796 Phil. 79

SECOND DIVISION

[G.R. No. 185765. September 28, 2016]

PHILIPPINE ECONOMIC ZONE AUTHORITY, PETITIONER, VS. PILHINO SALES CORPORATION, RESPONDENT.

DECISION

LEONEN, J.:

Although the provisions of a contract are legally null and void, the stipulated method of computing liquidated damages may be accepted as evidence of the intent of the parties. The provisions, therefore, can be basis for finding a factual anchor for liquidated damages. The liable party may nevertheless present better evidence to establish a more accurate basis for awarding damages. In this case, the respondent failed to do so.

This resolves a Petition for Review on Certiorari[1] praying that the assailed May 2, 2008 Decision[2] and November 25, 2008 Resolution[3] of the Court of Appeals in CA G.R. CV No. 86406 be reversed and set aside and that the Decision[4] dated November 2, 2005 of Branch 108 of the Regional Trial Court of Pasay City in Civil Case No. 00-0343 be reinstated.

The Regional Trial Court's November 2, 2005 Decision ruled in favor of petitioner Philippine Economic Zone Authority, which, as plaintiff, brought an action for rescission of contract and damages against the defendant, now respondent Pilhino Sales Corporation (Pilhino).[5]

The assailed Court of Appeals Decision partly granted Pilhino's appeal by reducing the amount of liquidated damages due from it to the Philippine Economic Zone Authority, and by deleting the forfeiture of its performance bond.[6] The assailed Court of Appeals Resolution denied the Philippine Economic Zone Authority's Motion for Reconsideration.[7]

The facts are not disputed, and all that is in issue is the consequence of Pilhino's contractual breach.

On October 4, 1997, the Philippine Economic Zone Authority published an invitation to bid

in the Business Daily for its acquisition of two (2) brand new fire truck units "with a capacity of 4,000-5,000 liters [of] water and 500-1,000 liters [of chemical foam,] with complete accessories."[8]

Three (3) companies participated in the bidding: Starbilt Enterprise, Inc., Shurway Industries, Inc., and Pilhino.[9] Pilhino secured the contract for the acquisition of the fire trucks.[10] The contract price was initially at P3,000,000.00 per truck, but this was reduced after negotiation to P2,900,000.00 per truck.[11]

The contract awarded to Pilhino stipulated that Pilhino was to deliver to the Philippine Economic Zone Authority two (2) FF3HP brand fire trucks within 45 days of receipt of a purchase order from the Philippine Economic Zone Authority.[12] A further stipulation stated that "[i]n case of fail[u]re to deliver the . . . good on the date specified . . . , the Supplier agree[s] to pay penalty at the rate of 1/10 of 1% of the total contract price for each days [sic] commencing on the first day after the date stipulated above."[13]

The Philippine Economic Zone Authority furnished Pilhino with a purchase order dated November 6, 1997.[14] Pilhino failed to deliver the trucks as it had committed.[15] This prompted the Philippine Economic Zone Authority to make formal demands on Pilhino on July 27, 1998[16] and on February 23, 1999.[17] As Pilhino still failed to comply, the Philippine Economic Zone Authority filed before the Regional Trial Court of Pasay City a Complaint[18] for rescission of contract and damages. This was docketed as Civil Case No. 00-0343 and raffled to Branch 108.[19]

In its defense, Pilhino claimed that there was no starting date from which its obligation to deliver could be reckoned, considering that the Complaint supposedly failed to allege acceptance by Pilhino of the purchase order.[20] Pilhino suggested that there was not even a meeting of minds between it and the Philippine Economic Zone Authority.[21]

In its November 2, 2005 Decision,[22] the Regional Trial Court ruled for the Philippine Economic Zone Authority. The dispositive portion of the Decision reads:

> WHEREFORE, judgment is hereby rendered in favor of the plaintiff and against the defendant ordering the latter to:
>
> 1. Pay the plaintiff in liquidated damages a[t] the rate of 1/10 of 1% of the total contract price of Php 5,800,000.00 for each day of delay commencing

from June 19, 1998.

2. Pay the plaintiff exemplary damages in the amount of Php 100,00[0].00.
3. That the contract be declared rescinded and the performance bond posted by the defendant be forfeited in favor of the plaintiff.
4. For defendant to pay the cost of the suit.

SO ORDERED.[23]

Pilhino then appealed before the Court of Appeals.

In its assailed May 2, 2008 Decision,[24] the Court of Appeals partly granted Pilhino's appeal by deleting the forfeiture of Pilhino's performance bond and pegging the liquidated damages due from it to the Philippine Economic Zone Authority in the amount of P1,400,000.00.

The Court of Appeals debunked Pilhino's claim that there was no meeting of minds. It emphasized that Pilhino "manifested its acquiescence . . . [to] the Purchase Order . . . when it submitted to [the Philippine Economic Zone Authority] a Performance Bond dated 02 June 1999 and Indemnity Agreement dated 09 June 1998 duly signed by its Vice President."[25] It added that in a subsequent letter dated March 29, 1999[26] "signed by [Pilhino's] Hino Division Manager Edgar R. Santiago and noted by VP-Operations Roberto R. Garcia, [Pilhino] admitted that it can no longer meet the requirements regarding the specification on the two (2) units of fire truck[s]."[27]

In this March 29, 1999 letter, Pilhino not only acknowledged its inability to meet its obligations but also proposed a modified arrangement with the Philippine Economic Zone Authority:

> [P]lease allow us to submit our new proposal for your consideration (please see attached specifications). Our price for this new specification if P3,600,000.00/unit. However, we are willing to shoulder the difference between the original price of P2,900,000.00/unit and P3,600,000.00 in lieu of the penalty. May we also request your good office to stop the accumulation of the penalty [.][28]

In calibrating the amount of liquidated damages, the Court of Appeals cited Articles 1229[29]

and 2227[30] of the Civil Code. It reasoned that through its March 29, 1999 letter, Pilhino made an attempt at rectification or mitigation:

> In the instant case, we consider the supervening reality that after appellant's failure to deliver to appellee the two (2) brand new units of fire trucks in accordance with the specifications previously agreed upon, appellant nevertheless tried to remedy the situation by offering to appellee new specifications at P3,600,000.00 per unit; and expressed willingness to shoulder the difference between the original price (based on the contract) of P2,900,000.00 per unit and the price corresponding to the new specifications. Further, it is undisputed that appellee has not paid any amount to appellant in connection with said undelivered two (2) brand new units of fire trucks. We thus equitably reduce said liquidated damages to P1,400,000.00, which is the difference between the contract price of P5,800,000.00 and P7,200,000.00 based on the new specifications for two (2) new units of fire trucks.[31]

The Philippine Economic Zone Authority moved for reconsideration of the modifications to the Regional Trial Court's award. As this Motion was denied in the Court of Appeals' assailed November 25, 2008 Resolution,[32] the Philippine Economic Zone Authority filed the present Petition.

Petitioner asks for the reinstatement of the Regional Trial Court's award asserting that it already suffered damage when respondent Pilhino Sales Corporation failed to deliver the trucks on time;[33] that the contractually stipulated penalty of 1/10 of 1% of the contract price for every day of delay was neither unreasonable[34] nor contrary to law, morals, or public order;[35] that the stipulation on liquidated damages was freely entered into by it and respondent;[36] and that the Court of Appeals' computation had no basis in fact and law.[37] Regarding respondent's supposed attempt at mitigation, petitioner notes that by the time the offer was made, the Complaint for rescission and damages had already been filed[38] and was, therefore, inconsequential and hardly a remedy.

Commenting on petitioner's Petition,[39] respondent raises the question of:

> Whether or not a contract can be rescinded and declared void ab initio, and then thus rescinded, can a stipulation for liquidated damages or penalty contained in

> that very same contract be given separate life, force and effect, that is, separate and distinct from the rescinded and voided contract itself?[40]

Therefore, respondent suggests that with the rescission of its contract with petitioner must have come the negation of the contractual stipulation on liquidated damages and the obliteration of its liability for such liquidated damages.[41]

We resolve the twin issues of:

First, the propriety of an award based on contractually stipulated liquidated damages notwithstanding the rescission of the same contract stipulating it; and

Second, on the assumption that such award is proper, the propriety of the Court of Appeals' reduction of the liquidated damages due to petitioner.

I

Respondent's intimation that with the rescission of a contract necessarily and inexorably follows the obliteration of liability for what the same contracts stipulates as liquidated damages[42] is entirely misplaced.

A contract of. sale, such as that entered into by petitioner and respondent, entails reciprocal obligations. As explained in *Spouses Velarde v. Court of Appeals*,[43] "[i]n a contract of sale, the seller obligates itself to transfer the ownership of and deliver a determinate thing, and the buyer to pay therefor a price certain in money or its equivalent."[44]

Rescission on account of breach of reciprocal obligations is provided for in Article 1191 of the Civil Code:

> Article 1191. The power to rescind obligations is implied in reciprocal ones, in case one of the obligors should not comply with what is incumbent upon him.
>
> The injured party may choose between the fulfillment and the rescission of the obligation, *with the payment of damages in either case*. He may also seek rescission, even after he has chosen fulfillment, if the latter should become impossible.

> The court shall decree the rescission claimed, unless there be just cause authorizing the fixing of a period.
>
> This is understood to be without prejudice to the rights of third persons who have acquired the thing, in accordance with articles 1385 and 1388 and the Mortgage Law. (Emphasis supplied)

Respondent correctly notes that rescission under Article 1911 results in mutual restitution. Jurisprudence has long settled that the restoration of the contracting parties to their original state is the very essence of rescission. In *Spouses Velarde*:

> Considering that the rescission of the contract is based on Article 1191 of the Civil Code, mutual restitution is required to bring back the parties to their original situation prior to the inception of the contract. Accordingly, the initial payment of P800,000 and the corresponding mortgage payments . . . should be returned by private respondents, lest the latter unjustly enrich themselves at the expense of the former.
>
> Rescission creates the obligation to return the object of the contract. It can be carried out only when the one who demands rescission can return whatever he may be obliged to restore. To rescind is to declare a contract void at its inception and to put an end to it as though it never was. It is not merely to terminate it and release the parties from further obligations to each other, but to abrogate it from the beginning and restore the parties to their relative positions as if no contract has been made.[45] (Citations omitted)

Laperal v. Solid Homes, Inc.[46] has explained how the restitution spoken of in rescission under Article 1385 of the Civil Code equally holds true for rescission under Article 1191 of the Civil Code:

> Despite the fact that Article 1124 of the old Civil Code from whence Article 1191 was taken, used the term "resolution", the amendment thereto (presently, Article 1191) explicitly and clearly used the term "rescission". Unless Article 1191 is subsequently amended to revert back to the term "resolution", this Court has no alternative but to apply the law, as it is written.

Again, since Article 1385 of the Civil Code expressly and clearly states that "rescission creates the obligation to return the things which were the object of the contract, together with their fruits, and the price with its interest," the Court finds no justification to sustain petitioners' position that said Article 1385 does not apply to rescission under Article 1191.

In *Palay, Inc. vs. Clave*, this Court applied Article 1385 in a case involving "resolution" under Article 1191, thus:

> Regarding the second issue on refund of the installment payments made by private respondent. Article 1385 of the Civil Code provides:
>
> > "ART. 1385. Rescission creates the obligation to return the things which were the object of the contract, together with their fruits, and the price with its interest; consequently, it can be carried out only when he who demands rescission can return whatever he may be obliged to restore.
> >
> > "Neither shall rescission take place when the things which are the object of the contract are legally in the possession of third persons who did not act in bad faith.
> >
> > "In this case, indemnity for damages may be demanded from the person causing the loss."
>
> As a consequence of the resolution by petitioners, rights to the lot should be restored to private respondent or the same should be replaced by another acceptable lot. However, considering that the property had already been sold to a third person and there is no evidence on record that other lots are still available, private respondent is entitled to the refund of installments paid plus interest at the legal rate of 12% computed from the date of the institution of the action. It would be most inequitable if petitioners were to be allowed to retain private respondent's payments and at the same time appropriate the proceeds of the second sale to another.

> Applying the clear language of the law and the consistent jurisprudence on the matter, therefore, the Court rules that rescission under Article 1191 in the present case, carries with it the corresponding obligation of restitution.[47] (Citations omitted)

Contrary to respondent's assertion, mutual restitution under Article 1191 is, however, no license for the negation of contractually stipulated liquidated damages.

Article 1191 itself clearly states that the options of rescission and specific performance come with "with the payment of damages in either case." The very same breach or delay in performance that triggers rescission is what makes damages due.

When the contracting parties, by their own free acts of will, agreed on what these damages ought to be, they established the law between themselves. Their contemplation of the consequences proper in the event of a breach has been articulated. When courts are, thereafter, confronted with the need to award damages in tandem with rescission, courts must not lose sight of how the parties have explicitly stated, in their own language, these consequences. To uphold both Article 1191 of the Civil Code and the parties' will, contractually stipulated liquidated damages must, as a rule,[48] be maintained.

What respondent purports to be the ensuing nullification of liquidated damages is not a novel question in jurisprudence. This matter has been settled, and respondent's position has been rebuked. In *Laperal*:

> This notwithstanding, the Court does not agree with the Court of Appeals that, as a consequence of the obligation of mutual restitution in this case, petitioners should return the amount of P5,200,833.27 to respondent.
>
> Article 1191 states that "the injured party may choose between fulfillment and rescission of the obligation, with the payment of damages in either case." In other words, while petitioners are indeed obliged to return the said amount to respondent under Article 1385, assuming said figure is correct, respondent is at the same time liable to petitioners in the same amount as liquidated damages by virtue of the forfeiture/penalty clause as freely stipulated upon by the parties in the Addendum, paragraphs 1 and 2 of which respectively read:

> WHEREAS, included as part of said agreement are the following:
>
> 1. Further to the stipulations on paragraph 10, upon default of performances, violations and/or non-compliance with the terms and conditions herein agreed upon by the DEVELOPER wherein it appears that the DEVELOPER deliberately abandoned or discontinued the work on the project, said party shall lose any entitlement, if any, to any refund and/or advances it may have incurred in connection with or relative to previous development works in the subdivision; likewise, all improvements of whatever nature and kind introduced by the DEVELOPER on the property, existing as of the date of default or violation, shall automatically belong to the OWNER without obligation on his part to pay for the costs thereof.
>
> 2. Similarly with the same condition of default or violation obtaining, as stated in paragraph 10 of said agreement, all advances made and remittances of proceeds from reservations and sales given by the DEVELOPER to the OWNER as provided for in this agreement shall be deemed absolutely forfeited in favor of the OWNER, resulting to waiver of DEVELOPER'S rights, if any, with respect to said amount(s).

> If this Court recognized the right of the parties to stipulate on an extrajudicial rescission under Article 1191, there is no reason why this Court will not allow the parties to stipulate on the matter of damages in case of such rescission under Book IV, Title VIII, Chapter 3, Section 2 of the Civil Code governing liquidated damages.[49] (Citations omitted)

We see no reason for departing from this. It is true that *Laperal* involved extrajudicial rescission, while this case involves rescission through judicial action. The distinction between judicial and extrajudicial rescission is in how extrajudicial rescission is possible only when the contract has an express stipulation to that effect.[50] This distinction does not diminish the rights of a contracting party under Article 1191 of the Civil Code and is immaterial for purposes of the availability of liquidated damages.

To sustain respondent's claim would be to sustain an absurdity and an injustice. Respondent's position suggests that with rescission must necessarily come the obliteration

of the punitive consequence which, to begin with, was the product of its own (along with the other contracting party's) volition. Its position turns delinquency into a profitable enterprise, enabling contractual breach to itself be the means for evading its own fallout. It is a position we cannot tolerate.

II

In calibrating the amount of liquidated damages, the Court of Appeals relied on how respondent supposedly attempted to rectify things "by offering to [petitioner] new specifications at P3,600,000.00 per unit; and expressed willingness to shoulder the difference between the original price (based on the contract) of P2,900,000.00 per unit and the price corresponding to the new specifications."[51]

As underscored by petitioner, however, this offer was inconsequential and hardly a remedy to the predicament it found itself in.

Petitioner already suffered damage by respondent's mere delay. Philippine Economic Zone Authority Director General Lilia B. De Lima's internal memorandum to its Board of Directors emphasized what was, at the time, the specific urgency of obtaining fire trucks:

> 1. With the increase in the number of locator-enterprises at the regular zones, there is a need for additional units of fire trucks to address any eventuality. *The onset of the El Niño phenomena further makes it imperative that PEZA be more prepared.*
>
> 2. At present, there are only six (6) units of serviceable fire trucks distributed as follows:
>
> | | |
> |---|---|
> | Bataan EZ | 2 |
> | Baguio City EZ | 1 |
> | Cavite EZ | 1 |
> | Mactan EZ | 2[52] (Emphasis supplied) |

The Court of Appeals itself recognized that "time was of the essence when the contract . . . was awarded to [respondent] and the non-compliance therewith exposed [petitioner's] operations [at] risk."[53]

Respondent's attempt at rectification came too late and under such circumstances that petitioner was no longer even in a position to accept respondent's offer. As petitioner notes, by the time respondent made its offer, the Complaint for rescission and damages had already been filed before the Regional-Trial Court of Pasay City.[54] If at all, the offer was nothing more than a belated reaction to undercut litigation.

By the time respondent made its attempt at rectification, petitioner was no longer capable of accommodating contractual modifications. Jurisprudence has established the impropriety of modifying awarded contracts that were previously subjected to public bidding, such as that between petitioner and respondent:

> An essential element of a publicly bidded contract is that all bidders must be on equal footing. Not simply in terms of application of the procedural rules and regulations imposed by the relevant government agency, but more importantly, on the contract bidded upon. Each bidder must be able to bid on the same thing. The rationale is obvious. *If the winning bidder is allowed to later include or modify certain provisions in the contract awarded such that the contract is altered in any material respect, then the essence of fair competition in the public bidding is destroyed. A public bidding would indeed be a farce if after the contract is awarded, the winning bidder may modify the contract* and include provisions which are favorable to it that were not previously made available to the other bidders. Thus:
>
> > It is inherent in public biddings that there shall be a fair competition among the bidders. The specifications in such biddings provide the common ground or basis for the bidders. The specifications should, accordingly, operate equally or indiscriminately upon all bidders.
>
> The same rule was restated by Chief Justice Stuart of the Supreme Court of Minnesota:
>
> > The law is well settled that where, as in this case, municipal authorities can only let a contract for public work to the lowest responsible bidder, the proposals and specifications therefore must be so framed as to permit free and full competition. *Nor can they enter*

> *into a contract with the best bidder containing substantial provisions beneficial to him, not included or contemplated in the terms and specifications upon which the bids were invited.*[55] (Emphasis supplied)

By definition, liquidated damages are a penalty, meant to impress upon defaulting obligors the *graver* consequences of their own culpability. Liquidated damages must necessarily make non-compliance *more cumbersome* than compliance. Otherwise, contracts might as well make no threat of a penalty at all:

> Liquidated damages are those that the parties agree to be paid in case of a breach. As worded, the amount agreed upon answers for damages suffered by the owner due to delays in the completion of the project. Under Philippine laws, these damages take the nature of penalties. A penal clause is an accessory undertaking to assume greater liability in case of a breach. It is attached to an obligation in order to ensure performance.[56] (Citations omitted)

Respondent cannot now balk at the natural result of its own breach. As for the Court of Appeals, we find it to be in error in frustrating the express terms of the contract that respondent actively endeavored to be awarded to it. The exigencies that impelled petitioner to obtain fire trucks made it imperative for respondent to act with dispatch. Instead, it dragged its feet, left petitioner with inadequate means for addressing the very emergencies that engendered the need for fire trucks, and forced it into litigation to enforce its rights.

WHEREFORE, the Petition is **GRANTED**. The assailed May 2, 2008 Decision and November 25, 2008 Resolution of the Court of Appeals in CA G.R. CV No. 86406 are **REVERSED** and **SET ASIDE**. The Decision dated November 2, 2005 of Branch 108 of the Regional Trial Court of Pasay City in Civil Case No. 00-0343 is **REINSTATED**.

SO ORDERED.

Brion,[**] *(Acting Chairperson), Del Castillo*, and *Mendoza, JJ.*, concur.
Carpio, J., on official leave.

[**] Designated Acting Chairperson per Special Order No. 2374 dated September 14, 2016.

[1] *Rollo*, pp. 14-33. The Petition was filed under Rule 45 of the 1997 Rules of Civil Procedure.

[2] Id. at 35-58. The Decision was penned by Associate Justice Celia C. Librea-Leagogo and concurred in by Associate Justices Regalado E. Maambong and Agustin S. Dizon of the Sixteenth Division, Court of Appeals, Manila.

[3] Id. at 60-61. The Resolution was penned by Associate Justice Celia C. Librea-Leagogo and concurred in by Associate Justices Josefina Gievarra-Salonga and Regalado E. Maambong of the Special Former Sixteenth Division, Court of Appeals, Manila.

[4] Id. at 62-65. The Decision was penned by Pairing Judge Tingaraan U. Guiling.

[5] Id. at 65.

[6] Id. at 55.

[7] Id. at 61.

[8] Id. at 62.

[9] Id.

[10] Id.

[11] Id.

[12] Id.

[13] Id. at 75-77.

[14] Id.

[15] Id. at 78.

[16] Id.

[17] Id. at 79.

[18] Id. at 80-85.

[19] Id. at 62.

[20] Id. at 37.

[21] Id. at 38.

[22] Id. at 62-65.

[23] Id. at 65.

[24] Id. at 35-56.

[25] Id. at 51.

[26] Id. at 50.

[27] Id. at 51.

[28] Id. at 50.

[29] CIVIL CODE, art. 1229 provides:

Article 1229. The judge shall equitably reduce the penalty when the principal obligation has been partly or irregularly complied with by the debtor. Even if there has been no performance, the penalty may also be reduced by the courts if it is iniquitous or unconscionable.

[30] CIVIL CODE, art. 2227 provides:

Article 2227. Liquidated damages, whether intended as an indemnity or a penalty, shall be equitably reduced if they are iniquitous or unconscionable.

[31] *Rollo*, pp. 54-55.

[32] Id. at 60-61.

[33] Id. at 23.

[34] Id. at 24-26.

[35] Id. at 26-27

[36] Id. at 26.

[37] Id. at 27-28.

[38] Id. at 24.

[39] Id. at 232-241.

[40] Id. at 238.

[41] Id. at 238-239.

[42] CIVIL CODE, art. 2226 provides:

Article 2226. Liquidated damages are those agreed upon by the parties to a contract, to be paid in case of breach thereof.

[43] 413 Phil. 360 (2001) [Per J. Panganiban, Third Division].

[44] Id. at 372.

[45] Id. at 375.

[46] 499 Phil. 367 (2005) [Per J. Garcia, Third Division].

[47] Id. at 379-380.

[48] Subject to equitable reduction under Articles 1229 and 2227 of the Civil Code.

[49] *Laperal v. Solid Homes, Inc.*, 499 Phil. 367, 380-382 (2005) [Per J. Garcia, Third Division].

[50] *Spouses Alcaraz v. Tangga-an*, 449 Phil. 62, 73 (2003) [Per J. Corona, Third Division]. *See also Nissan Car Lease Phils., Inc. v. Lica Management, Inc.*, G.R. No. 176986, January 13, 2016 <http://sc.judiciary.gov.ph/pdf/web/viewer.html?file=/jurisprudence/2016/january2016/176986.pdf> [Per J. Jardeleza, Third Division].

[51] *Rollo*, p. 54.

[52] Id. at 66.

[53] Id. at 53.

[54] Id. at 24.

[55] *Agan, Jr. v. Philippine International Air Terminals Co., Inc.*, 450 Phil. 744, 814-815 (2006) [Per J. Puno, En Banc].

[56] *H.L. Carlos Construction, Inc. v. Marina Properties Corp.*, 466 Phil. 182, 205 (2004) [Per J. Panganiban, First Division].

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