SPOUSES JOSE T. VALENZUELA AND GLORIA VALENZUELA, PETITIONERS, VS. KALAYAAN DEVELOPMENT & INDUSTRIAL CORPORATION, RESPONDENT.

G.R. No. 163244. June 22, 2009

Ponente: PERALTA, J.

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PERALTA, J.:

This is a petition for review on certiorari assailing the Decision[1] dated January 23, 2004 of the Court of Appeals in CA-G.R. CV No. 69814, and its Resolution[2] dated April 20, 2004, denying petitioners' motion for reconsideration.

The factual and procedural antecedents are as follows:

Kalayaan Development and Industrial Corporation (Kalayaan) is the owner of a parcel of land covered by Transfer Certificate of Title (TCT) No. T-133026[3] issued by the Register of Deeds of Metro Manila, District III. Later, petitioners, Spouses Jose T. Valenzuela and Gloria Valenzuela (Gloria), occupied the said property and introduced several improvements thereon.

When Kalayaan discovered that the lot was being illegally occupied by the petitioners, it demanded that they immediately vacate the premises and surrender possession thereof. Petitioners then negotiated with Kalayaan to purchase the portion of the lot they were occupying. On August 5, 1994, the parties executed a Contract to Sell[4] wherein they stipulated that petitioners would purchase 236 square meters of the subject property for P1,416,000.00. Petitioners initially gave P500,000.00 upon signing the contract and agreed to pay the balance of P916,000.00 in twelve (12) equal monthly installments, or P76,333.75 a month until fully paid.[5] The parties also agreed that, in case petitioners failed to pay any of the installments, they would be liable for liquidated penalty at the rate of 3% a month compounded monthly until fully paid. It was also stipulated that Kalayaan shall execute the corresponding deed of absolute sale over the subject property only upon full payment of the total purchase price.[6]

Thereafter, petitioners made the following payments: P70,000.00 on October 20, 1994; P70,000.00 on November 23, 1994; and P68,000.00 on December 20, 1994, or a total of P208,000.00. After these payments, petitioners failed to pay the agreed monthly installments.

In a letter[7] dated September 6, 1995, petitioners requested Kalayaan that they be issued a deed of sale for the 118 sq. m. portion of the lot where their house was standing, considering that they no longer had the resources to pay the remaining balance. They reasoned that, since they had already paid one-half of the purchase price, or a total of P708,000.00 representing 118 sq. m. of the subject property, they should be issued a deed of sale for the said portion of the property.

In a letter[8] dated December 15, 1995, Kalayaan reminded petitioners of their unpaid balance and asked that they settle it within the next few days. In a demand letter[9] dated January 30, 1996, Kalayaan, through counsel,

demanded that petitioners pay their outstanding obligation, including the agreed penalties, within ten (10) days from receipt of the letter, or they would be constrained to file the necessary actions against them. Again, in a letter[10] dated March 30, 1996, Kalayaan gave petitioners another opportunity to settle their obligation within a period of ten (10) days from receipt thereof.

On June 13, 1996, petitioners wrote Atty. Atilano Huaben Lim, then counsel of Kalayaan, and requested him to intercede on their behalf and to propose to Kalayaan that Gloria's sister, Juliet Flores Giron (Juliet), was willing to assume payment of the remaining balance for the 118 sq. m. portion of the subject property at P10,000.00 a month.[11] Petitioners stated that they had already separated the said 118 sq. m. portion and had the property surveyed by a licensed geodetic engineer to determine the unpaid portion of the property that needed to be separated from their lot.

On January 20, 1997, March 20, 1997, April 20, 1997, June 20, 1997, July 20, 1997, September 20, 1997, October 20, 1997, and December 20, 1997, Juliet made payments of P10,000.00 per month to Kalayaan, which the latter accepted for and in behalf of her sister Gloria.[12]

Thereafter, Kalayaan's in-house counsel, Atty. Reynaldo Romero, demanded that petitioners pay their outstanding obligation. However, his demands remained unheeded. Thus, on June 19, 1998, Kalayaan filed a Complaint for Rescission of Contract and Damages[13] against petitioners before the Regional Trial Court (RTC) of Caloocan City, Branch 126, which was later docketed as Civil Case No. C-18378.

On September 3, 1998, petitioners filed their Answer with Counterclaim[14] praying, among other things, that the RTC dismiss the complaint and for Kalayaan to deliver the corresponding TCT to the subject property, so that the same may be cancelled and a new one issued in the name of the petitioners. Petitioners also prayed for the award of exemplary damages, moral damages, attorney's fees, and cost of suit.[15]

After filing their respective pleadings, trial on the merits ensued. On August 2, 2000, the RTC rendered a Decision[16] in favor of Kalayaan, rescinding the contract between the parties; ordering the petitioners to vacate the premises; and to pay the amount of P100,000.00 as attorney's fees. The decretal portion of the Decision reads:

> IN VIEW OF ALL THE FOREGOING, judgment is hereby rendered rescinding the contract between the plaintiff and the defendants and ordering the defendants and all persons claiming rights under them to vacate the premises and to surrender possession thereof to the plaintiff. Moreover, defendants shall pay the amount of P100,000.00 as attorney's fees.
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> The counterclaim of the defendants is hereby ordered DISMISSED for lack of merit.
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> SO ORDERED.[17]

Aggrieved, petitioners sought recourse before the Court of Appeals (CA) in their appeal docketed as CA-G.R. CV No. 163244. Petitioners argued that the RTC erred when:

> IT RULED THAT THE PLAINTIFF-APPELLEE MADE A VALID FORMAL DEMAND UPON THE DEFENDANTS-APPELANTS TO PAY THE LATTER'S DUE AND OUTSTANDING OBLIGATION;
>
> IT RULED THAT THE PRINCIPLE OF NOVATION OF AN EXISTING OBLIGATION IS NOT APPLICABLE IN THE INSTANT CASE;
>
> IT RULED THAT THE PRINCIPLE OF RESCISSION IS APPLICABLE IN THE CASE AND THAT THE PLAINTIFF-APPELLEE IS ENTITLED THERETO VIS-À-VIS THE DEFENDANTS-APPELLANTS;
>
> IT FAILED TO RULE THAT THE PLAINTIFF-APPELLEE IS BARRED BY ESTOPPEL FROM ASKING FOR THE RESCISSION OF THE CONTRACT TO SELL.

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> IT RULED THAT THE DEFENDANTS-APPELLANTS DID NOT HAVE THE FINANCIAL CAPACITY TO PAY THE REMAINING BALANCE OF THE OBLIGATION AND THAT, CONSEQUENTLY, COMPLIANCE WITH THE TERMS OF THE SAID OBLIGATION HAS BECOME IMPOSSIBLE.
>
> IT RULED THAT THE PLAINTIFF-APPELLEE IS ENTITLED TO ITS CLAIM FOR ATTORNEY'S FEES AND THE COST OF SUIT.[18]

On January 23, 2004, the CA rendered a Decision affirming the Decision of the RTC, the dispositive portion of which reads:

> WHEREFORE, premises considered, the assailed decision dated August 2, 2000 is hereby AFFIRMED, and the present appeal is hereby DISMISSED for lack of merit.
>
> SO ORDERED. (Emphasis supplied.)[19]

Petitioners filed a Motion for Reconsideration,[20] but it was denied for lack of merit in a Resolution[21] dated April 20, 2004.

Hence, the present petition assigning the following errors:

> - THE HONORABLE COURT OF APPEALS ERRED IN FAILING TO APPLY THE PROVISIONS OF THE NEW CIVIL CODE REGARDING SUBSTANTIAL PERFORMANCE IN THE JUST RESOLUTION OF THE PETITIONERS' APPEAL.
>
> - THE HONORABLE COURT OF APPEALS SHOULD HAVE APPLIED THE APPLICABLE PROVISIONS OF THE LAW VIS-À-VIS THE RESCISSION OF CONTRACTS TO SELL REAL PROPERTY, SPECIFICALLY THE REQUIREMENT OF A PRIOR AND VALIDLY NOTARIZED LETTER OF DEMAND.
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> - THE HONORABLE COURT OF APPEALS FAILED TO APPLY TO THE INSTANT CASE THE PERTINENT PROVISIONS OF THE NEW CIVIL CODE REGARDING THE PRINCIPLE OF NOVATION AS A MODE OF EXTINGUISHING AN OBLIGATION.
>
> - THE AWARD, BY THE COURT OF APPEALS, OF ATTORNEY'S FEES, WAS NOT IN ACCORD WITH THE FACTS AND THE LAW.

Petitioners maintain that they should have been entitled to get at least one-half of the subject property, because payment equivalent to its value has been made to, and received by Kalayaan. Petitioners posit that the RTC should have applied Article 1234[22] of the Civil Code to the present case, considering that it has been factually established that they were able to pay at least one-half of the total obligation in good faith.

Petitioners contend that Kalayaan allowed Juliet to continue with the payment of the other half of the property in installments of P10,000.00 a month. They also insist that they or Juliet was not given proper demand. They maintain that the demand letters that were previously sent to them were for their previous obligation with Kalayaan and not for the new agreement between Juliet and Kalayaan to assume payment of the unpaid portion of the subject property. Petitioners aver that, for a demand of rescission to be valid, it is an absolute requirement that should be made by way of a duly notarized written notice.

Petitioners likewise claim that there was a valid novation in the present case. They aver that the CA failed to see that the original contract between the petitioners and Kalayaan was altered, changed, modified and restructured, as a consequence of the change in the person of the principal debtor and the monthly amortization to be paid for the subject property. When they agreed to a monthly amortization of P10,000.00 per month, the original contract was changed; and Kalayaan recognized Juliet's capacity to pay, as well as her designation as the new debtor. The

original contract was novated and the principal obligation to pay for the remaining half of the subject property was transferred from petitioners to Juliet. When Kalayaan accepted the payments made by the new debtor, Juliet, it waived its right to rescind the previous contract. Thus, the action for rescission filed by Kalayaan against them, was unfounded, since the contract sought to be rescinded was no longer in existence.

Finally, petitioners question the RTC's award of attorney's fees. They maintain that there was no basis for the RTC to have awarded the same. They claim that Kalayaan was not forced, by their acts, to litigate, because Juliet was offering to pay the installments, but the offer was denied by Kalayaan. Moreover, since there were no awards for moral and exemplary damages, the award of attorney's fees would have no basis and should be deleted.

The petition is devoid of merit.

In the present case, the nature and characteristics of a contract to sell is determinative of the propriety of the remedy of rescission and the award of attorney's fees.

Under a contract to sell, the seller retains title to the thing to be sold until the purchaser fully pays the agreed purchase price. The full payment is a positive suspensive condition, the non-fulfillment of which is not a breach of contract, but merely an event that prevents the seller from conveying title to the purchaser. The non-payment of the purchase price renders the contract to sell ineffective and without force and effect.[23] Unlike a contract of sale, where the title to the property passes to the vendee upon the delivery of the thing sold, in a contract to sell, ownership is, by agreement, reserved to the vendor and is not to pass to the vendee until full payment of the purchase price. Otherwise stated, in a contract of sale, the vendor loses ownership over the property and cannot recover it until and unless the contract is resolved or rescinded; whereas, in a contract to sell, title is retained by the vendor until full payment of the purchase price. In the latter contract, payment of the price is a positive suspensive condition, failure of which is not a breach but an event that prevents the obligation of the vendor to convey title from becoming effective.[24]

Since the obligation of respondent did not arise because of the failure of petitioners to fully pay the purchase price, Article 1191[25] of the Civil Code would have no application.

Rayos v. Court of Appeals[26] elucidates:

> Construing the contracts together, it is evident that the parties executed a contract to sell and not a contract of sale. The petitioners retained ownership without further remedies by the respondents until the payment of the purchase price of the property in full. Such payment is a positive suspensive condition, failure of which is not really a breach, serious or otherwise, but an event that prevents the obligation of the petitioners to convey title from arising, in accordance with Article 1184 of the Civil Code. x x x
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> x x x x
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> The non-fulfillment by the respondent of his obligation to pay, which is a suspensive condition to the obligation of the petitioners to sell and deliver the title to the property, rendered the contract to sell ineffective and without force and effect. The parties stand as if the conditional obligation had never existed. Article 1191 of the New Civil Code will not apply because it presupposes an obligation already extant. There can be no rescission of an obligation that is still non-existing, the suspensive condition not having happened.

The parties' contract to sell explicitly provides that Kalayaan "shall execute and deliver the corresponding deed of absolute sale over" the subject property to the petitioners "upon full payment of the total purchase price." Since petitioners failed to fully pay the purchase price for the entire property, Kalayaan's obligation to convey title to the property did not arise. Thus, Kalayaan may validly cancel the contract to sell its land to petitioner, not because it had the power to rescind the contract, but because their obligation thereunder did not arise.

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Petitioners failed to pay the balance of the purchase price. Such payment is a positive suspensive condition, failure of which is not a breach, serious or otherwise, but an event that prevents the obligation of the seller to convey title from arising.[27] The non-fulfillment by petitioners of their obligation to pay, which is a suspensive condition for the obligation of Kalayaan to sell and deliver the title to the property, rendered the Contract to Sell ineffective and without force and effect. The parties stand as if the conditional obligation had never existed.[28] Inasmuch as the suspensive condition did not take place, Kalayaan cannot be compelled to transfer ownership of the property to petitioners.

As regards petitioners' claim of novation, we do not give credence to petitioners' assertion that the contract to sell was novated when Juliet was allegedly designated as the new debtor and substituted the petitioners in paying the balance of the purchase price.

Novation is the extinguishment of an obligation by the substitution or change of the obligation by a subsequent one which extinguishes or modifies the first, either by changing the object or principal conditions, or by substituting another in place of the debtor, or by subrogating a third person in the rights of the creditor.[29]

Article 1292 of the Civil Code provides that "[i]n order that an obligation may be extinguished by another which substitutes the same, it is imperative that it be so declared in unequivocal terms, or that the old and the new obligations be on every point incompatible with each other." Novation is never presumed. Parties to a contract must expressly agree that they are abrogating their old contract in favor of a new one. In the absence of an express agreement, novation takes place only when the old and the new obligations are incompatible on every point.[30] The test of incompatibility is whether or not the two obligations can stand together, each one having its independent existence. If they cannot, they are incompatible and the latter obligation novates the first.[31]

Thus, in order that a novation can take place, the concurrence of the following requisites are indispensable:

1) There must be a previous valid obligation;
2) There must be an agreement of the parties concerned to a new contract;
3) There must be the extinguishment of the old contract; and
4) There must be the validity of the new contract.

In the instant case, none of the requisites are present. There is only one existing and binding contract between the parties, because Kalayaan never agreed to the creation of a new contract between them or Juliet. True, petitioners may have offered that they be substituted by Juliet as the new debtor to pay for the remaining obligation. Nonetheless, Kalayaan did not acquiesce to the proposal.

Its acceptance of several payments after it demanded that petitioners pay their outstanding obligation did not modify their original contract. Petitioners, admittedly, have been in default; and Kalayaan's acceptance of the late payments is, at best, an act of tolerance on the part of Kalayaan that could not have modified the contract.

As to the partial payments made by petitioners from September 16, 1994 to December 20, 1997, amounting to P788,000.00, this Court resolves that the said amount be returned to the petitioners, there being no provision regarding forfeiture of payments made in the Contract to Sell. To rule otherwise will be unjust enrichment on the part of Kalayaan at the expense of the petitioners.

Also, the three percent (3%) penalty interest appearing in the contract is patently iniquitous and unconscionable as to warrant the exercise by this Court of its judicial discretion. Article 2227 of the Civil Code provides that "[l]iquidated damages, whether intended as an indemnity or a penalty, shall be equitably reduced if they are iniquitous or unconscionable." A perusal of the Contract to Sell reveals that the three percent (3%) penalty interest on unpaid monthly installments (per condition No. 3) would translate to a yearly penalty interest of thirty-six

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percent (36%).

Although this Court on various occasions has eliminated altogether the three percent (3%) penalty interest for being unconscionable,[32] We are not inclined to do the same in the present case. A reduction is more consistent with fairness and equity. We should not lose sight of the fact that Kalayaan remains an unpaid seller and that it has suffered, one way or another, from petitioners' non-performance of its contractual obligations. In view of such glaring reality, We invoke the authority granted to us by Article 1229[33] of the Civil Code, and as equity dictates, the penalty interest is accordingly reimposed at a reduced rate of one percent (1%) interest per month, or twelve percent (12%) per annum,[34] to be deducted from the partial payments made by the petitioners.

As to the award of attorney's fees, the undeniable source of the present controversy is the failure of petitioners to pay the balance of the purchase price. It is elementary that when attorney's fees is awarded, they are so adjudicated, because it is in the nature of actual damages suffered by the party to whom it is awarded, as he was constrained to engage the services of a counsel to represent him for the protection of his interest.[35] Thus, although the award of attorney's fees to Kalayaan was warranted by the circumstances obtained in this case, we find it equitable to reduce the award from P100,000.00 to P50,000.00.

WHEREFORE, premises considered, the Decision of the Regional Trial Court in Civil Case No. C-18378, dated August 2, 2000, is hereby MODIFIED to the extent that the contract between the parties is cancelled and the attorney's fees is reduced to P50,000.00. Respondent is further ordered to refund the amount paid by the petitioners after deducting the penalty interest due. In all other aspects, the Decision stands.

Subject to the above disquisitions, the Decision dated January 23, 2004 and the Resolution dated April 20, 2004, of the Court of Appeals in CA-G.R. CV No. 69814, are AFFIRMED.

SO ORDERED.

Ynares-Santiago, (Chairperson), Chico-Nazario, Velasco, Jr., and Nachura, JJ., concur.

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[1] Penned by Associate Justice B.A. Adefuin-De la Cruz, with Associate Justices Eliezer R. De los Santos and Jose C. Mendoza, concurring; rollo, pp. 76-82.

[2] Id. at 94.

[3] Records, pp. 153-155.

[4] Id. at 156-157.

[5] Id. at 156.

[6] Id. at 157.

[7] Id. at 228.

[8] Id. at 165.

[9] Id. at 163.

[10] Id. at 162.

[11] Id. at 229.

[12] Rollo, p. 80.

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[13] Records, pp. 1-6.

[14] Id. at 22-30.

[15] Id. at 29.

[16] Rollo, pp. 34-44.

[17] Id. at 44.

[18] Id. at 51.

[19] Id. at 81.

[20] Id. at 82-88.

[21] Id. at 94.

[22] Art. 1234. If the obligation has been substantially performed in good faith, the obligor may recover as though there had been a strict and complete fulfillment, less damages suffered by the obligee.

[23] Cordero v. F.S. Management and Development Corporation, G.R. No. 167213, October 31, 2006, 506 SCRA 451, 461-462.

[24] Spouses Cornelio Joel I. Orden and Maria Nympha A. Orden, et al. v. Spouses Arturo and Melodia Aurea, et al., G.R. No. 172733, August 20, 2008.

[25] 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.

x x x x

[26] 478 Phil. 477, 495-496 (2001). (Emphasis supplied; citations omitted.)

[27] Leaño v. Court of Appeals, 420 Phil. 836, 846 (2001).

[28] Supra note 24.

[29] Agro Conglomerates, Inc. v. Court of Appeals, 401 Phil. 644, 655 (2000).

[30] Rillo v. Court of Appeals, G.R. No. 125347, June 19, 1997, 274 SCRA 461, 469.

[31] Fabrigas v. San Francisco del Monte, Inc., G.R. No. 152346, November 25, 2005, 467 SCRA 247, 259.

[32] Palmares v. Court of Appeals, 351 Phil. 664 (1998); Minute Resolution in Magallanes v. Court of Appeals, G.R. No. 112614, May 16, 1994.

[33] 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.

[34] Segovia Development Corporation v. J.L. Dumatol Realty and Development Corporation, 416 Phil. 528, 541 (2001).

[35] Mactan Cebu International Airport Authority v. Hontanosas, Jr., A.M. No. RTJ-03-1815, October 25, 2004, 411 SCRA 229, 244-245.

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