DOMEL TRADING CORPORATION, PETITIONER, VS. HONORABLE COURT OF APPEALS AND NDC-NACIDA RAW MATERIALS, CORPORATION, RESPONDENTS.

G.R. No. 84813. September 22, 1999

Ponente: YNARES_SANTIAGO, J.

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YNARES_SANTIAGO, J.:

Assailed before this Court is the decision[1] of the Court of Appeals in CA-G.R. CV No. 08952 which modified the decision of the lower court granting private respondent's prayer for damages.

On June 3, 1981, private respondent NDC-NACIDA Raw Materials Corporation (NNRMC) ordered from petitioner Domel Trading Corporation (DOMEL) 22,000 bundles of buri midribs at P16.00 per bundle to be delivered within 30 working days from the date of the opening of a letter of credit. On June 4, 1981, private respondent again ordered 300,000 pieces of rattan poles at P9.65 per piece for a total price of P2,895,000.00, also to be delivered within 60 days from the date of the opening of a letter of credit. The specifications and provisions of both transactions, which served as their agreement, were printed in two separate purchase orders.[2]

In accordance with their agreement, NNRMC, on July 9, 1981, opened a letter of credit with Philippine National Bank (PNB) in favor of DOMEL in the amount of P1,997,000.00 to cover its order for 206,943 pieces of rattan poles. On July 13, 1981, NNRMC opened another letter of credit in favor of DOMEL in the amount of P1,236,000.00 to cover the price of 93,057 pieces of rattan poles and 22,000 bundles of buri midribs.

In violation of their agreement, DOMEL failed to deliver the buri midribs and rattan poles within the stipulated period. Thus, on September 23, 1981, DOMEL and NNRMC agreed to restructure the latter's purchase orders in a Memorandum of Agreement[3]. Under the agreement, NNRMC extended the expiry date of its two letters of credit to November 5, 1981. It also reduced the quantity of the rattan poles from 300,000 to only 100,000 pieces while the quantity of buri midribs remained at 22,000 bundles. Further, DOMEL undertook to deliver the goods on or before October 31, 1981. However, no deliveries were again made on the said date. Consequently, demands were made by NNRMC on January 19, 1982 for the payment of damages, which demands were ignored by DOMEL.

Hence, NNRMC filed a complaint for damages before the Regional Trial Court of Pasig. After trial, judgment was rendered in favor of plaintiff and against defendant, the dispositive portion of which reads:

> "WHEREFORE, judgment is hereby rendered in favor of plaintiff and against defendant, ordering the latter to pay the former:
>
> 1) the sum of Nine Hundred Eight Thousand Nine Hundred Sixty Six and 77/100 Pesos (P908,966.77), representing actual and contractual damages, with legal interest thereon from August 4, 1982, when the complaint was filed until fully paid, and
>
> 2) the further sum equivalent to fifteen percent (15%) of the total of the foregoing for and as attorney's fees

> and litigation expenses."

On appeal, the Court of Appeals modified the decision of the lower court, as follows:

> "WHEREFORE, appealed judgment is modified as above-indicated and appellant is hereby ordered to pay appellee liquidated damages of P150,000.00, to reimburse the latter the amount of P7,907.68 on subject letters of credit, with interest of six (6) percent per annum from August 4, 1982 on said amounts of P150,000.00 and P7,907.68; and to pay attorney's fees of P20,000.00. Costs against appellee."

Both DOMEL and NNRMC assail the above-quoted decision in separate petitions which have been consolidated before this Court.

Based on the pleadings submitted by the parties, this Court has resolved to give due course to the petition and decides the same.

DOMEL submits it has not breached its contractual obligation to NNRMC inasmuch as it was the fault of the latter for not inspecting and examining the rattan poles as well as the buri midribs already shipped by the suppliers and stored in the former's warehouse. Thus, it should not be made liable for liquidated and other damages. DOMEL argues in this wise:

> "Experience had shown that it would be more expedient that goods and materials to be delivered must first be inspected so as to avoid additional handling expenses in case the deliveries were rejected because the purchase of the supplies and materials may not conform to what is being specified. If inspections were conducted, the danger and expenses connected therewith for the return of the rejected materials would be minimized. In other words, the need for the inspection cannot be done away to avoid further losses not only on the part of the obligor but also for the benefit of the obligee, although indirectly, in the sense that in case the supplies and materials are rejected the obligee also suffers from the diminished profits.
>
> "x x x x x x x x x
> "In other words, because of the fact that the subject supplies were understood to come from the Visayas and parts of far flung Mindanao, there is indeed a need for inspection because several deliveries would be made. This is so because if the inspection is not conducted, what would stop the private respondent from rejecting all deliveries and in such eventuality, as the petitioner herein would be placing said orders from suppliers from Visayas and far flung Mindanao only to be rejected by the private respondent upon delivery; hence, the losses to be shouldered by the petitioner under an inequitable arrangement would be unthinkable. It thus follows then that the inspection is indispensably necessary to give rise to the agreement to supply."[4]

In short, DOMEL claims that NNRMC must first inspect the ordered items before delivery could be made.

We do not agree.

The purchase order,[5] which constitutes the contract between DOMEL and NNRMC, provides the specifications for the buri midribs, thus:

> "20,000 bundles of buri midribs 'Class A and B; Palawan, Zamboanga, Cotabato origin; 1,000 pcs. per bundle, 6 ft. up"
>
> "2,000 bundles of buri midribs "Class A and B; Palawan, Zamboanga, Cotabato origin, 1,000 pcs. per bundle 3 ft. - 5 ft."

The purchase order[6] for rattan poles contains the following specifications, thus:

> "300,000 pieces of rattan poles, Palasan variety, 1-1/4 and up, straightened, cleaned, chemically treated, single, scraped and free from molds, and pinholes, by 14 feet long, Cotabato/Zamboanga origin"

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The purchase orders were duly noted and confirmed by Mr. Gerardo R. Jose, the Vice President of DOMEL. It is thus clear that DOMEL agreed to provide the buri midribs and the rattan poles in accordance with the specifications provided by NNRMC.

Therefore, there is no merit in DOMEL's argument that "goods and materials to be delivered must first be inspected so as to avoid additional handling expenses in case the deliveries were rejected because the purchase of the supplies and materials may not conform to what is being specified." There is likewise no basis for DOMEL to argue that "if the inspection is not conducted, what would stop the private respondent from rejecting all deliveries and in such eventuality, as the petitioner herein would be placing said orders from suppliers from Visayas and far flung Mindanao only to be rejected by the private respondent upon delivery."

DOMEL assumes that NNRMC might reject the items if they were delivered without first being inspected. That assumption would, in turn, rest on the supposition that the goods and materials delivered might not conform to specifications or might be defective when delivered.

The reasoning is flawed. First, DOMEL was bound to deliver the goods according to specifications. It is not for NNRMC, as the buyer, to ensure that the goods and materials ordered conform with the specifications. Precisely, NNRMC fixed the specifications of the items it wanted delivered. Second, it was DOMEL which dealt with the suppliers of the goods needed by NNRMC. Consequently the task of inspecting the items fell on DOMEL which should, therefore, ensure that the suppliers ship goods that strictly comply with the specifications required by NNRMC. Third, Mr. Jose of DOMEL signified his agreement to ship items according to the specifications. By affixing his signature, he signified his assurance to NNRMC that DOMEL can deliver the materials as specified. Accordingly, DOMEL had the obligation to ensure that the goods ordered by NNRMC were in accordance with the specifications provided in the purchase orders. The duty of inspecting the materials did not fall on NNRMC, otherwise, it could have dealt directly with the suppliers and not through DOMEL.

Although it was stated in the amended Letters of Credit[7] that PNB required a Certificate of Inspection from NNRMC, nevertheless, it is the view of this Court that the Certificate of Inspection was not an indispensable requirement or condition precedent for DOMEL to comply with its obligation to deliver the specified buri midribs and rattan poles. First, it was a requirement by PNB from NNRMC. Second, it was only stated in the Letter of Credit which is a contract entered into by NNRMC with PNB. The provisions in the Letter of Credit were not carried into as additional stipulations in the purchase orders which is the contract between DOMEL and NNRMC. As such, it should not in any way affect DOMEL's obligation to deliver the goods to NNRMC. At most, it may only affect DOMEL's collection of payment from PNB. Third, granting that it was an obligation by NNRMC to conduct the inspection and issue the corresponding certificate, nowhere in the Letters of Credit, Purchase Orders or the Memorandum of Agreement is it found that the inspection should be conducted before delivery of the goods. It is NNRMC's lookout if it does not conduct the inspection before the goods are delivered. Besides, considering the natural sequence of events in business transactions, it is incumbent upon the supplier, in this case DOMEL, to first make the delivery to NNRMC, the buyer, before it can properly inspect the items.

In view of the above disquisition, it is clear that DOMEL breached its obligation to NNRMC by failing to deliver to the latter the specified buri midribs and rattan poles.

In assailing the decision of the Court of Appeals, NNRMC, in turn, submits the following:

> 1. DOMEL is liable to NNRMC for the full amount of contractually determined liquidated damages; and
>
> 2. DOMEL is liable to NNRMC for actual and contractual damages in the total amount of P908,966.77 with legal interest thereon from January 19, 1982 when extrajudicial demand was made, until fully paid and 15% of the foregoing sum for and as attorney's fees and litigation expenses.

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In the assailed decision modifying the decision of the lower court as to the stipulated amount of liquidated damages, the Court of Appeals ratiocinated thus:

> "x x x The lower court did not err in finding a breach of contract on the part of defendant appellant. The mere fact that plaintiff's representative failed to make the requested inspection of the initial stocks of buri midribs and rattan poles in appellant's warehouse did not constitute a complete defense or justification for the admitted failure of the appellant to deliver the contracted items. At best, such circumstance alone could merely mitigate defendant-appellant's liability for the liquidated damages of P2,000.00 per day of delay. As correctly observed by the trial court, even assuming that the 5,000 buri midribs and 2,000 rattan poles then ready for inspection were really available for delivery upon satisfactory inspection thereof, such quantities were shy of what appellant was bound to deliver to appellee. But, of course, it can be perceived that the failure of plaintiff to make the promised inspection could have slowed down or deterred appellant's efforts to meet its commitment, in view of its uncertainty of the acceptability of its stock of buri midribs and rattan poles. However, such failure of plaintiff to cause the desired inspection of appellant's stock of buri midribs and rattan poles did not totally excuse appellant from increasing its supply of such items. At the very least, it should have brought samples of the buri midribs and rattan poles it had to the office of appellee in order to make sure that what it was procuring were acceptable to the appellee. It was not enough for appellant to write appellee about the matter. More follow-ups on its part were required under the circumstances. Its failure to do so exposed itself to the inevitable conclusion that it was actually unable to fill-up the quantity and quality of buri midribs and rattan poles contracted for the appellee. Therefore, the failure of plaintiff's Yatco to make the promised inspection of appellant's stocks can only serve to mitigate appellant's civil liability for the breach of contract litigated upon. Instead of requiring appellant to pay the stipulated liquidated damages of P2,000.00 for every day of delay, P1,000.00 per day should suffice under the premises. Conformably, the P300,000.00 of liquidated damages awarded below should be reduced to only P150,000.00."

While we do not agree with the Court of Appeals that the failure of NNRMC to conduct the inspection mitigated DOMEL's liability for liquidated damages, nevertheless, we agree in the reduction of the amount of liquidated damages to only P150,000.00. The amount of P2,000.00 as penalty for every day of delay is excessive and unconscionable.

> Article 1229 of the Civil Code states, thus:
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> "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."
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> Article 2227 of the Civil Code likewise states, thus:
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> "Liquidated damages, whether intended as an indemnity or a penalty, shall be equitably reduced if they are iniquitous or unconscionable."

In determining whether a penalty clause is "iniquitous and unconscionable," a court may very well take into account the actual damages sustained by a creditor who was compelled to sue the defaulting debtor, which actual damages would include the interest and penalties the creditor may have had to pay on its own from its funding source.[8] In this case, NNRMC was only able to prove that it incurred the amounts of P5,995.83 as opening charges on the two Letters of Credit and an additional P1,911.85 as amendment charges on the same Letters of Credit. Other than that, NNRMC failed to prove it had suffered actual damages resulting from the nondelivery of the specified buri midribs and rattan poles. In fact, what it allegedly suffered are what it calls "Foregone Interest Income" and "Foregone Profit" from the two Letters of Credit. Such could not be considered as actual damages. We agree with the following observation of the Court of Appeals:

> "Necessarily, We discern some merit in the second assignment of error. The trial court erred in holding the

> appellant liable for P908,966.72 in damages. The said unitemized amounts and various types of damages is too much and has to be reduced within reasonable limits. As already elaborated upon in connection with the first assignment of error, the amount of liquidated damages has to be lessened to P150,000.00. But the charges of P5,995.83 and P1,911.85 on the two letters of credit involved should be reimbursed by appellant (tsn, p. 23, July 13, 1983 hearing). As regards the alleged forgone profits of P206,943.00 testified on by Jose Victorioso as the profit appellee could have realized had appellant been able to supply the goods in question, we consider such amount of expected profit highly conjectural and speculative (p. 24, id.). The aforesaid testimony regarding the matter of profits is utterly lacking of the requisite details on how such huge amount of profits could be made possible. Plaintiff-appellee's witness did not detail out how such huge amount of gain could have been derived from the would-be exportation of buri midribs and rattan poles. Well-entrenched is the doctrine that actual, compensatory and consequential damages must be proved, and cannot be presumed (Hua Liong Electrical Equipment Corporation v. Reyes 145 SCRA 713). If, as in this case, the proof adduced thereon is flimsy and insufficient, no damages will be allowed (Rubio v. Court of Appeals, 141 SCRA 488). Verily, the testimonial evidence on alleged unrealized profits earlier referred to is not enough to warrant the award of damages appealed from. It is too scanty, vague and unspecified to induce faith and reliance. Absent the needed quantum of proof, We are of the sense that, apart from the aforestated amount of liquidated damages and reimbursement of the charges paid by appellee for the unutilized letters of credit, no other damages can be granted."

WHEREFORE, the Decision of the Court of Appeals in C.A.-G.R. CV No. 08952, dated August 22, 1988, is AFFIRMED in toto.

SO ORDERED.

Davide, Jr., C.J., (Chairman), Puno, Kapunan, and Pardo, JJ., concur.

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[1] Penned by Associate Justice Fidel P. Purisima (now Associate Justice of the Supreme Court) and concurred in by Associate Justices Segundino G. Chua and Nicolas P. Lapena Jr.

[2] Exhibits "B" and "C", Records, pp. 56 & 57.

[3] Exhibit "F", Records, p. 60.

[4] Domel's Petition, Rollo, G.R. 84813, pp. 17-29.

[5] Exhibit "B", Records, p. 56.

[6] Exhibit "C", Records, p. 57.

[7] Exhibits "H" and "G", Records, p. 64.

[8] Pacific Mills, Inc. v. Court of Appeals, 206 SCRA 317 [1992].

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