

FILINVEST LAND, INC., PETITIONER, VS. HON. COURT OF APPEALS, PHILIPPINE AMERICAN GENERAL INSURANCE COMPANY, AND PACIFIC EQUIPMENT CORPORATION, RESPONDENTS.

G.R. NO. 138980. September 20, 2005

Ponente: CHICO-NAZARIO, J.

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CHICO-NAZARIO, J.

This is a petition for review on certiorari of the Decision[1] of the Court of Appeals dated 27 May 1999 affirming the dismissal by the Regional Trial Court of Makati, Branch 65,[2] of the complaint for damages filed by Filinvest Land, Inc. (Filinvest) against herein private respondents Pacific Equipment Corporation (Pecorp) and Philippine American General Insurance Company.

The essential facts of the case, as recounted by the trial court, are as follows:

On 26 April 1978, Filinvest Land, Inc. ("FILINVEST", for brevity), a corporation engaged in the development and sale of residential subdivisions, awarded to defendant Pacific Equipment Corporation ("PACIFIC", for brevity) the development of its residential subdivisions consisting of two (2) parcels of land located at Payatas, Quezon City, the terms and conditions of which are contained in an "Agreement". (Annex A, Complaint). To guarantee its faithful compliance and pursuant to the agreement, defendant Pacific posted two (2) Surety Bonds in favor of plaintiff which were issued by defendant Philippine American General Insurance ("PHILAMGEN", for brevity). (Annexes B and C, Complaint).

Notwithstanding three extensions granted by plaintiff to defendant Pacific, the latter failed to finish the contracted works. (Annexes G, I and K, Complaint). On 16 October 1979, plaintiff wrote defendant Pacific advising the latter of its intention to takeover the project and to hold said defendant liable for all damages which it had incurred and will incur to finish the project. (Annex "L", Complaint).

On 26 October 1979, plaintiff submitted its claim against defendant Philamgen under its performance and guarantee bond (Annex M, Complaint) but Philamgen refused to acknowledge its liability for the simple reason that its principal, defendant Pacific, refused to acknowledge liability therefore. Hence, this action.

In defense, defendant Pacific claims that its failure to finish the contracted work was due to inclement weather and the fact that several items of finished work and change order which plaintiff refused to accept and pay for caused the disruption of work. Since the contractual relation between plaintiff and defendant Pacific created a reciprocal obligation, the failure of the plaintiff to pay its progressing bills estops it from demanding fulfillment of what is incumbent upon defendant Pacific. The acquiescence by plaintiff in granting three extensions to defendant Pacific is likewise a waiver of the former's right to claim any damages for the delay. Further, the unilateral and voluntary action of plaintiff in preventing defendant Pacific from completing the work has relieved the latter from the obligation of completing the same.

On the other hand, Philamgen contends that the various amendments made on the principal contract and the deviations in the implementation thereof which were resorted to by plaintiff and co-defendant Pacific without its (defendant Philamgen's) written consent thereto, have automatically released the latter from any or all

liability within the purview and contemplation of the coverage of the surety bonds it has issued. Upon agreement of the parties to appoint a commissioner to assist the court in resolving the issues confronting the parties, on 7 July 1981, an order was issued by then Presiding Judge Segundo M. Zosa naming Architect Antonio Dimalanta as Court Commissioner from among the nominees submitted by the parties to conduct an ocular inspection and to determine the amount of work accomplished by the defendant Pacific and the amount of work done by plaintiff to complete the project.

On 28 November 1984, the Court received the findings made by the Court Commissioner. In arriving at his findings, the Commissioner used the construction documents pertaining to the project as basis. According to him, no better basis in the work done or undone could be made other than the contract billings and payments made by both parties as there was no proper procedure followed in terminating the contract, lack of inventory of work accomplished, absence of appropriate record of work progress (logbook) and inadequate documentation and system of construction management.

Based on the billings of defendant Pacific and the payments made by plaintiff, the work accomplished by the former amounted to P11,788,282.40 with the exception of the last billing (which was not acted upon or processed by plaintiff) in the amount of P844,396.42. The total amount of work left to be accomplished by plaintiff was based on the original contract amount less value of work accomplished by defendant Pacific in the amount of P681,717.58 (12,470,000-11,788,282.42).

As regards the alleged repairs made by plaintiff on the construction deficiencies, the Court Commissioner found no sufficient basis to justify the same. On the other hand, he found the additional work done by defendant Pacific in the amount of P477,000.00 to be in order.

On 01 April 1985, plaintiff filed its objections to the Commissioner's Resolution on the following grounds:

- a) Failure of the commissioner to conduct a joint survey which according to the latter is indispensable to arrive at an equitable and fair resolution of the issues between the parties;
- b) The cost estimates of the commissioner were based on pure conjectures and contrary to the evidence; and,
- c) The commissioner made conclusions of law which were beyond his assignment or capabilities.

In its comment, defendant Pacific alleged that the failure to conduct joint survey was due to plaintiff's refusal to cooperate. In fact, it was defendant Pacific who initiated the idea of conducting a joint survey and inventory dating back 27 November 1983. And even assuming that a joint survey were conducted, it would have been an exercise in futility because all physical traces of the actual conditions then obtaining at the time relevant to the case had already been obliterated by plaintiff.

On 15 August 1990, a Motion for Judgment Based on the Commissioner's Resolution was filed by defendant Pacific.

On 11 October 1990, plaintiff filed its opposition thereto which was but a rehash of objections to the commissioner's report earlier filed by said plaintiff.[3]

On the basis of the commissioner's report, the trial court dismissed Filinvest's complaint as well as Pecorp's counterclaim. It held:

In resolving this case, the court observes that the appointment of a Commissioner was a joint undertaking among the parties. The findings of facts of the Commissioner should therefore not only be conclusive but final among the parties. The court therefore agrees with the commissioner's findings with respect to

- Cost to repair deficiency or defect – P532,324.02
- Unpaid balance of work done by defendant - P1,939,191.67

- Additional work/change order (due to defendant) – P475,000.00

The unpaid balance due defendant therefore is P1,939,191.67. To this amount should be added additional work performed by defendant at plaintiff's instance in the sum of P475,000.00. And from this total of P2,414,191.67 should be deducted the sum of P532,324.01 which is the cost to repair the deficiency or defect in the work done by defendant. The commissioner arrived at the figure of P532,324.01 by getting the average between plaintiff's claim of P758,080.37 and defendant's allegation of P306,567.67. The amount due to defendant per the commissioner's report is therefore P1,881,867.66.

Although the said amount of P1,881,867.66 would be owing to defendant Pacific, the fact remains that said defendant was in delay since April 25, 1979. The third extension agreement of September 15, 1979 is very clear in this regard. The pertinent paragraphs read:

a)

You will complete all the unfinished works not later than Oct. 15, 1979. It is agreed and understood that this date shall DEFINITELY be the LAST and FINAL extension & there will be no further extension for any cause whatsoever.

b)

We are willing to waive all penalties for delay which have accrued since April 25, 1979 provided that you are able to finish all the items of the contracted works as per revised CPM; otherwise you shall continue to be liable to pay the penalty up to the time that all the contracted works shall have been actually finished, in addition to other damages which we may suffer by reason of the delays incurred.

Defendant Pacific therefore became liable for delay when it did not finish the project on the date agreed on October 15, 1979. The court however, finds the claim of P3,990,000.00 in the form of penalty by reason of delay (P15,000.00/day from April 25, 1979 to Jan. 15, 1980) to be excessive. A forfeiture of the amount due defendant from plaintiff appears to be a reasonable penalty for the delay in finishing the project considering the amount of work already performed and the fact that plaintiff consented to three prior extensions.

The foregoing considered, this case is dismissed. The counterclaim is likewise dismissed.

No Costs.[4]

The Court of Appeals, finding no reversible error in the appealed decision, affirmed the same.

Hence, the instant petition grounded solely on the issue of whether or not the liquidated damages agreed upon by the parties should be reduced considering that: (a) time is of the essence of the contract; (b) the liquidated damages was fixed by the parties to serve not only as penalty in case Pecorp fails to fulfill its obligation on time, but also as indemnity for actual and anticipated damages which Filinvest may suffer by reason of such failure; and (c) the total liquidated damages sought is only 32% of the total contract price, and the same was freely and voluntarily agreed upon by the parties.

At the outset, it should be stressed that as only the issue of liquidated damages has been elevated to this Court, petitioner Filinvest is deemed to have acquiesced to the other matters taken up by the courts below. Section 1, Rule 45 of the 1997 Rules of Court states in no uncertain terms that this Court's jurisdiction in petitions for review on certiorari is limited to "questions of law which must be distinctly set forth." [5] By assigning only one legal issue, Filinvest has effectively cordoned off any discussion into the factual issue raised before the Court of Appeals. [6] In effect, Filinvest has yielded to the decision of the Court of Appeals, affirming that of the trial

court, in deferring to the factual findings of the commissioner assigned to the parties' case. Besides, as a general rule, factual matters cannot be raised in a petition for review on certiorari. This Court at this stage is limited to reviewing errors of law that may have been committed by the lower courts.[7] We do not perceive here any of the exceptions to this rule; hence, we are restrained from conducting further scrutiny of the findings of fact made by the trial court which have been affirmed by the Court of Appeals. Verily, factual findings of the trial court, especially when affirmed by the Court of Appeals, are binding and conclusive on the Supreme Court.[8] Thus, it is settled that:

(a)

Based on Pecorps billings and the payments made by Filinvest, the balance of work to be accomplished by Pecorp amounts to P681,717.58 representing 5.47% of the contract work. This means to say that Pecorp, at the time of the termination of its contract, accomplished 94.53% of the contract work;

(b)

The unpaid balance of work done by Pecorp amounts to P1,939,191.67;

(c)

The additional work/change order due Pecorp amounts to P475,000.00;

(d)

The cost to repair deficiency or defect, which is for the account of Pecorp, is P532,324.02; and

(e)

The total amount due Pecorp is P1,881,867.66.

Coming now to the main matter, Filinvest argues that the penalty in its entirety should be respected as it was a product of mutual agreement and it represents only 32% of the P12,470,000.00 contract price, thus, not shocking and unconscionable under the circumstances. Moreover, the penalty was fixed to provide for actual or anticipated liquidated damages and not simply to ensure compliance with the terms of the contract; hence, pursuant to *Laureano v. Kilayco*,[9] courts should be slow in exercising the authority conferred by Art. 1229 of the Civil Code.

We are not swayed.

There is no question that the penalty of P15,000.00 per day of delay was mutually agreed upon by the parties and that the same is sanctioned by law. A penal clause is an accessory undertaking to assume greater liability in case of breach.[10] It is attached to an obligation in order to insure performance[11] and has a double function: (1) to provide for liquidated damages, and (2) to strengthen the coercive force of the obligation by the threat of greater responsibility in the event of breach.[12] Article 1226 of the Civil Code states:

Art. 1226. In obligations with a penal clause, the penalty shall substitute the indemnity for damages and the payment of interests in case of noncompliance, if there is no stipulation to the contrary. Nevertheless, damages

shall be paid if the obligor refuses to pay the penalty or is guilty of fraud in the fulfillment of the obligation.

The penalty may be enforced only when it is demandable in accordance with the provisions of this Code.

As a general rule, courts are not at liberty to ignore the freedom of the parties to agree on such terms and conditions as they see fit as long as they are not contrary to law, morals, good customs, public order or public policy.[13] Nevertheless, courts may equitably reduce a stipulated penalty in the contract in two instances: (1) if the principal obligation has been partly or irregularly complied; and (2) even if there has been no compliance if the penalty is iniquitous or unconscionable in accordance with Article 1229 of the Civil Code which provides:

Art. 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.

In herein case, the trial court ruled that the penalty charge for delay – pegged at P15,000.00 per day of delay in the aggregate amount of P3,990,000.00 -- was excessive and accordingly reduced it to P1,881,867.66 "considering the amount of work already performed and the fact that [Filinvest] consented to three (3) prior extensions." The Court of Appeals affirmed the ruling but added as well that the penalty was unconscionable "as the construction was already not far from completion." Said the Court of Appeals:

Turning now to plaintiff's appeal, We likewise agree with the trial court that a penalty interest of P15,000.00 per day of delay as liquidated damages or P3,990,000.00 (representing 32% penalty of the P12,470,000.00 contract price) is unconscionable considering that the construction was already not far from completion. Penalty interests are in the nature of liquidated damages and may be equitably reduced by the courts if they are iniquitous or unconscionable (*Garcia v. Court of Appeals*, 167 SCRA 815, *Lambert v. Fox*, 26 Phil. 588). 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 (Art. 1229, New Civil Code). Moreover, plaintiff's right to indemnity due to defendant's delay has been cancelled by its obligations to the latter consisting of unpaid works.

This Court finds no fault in the cost estimates of the court-appointed commissioner as to the cost to repair deficiency or defect in the works which was based on the average between plaintiff's claim of P758,080.37 and defendant's P306,567.67 considering the following factors: that "plaintiff did not follow the standard practice of joint survey upon take over to establish work already accomplished, balance of work per contract still to be done, and estimate and inventory of repair" (Exhibit "H"). As for the cost to finish the remaining works, plaintiff's estimates were brushed aside by the commissioner on the reasoned observation that "plaintiff's cost estimate for work (to be) done by the plaintiff to complete the project is based on a contract awarded to another contractor (JPT), the nature and magnitude of which appears to be inconsistent with the basic contract between defendant PECORP and plaintiff FILINVEST." [14]

We are hamstrung to reverse the Court of Appeals as it is rudimentary that the application of Article 1229 is essentially addressed to the sound discretion of the court.[15] As it is settled that the project was already 94.53% complete and that Filinvest did agree to extend the period for completion of the project, which extensions Filinvest included in computing the amount of the penalty, the reduction thereof is clearly warranted.

Filinvest, however, hammers on the case of *Laureano v. Kilayco*, [16] decided in 1915, which cautions courts to distinguish between two kinds of penalty clauses in order to better apply their authority in reducing the amount recoverable. We held therein that:

. . . [I]n any case wherein there has been a partial or irregular compliance with the provisions in a contract for special indemnification in the event of failure to comply with its terms, courts will rigidly apply the doctrine of strict construction against the enforcement in its entirety of the indemnification, where it is clear from the

terms of the contract that the amount or character of the indemnity is fixed without regard to the probable damages which might be anticipated as a result of a breach of the terms of the contract; or, in other words, where the indemnity provided for is essentially a mere penalty having for its principal object the enforcement of compliance with the contract. But the courts will be slow in exercising the jurisdiction conferred upon them in article 1154[17] so as to modify the terms of an agreed upon indemnification where it appears that in fixing such indemnification the parties had in mind a fair and reasonable compensation for actual damages anticipated as a result of a breach of the contract, or, in other words, where the principal purpose of the indemnification agreed upon appears to have been to provide for the payment of actual anticipated and liquidated damages rather than the penalization of a breach of the contract. (Emphases supplied)

Filinvest contends that the subject penalty clause falls under the second type, i.e., the principal purpose for its inclusion was to provide for payment of actual anticipated and liquidated damages rather than the penalization of a breach of the contract. Thus, Filinvest argues that had Pecorp completed the project on time, it (Filinvest) could have sold the lots sooner and earned its projected income that would have been used for its other projects.

Unfortunately for Filinvest, the above-quoted doctrine is inapplicable to herein case. The Supreme Court in Laureano instructed that a distinction between a penalty clause imposed essentially as penalty in case of breach and a penalty clause imposed as indemnity for damages should be made in cases where there has been neither partial nor irregular compliance with the terms of the contract. In cases where there has been partial or irregular compliance, as in this case, there will be no substantial difference between a penalty and liquidated damages insofar as legal results are concerned.[18] The distinction is thus more apparent than real especially in the light of certain provisions of the Civil Code of the Philippines which provides in Articles 2226 and Article 2227 thereof:

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

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

Thus, we lamented in one case that "(t)here is no justification for the Civil Code to make an apparent distinction between a penalty and liquidated damages because the settled rule is that there is no difference between penalty and liquidated damages insofar as legal results are concerned and that either may be recovered without the necessity of proving actual damages and both may be reduced when proper." [19]

Finally, Filinvest advances the argument that while it may be true that courts may mitigate the amount of liquidated damages agreed upon by the parties on the basis of the extent of the work done, this contemplates a situation where the full amount of damages is payable in case of total breach of contract. In the instant case, as the penalty clause was agreed upon to answer for delay in the completion of the project considering that time is of the essence, "the parties thus clearly contemplated the payment of accumulated liquidated damages despite, and precisely because of, partial performance." [20] In effect, it is Filinvest's position that the first part of Article 1229 on partial performance should not apply precisely because, in all likelihood, the penalty clause would kick in in situations where Pecorp had already begun work but could not finish it on time, thus, it is being penalized for delay in its completion.

The above argument, albeit sound,[21] is insufficient to reverse the ruling of the Court of Appeals. It must be remembered that the Court of Appeals not only held that the penalty should be reduced because there was partial compliance but categorically stated as well that the penalty was unconscionable. Otherwise stated, the Court of Appeals affirmed the reduction of the penalty not simply because there was partial compliance per se on the part of Pecorp with what was incumbent upon it but, more fundamentally, because it deemed the penalty unconscionable in the light of Pecorp's 94.53% completion rate.

In *Ligutan v. Court of Appeals*,^[22] we pointed out that the question of whether a penalty is reasonable or iniquitous can be partly subjective and partly objective as its "resolution would depend on such factors as, but not necessarily confined to, the type, extent and purpose of the penalty, the nature of the obligation, the mode of breach and its consequences, the supervening realities, the standing and relationship of the parties, and the like, the application of which, by and large, is addressed to the sound discretion of the court."^[23]

In herein case, there has been substantial compliance in good faith on the part of Pecorp which renders unconscionable the application of the full force of the penalty especially if we consider that in 1979 the amount of P15,000.00 as penalty for delay per day was quite steep indeed. Nothing in the records suggests that Pecorp's delay in the performance of 5.47% of the contract was due to it having acted negligently or in bad faith. Finally, we factor in the fact that Filinvest is not free of blame either as it likewise failed to do that which was incumbent upon it, i.e., it failed to pay Pecorp for work actually performed by the latter in the total amount of P1,881,867.66. Thus, all things considered, we find no reversible error in the Court of Appeals' exercise of discretion in the instant case.

Before we write *finis* to this legal contest that had spanned across two and a half decades, we take note of Pecorp's own grievance. From its Comment and Memorandum, Pecorp, likewise, seeks affirmative relief from this Court by praying that not only should the instant case be dismissed for lack of merit, but that Filinvest should likewise be made to pay "what the Court Commissioner found was due defendant" in the "total amount of P2,976,663.65 plus 12% interest from 1979 until full payment thereof plus attorneys fees."^[24] Pecorp, however, cannot recover that which it seeks as we had already denied, in a Resolution dated 21 June 2000, its own petition for review of the 27 May 1999 decision of the Court of Appeals. Thus, as far as Pecorp is concerned, the ruling of the Court of Appeals has already attained finality and can no longer be disturbed.

WHEREFORE, premises considered, the Decision of the Court of Appeals dated 27 May 1999 is **AFFIRMED**. No pronouncement as to costs.

SO ORDERED.

Puno (chairman), Austria-Martinez, Callejo, Sr., and Tinga, JJ., concur.

[1] Penned by Associate Justice Portia Aliño-Hormachuelos with Associate Justices Buenaventura J. Guerrero and Eloy R. Bello, Jr., concurring.

[2] Penned by Judge Salvador S. Abad Santos.

[3] Rollo, pp. 114-116.

[4] *Id.*, pp. 116-117.

[5] Section 1. Filing of petition with the Supreme Court. – A party desiring to appeal by certiorari from a judgment or final order or resolution of the Court of Appeals, the Sandiganbayan, the Regional Trial Court or other courts whenever authorized by law, may file with the Supreme Court a verified petition for review on certiorari. The petition shall raise only questions of law which must be distinctly set forth.

[6] *Cf Ponce, et al. v. National Labor Relations Commission, et al.*, G.R. No. 158244, 09 August 2005.

[7] *Alvarez v. Court of Appeals*, G.R. No. 142843, 06 August 2003, 408 SCRA 419, 429 (citations omitted).

[8] *Ibid.*

[9] 32 Phil. 194

[10] Social Security System v. Moonwalk Development and Housing Corporation, G.R. No. 73345, 07 April 1993, 221 SCRA 119, 127, citing 4 Tolentino, Civil Code of the Philippines, p. 259 (1991 ed.).

[11] H.L. Carlos Construction, Inc. v. Marina Properties Corporation, G.R. No. 147614, 29 January 2004, 421 SCRA 428, 445.

[12] Social Security System v. Moonwalk Development and Housing Corporation, *supra*, note 10.

[13] Lo v. Court of Appeals, G.R. No. 141434, 23 September 2003, 411 SCRA 523, 526.

[14] Rollo, pp. 42-43.

[15] Cf. Ligutan v. Court of Appeals, G.R. No. 138677, 12 February 2002, 376 SCRA 560, 568.

[16] *Supra*, note 9, pp. 200-201.

[17] Civil Code of Spain.

[18] Laureano, v. Kilayco, *supra*, note 9, citing Lambert v. Fox, 26 Phil. Rep. 588.

[19] Pamintual v. Court of Appeals, 94 Phil. 556, 562 (1979).

[20] Rollo, p. 28.

[21] Thus, in H.L. Carlos Construction, Inc. v. Marina Properties Corporation (*supra*, note 11 at 443-445), we affirmed the Court of Appeals' ruling imposing the penalty in its entirety as against the building contractor in favor of the real estate developer. As in this case, the penalty in the H.L. Construction case was to answer for delay in the accomplishment of the contract work.

[22] G.R. No. 138677, 12 February 2002, 376 SCRA 560, 568.

[23] See also Lo v. Court of Appeals, *supra*, note 13.

[24] Rollo, p. 131.

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