

**ERMINDA F. FLORENTINO, PETITIONER, VS. SUPERVALUE, INC.,
RESPONDENT.***G.R. No. 172384. September 12, 2007*

Ponente: CHICO-NAZARIO, J.

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Before this Court is a Petition for Review on Certiorari under Rule 45 of the Revised Rules of Court, filed by petitioner Erminda F. Florentino, seeking to reverse and set aside the Decision,[1] dated 10 October 2003 and the Resolution,[2] dated 19 April 2006 of the Court of Appeals in CA-G.R. CV No. 73853. The appellate court, in its assailed Decision and Resolution, modified the Decision dated 30 April 2001 of the Regional Trial Court (RTC) of Makati, Branch 57, in Civil Case No. 00-1015, finding the respondent Supervalve, Inc., liable for the sum of P192,000.00, representing the security deposits made by the petitioner upon the commencement of their Contract of Lease. The dispositive portion of the assailed appellate court's Decision thus reads:

WHEREFORE, premises considered, the appeal is PARTLY GRANTED. The April 30, 2001 Decision of the Regional Trial Court of Makati, Branch 57 is therefore MODIFIED to wit: (a) the portion ordering the [herein respondent] to pay the amount of P192,000.00 representing the security deposits and P50,000.00 as attorney's fees in favor of the [herein petitioner] as well as giving [respondent] the option to reimburse [petitioner] ½ of the value of the improvements introduced by the [petitioner] on the leased [premises] should [respondent] choose to appropriate itself or require the [petitioner] to remove the improvements, is hereby REVERSED and SET ASIDE; and (b) the portion ordering the return to [petitioner] the properties seized by [respondent] after the former settled her obligation with the latter is however MAINTAINED.[3]

The factual and procedural antecedents of the instant petition are as follows:

Petitioner is doing business under the business name "Empanada Royale," a sole proprietorship engaged in the retail of empanada with outlets in different malls and business establishments within Metro Manila.[4]

Respondent, on the other hand, is a domestic corporation engaged in the business of leasing stalls and commercial store spaces located inside SM Malls found all throughout the country.[5]

On 8 March 1999, petitioner and respondent executed three Contracts of Lease containing similar terms and conditions over the cart-type stalls at SM North Edsa and SM Southmall and a store space at SM Megamall. The term of each contract is for a period of four months and may be renewed upon agreement of the parties.[6]

Upon the expiration of the original Contracts of Lease, the parties agreed to renew the same by extending their terms until 31 March 2000.[7]

Before the expiration of said Contracts of Lease, or on 4 February 2000, petitioner received two letters from the respondent, both dated 14 January 2000, transmitted through facsimile transmissions.[8]

In the first letter, petitioner was charged with violating Section 8 of the Contracts of Lease by not opening on 16 December 1999 and 26 December 1999.[9]

Respondent also charged petitioner with selling a new variety of empanada called "mini-embutido" and of increasing the price of her merchandise from P20.00 to P22.00, without the prior approval of the respondent.[10]

Respondent observed that petitioner was frequently closing earlier than the usual mall hours, either because of non-delivery or delay in the delivery of stocks to her outlets, again in violation of the terms of the contract. A stern warning was thus given to petitioner to refrain from committing similar infractions in the future in order to avoid the termination of the lease contract.[11]

In the second letter, respondent informed the petitioner that it will no longer renew the Contracts of Lease for the three outlets, upon their expiration on 31 March 2000.[12]

In a letter-reply dated 11 February 2000, petitioner explained that the "mini-embutido" is not a new variety of empanada but had similar fillings, taste and ingredients as those of pork empanada; only, its size was reduced in order to make it more affordable to the buyers.[13]

Such explanation notwithstanding, respondent still refused to renew its Contracts of Lease with the petitioner. To the contrary, respondent took possession of the store space in SM Megamall and confiscated the equipment and personal belongings of the petitioner found therein after the expiration of the lease contract.[14]

In a letter dated 8 May 2000, petitioner demanded that the respondent release the equipment and personal belongings it seized from the SM Megamall store space and return the security deposits, in the sum of P192,000.00, turned over by the petitioner upon signing of the Contracts of Lease. On 15 June 2000, petitioner sent respondent another letter reiterating her previous demands, but the latter failed or refused to comply therewith. [15]

On 17 August 2000, an action for Specific Performance, Sum of Money and Damages was filed by the petitioner against the respondent before the RTC of Makati, Branch 57.[16]

In her Complaint docketed as Civil Case No. 00-1015, petitioner alleged that the respondent made verbal representations that the Contracts of Lease will be renewed from time to time and, through the said representations, the petitioner was induced to introduce improvements upon the store space at SM Megamall in the sum of P200,000.00, only to find out a year later that the respondent will no longer renew her lease contracts for all three outlets.[17]

In addition, petitioner alleged that the respondent, without justifiable cause and without previous demand, refused to return the security deposits in the amount of P192,000.00.[18]

Further, petitioner claimed that the respondent seized her equipment and personal belongings found inside the store space in SM Megamall after the lease contract for the said outlet expired and despite repeated written demands from the petitioner, respondent continuously refused to return the seized items.[19]

Petitioner thus prayed for the award of actual damages in the sum of P472,000.00, representing the sum of security deposits, cost of improvements and the value of the personal properties seized. Petitioner also asked for the award of P300,000.00 as moral damages; P50,000.00 as exemplary damages; and P80,000.00 as attorney's fees and expenses of litigation.[20]

For its part, respondent countered that petitioner committed several violations of the terms of their Contracts of Lease by not opening from 16 December 1999 to 26 December 1999, and by introducing a new variety of empanada without the prior consent of the respondent, as mandated by the provision of Section 2 of the Contract of Lease. Respondent also alleged that petitioner infringed the lease contract by frequently closing earlier than the agreed closing hours. Respondent finally averred that petitioner is liable for the amount P106,474.09, representing

the penalty for selling a new variety of empanada, electricity and water bills, and rental adjustment, among other charges incidental to the lease agreements. Respondent claimed that the seizure of petitioner's personal belongings and equipment was in the exercise of its retaining lien, considering that the petitioner failed to settle the said obligations up to the time the complaint was filed.[21]

Considering that petitioner already committed several breaches of contract, the respondent thus opted not to renew its Contracts of Lease with her anymore. The security deposits were made in order to ensure faithful compliance with the terms of their lease agreements; and since petitioner committed several infractions thereof, respondent was justified in forfeiting the security deposits in the latter's favor.

On 30 April 2001, the RTC rendered a Judgment[22] in favor of the petitioner and found that the physical takeover by the respondent of the leased premises and the seizure of petitioner's equipment and personal belongings without prior notice were illegal. The decretal part of the RTC Judgment reads:

WHEREFORE, premises duly considered, judgment is hereby rendered ordering the [herein respondent] to pay [herein petitioner] the amount of P192,000.00 representing the security deposits made by the [petitioner] and P50,000.00 as and for attorney's fees.

The [respondent] is likewise ordered to return to the [petitioner] the various properties seized by the former after settling her account with the [respondent].

Lastly, the [respondent] may choose either to reimburse the [petitioner] one half (1/2) of the value of the improvements introduced by the plaintiff at SM Megamall should [respondent] choose to appropriate the improvements to itself or require the [petitioner] to remove the improvements, even though the principal thing may suffer damage thereby. [Petitioner] shall not, however, cause anymore impairment upon the said leased premises than is necessary.

The other damages claimed by the plaintiff are denied for lack of merit.

Aggrieved, the respondent appealed the adverse RTC Judgment to the Court of Appeals.

In a Decision[23] dated 10 October 2003, the Court of Appeals modified the RTC Judgment and found that the respondent was justified in forfeiting the security deposits and was not liable to reimburse the petitioner for the value of the improvements introduced in the leased premises and to pay for attorney's fees. In modifying the findings of the lower court, the appellate court declared that in view of the breaches of contract committed by the petitioner, the respondent is justified in forfeiting the security deposits. Moreover, since the petitioner did not obtain the consent of the respondent before she introduced improvements on the SM Megamall store space, the respondent has therefore no obligation to reimburse the petitioner for the amount expended in connection with the said improvements.[24] The Court of Appeals, however, maintained the order of the trial court for respondent to return to petitioner her properties after she has settled her obligations to the respondent. The appellate court denied petitioner's Motion for Reconsideration in a Resolution[25] dated 19 April 2006.

Hence, this instant Petition for Review on Certiorari[26] filed by the petitioner assailing the Court of Appeals Decision. For the resolution of this Court are the following issues:

- Whether or not the respondent is liable to return the security deposits to the petitions.
- Whether or not the respondent is liable to reimburse the petitioner for the sum of the improvements she introduced in the leased premises.
- Whether or not the respondent is liable for attorney's fees.[27]

The appellate court, in finding that the respondent is authorized to forfeit the security deposits, relied on the

provisions of Sections 5 and 18 of the Contract of Lease, to wit:

Section 5. DEPOSIT. The LESSEE shall make a cash deposit in the sum of SIXTY THOUSAND PESOS (P60,000.00) equivalent to three (3) months rent as security for the full and faithful performance to each and every term, provision, covenant and condition of this lease and not as a pre-payment of rent. If at any time during the term of this lease the rent is increased[,] the LESSEE on demand shall make an additional deposit equal to the increase in rent. The LESSOR shall not be required to keep the deposit separate from its general funds and the deposit shall not be entitled to interest. The deposit shall remain intact during the entire term and shall not be applied as payment for any monetary obligations of the LESSEE under this contract. If the LESSEE shall faithfully perform every provision of this lease[,] the deposit shall be refunded to the LESSEE upon the expiration of this Lease and upon satisfaction of all monetary obligation to the LESSOR.

x x x x

Section 18. TERMINATION. Any breach, non-performance or non-observance of the terms and conditions herein provided shall constitute default which shall be sufficient ground to terminate this lease, its extension or renewal. In which event, the LESSOR shall demand that LESSEE immediately vacate the premises, and LESSOR shall forfeit in its favor the deposit tendered without prejudice to any such other appropriate action as may be legally authorized.[28]

Since it was already established by the trial court that the petitioner was guilty of committing several breaches of contract, the Court of Appeals decreed that she cannot therefore rightfully demand the return of the security deposits for the same are deemed forfeited by reason of evident contractual violations.

It is undisputed that the above-quoted provision found in all Contracts of Lease is in the nature of a penal clause to ensure petitioner's faithful compliance with the terms and conditions of the said contracts.

A penal clause is an accessory undertaking to assume greater liability in case of breach. It is attached to an obligation in order to insure performance 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.[29] The obligor would then be bound to pay the stipulated indemnity without the necessity of proof of the existence and the measure of damages caused by the breach.[30] 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 freedoms 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. Nevertheless, courts may equitably reduce a stipulated penalty in the contracts in two instances: (1) if the principal obligation has been partly or irregularly complied with; 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 clearly 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.[31]

In ascertaining whether the penalty is unconscionable or not, this court set out the following standard in *Ligutan v. Court of Appeals*,[32] to wit:

The question of whether a penalty is reasonable or iniquitous can be partly subjective and partly objective. Its resolution would depend on such factor 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. xxx.

In the instant case, the forfeiture of the entire amount of the security deposits in the sum of P192,000.00 was excessive and unconscionable considering that the gravity of the breaches committed by the petitioner is not of such degree that the respondent was unduly prejudiced thereby. It is but equitable therefore to reduce the penalty of the petitioner to 50% of the total amount of security deposits.

It is in the exercise of its sound discretion that this court tempered the penalty for the breaches committed by the petitioner to 50% of the amount of the security deposits. The forfeiture of the entire sum of P192,000.00 is clearly a usurious and iniquitous penalty for the transgressions committed by the petitioner. The respondent is therefore under the obligation to return the 50% of P192,000.00 to the petitioner.

Turning now to the liability of the respondent to reimburse the petitioner for one-half of the expenses incurred for the improvements on the leased store space at SM Megamall, the following provision in the Contracts of Lease will enlighten us in resolving this issue:

Section 11. ALTERATIONS, ADDITIONS, IMPROVEMENTS, ETC. The LESSEE shall not make any alterations, additions, or improvements without the prior written consent of LESSOR; and all alterations, additions or improvements made on the leased premises, except movable or fixtures put in at LESSEE's expense and which are removable, without defacing the buildings or damaging its floorings, shall become LESSOR's property without compensation/reimbursement but the LESSOR reserves the right to require the removal of the said alterations, additions or improvements upon expiration of the lease.

The foregoing provision in the Contract of Lease mandates that before the petitioner can introduce any improvement on the leased premises, she should first obtain respondent's consent. In the case at bar, it was not shown that petitioner previously secured the consent of the respondent before she made the improvements on the leased space in SM Megamall. It was not even alleged by the petitioner that she obtained such consent or she at least attempted to secure the same. On the other hand, the petitioner asserted that respondent allegedly misrepresented to her that it would renew the terms of the contracts from time to time after their expirations, and that the petitioner was so induced thereby that she expended the sum of P200,000.00 for the improvement of the store space leased.

This argument was squarely addressed by this court in *Fernandez v. Court of Appeals*,^[33] thus:

The Court ruled that the stipulation of the parties in their lease contract "to be renewable" at the option of both parties stresses that the faculty to renew was given not to the lessee alone nor to the lessor by himself but to the two simultaneously; hence, both must agree to renew if a new contract is to come about.

Petitioner's contention that respondents had verbally agreed to extend the lease indefinitely is inadmissible to qualify the terms of the written contract under the parole evidence rule, and unenforceable under the statute of frauds.^[34]

Moreover, it is consonant with human experience that lessees, before occupying the leased premises, especially store spaces located inside malls and big commercial establishments, would renovate the place and introduce improvements thereon according to the needs and nature of their business and in harmony with their trademark designs as part of their marketing ploy to attract customers. Certainly, no inducement or misrepresentation from the lessor is necessary for this purpose, for it is not only a matter of necessity that a lessee should re-design its

place of business but a business strategy as well.

In ruling that the respondent is liable to reimburse petitioner one half of the amount of improvements made on the leased store space should it choose to appropriate the same, the RTC relied on the provision of Article 1678 of the Civil Code which provides:

Art. 1678. If the lessee makes, in good faith, useful improvements which are suitable to the use for which the lease is intended, without altering the form or substance of the property leased, the lessor upon the termination of the lease shall pay the lessee one-half of the value of the improvements at that time. Should the lessor refuse to reimburse said amount, the lessee may remove the improvements, even though the principal thing may suffer damage thereby. He shall not, however, cause any more impairment upon the property leased than is necessary.

While it is true that under the above-quoted provision of the Civil Code, the lessor is under the obligation to pay the lessee one-half of the value of the improvements made should the lessor choose to appropriate the improvements, Article 1678 however should be read together with Article 448 and Article 546 of the same statute, which provide:

Art. 448. The owner of the land on which anything has been built, sown or planted in good faith, shall have the right to appropriate as his own the works, sowing or planting, after payment of the indemnity provided for in articles 546 and 548, or to oblige the one who built or planted to pay the price of the land, and the one who sowed, the proper rent. However, the builder or planter cannot be obliged to buy the land if its value is considerably more than that of the building or trees. In such case, he shall pay reasonable rent, if the owner of the land does not choose to appropriate the building or trees after proper indemnity. The parties shall agree upon the terms of the lease and in case of disagreement, the court shall fix the terms thereof.

x x x x

Art. 546. Necessary expenses shall be refunded to every possessor; but only possessor in good faith may retain the thing until he has been reimbursed therefor.

Useful expenses shall be refunded only to the possessor in good faith with the same right of retention, the person who has defeated him in the possession having the option of refunding the amount of the expenses or of paying the increase in value which the thing may have acquired by reason thereof.

Thus, to be entitled to reimbursement for improvements introduced on the property, the petitioner must be considered a builder in good faith. Further, Articles 448 and 546 of the Civil Code, which allow full reimbursement of useful improvements and retention of the premises until reimbursement is made, apply only to a possessor in good faith, i.e., one who builds on land with the belief that he is the owner thereof. A builder in good faith is one who is unaware of any flaw in his title to the land at the time he builds on it.[35] In this case, the petitioner cannot claim that she was not aware of any flaw in her title or was under the belief that she is the owner of the subject premises for it is a settled fact that she is merely a lessee thereof.

In *Geminiano v. Court of Appeals*,^[36] this Court was emphatic in declaring that lessees are not possessors or builders in good faith, thus:

Being mere lessees, the private respondents knew that their occupation of the premises would continue only for the life of the lease. Plainly, they cannot be considered as possessors nor builders in good faith.

In a plethora of cases, this Court has held that Article 448 of the Civil Code, in relation to Article 546 of the same Code, which allows full reimbursement of useful improvements and retention of the premises until reimbursement is made, applies only to a possessor in good faith, i.e., one who builds on land with the belief that he is the owner thereof. It does not apply where one's only interest is that of a lessee under a rental

contract; otherwise, it would always be in the power of the tenant to "improve" his landlord out of his property.

Since petitioner's interest in the store space is merely that of the lessee under the lease contract, she cannot therefore be considered a builder in good faith. Consequently, respondent may appropriate the improvements introduced on the leased premises without any obligation to reimburse the petitioner for the sum expended.

Anent the claim for attorney's fees, we resolve to likewise deny the award of the same. Attorney's fees may be awarded when a party is compelled to litigate or to incur expenses to protect its interest by reason of unjustified act of the other.^[37]

In the instant petition, it was not shown that the respondent unjustifiably refused to grant the demands of the petitioner so as to compel the latter to initiate legal action to enforce her right. As we have found herein, there is basis for respondent's refusal to return to petitioner the security deposits and to reimburse the costs of the improvements in the leased premises. The award of attorney's fees is therefore not proper in the instant case.

WHEREFORE, premises considered, the instant Petition is PARTLY GRANTED. The Court of Appeals Decision dated 10 October 2003 in CA-G.R. CV No. 73853 is hereby AFFIRMED with the MODIFICATION that the respondent may forfeit only 50% of the total amount of the security deposits in the sum of P192,000.00, and must return the remaining 50% to the petitioner. No costs.

SO ORDERED.

Ynares-Santiago, (Chairperson), Austria-Martinez, Nachura, and Reyes, JJ., concur.

[1] Penned by Associate Justice Elvi John S. Asuncion with Associate Justices Godardo A. Jacinto and Lucas P. Bersamin, concurring. Rollo, pp. 8-17.

[2] Id. at 9.

[3] Id. at 16-17.

[4] Records, p. 1.

[5] Id.

[6] Id. at 55-56.

[7] Id. at 58.

[8] Id.

[9] Id.

[10] Id.

[11] Id.

[12] Id. at 13.

[13] Rollo, p. 39.

[14] Id.

[15] Id. at 14-15.

- [16]Records, pp. 1-5.
- [17] Id.
- [18] Id.
- [19] Id.
- [20] Id.
- [21] Id. at 20-28.
- [22]Rollo, pp. 38-43.
- [23] Id. at 8-17.
- [24] Id.
- [25] Id. at 19.
- [26] Id. at 22-37.
- [27] Id. at 27-28.
- [28] Records, pp. 9-10.
- [29] Filinvest Land, Inc. v. Court of Appeals, G.R. No. 138980, 20 September 2005, 470 SCRA 260, 269.
- [30]Ligutan v. Court of Appeals, 427 Phil. 42, 51 (2002).
- [31]Filinvest Land, Inc. v. Court of Appeals, supra note 29 at 269-270.
- [32] Supra note 30 at 52.
- [33]G.R. No. L-80231, 18 October 1988, 166 SCRA 577, 587-588.
- [34] Josefa v. San Buenaventura, G.R. No. 163429, 3 March 2006, 484 SCRA 49, 60.
- [35] Lopez v. Sarabia, G.R. No. 140357, 24 September 2004, 439 SCRA 35, 49.
- [36]328 Phil. 682, 689-690 (1996).
- [37] Philippine Air Lines, Inc. v. Court of Appeals, 193 Phil. 560, 580 (1981).

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