

## THIRD DIVISION

[ G.R. No. 172384, September 12, 2007 ]

**ERMINDA F. FLORENTINO, PETITIONER, VS. SUPERVALUE, INC.,  
RESPONDENT.**

### D E C I S I O N

**CHICO-NAZARIO, J.:**

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,<sup>[1]</sup> dated 10 October 2003 and the Resolution,<sup>[2]</sup> 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.<sup>[3]</sup>

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.<sup>[4]</sup>

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.<sup>[5]</sup>

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.<sup>[6]</sup>

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

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.<sup>[8]</sup>

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.<sup>[9]</sup>

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.<sup>[10]</sup>

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.<sup>[11]</sup>

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.<sup>[12]</sup>

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.<sup>[13]</sup>

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.<sup>[14]</sup>

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. <sup>[15]</sup>

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.<sup>[16]</sup>

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.<sup>[17]</sup>

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.<sup>[18]</sup>

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.<sup>[19]</sup>

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.<sup>[20]</sup>

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.<sup>[21]</sup>

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<sup>[22]</sup> 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<sup>[23]</sup> 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.<sup>[24]</sup> 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<sup>[25]</sup> dated 19 April 2006.

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

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

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.**<sup>[28]</sup>

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.<sup>[29]</sup> 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.<sup>[30]</sup> 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