

Title: Francisco Lao Lim vs. Court of Appeals and Benito Villavicencio Dy

Facts:

The legal battle between Francisco Lao Lim (petitioner) and Benito Villavicencio Dy (private respondent) revolved around a lease agreement initially set for three years (1976-1979) for a property owned by Lim. After the lease expired, Dy refused to vacate, leading Lim to file an ejectment suit which concluded with a compromise agreement allowing lease renewals every three years, conditioned on a 20% rental increase every renewal, provided Dy gives notice 60 days before expiry. Despite Dy's intent to renew for 1985-1988, Lim refused, prompting another ejectment suit by Lim when Dy did not vacate. The suit was dismissed at both municipal (Metropolitan Trial Court of Manila) and regional (Regional Trial Court of Manila) levels, with affirmance by the Court of Appeals, citing the lease's valid resolutory condition and the compromise agreement's effect of *res judicata*.

Issues:

1. The validity of the lease condition allowing perpetual renewal based on the lessee's need and capacity to pay.
2. The applicability of *res judicata* due to the compromise agreement in dismissing the subsequent ejectment suit.

Court's Decision:

The Supreme Court reversed the Court of Appeals' decision, holding that the lease condition was indeed purely potestative, leaving leasehold rights' effectivity to the lessee's discretion—thus invalid under Article 1308 of the Civil Code. The court distinguished this case from *Encarnacion vs. Baldomar* and clarified that perpetual leases contravene mutual contract principles. The court also found the action for ejectment not barred by *res judicata*, as there was no complete identity in subject matter and cause of action between the initial and subsequent ejectment suits. The Supreme Court ordered Dy to vacate the premises and pay due rentals according to the compromise agreement until vacating.

Doctrine:

1. A lease's continuance and effectivity cannot depend exclusively on the lessee's will, aligning with mutual contract principles and Article 1308 of the Civil Code.
2. A compromise agreement producing the effect of *res judicata* does not preclude subsequent actions arising from violations of its terms when there is no identity of subject matter and cause of action.

Class Notes:

- Lease contracts should have definite terms and cannot be perpetually renewable at the lessee's sole discretion.
- Conditions making a contract's obligations dependent solely on one party's will are invalid.
- The doctrine of res judicata requires finality of judgment, jurisdiction over subject matter and parties, judgment on the merits, and identity of parties, subject matter, and cause of action between cases.
- A compromise agreement is subject to interpretation within the legal bounds, ensuring mutual agreement requirements for contract renewal.

Historical Background:

This case reflects judicial scrutiny over lease agreements and emphasizes the necessity for clear, definitive terms that safeguard both parties' interests. It also underscores the Philippine legal system's stance against perpetual obligations that place disproportionate control in the hands of one party. Through this ruling, the Supreme Court reinforced principles of contract mutuality and the limits of compromise agreements in successive legal disputes.