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FIRST DIVISION

[G.R. No. 183794, June 13, 2016]

SPOUSES JAIME AND MATILDE POON, PETITIONERS, VS. PRIME SAVINGS BANK REPRESENTED BY THE PHILIPPINE DEPOSIT INSURANCE CORPORATION AS STATUTORY LIQUIDATOR, RESPONDENT.

DECISION

SERENO, C.J.:

Before this Court is a Petition for Review on Certiorari[1] assailing the Court of Appeals (CA) Decision[2] which affirmed the Decision[3] issued by Branch 21, Regional Trial Court (RTC) of Naga City.

The RTC ordered the partial rescission of the penal clause in the lease contract over the commercial building of Spouses Jaime and Matilde Poon (petitioners). It directed petitioners to return to Prime Savings Bank (respondent) the sum of P1,740,000, representing one-half of the unused portion of its advance rentals, in view of the closure of respondent's business upon order by the *Bangko Sentral ng Pilipinas* (BSP).

Antecedent Facts

The facts are undisputed.

Petitioners owned a commercial building in Naga City, which they used for their bakery business. On 3 November 2006, Matilde Poon and respondent executed a 10-year Contract of Lease[4] (Contract) over the building for the latter's use as its branch office in Naga City. They agreed to a fixed monthly rental of P60,000, with an advance payment of the rentals for the first 100 months in the amount of P6,000,000. As agreed, the advance payment was to be applied immediately, while the rentals for the remaining period of the Contract were to be paid on a monthly basis.[5]

In addition, paragraph 24 of the Contract provides:

> 24. Should the lease[d] premises be closed, deserted or vacated by the LESSEE, the LESSOR shall have the right to terminate the lease without the necessity of serving a court order and to immediately repossess the leased premises. Thereafter the LESSOR shall open and enter the leased premises in the presence of a representative of the LESSEE (or of the proper authorities) for the purpose of taking a complete inventory of all furniture, fixtures, equipment and/or other materials or property found within the leased premises.

> The LESSOR shall thereupon have the right to enter into a new contract with another party. All advanced rentals shall be forfeited in favor of the LESSOR.[6]

Barely three years later, however, the BSP placed respondent under the receivership of the Philippine Deposit Insurance Corporation (PDIC) by virtue of BSP Monetary Board Resolution No. 22,[7] which reads:

> On the basis of the report of Mr. Candon B. Guerrero, Director of Thrift Banks and Non-Bank Financial Institutions (DTBNBF1), in his memorandum dated January 3, 2000, which report showed that the Prime Savings Bank, Inc. (a) is unable to pay its liabilities as they became due in the ordinary course of business; (b) has insufficient realizable assets as determined by the Bangko Sentral ng Pilipinas to meet its liabilities; (c) cannot continue in business without involving probable losses to its depositors and creditors; and **(d) has wilfully violated cease and desist orders under Section 37 that has become final, involving acts or transactions which amount to fraud or a dissipation of the assets of the institution**; x x x.[8] (Emphasis supplied)

The BSP eventually ordered respondent's liquidation under Monetary Board Resolution No. 664.[9]

On 12 May 2000, respondent vacated the leased premises and surrendered them to petitioners.[10] Subsequently, the PDIC issued petitioners a demand letter[11] asking for the return of the unused advance rental amounting to P3,480,000 on the ground that paragraph 24 of the lease agreement had become inoperative, because respondent's closure constituted *force majeure*. The PDIC likewise invoked the principle of *rebus sic stantibus* under Article 1267 of Republic Act No. 386 (Civil Code) as alternative legal basis for demanding the refund.

Petitioners, however, refused the PDIC's demand.[12] They maintained that they were entitled to retain the remainder of the advance rentals following paragraph 24 of their Contract.

Consequently, respondent sued petitioners before the RTC of Naga City for a partial rescission of contract and/or recovery of a sum of money.

The RTC Ruling

After trial, the RTC ordered the partial rescission of the lease agreement, disposing as follows:

> WHEREFORE, judgment is hereby entered ordering the partial rescission of the Contract of Lease dated November 3, 1996 particularly the second paragraph of Par. 24 thereof and directing the defendant-spouses Jaime and Matilde Poon to return or refund to the Plaintiff the sum of One Million Seven Hundred Forty Thousand Pesos (P1,740,000) representing one-half of the unused portion of the advance rentals.
>
> Parties' respective claims for damages and attorney's fees are dismissed.

No costs.[13]

The trial court ruled that the second clause in paragraph 24 of the Contract was penal in nature, and that the clause was a valid contractual agreement.[14] Citing *Provident Savings Bank v. CA*[15] as legal precedent, it ruled that the premature termination of the lease due to the BSP's closure of respondent's business was actually involuntary. Consequently, it would be iniquitous for petitioners to forfeit the entire amount of P 3,480,000.[16] Invoking its equity jurisdiction under Article 1229 of the Civil Code,[17] the trial court limited the forfeiture to only one-half of that amount to answer for respondent's unpaid utility bills and E-VAT, as well as petitioner's lost business opportunity from its former bakery business.[18]

The CA Ruling

On appeal, the CA affirmed the RTC Decision,[19] but had a different rationale for applying Article 1229. The appellate court ruled that the closure of respondent's business was not a fortuitous event. Unlike *Provident Savings Bank*,[20] the instant case was one in which respondent was found to have committed fraudulent acts and transactions. Lacking, therefore, was the first requisite of a fortuitous event, i.e, that the cause of the breach of obligation must be independent of the will of the debtor.[21]

Still, the CA sustained the trial court's interpretation of the *proviso* on the forfeiture of advance rentals as a penal clause and the consequent application of Article 1229. The appellate court found that the forfeiture clause in the Contract was intended to prevent respondent from defaulting on the latter's obligation to finish the term of the lease. It further found that respondent had partially performed that obligation and, therefore, the reduction of the penalty was only proper. Similarly, it ruled that the RTC had properly denied petitioners' claims for actual and moral damages for lack of basis.[22]

On 10 July 2008,[23] the CA denied petitioners' Motion for Reconsideration. Hence, this Petition.

Issues

The issues to be resolved are whether (1) respondent may be released from its contractual obligations to petitioners on grounds of fortuitous event under Article 1174 of the Civil Code and unforeseen event under Article 1267 of the Civil Code; (2) the proviso in the parties' Contract allowing the forfeiture of advance rentals was a penal clause; and (3) the penalty agreed upon by the parties may be equitably reduced under Article 1229 of the Civil Code.

COURT RULING

We DENY the Petition.

Preliminarily, we address petitioners' claim that respondent had no cause of action for rescission, because this case does not fall under any of the circumstances

enumerated in Articles 1381[24] and 1382[25] of the Civil Code.

The legal remedy of rescission, however, is by no means limited to the situations covered by the above provisions. The Civil Code uses rescission in two different contexts, namely: (1) rescission on account of breach of contract under Article 1191; and (2) rescission by reason of lesion or economic prejudice under Article 1381.[26] While the term "rescission" is used in Article 1191, "resolution" was the original term used in the old Civil Code, on which the article was based. Resolution is a principal action based on a breach by a party, while rescission under Article 1383 is a subsidiary action limited to cases of rescission for lesion under Article 1381 of the New Civil Code.[27]

It is clear from the allegations in paragraphs 12 and 13 of the Complaint[28] that respondent's right of action rested on the alleged abuse by petitioners of their right under paragraph 24 of the Contract. Respondent's theory before the trial court was that the tenacious enforcement by petitioners of their right to forfeit the advance rentals was tainted with bad faith, because they knew that respondent was already insolvent. In other words, the action instituted by respondent was for the rescission of reciprocal obligations under Article 1191. The lower courts, therefore, correctly ruled that Articles 1381 and 1382 were inapposite.

We now resolve the main issues.

***The closure of respondent's business was neither a fortuitous nor an unforeseen event that rendered the lease agreement* functus officio.**

Respondent posits that it should be released from its contract with petitioners, because the closure of its business upon the BSP's order constituted a fortuitous event as the Court held in *Provident Savings Bank*.[29]

The cited case, however, must always be read in the context of the earlier Decision in *Central Bank v. Court of Appeals*.[30] The Court ruled in that case that the Monetary Board had acted arbitrarily and in bad faith in ordering the closure of Provident Savings Bank. Accordingly, in the subsequent case of *Provident Savings Bank* it was held that *fuerza mayor* had interrupted the prescriptive period to file an action for the foreclosure of the subject mortgage.[31]

In contrast, there is no indication or allegation that the BSP's action in this case was tainted with arbitrariness or bad faith. Instead, its decision to place respondent under receivership and liquidation proceedings was pursuant to Section 30 of Republic Act No. 7653.[32] Moreover, respondent was partly accountable for the closure of its banking business. It cannot be said, then, that the closure of its business was independent of its will as in the case of Provident Savings Bank. The legal effect is analogous to that created by contributory negligence in quasi-delict actions.

The period during which the bank cannot do business due to insolvency is not a fortuitous event,[33] unless it is shown that the government's action to place a bank under receivership or liquidation proceedings is tainted with arbitrariness, or that the regulatory body has acted without jurisdiction.[34]

As an alternative justification for its premature termination of the Contract, respondent lessee invokes the doctrine of unforeseen event under Article 1267 of the Civil Code, which provides:

> Art. 1267. When the service has become so difficult as to be manifestly beyond the contemplation of the parties, the obligor may also be released therefrom, in whole or in part.

The theory of *rebus sic stantibus* in public international law is often cited as the basis of the above article. Under this theory, the parties stipulate in light of certain prevailing conditions, and the theory can be made to apply when these conditions cease to exist.[35] The Court, however, has once cautioned that Article 1267 is not an absolute application of the principle of *rebus sic stantibus*, otherwise, it would endanger the security of contractual relations. After all, parties to a contract are presumed to have assumed the risks of unfavorable developments. It is only in absolutely exceptional changes of circumstance, therefore, that equity demands assistance for the debtor.[36]

Tagaytay Realty Co., Inc. v. Gacutan[37] lays down the requisites for the application of Article 1267, as follows:

1. The event or change in circumstance could not have been foreseen at the time of the execution of the contract.

2. It makes the performance of the contract extremely difficult but not impossible.

3. It must not be due to the act of any of the parties.

4. The contract is for a future prestation.[38]

The difficulty of performance should be such that the party seeking to be released from a contractual obligation would be placed at a disadvantage by the unforeseen event. Mere inconvenience, unexpected impediments, increased expenses,[39] or even pecuniary inability to fulfil an engagement,[40] will not relieve the obligor from an undertaking that it has knowingly and freely contracted.

The law speaks of "service." This term should be understood as referring to the performance of an obligation or a prestation.[41] A prestation is the object of the contract; i.e., it is the conduct (to give, to do or not to do) required of the parties.[42] In a reciprocal contract such as the lease in this case, one obligation of respondent as the lessee was to pay the agreed rents for the whole contract period.[43] It would be hard-pressed to complete the lease term since it was already out of business only three and a half years into the 10-year contract period. Without a doubt, the second and the fourth requisites mentioned above are present in this case.

The first and the third requisites, however, are lacking. It must be noted that the lease agreement was for 10 years. As shown by the unrebutted testimony of Jaime Poon during trial, the parties had actually considered the possibility of a deterioration or loss of respondent's business within that period: