisions of Circular No. 387 are as follows:

The Monetary Board, Central Bank of the Philippines, pursuant to its powers under its Charter, R.A. No. 265, as amended, and under the General Banking Act, R.A. No. 337, as amended, promulgated the following rules and regulations governing quasi-banking functions:

SECTION 1. Quasi-banking functions consist of the following:

- a. Borrowing funds for the borrower's own account;
- b. Twenty or more lenders at any one time;
- c. Methods of borrowing:
 - (1) Issuance, endorsement, or acceptance of debt instruments of any kind, other than deposits, such as:
 - (a) acceptances;
 - (b) promissory notes;
 - (c) participations;
 - (d) certificates of assignment or similar instruments with recourse;
 - (e) trust certificates;
 - (f) repurchase agreements;
 - (g) such other instruments as the Monetary Board may determine.
- d. Purpose:
 - (1) relending, or
 - (2) purchasing receivables or other obligations

SEC. 2. As used in this Circular, the following terms and phrases shall be understood as follows:

"Borrowing" shall refer to all forms of obtaining or raising funds through any of the methods and for any of the purposes provided in

²⁶ *Ibid*; See also WEBB, LAW OF USURY, Sec. 29 (1899).

Section 1 of this Circular, whether the borrower's liability thereby is treated as real or contingent.

"For the borrower's own account" shall refer to the assumption of liability in one's own capacity and not in representation, or as an agent or trustee, of another.

"Purchasing of receivables or other obligations" shall refer to the acquisition of claims collectible in money including inter-bank borrowings or borrowings between financial institutions, or of securities, of any amount and maturity, from domestic or foreign sources.

"Relending" shall refer to the extension of loans by an institution with antecedent borrowing transactions. Relending shall be presumed, in the absence of express stipulation, when the institution is regularly engaged in lending.

"Regularly engaged in lending" shall refer to the practice of extending loans, advances, discounts or rediscounts as a matter of business; continuous or consistent lending as distinguished from isolated lending transactions.

* * *

Sec. 4. Only duly incorporated stock corporations may undertake or perform quasi-banking functions as defined in Section 1 hereof: *Provided*, That the following preconditions are complied with:

- a. a minimum paid-in capital of ₱10 million;
- b. at least a majority of the voting stock shall be owned by citizens of the Philippines;
- c. at least a majority of the members of the Board of Directors shall be citizens of the Philippines;
- d. that the managerial staff possess the integrity, experience and expertise which provide reasonable assurance that the enterprise is being conducted with financial prudence.

* * *

Sec. 7. The minimum size for every transaction of fund borrowing, either through issuance, endorsement or acceptance of debt instruments, by a corporation engaging in quasi-banking functions under this Circular, shall be Fifty Thousand (₱50,000.00) Pesos for maturities of one (1) year or less, and for maturities of more than one (1) year, in blocks of ₱1,000, ₱5,000, ₱10,000, ₱50,000, and ₱100,000: *Provided*, *However*, That trading in government securities shall not be subject to these limitations.

* * *

Sec. 9. A corporation performing quasi-banking functions under this Circular shall not relend to or purchase receivables or other obligations of other corporations majority of the voting stock of which is owned by subject corporation, unless the terms of the transactions are not more favorable than those of other similar transactions.

* * *

The authority of the Monetary Board of the Central Bank to empower commercial banks and investment houses to engage in the money market is unquestionable. However, it is doubtful whether such permit carries with it the unrestricted power to charge, take, demand or otherwise receive any rate of interest from customers in money market transactions, the Usury Law notwithstanding. In fact, the Monetary Board itself is expressly restricted on this point by no less than its own charter,²⁷ which under Sec. 109 provides:

The Monetary Board may, within the limits prescribed in the Usury Law (Act. No. 2655, as amended), fix the maximum rates of interest which banks may charge for different types of loans and for any other credit operations, or may fix the maximum differences which may exist between the interest or rediscount rates of the Central Bank and the rates which the banks may charge their customers if the respective credit documents are not to lose their eligibility for rediscount or advances in the Central Bank.

Any modification in the maximum interest rates permitted for the borrowing or lending operations of the banks shall apply only to future operations and not to those made prior to the date on which the modification becomes effective.

In order to avoid possible evasion of maximum interest rates set by the Monetary Board, the Board may also fix the maximum rates that banks may pay to or collect from their customers in the form of commissions, discounts, charges, fees or payments of any sort.

The above dictum is consistent with law that in all cases of simple loans where interest is agreed upon, the rate shall in no case exceed the maximum prescribed by Act No. 2655. Any violation is usury and is subject to the sanctions of law.²⁸

It is of no help to say that money market interest rates should be deemed excluded from the operation of the Usury Law on the ground that such rates are not merely the product of agreement between the parties but are the result of the interactions of economic forces, particularly of supply and demand.²⁹ Such an argument beclouds the issues. Although money market rates are indeed determined by the economic law of supply and demand, such determination is made subject to legal restraints in the interest of the public. It is not correct to say that economic laws, although irrevocable by legislative act, are entirely outside legislative influence. It is not uncommon that whenever economic laws operate to the detriment of the general welfare of the people, the legislature, in the legitimate exercise of police power, steps in to check, cushion, or attempt to neutralize the adverse effects produced by such economic laws. Instances of such legislative action are not difficult

²⁷ Rep. Act No. 265 (1948).

²⁸ GREEN & LAWRENCE, *THE LAW OF DEBTORS AND CREDITORS*, 41 (1948 ed.).

²⁹ BAXTER, *supra*, note 3.

to cite. One readily available example of a statute acting to regulate economic trends is the Price Regulation Act³⁰ which hopes to check the rise of prices of prime commodities by setting maximum ceilings for their sale. Although, for instance, the price of a particular commodity as determined by the economic law of supply and demand should be, say, ₱2.00, the state has all the prerogative in the interest of the public to set the maximum selling price at a lower amount. Another example is the Minimum Wage Law³¹ which prescribes ₱8.00 to be the minimum price of one day's labor notwithstanding that in a given sector of our community, the same labor should cost only say, ₱5.00, as determined by the supply-demand ratio, there being a scarcity of employment coupled with an over-supply of workers. Thus, we see the State to be ever present in almost every economic endeavor, intervening, regulating, restricting and even prohibiting. *Laissez-faire* is out and State concern is in; and, aside from the others, the Usury Law is just one way of expressing this policy.

Presidential Decree No. 116

The promulgation of Presidential Decree No. 116, although a substantial amendment to the Usury Law, does not in the least alter the situation. The pertinent provisions of the decree are:

SECTION 1. Section one of Act Numbered Two Thousand Six Hundred Fifty-Five is hereby amended to read as follows:

"SEC. 1. 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 or such rate as may be prescribed by the Monetary Board of the Central Bank of the Philippines for that purpose in accordance with the authority hereby granted."

SEC. 2. The same Act is hereby amended by adding the following section immediately after section one thereof, which reads as follows:

"SEC. 1-a. The Monetary Board is hereby authorized to prescribe the maximum rate or rates of interest for the loan or renewal thereof or the forbearance of any money, goods or credits, and to change such rate or rates whenever warranted by prevailing economic and social conditions: *Provided*, That such changes shall not be made oftener than once every twelve months.

"In the exercise of the authority herein granted, the Monetary Board may prescribe maximum interest rates for consumer loans or renewals thereof as well as such loans made by pawnshops, finance companies and other similar credit institutions although the rates prescribed for these institutions need not necessarily be uniform."

³⁰ Rep. Act No. 509 (1950).

³¹ Rep. Act No. 6129 (1970), as amended.

SEC. 3. Section two of the same Act is hereby amended to read as follows:

"SEC. 2. No person or corporation shall directly or indirectly take or receive in money or other property, real or personal, or chases in action, a higher rate of interest or greater sum or value, including commissions, premiums, fines and penalties, for the loan or renewal thereof or forbearance of money, goods, or credits, where such loan or renewal 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 or the maximum rate prescribed by the Monetary Board and in force at the time the loan or renewal thereof or forbearance is granted: *Provided*, That the rate of interest under this section or the maximum rate of interest that may be prescribed by the Monetary Board under this section may likewise apply to loans secured by other types of security as may be specified by the Monetary Board."

SEC. 4. Section three of the same Act is hereby amended to read as follows:

"SEC. 3. No person or corporation shall directly or indirectly demand, take, receive, or agree to charge 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 or the maximum rate or rates prescribed by the Monetary Board and in force at the time the loan or forbearance is granted."

* * *

SEC. 6. The same Act is hereby amended by adding the following section immediately after Section four thereof, which reads as follows:

"SEC. 4-a. In the exercise of its authority to fix the maximum rate or rates of interest under this Act, the Monetary Board shall be guided by the following:

- "1. The existing economic conditions in the country and the general requirements of the national economy;
- "2. The supply of and demand for credit;
- "3. The rate of increase in the price levels; and
- "4. Such other relevant criteria as the Monetary Board may adopt."

SEC. 7. Section five of the same Act is hereby amended to read as follows:

"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: *Provided*, That whenever compound interest is agreed upon, the effective rate of interest charged by the creditor shall not exceed the equivalent of the maximum rate prescribed by the Monetary Board, or, in default thereof, whenever the debt is judicially claimed, in which last case it shall draw six *per centum* per annum interest or such rate as may be prescribed by the Monetary Board. No person or corporation shall require interest to be paid in advance for a period of more than one year: *Provided, however*, That

whenever interest is paid in advance, the effective rate of interest charged by the creditor shall not exceed the equivalent of the maximum rate prescribed by the Monetary Board."

SEC. 8. Section seven of the same Act is hereby amended to read as follows:

"SEC. 7. All covenants and stipulations contained in conveyances, mortgages, bonds, bills, notes, and other contracts or evidences of debts, and all deposits of goods or other things, whereupon or whereby there shall be stipulated, charged, demanded, reserved, secured, taken, or received, directly or indirectly, a higher rate or greater sum or value for the loan or renewal or forbearance of money, goods, or credits than is hereinbefore allowed, shall be void: *Provided, however,* That no mere clerical error in the computation of interest, made without intent to evade any of the provisions of this Act, shall render a contract void: *Provided further,* That parties to a loan agreement, the proceeds of which may be availed of partially or fully at some future time, may stipulate that the rate of interest agreed upon at the time the loan agreement is entered into, which rate shall not exceed the maximum allowed by law, shall prevail notwithstanding subsequent changes in the maximum rates that may be made by the Monetary Board: And *Provided, finally,* That nothing herein contained shall be construed to prevent the purchase by an innocent purchaser of a negotiable mercantile paper, usurious or otherwise, for valuable consideration before maturity, when there has been no intention on the part of said purchaser to evade the provisions of this Act and said purchase was not a part of the original usurious transaction. In any case, however, the maker of said note shall have the right to recover from said original holder the same interest paid by him thereon and, in case of litigation, also the costs and such attorney's fees as may be allowed by the court."

SEC. 9. The same Act is hereby amended by adding the following section immediately after Section nine thereof, which reads as follows:

"SEC. 9-a. The Monetary Board shall promulgate such rules and regulations as may be necessary to implement effectively the provisions of this Act."

* * *

The decree merely adds to the powers of the Monetary Board of the Central Bank the authority to "prescribe the maximum rate or rates of interest for the loan or renewal thereof or the forbearance of any money, . . . and to change such rate or rates whenever warranted by prevailing economic and social conditions: *Provided,* That such changes shall not be made oftener than once every twelve months." The only effect of this amendment obviously is to grant to the Monetary Board the authority to change the maximum rate or rates for loans to some other level. The fact remains, however, that a contract becomes usurious whenever the interest charged, received or otherwise taken exceeds the maximum rate or rates as prescribed by the Monetary Board. The de-

termination of what is usurious, therefore, is made by the decree dependent on the prescriptions of the Monetary Board in the exercise of the authority granted thereto. In the case of the money market, if the interest charged, received, or demanded or otherwise taken by the lender, be it the investor with respect to the dealer, or the dealer with respect to the borrower, exceeds the maximum rate allowed by the Monetary Board, then the entire transaction is usurious and illegal. In short, although the determination of money market interests may be based on supply-demand factors, such rates must never exceed the limits of the Monetary Board's prescription.

For the moment, however, the situation is as if P.D. No. 116 had not been promulgated, inasmuch as the Monetary Board has not as yet acted to fix any new rate or rates of interest for loans; and consequently, the maximum lawful rate for money market loans remains fixed at 14 percent *per annum*³² in consonance with the law.

Recovery of Interest Paid by the Debtor; Principal, by the Creditor

Central in almost every problem in usury are two questions: (1) Can the debtor recover the entire usurious interest paid or only so much of the amount as exceeds the maximum lawful rate?; and, (2) Can the creditor recover the principal lent to the debtor? In a complete money market transaction covering both the primary and secondary stages, it may be noted that there are really two contracts of loan entered into, one being entirely distinct from and independent of the other. If we refer to the model above,³³ one contract of loan is deemed consummated between A and B, with A as the lender and B as the borrower; and another between B and C, with B as the lender and C as the borrower. Applying the problem to this situation, the question now is: whether B can recover from A the entire usurious interest paid, that is, the whole fifteen percent, or only so much as exceeds the maximum lawful rate, that is, one percent; and, by analogy, whether C can recover from B in the same manner and extent that B can recover from A. The second question is: whether A can recover his principal (P100,000) from B, and again B from C whatever amount was given by B.

On the first question, jurisprudence was, at one time, as confusing as the provisions of law. In the case of *Palileo v. Cosio*,³⁴ the debtor borrowed the sum of P12,000 from the creditor. In accordance with

³² Sec. 3, *supra*.

³³ *Supra*.

³⁴ 97 Phil. 919 (1955); *cf.* also *Garcia v. De Aramburo*, 59 Phil. 478 (1934).

their covenant, the debtor paid ₱2,250 as interest for nine months despite the mortgaged real estate given as security. By law, the creditor was entitled to receive by way of interest only 12 percent *per annum*.³⁵ In deciding the case, the Supreme Court ordered the creditor to refund to the debtor the sum of ₱810 which was the amount exceeding the maximum rate of 12 percent *per annum*, permitting the creditor to retain 12 percent interest paid. This doctrine seems to ascribe a divisible character to the interest stipulated, the segments being: the maximum lawful interest, and the excess. The court admitted the former but annulled the latter.

This ruling, as shown by the Court in a later case,³⁶ ignores Section 6 of the Usury Law, which provides:

SEC. 6. Any person or corporation who, for any such loan or renewal thereof or forbearance, shall have paid or delivered a higher rate or greater sum or value than is hereinbefore allowed³⁷ to be taken or received, may recover the whole interest, commissions, premiums, penalties and surcharges paid or delivered with costs and attorney's fees in such sum as may be allowed by the court in an action against the person or corporation who took or received them if such action is brought within two years after such payment or delivery: *Provided, however*, That the creditor shall not be obliged to return the interest, commissions and premiums for a period of not more than one year collected by him in advance when the debtor shall have paid the obligation before it is due, provided such interest, commissions and premiums do not exceed the rates fixed by this Act.

At a glance, the above provision seems to clash with Art. 1413 of the New Civil Code which states that: "Interest paid in excess of the interest allowed by the usury laws may be recovered by the debtor, with interest thereon from the date of the payment." This latter provision apparently limits the recovery by the debtor only to the amount in excess of the maximum lawful rate, plus legal interest from the date of payment. The matter becomes more intriguing if viewed in the light of another provision³⁸ of the New Civil Code stating that: "Usurious transactions shall be governed by special laws", and still further complicated by Article 1961, providing that: "Usurious contracts shall be governed by the Usury Law and other special laws, so far as they are not inconsistent with this Code."

The foregoing provisions appear to create a vicious circle on the question of which law is to apply. The confusion, however, is merely superficial as the Supreme Court later held in a series of cases. Thus,

³⁵ Sec. 2, *supra*.

³⁶ *Delgado v. Valgona*, 44 Phil. 739 (1923).

³⁷ Fourteen percent in case of money market loans. See Sec. 3, *supra*.

³⁸ Art. 1175.

correcting its stand and reversing the *Cosio* ruling, the Court opted to allow both the New Civil Code provisions as well as Sec. 6 of the Usury Law to stand consistently side by side. The Court harmonized the provisions with one another by reasoning that although the New Civil Code is to prevail over the Usury Law in consonance with Art. 1961, only in cases of real conflict should the provisions of the Usury Law yield. Sec. 6 of the latter law, therefore, ought to be permitted to stand since it does not run counter with any New Civil Code provision, not even with Art. 1413. The only effect of Art. 1413 is, therefore, to give the debtor an option to demand interest on the amount in excess of the lawful maximum at the legal rate of 6 percent *per annum* from the date of payment. It does not in any way prohibit the recovery of any interest paid aside from the amount which is in excess of the maximum lawful rate.³⁹ To further support this rule, the Supreme Court added in the case of *Angel Jose Warehousing Inc. v. Chelda Enterprises*⁴⁰ that "Article 1413, in speaking of 'interest paid in excess of the interest allowed by the usury laws' [really] means the whole usurious interest; that is, in a loan of ₱1,000, with interest of 20% per annum or ₱200 for one year, if the borrower pays ₱200, the whole ₱200 is the usurious interest, not just that part thereof in excess of the interest allowed by law. It is in this case that the law does not allow *division*. The whole stipulation as to interest is void, since payment of said interest is the cause or object and said interest is illegal. The only change effected, therefore, by Article 1413, New Civil Code, is not to provide for the recovery of the interest paid in excess of that allowed by law, which the Usury Law already provided for, but to add that the same can be recovered 'with interest thereon from the date of payment.'"

On the question whether or not the creditor can recover his principal, the debate continues as we find a split Court on the issue.

Two cases are prominent on this point, notably: *Angel Jose Warehousing Co., Inc. v. Chelda Enterprises* and *Briones v. Cammayo*.⁴¹ In the *Angel Jose* case, the debtors were indebted under a contract of loan in the amount of ₱26,500 of which ₱20,800 had remained unpaid. In the action to recover the amount from the debtors, the latter interposed in defense "that [the] plaintiff charged and deducted from the loan usurious interests thereon, at rates of 2% and 2.5% per month, and, consequently, plaintiff has no cause of action against [the] defendants." The trial court found that of the principal debt, ₱20,287.50 remained

³⁹ *Supra*, note 36.

⁴⁰ G.R. No. L-25704, April 24, 1968, 23 SCRA 119 (1968).

⁴¹ G.R. No. L-23559, October 4, 1971, 41 SCRA 404 (1971).

unsettled and that the plaintiff had, in advance, deducted the usurious interest of ₱1,048.15. Declaring the usurious interest as void, the trial court rendered judgment ordering the defendants to pay the remaining unpaid principal minus the usurious interest.⁴² Upon appeal, the Supreme Court, affirming the trial court's ruling, held:

The foregoing interpretation is reached with the philosophy of usury legislation in mind; to discourage stipulations on usurious interest, said stipulations are treated as wholly void, so that the loan becomes one without stipulation as to payment of interest. It should not, however, be interpreted to mean forfeiture even of the principal, for this would unjustly enrich the borrower at the expense of the lender. Furthermore, penal sanctions are available against a usurious lender, as a further deterrence to usury.⁴³

In *Angel Jose*, the Supreme Court was unanimous, no dissent having been registered by any of the Justices. The disagreement on the issue was born later in the *Briones* case, bearing similar facts. In *Briones*, the majority of the Court, led by Mr. Justice Dizon, favored the recovery of the principal by the creditor. The minority view which adhered to the contrary was advanced by Justices Castro, Concepcion and Fernando. The root of the problem lay in the application of Art. 1411 of the New Civil Code which provides:

ART. 1411. When the nullity proceeds from the illegality of the cause or object of the contract, and the act constitutes a criminal offense, both parties being in *pari delicto*, they shall have no action against each other, and both shall be prosecuted. Moreover, the provisions of the Penal Code relative to the disposal of effects or instruments of a crime shall be applicable to the things or the price of the contract.

This rule shall be applicable when only one of the parties is guilty; but the innocent one may claim what he has given, and shall not be bound to comply with his promise.

According to the majority view the aforesaid *pari delicto* rule does not apply in cases of usurious contracts. Citing *Angel Jose*, the majority held that:

. . . [A] contract of loan with usurious interest consists of principal and accessory stipulations; the principal one is to pay the debt; the accessory stipulation is to pay interest thereon.

And said two stipulations are divisible in the sense that the former can still stand without the latter.

On the basis of Art. 1420 of the New Civil Code, "[i]n case of a divisible contract, if the illegal terms can be separated from the legal ones, the latter may be enforced." Consequently, the nullity of the

⁴² ₱19,247.35.

⁴³ *Angel Jose Warehousing Co., Inc. v. Chelda Enterprises*, *supra*, note 40 at 125.

stipulation to pay usurious interest does not carry with it the nullity of the stipulation to pay the principal.⁴⁴ In addition to this, the majority held that in a simple contract of loan with stipulation of usurious interest, the prestation of the debtor to pay the principal debt, which is the cause of the contract,⁴⁶ is not illegal. "The illegality lies only as to the prestation to pay the stipulated interest; hence, being separable, the latter only should be deemed void, since it is the only one that is illegal."⁴⁶

To the minority, however, the matter should be resolved differently. In the words of Mr. Justice Castro: "a contract which is tainted with usury, that is, with a stipulation (whether written or unwritten) to pay usurious interest, the prestation to pay such interest is an integral part of the cause of the contract. It is also the controlling cause, for a usurer lends his money not just to have it returned but indeed to acquire inordinate gain."⁴⁷ In support of this view, Justice Castro cited the rule that: "Contracts and stipulations under any cloak or device whatever, intended to circumvent the laws against usury shall be void. The borrower may recover in accordance with the laws on usury."⁴⁸ The provision is thereby given the effect of nullifying not merely the stipulation of paying usurious interest, but also the entire contract of loan itself. The dissenters added: ". . . the motive of the usurer is his desire to acquire inordinate gain; this motive becomes an integral and controlling part of the cause because its realization can be achieved only by compliance by the borrower with the stipulated prestation to pay usurious interest." It was pointed out that though the law never proscribes a contract merely because of the immoral motive of a contracting party, for the reason that it does not concern itself with motive but only with cause,⁴⁹ "[a]n exception is where such motive becomes an integral part of the cause, like the stipulated usurious interest in a contract of loan."⁵⁰

⁴⁴ Lopez v. El Hogar, *supra*, note 43.

⁴⁵ CIVIL CODE, art. 1350: In onerous contracts the cause is understood to be, for each contracting party, the prestation or promise of a thing or service by the other; in remuneratory ones, the service or benefit which is remunerated; and in contracts of pure beneficence, the mere liberality of the benefactor.

⁴⁶ Briones v. Cammayo, *supra*, note 41, citing Angel Jose v. Chelda Enterprises, *supra*, note 40; see also Go Chioco v. Martinez, 45 Phil. 256 (1923); Gui Jong & Co. v. Rivera, 45 Phil. 778 (1924); Aguilar v. Rubiato, 40 Phil. 570 (1919); Delgado v. Valgona, *supra*, note 36; Palileo v. Cosio, *supra*, note 43; Pascua v. Perez, G.R. No. L-19554, January 31, 1964, 10 SCRA 199, 200-202 (1964).

⁴⁷ Briones v. Cammayo, *supra*, note 41.

⁴⁸ CIVIL CODE, Art. 1957.

⁴⁹ Jesus v. Urrutia and Company, 33 Phil. 171 (1916).

⁵⁰ Briones v. Cammayo, *supra*, note 41.

Jurisprudence is not without support for this contention. In an early case⁵¹ the Supreme Court, speaking through Mr. Justice Moran, said:

...[W]e are of the opinion that the petitioner should be ordered to return . . . the amount of . . . P480. This last amount is not usurious interest on the capital of the loan but the value of the produce of the land sold to petitioner under *pacto de retro*, with the unpaid balance of the usurious interest (P546.73) as the consideration of the transaction. This consideration, because contrary to law, is illicit, and the contract which results therefrom, null and void.

Then, in the case of *Asturias, et al. v. Court of Appeals*,⁵² Mr. Justice Barrera, speaking for the Court, held: "A contract designed to hide a usurious agreement not only violates the law but contravenes public policy. Such a contract can not be countenanced and is therefore illegal and void from its inception."

All the arguments of the minority no doubt are highly convincing and easily acceptable, but fail to counter the final stand of the majority based on the principle of *solutio indebiti*.⁵³ It certainly is not equitable to permit the borrower to keep the usurious interest as well as the principal of the loan inasmuch as he will be unjustly enriched at the expense of another. The law has, since time immemorial, recognized the rule that *condicio causa data non secuta, i.e.*, a person has a course of action against another, having performed an act in anticipation of counter performance by the other.⁵⁴ For this purpose it is enough that the enrichment comes in the form of some positive pecuniary value including enjoyment of the thing that belongs to another.

But the rule on unjust enrichment does not necessarily apply to all cases of usurious transactions. In this connection, it must be emphasized that the Usury Law has a dual aspect: the civil and the penal. Where there is corrupt and criminal intent to take usurious interest out of the transaction, the penalty⁵⁵ prescribed by the Usury Law

⁵¹ *Mulet v. People*, 73 Phil. 60 (1941).

⁵² G.R. No. L-17895, September 30, 1963, 9 SCRA 131 (1963).

⁵³ CIVIL CODE, Art. 22: Every person who through an act of performance by another, or any other means, acquires or comes into possession of something at the expense of the latter without just or legal ground, shall return the same to him.

⁵⁴ 1 TOLENTINO, COMMENTARIES AND JURISPRUDENCE ON THE CIVIL CODE OF THE PHILIPPINES, 73 (1968 ed.); 2 ENNECCERUS, KIPPS & WOLFF, 569-571; PLANIOL & RIPERT, pp. 54-55; GASPERI, pp. 372-374.

⁵⁵ Act No. 2655 (1916), Sec. 10: Without prejudice to the proper civil action, violation of this Act shall be subject to criminal prosecution and the guilty person shall, upon conviction, be sentenced to a fine of not less than fifty pesos nor more than five hundred pesos, or to imprisonment for not less than thirty days nor more than one year, or both, in the discretion of the

attaches; otherwise, only civil liability can be sustained. Insofar as the transaction amounts to criminal usury the dilemma created by the rule on unjust enrichment will, fortunately, not arise. The New Civil Code has seen to it that where the contract amounts to a criminal offense, the provisions of the Penal Code relative to the "disposal of effects or instruments of a crime shall be applicable to the things or the price of the contract."⁵⁶ This rule applies even if only one of the parties is guilty,⁵⁷ provided, that the effects on instruments of the crime do not belong to an innocent third person.⁵⁸ Thus, where the usurious contract amounts to a criminal offense the pertinent rule to be observed is Art. 45 of the Revised Penal Code declaring that effects and instruments of a crime shall, as an accessory penalty, be forfeited in favor of the State. The forfeiture, upon the imposition of the penalty, automatically attaches without further need of court declaration.⁵⁹ This assumes, however, that money can be considered an instrument of the crime of usury. Although direct jurisprudence is silent on the point, inference may be made from the case of *United States v. Bruchez*⁶⁰ where the court held that money to purchase opium was properly within the meaning of "instruments" of a crime.

In consonance with the foregoing, it is no longer proper to lean on the *solutio indebiti* doctrine insofar as criminal usury is concerned since no one, at least as between the parties to the usurious transaction, is unjustly enriched at the expense of the other. The real problem remains with civil usury, and it is along this line that the debate goes on. In relation to the money market transaction involving usurious rates, hardly can it be proved to amount to criminal usury. If the loan is usurious, the most that can likely be established is only civil usury. The good faith of those who engage as lenders in the money market is by law presumed, such that the prosecutor is burdened with proving corrupt and criminal intent to take usurious profits on the part of individuals some of whom might even be the most respectable members of the community innocently interested only in a sound business investment. But, as it stands now, the creditor, whether investor or dealer,

court, . . . *Provided* That in case of corporations, associations, societies or companies, the manager, administrator or *gerente* or the person who has charge of the management or administration of the business shall be criminally responsible for any violation of this Act. (As amended by Act No. 3998).

⁵⁶ CIVIL CODE, Art. 1411.

⁵⁷ *Ibid.*

⁵⁸ *United States v. Filart*, 30 Phil. 80 (1915); *United States v. Constantino*, *supra*, note 24; *Hodges v. People*, 68 Phil. 178 (1939); *People v. De Guzman*, 73 Phil. 184 (1941); *Mulet v. People*, *supra*, note 51.

⁵⁹ *Garcia v. Bituin*, CA — G.R. No. 12297-R, September 24, 1958, 55 O.G. 1782 (March, 1959).

⁶⁰ 28 Phil. 305 (1914); see also *Villaruz v. Court of First Instance of Nueva Ecija*, 71 Phil. 72 (1940) *re* forfeiture of documents and papers in connection with the perpetration of the crime of usury.

in a money market transaction with usurious interest rates is protected by the majority view in *Briones*, permitting the recovery of the principal debt.

Money Market — Sale of Commercial Paper

One way of removing the money market from the operation of the Usury Law is to distinguish the nature of its transactions entirely from that of a loan and to individuate them instead as transactions involving a sale⁶¹ of commercial paper. For this purpose, it becomes indispensable that at least two elements are established: (a) that there is an existing credit belonging to a person, consisting of a right to collect a sum of money due from another person and which right becomes denominated as the object of the contract of sale, and (b) that the right is transferred by negotiation of the commercial paper and is not acquired by the transferee by issuance.

The first requirement constitutes an essential ingredient of a contract of sale. In this connection, it need not be elaborated that intangible properties, whether real or personal, may properly be the object of a sale; that a credit or the right to demand payment of a sum of money from another is an intangible personal property right well within the meaning of "determinate object" of a contract of sale. Viewed in this light, the transfer of a commercial paper by one to another for a certain sum of money becomes no more than a sale of the right represented by the commercial paper. Thus, when B, the dealer in our model⁶² who owns the right evidenced by the paper to demand payment of ₱100,000 from X Corporation, transfers⁶³ such right to A by delivering the paper to A after endorsement, B, in effect, is deemed to have sold to A such right to demand the ₱100,000 from X Corporation. The repurchase agreement between A and B merely renders the sale conditional in the sense that upon the lapse of the agreed period of time, B is bound by the agreement to buy back the same right to collect the ₱100,000 from X Corporation as represented by the commercial paper and to pay therefor a price 15 percent more than what A paid for it. In short, both parties to the transaction neither intended nor envisioned a loan of a sum of money to be secured by the commercial paper and to be paid at interest: the

⁶¹ CIVIL CODE, Art. 1458: By the contract of sale one of the contracting parties obligates himself to transfer the ownership of and to deliver a determinate thing, and the other to pay therefor a price certain in money or its equivalent.

A contract of sale may be absolute or conditional.

⁶² *Supra*.

⁶³ Understood in the sense that the paper is "negotiated" as contemplated by the Negotiable Instruments Law, *supra*; Sec. 30.

commercial paper is not a security for loan, but rather, evidence of the sale or "transfer of credit."⁶⁴ The difference of 15 percent between the seller's (B's) selling price and the purchaser's (A's) repurchase price is of no consequence. "On principle and authority, the owner of property . . . has a perfect right to name the price on which he is willing to sell, and to refuse to accede to any other";⁶⁵ or to have one price for a thing at a given time and to insist on another price for the same thing at another time; or still, to "offer to sell at a designated price for cash or at a much higher price on credit,"⁶⁶ and "the mere fact that the credit price exceeds the cost price by a greater percentage than is permitted by the usury laws is a matter of concern to the parties but not to the courts, barring evidence of bad faith. If the parties have acted in good faith, such transaction is not a loan, and not usurious."⁶⁷

Unfortunately, the foregoing cannot be availed of by all the parties involved in a money market transaction. In fact, going back to the model, only A will be benefited thereby if ever an action against him is brought by B. The argument will not save B if an action for the recovery of the interest is instituted by C. The reason for this is plain from the basic difference in the nature of the separate transactions taking place between A and B on the one hand, and B and C on the other hand. Note that in the contract between A and B, the transfer of the commercial paper is effected by negotiation; that is, by B to constitute A the holder⁶⁸ of the p.n. of X Corporation; but, in the contract between B and C, the transfer of C's p.n. is effected by its issuance⁶⁹ to B. The difference is crucial since negotiation of a commercial paper necessarily implies the pre-existence of credit, a right to demand payment from somebody, which right, as evidenced by the paper, may very well be the object of a contract of sale.⁷⁰ But, in case of the issuance of the same paper, there is no such pre-existing credit or right to demand payment from some other person to speak of. In fact, it is only upon the issuance of the paper that the credit is created, and it belongs not to the issuer, but to the transferee. In short, at the time of the issuance of a note, the maker is not the owner of any credit or right to demand payment from somebody, and consequently, he has nothing to sell and there is nothing that can be made

⁶⁴ GREEN & LAWRENCE *supra*, note 28 at 37; See also CAMPOS & CAMPOS, NOTES AND SELECTED CASES ON NEGOTIABLE INSTRUMENTS LAW, 3 (1971 ed.).

⁶⁵ Manila Trading & Supply Co. v. Tamaraw Plantation Co., 47 Phil. 513 (1925), citing 27 R.C.L. 214 (1920).

⁶⁶ *Ibid.*

⁶⁷ ABAD SANTOS, *supra*, note 25, citing 39 Cyc., p. 927.

⁶⁸ See Negotiable Instruments Law, sec. 30.

⁶⁹ CAMPOS & CAMPOS, *supra*, note 64.

⁷⁰ GREEN & LAWRENCE, *supra*, note 28.

the determinate object of a contract of sale with the transferee. Thus, the only contract that can be said to have been consummated between B and C will be a loan.

Money Market — Exception to the Usury Law

Even assuming the money market transaction to fit properly within the meaning of a loan, one other stand remains in support of advocates of the money market, that is, to view the device as an exception to the application of the Usury Law.

The history of usury and usury legislation shows that a "law against usury can be classified as a paternal law or one enacted by the State in the exercise of its police power."⁷¹ The interest of the State in proscribing usurious loans is motivated by the desire to protect "borrowers who are in [such] necessitous condition [that they] lack proper bargaining power and are an easy prey to the greedy and unscrupulous."⁷²

But, if such should be the reason behind the law, hardly then can it be said to have any bearing on the money market. As discussed in an early part of this essay, money market borrowers are said to be prime clients of the money market dealers. They are corporations who are far from being the necessitous individuals contemplated in the Usury Law. A prime corporation that avails itself of the money market does so not because it needs funds so badly that obtaining them will spell the difference between survival and extinction, but because of some other "unnecessitous" considerations. It is not uncommon that we find a corporation, which, due to rapid business advancements and raking in profits greater than predicted, should be desirous of sharing its bounty with its small employees in the spirit of, say, the Yuletide season, but which corporation for the moment finds itself short of funds to meet its noble objective since its collectibles are to become due only in the following month; the corporation then remedies the situation by borrowing from the money market. Certainly, this corporation, which is willing to afford to pay usurious interest just to be able to give away money, could not have been the kind of "necessitous borrower" the Usury Law meant to protect. Squarely applicable is the well-established principle of statutory construction that when the reason behind the law ceases to exist, the law itself must cease to apply.

⁷¹ ABAD SANTOS, *supra*, note 25 at 21; see also *Appraisal of Usury Laws*, 25 PHIL. L. J. 501 (August, 1950).

⁷² *Ibid.*

CONCLUSION

Whichever might be the proper interpretation that will accurately characterize a money market transaction under its true legal category, in the meantime the question is unanswered. If the money market transaction is indeed no more than an ordinary sale of commercial paper, it is a wise device that facilitates the easy flow and acquisition of capital, and hence, may very well be the answer to the problems of an anemic economy. If it is held to be a loan, the consequences for the local mercantile community might not be too welcome.