SPOUSES MARIANO Z. VELARDE AND AVELINA D. VELARDE, PETITIONERS, VS. COURT OF APPEALS, DAVID A. RAYMUNDO AND GEORGE RAYMUNDO, RESPONDENTS.

G.R. No. 108346. July 11, 2001

Ponente: PANGANIBAN, J.

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PANGANIBAN, J.:

A substantial breach of a reciprocal obligation, like failure to pay the price in the manner prescribed by the contract, entitles the injured party to rescind the obligation. Rescission abrogates the contract from its inception and requires a mutual restitution of benefits received.

The Case

Before us is a Petition for Review on Certiorari[1] questioning the Decision[2] of the Court of Appeals (CA) in CA-GR CV No. 32991 dated October 9, 1992, as well as its Resolution[3] dated December 29, 1992 denying petitioner's motion for reconsideration.[4]

The dispositive portion of the assailed Decision reads:

> "WHEREFORE, the Order dated May 15, 1991 is hereby ANNULLED and SET ASIDE and the Decision dated November 14, 1990 dismissing the [C]omplaint is REINSTATED. The bonds posted by plaintiffs-appellees and defendants-appellants are hereby RELEASED."[5]

The Facts

The factual antecedents of the case, as found by the CA, are as follows:

> "x x x. David Raymundo [herein private respondent] is the absolute and registered owner of a parcel of land, together with the house and other improvements thereon, located at 1918 Kamias St., Dasmariñas Village, Makati and covered by TCT No. 142177. Defendant George Raymundo [herein private respondent] is David's father who negotiated with plaintiffs Avelina and Mariano Velarde [herein petitioners] for the sale of said property, which was, however, under lease (Exh. `6', p. 232, Record of Civil Case No. 15952).
>
> "On August 8, 1986, a Deed of Sale with Assumption of Mortgage (Exh. 'A'; Exh. `1', pp. 11-12, Record) was executed by defendant David Raymundo, as vendor, in favor of plaintiff Avelina Velarde, as vendee, with the following terms and conditions:
> `x x x x x x x x x
>
> `That for and in consideration of the amount of EIGHT HUNDRED THOUSAND PESOS (P800,000.00), Philippine currency, receipt of which in full is hereby acknowledged by the VENDOR from the VENDEE, to his entire and complete satisfaction, by these presents the VENDOR hereby SELLS, CEDES, TRANSFERS, CONVEYS AND DELIVERS, freely and voluntarily, with full warranty of a legal and valid title as provided by law, unto the VENDEE, her heirs, successors and assigns, the parcel of land mentioned and described above, together with the house and other improvements thereon.

> `That the aforesaid parcel of land, together with the house and other improvements thereon, were mortgaged by the VENDOR to the BANK OF THE PHILIPPINE ISLANDS, Makati, Metro Manila, to secure the payment of a loan of ONE MILLION EIGHT HUNDRED THOUSAND PESOS (P1,800,000.00), Philippine currency, as evidenced by a Real Estate Mortgage signed and executed by the VENDOR in favor of the said Bank of the Philippine Islands, on_____ and which Real Estate Mortgage was ratified before Notary Public for Makati, _____, as Doc. No. ____, Page No. ___, Book No. ___, Series of 1986 of his Notarial Register.
>
> `That as part of the consideration of this sale, the VENDEE hereby assumes to pay the mortgage obligations on the property herein sold in the amount of ONE MILLION EIGHT HUNDRED THOUSAND PESOS (P1,800,000.00), Philippine currency, in favor of Bank of the Philippine Islands, in the name of the VENDOR, and further agrees to strictly and faithfully comply with all the terms and conditions appearing in the Real Estate Mortgage signed and executed by the VENDOR in favor of BPI, including interests and other charges for late payment levied by the Bank, as if the same were originally signed and executed by the VENDEE.
>
> `It is further agreed and understood by the parties herein that the capital gains tax and documentary stamps on the sale shall be for the account of the VENDOR; whereas, the registration fees and transfer tax thereon shall be for the account of the VENDEE.' (Exh. `A', pp. 11-12, Record).'

"On the same date, and as part of the above-document, plaintiff Avelina Velarde, with the consent of her husband, Mariano, executed an Undertaking (Exh. `C', pp. 13-14, Record), the pertinent portions of which read, as follows:

> `x x x x x x x x x
>
> `Whereas, as per Deed of Sale with Assumption of Mortgage, I paid Mr. David A. Raymundo the sum of EIGHT HUNDRED THOUSAND PESOS (P800,000.00), Philippine currency, and assume the mortgage obligations on the property with the Bank of the Philippine Islands in the amount of ONE MILLION EIGHT HUNDRED THOUSAND PESOS (P1,800,000.00), Philippine currency, in accordance with the terms and conditions of the Deed of Real Estate Mortgage dated _____, signed and executed by Mr. David A. Raymundo with the said Bank, acknowledged before Notary Public for Makati, _____, as Doc. No. ___, Page No. ___, Book No. __, Series of 1986 of his Notarial Register.
>
> `WHEREAS, while my application for the assumption of the mortgage obligations on the property is not yet approved by the mortgagee Bank, I have agreed to pay the mortgage obligations on the property with the Bank in the name of Mr. David A. Raymundo, in accordance with the terms and conditions of the said Deed of Real Estate Mortgage, including all interests and other charges for late payment.
>
> `WHEREAS, this undertaking is being executed in favor of Mr. David A. Raymundo, for purposes of attesting and confirming our private understanding concerning the said mortgage obligations to be assumed.
>
> `NOW, THEREFORE, for and in consideration of the foregoing premises, and the assumption of the mortgage obligations of ONE MILLION EIGHT HUNDRED THOUSAND PESOS (P1,800,000.00), Philippine currency, with the Bank of the Philippine islands, I, Mrs. Avelina D. Velarde, with the consent of my husband, Mariano Z. Velarde, do hereby bind and obligate myself, my heirs, successors and assigns, to strictly and faithfully comply with the following terms and conditions:
>
> `1. That until such time as my assumption of the mortgage obligations on the property purchased is approved by the mortgagee bank, the Bank of the Philippine Islands, I shall continue to pay the said loan in accordance with the terms and conditions of the Deed of Real Estate Mortgage in the name of Mr. David A. Raymundo, the original Mortgagor.
>
> `2. That, in the event I violate any of the terms and conditions of the said Deed of Real Estate Mortgage, I hereby agree that my downpayment of P800,000.00, plus all payments made with the Bank of the Philippine Islands on the mortgage loan, shall be forfeited in favor of Mr. David A. Raymundo, as and by way of liquidated damages, without necessity of notice or any judicial declaration to that effect, and Mr. David A

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> Raymundo shall resume total and complete ownership and possession of the property sold by way of Deed of Sale with Assumption of Mortgage, and the same shall be deemed automatically cancelled and be of no further force or effect, in the same manner as if (the) same had never been executed or entered into.
>
> `3. That I am executing this Undertaking for purposes of binding myself, my heirs, successors and assigns, to strictly and faithfully comply with the terms and conditions of the mortgage obligations with the Bank of the Philippine Islands, and the covenants, stipulations and provisions of this Undertaking.
>
> `That, David A. Raymundo, the vendor of the property mentioned and identified above, [does] hereby confirm and agree to the undertakings of the Vendee pertinent to the assumption of the mortgage obligations by the Vendee with the Bank of the Philippine Islands. (Exh. `C', pp. 13-14, Record).'

"This undertaking was signed by Avelina and Mariano Velarde and David Raymundo.

"It appears that the negotiated terms for the payment of the balance of P1.8 million was from the proceeds of a loan that plaintiffs were to secure from a bank with defendant's help. Defendants had a standing approved credit line with the Bank of the Philippine Islands (BPI). The parties agreed to avail of this, subject to BPI's approval of an application for assumption of mortgage by plaintiffs. Pending BPI's approval o[f] the application, plaintiffs were to continue paying the monthly interests of the loan secured by a real estate mortgage.

"Pursuant to said agreements, plaintiffs paid BPI the monthly interest on the loan secured by the aforementioned mortgage for three (3) months as follows: September 19, 1986 at P27,225.00; October 20, 1986 at P23,000.00; and November 19, 1986 at P23,925.00 (Exh. `E', `H' & `J', pp. 15, 17 and 18, Record).

"On December 15, 1986, plaintiffs were advised that the Application for Assumption of Mortgage with BPI was not approved (Exh. `J', p. 133, Record). This prompted plaintiffs not to make any further payment.

"On January 5, 1987, defendants, thru counsel, wrote plaintiffs informing the latter that their non-payment to the mortgage bank constitute[d] non-performance of their obligation (Exh. `3', p. 220, Record).

"In a Letter dated January 7, 1987, plaintiffs, thru counsel, responded, as follows:

> `This is to advise you, therefore, that our client is willing to pay the balance in cash not later than January 21, 1987 provided: (a) you deliver actual possession of the property to her not later than January 15, 1987 for her immediate occupancy; (b) you cause the release of title and mortgage from the Bank of P.I. and make the title available and free from any liens and encumbrances; and (c) you execute an absolute deed of sale in her favor free from any liens or encumbrances not later than January 21, 1987.' (Exhs. `K', `4', p. 223, Record).

"On January 8, 1987, defendants sent plaintiffs a notarial notice of cancellation/rescission of the intended sale of the subject property allegedly due to the latter's failure to comply with the terms and conditions of the Deed of Sale with Assumption of Mortgage and the Undertaking (Exh. `5', pp. 225-226, Record).'"[6]

Consequently, petitioners filed on February 9, 1987 a Complaint against private respondents for specific performance, nullity of cancellation, writ of possession and damages. This was docketed as Civil Case No. 15952 at the Regional Trial Court of Makati, Branch 149. The case was tried and heard by then Judge Consuelo Ynares-Santiago (now an associate justice of this Court), who dismissed the Complaint in a Decision dated November 14, 1990.[7] Thereafter, petitioners filed a Motion for Reconsideration.[8]

Meanwhile, then Judge Ynares-Santiago was promoted to the Court of Appeals and Judge Salvador S. A. Abad Santos was assigned to the sala she vacated. In an Order dated May 15, 1991,[9] Judge Abad Santos granted petitioners' Motion for Reconsideration and directed the parties to proceed with the sale. He instructed petitioners to pay the balance of P1.8 million to private respondents who, in turn, were ordered to execute a deed of absolute

sale and to surrender possession of the disputed property to petitioners.

Private respondents appealed to the CA.

Ruling of the Court of Appeals

The CA set aside the Order of Judge Abad Santos and reinstated then Judge Ynares-Santiago's earlier Decision dismissing petitioners' Complaint. Upholding the validity of the rescission made by private respondents, the CA explained its ruling in this wise:

> "In the Deed of Sale with Assumption of Mortgage, it was stipulated that `as part of the consideration of this sale, the VENDEE (Velarde)' would assume to pay the mortgage obligation on the subject property in the amount of P1.8 million in favor of BPI in the name of the Vendor (Raymundo). Since the price to be paid by the Vendee Velarde includes the downpayment of P800,000.00 and the balance of P1.8 million, and the balance of P1.8 million cannot be paid in cash, Vendee Velarde, as part of the consideration of the sale, had to assume the mortgage obligation on the subject property. In other words, the assumption of the mortgage obligation is part of the obligation of Velarde, as vendee, under the contract. Velarde further agreed `to strictly and faithfully comply with all the terms and conditions appearing in the Real Estate Mortgage signed and executed by the VENDOR in favor of BPI x x x as if the same were originally signed and executed by the Vendee.' (p.2, thereof, p.12, Record). This was reiterated by Velarde in the document entitled `Undertaking' wherein the latter agreed to continue paying said loan in accordance with the terms and conditions of the Deed of Real Estate Mortgage in the name of Raymundo. Moreover, it was stipulated that in the event of violation by Velarde of any terms and conditions of said deed of real estate mortgage, the downpayment of P800,000.00 plus all payments made with BPI or the mortgage loan would be forfeited and the [D]eed of [S]ale with [A]ssumption of [M]ortgage would thereby be cancelled automatically and of no force and effect (pars. 2 & 3, thereof, pp. 13-14, Record).
>
> "From these 2 documents, it is therefore clear that part of the consideration of the sale was the assumption by Velarde of the mortgage obligation of Raymundo in the amount of P1.8 million. This would mean that Velarde had to make payments to BPI under the [D]eed of [R]eal [E]state [M]ortgage in the name of Raymundo. The application with BPI for the approval of the assumption of mortgage would mean that, in case of approval, payment of the mortgage obligation will now be in the name of Velarde. And in the event said application is disapproved, Velarde had to pay in full. This is alleged and admitted in Paragraph 5 of the Complaint. Mariano Velarde likewise admitted this fact during the hearing on September 15, 1997 (p. 47, t.s.n., September 15, 1987; see also pp. 16-26, t.s.n., October 8, 1989). This being the case, the non-payment of the mortgage obligation would result in a violation of the contract. And, upon Velarde's failure to pay the agreed price, the[n] Raymundo may choose either of two (2) actions - (1) demand fulfillment of the contract, or (2) demand its rescission (Article 1191, Civil Code).
>
> "The disapproval by BPI of the application for assumption of mortgage cannot be used as an excuse for Velarde's non-payment of the balance of the purchase price. As borne out by the evidence, Velarde had to pay in full in case of BPI's disapproval of the application for assumption of mortgage. What Velarde should have done was to pay the balance of P1.8 million. Instead, Velarde sent Raymundo a letter dated January 7, 1987 (Exh. `K', `4') which was strongly given weight by the lower court in reversing the decision rendered by then Judge Ynares-Santiago. In said letter, Velarde registered their willingness to pay the balance in cash but enumerated 3 new conditions which, to the mind of this Court, would constitute a new undertaking or new agreement which is subject to the consent or approval of Raymundo. These 3 conditions were not among those previously agreed upon by Velarde and Raymundo. These are mere offers or, at most, an attempt to novate. But then again, there can be no novation because there was no agreement of all the parties to the new contract (Garcia, Jr. vs. Court of Appeals, 191 SCRA 493).
>
> "It was likewise agreed that in case of violation of the mortgage obligation, the Deed of Sale with Assumption

> of Mortgage would be deemed `automatically cancelled and of no further force and effect, as if the same had never been executed or entered into.' While it is true that even if the contract expressly provided for automatic rescission upon failure to pay the price, the vendee may still pay, he may do so only for as long as no demand for rescission of the contract has been made upon him either judicially or by a notarial act (Article 1592, Civil Code). In the case at bar, Raymundo sent Velarde a notarial notice dated January 8, 1987 of cancellation/rescission of the contract due to the latter's failure to comply with their obligation. The rescission was justified in view of Velarde's failure to pay the price (balance) which is substantial and fundamental as to defeat the object of the parties in making the agreement. As adverted to above, the agreement of the parties involved a reciprocal obligation wherein the obligation of one is a resolutory condition of the obligation of the other, the non-fulfillment of which entitles the other party to rescind the contract (Songcuan vs. IAC, 191 SCRA 28). Thus, the non-payment of the mortgage obligation by appellees Velarde would create a right to demand payment or to rescind the contract, or to criminal prosecution (Edca Publishing & Distribution Corporation vs. Santos, 184 SCRA 614). Upon appellees' failure, therefore, to pay the balance, the contract was properly rescinded (Ruiz vs. IAC, 184 SCRA 720). Consequently, appellees Velarde having violated the contract, they have lost their right to its enforcement and hence, cannot avail of the action for specific performance (Voysaw vs. Interphil Promotions, Inc., 148 SCRA 635)."[10]

Hence, this appeal.[11]

The Issues

Petitioners, in their Memorandum,[12] interpose the following assignment of errors:

> "I.
>
> The Court of Appeals erred in holding that the non-payment of the mortgage obligation resulted in a breach of the contract.
>
> "II.
>
> The Court of Appeals erred in holding that the rescission (resolution) of the contract by private respondents was justified.
>
> "III.
>
> The Court of Appeals erred in holding that petitioners' January 7, 1987 letter gave three `new conditions' constituting mere offers or an attempt to novate necessitating a new agreement between the parties."

The Court's Ruling

The Petition is partially meritorious.

First Issue:
Breach of Contract

Petitioners aver that their nonpayment of private respondents' mortgage obligation did not constitute a breach of contract, considering that their request to assume the obligation had been disapproved by the mortgagee bank. Accordingly, payment of the monthly amortizations ceased to be their obligation and, instead, it devolved upon private respondents again.

However, petitioners did not merely stop paying the mortgage obligations; they also failed to pay the balance of the purchase price. As admitted by both parties, their agreement mandated that petitioners should pay the purchase price balance of P1.8 million to private respondents in case the request to assume the mortgage would be disapproved. Thus, on December 15, 1986, when petitioners received notice of the bank's disapproval of their

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application to assume respondents' mortgage, they should have paid the balance of the P1.8 million loan.

Instead of doing so, petitioners sent a letter to private respondents offering to make such payment only upon the fulfillment of certain conditions not originally agreed upon in the contract of sale. Such conditional offer to pay cannot take the place of actual payment as would discharge the obligation of a buyer under a contract of sale.

In 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.[13] Private respondents had already performed their obligation through the execution of the Deed of Sale, which effectively transferred ownership of the property to petitioner through constructive delivery. Prior physical delivery or possession is not legally required, and the execution of the Deed of Sale is deemed equivalent to delivery.[14]

Petitioners, on the other hand, did not perform their correlative obligation of paying the contract price in the manner agreed upon. Worse, they wanted private respondents to perform obligations beyond those stipulated in the contract before fulfilling their own obligation to pay the full purchase price.

Second Issue
Validity of the Rescission

Petitioners likewise claim that the rescission of the contract by private respondents was not justified, inasmuch as the former had signified their willingness to pay the balance of the purchase price only a little over a month from the time they were notified of the disapproval of their application for assumption of mortgage. Petitioners also aver that the breach of the contract was not substantial as would warrant a rescission. They cite several cases[15] in which this Court declared that rescission of a contract would not be permitted for a slight or casual breach. Finally, they argue that they have substantially performed their obligation in good faith, considering that they have already made the initial payment of P800,000 and three (3) monthly mortgage payments.

As pointed out earlier, the breach committed by petitioners was not so much their nonpayment of the mortgage obligations, as their nonperformance of their reciprocal obligation to pay the purchase price under the contract of sale. Private respondents' right to rescind the contract finds basis in Article 1191 of the Civil Code, which explicitly provides as follows:

> "Art. 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 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 right of rescission of a party to an obligation under Article 1191 of the Civil Code is predicated on a breach of faith by the other party who violates the reciprocity between them.[16] The breach contemplated in the said provision is the obligor's failure to comply with an existing obligation.[17] When the obligor cannot comply with what is incumbent upon it, the obligee may seek rescission and, in the absence of any just cause for the court to determine the period of compliance, the court shall decree the rescission.[18]

In the present case, private respondents validly exercised their right to rescind the contract, because of the failure of petitioners to comply with their obligation to pay the balance of the purchase price. Indubitably, the latter violated the very essence of reciprocity in the contract of sale, a violation that consequently gave rise to private respondents' right to rescind the same in accordance with law.

True, petitioners expressed their willingness to pay the balance of the purchase price one month after it became

due; however, this was not equivalent to actual payment as would constitute a faithful compliance of their reciprocal obligation. Moreover, the offer to pay was conditioned on the performance by private respondents of additional burdens that had not been agreed upon in the original contract. Thus, it cannot be said that the breach committed by petitioners was merely slight or casual as would preclude the exercise of the right to rescind.

Misplaced is petitioners' reliance on the cases[19] they cited because the factual circumstances in those cases are not analogous to those in the present one. In Song Fo there was, on the part of the buyer, only a delay of twenty (20) days to pay for the goods delivered. Moreover, the buyer's offer to pay was unconditional and was accepted by the seller. In Zepeda, the breach involved a mere one-week delay in paying the balance of P1,000, which was actually paid. In Tan, the alleged breach was private respondent's delay of only a few days, which was for the purpose of clearing the title to the property; there was no reference whatsoever to the nonpayment of the contract price.

In the instant case, the breach committed did not merely consist of a slight delay in payment or an irregularity; such breach would not normally defeat the intention of the parties to the contract. Here, petitioners not only failed to pay the P1.8 million balance, but they also imposed upon private respondents new obligations as preconditions to the performance of their own obligation. In effect, the qualified offer to pay was a repudiation of an existing obligation, which was legally due and demandable under the contract of sale. Hence, private respondents were left with the legal option of seeking rescission to protect their own interest.

Mutual Restitution
Required in Rescission

As discussed earlier, the breach committed by petitioners was the nonperformance of a reciprocal obligation, not a violation of the terms and conditions of the mortgage contract. Therefore, the automatic rescission and forfeiture of payment clauses stipulated in the contract does not apply. Instead, Civil Code provisions shall govern and regulate the resolution of this controversy.

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 in the amounts of P27,225, P23,000 and P23,925 (totaling P874,150.00) advanced by petitioners 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.[20] 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.[21]

Third Issue
Attempt to Novate

In view of the foregoing discussion, the Court finds it no longer necessary to discuss the third issue raised by petitioners. Suffice it to say that the three conditions appearing on the January 7, 1987 letter of petitioners to private respondents were not part of the original contract. By that time, it was already incumbent upon the former to pay the balance of the sale price. They had no right to demand preconditions to the fulfillment of their obligation, which had become due.

WHEREFORE, the assailed Decision is hereby AFFIRMED with the MODIFICATION that private respondents are ordered to return to petitioners the amount of P874,150, which the latter paid as a consequence of the rescinded contract, with legal interest thereon from January 8, 1987, the date of rescission. No pronouncement as to costs.

SO ORDERED.

Melo, (Chairman), Vitug, and Sandoval-Gutierrez, JJ., concur.
Gonzaga-Reyes, J., on leave.

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[1] Rollo, pp. 37-53.

[2] Rollo, pp. 68-78. Penned by Justice Regina G. Ordoñez-Benitez and concurred in by Justices Gloria C. Paras (Division chairman) and Eduardo G. Montenegro (member).

[3] Rollo, p. 81.

[4] Rollo, pp. 21-33.

[5] CA Decision, p. 11; rollo, p. 20.

[6] Rollo, pp. 68-73.

[7] Records, pp. 280-284.

[8] Records, pp. 285-293.

[9] Records, pp. 339-341.

[10] Rollo, pp. 75-78.

[11] To eradicate its backlog of old cases, the Court on February 27, 2001 resolved to redistribute long-pending cases to justices who had no backlog, and who were thus tasked to prioritize them. Consequently, this case was raffled and assigned to the undersigned ponente for study and report.

[12] Rollo, p. 227.

[13] Coronel v. CA, 263 SCRA 15, October 7, 1996.

[14] Power Commercial and Industrial Corp. v. CA, 274 SCRA 597, June 20, 1997.

[15] Song Fo & Co. v. Hawaiian-Philippine Co., 47 Phil. 821, September 16, 1925; Tan v. Court of Appeals, 175 SCRA 656, July 28, 1989; and Zepeda v. Court of Appeals, 216 SCRA 293, December 9, 1992.

[16] Uy v. Court of Appeals, 314 SCRA 69, September 9, 1999; Romero v. Court of Appeals, 250 SCRA 223, November 23, 1995.

[17] Cheng v. Genato, 300 SCRA 722, December 29, 1998.

[18] Central Philippine University v. Court of Appeals, 246 SCRA 511, July 17, 1995.

[19] See footnote 15.

[20] Co v. Court of Appeals, 312 SCRA 528, August 17, 1999. Vitug, Compendium of Civil Law and Jurisprudence, 1993 revised ed., p. 556.

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[21] Ocampo v. Court of Appeals, 233 SCRA 551, June 30, 1994.

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