

## FIRST DIVISION

[ G.R. No. 160600, January 15, 2014 ]

**DOMINGO GONZALO, PETITIONER, VS. JOHN TARNATE, JR.,  
RESPONDENT.**

### D E C I S I O N

**BERSAMIN, J.:**

The doctrine of *in pari delicto*, which stipulates that the guilty parties to an illegal contract are not entitled to any relief, cannot prevent a recovery if doing so violates the public policy against unjust enrichment.

#### **Antecedents**

After the Department of Public Works and Highways (DPWH) had awarded on July 22, 1997 the contract for the improvement of the Sadsadan-Maba-ay Section of the Mountain Province-Benguet Road in the total amount of P7,014,963.33 to his company, Gonzalo Construction,<sup>[1]</sup> petitioner Domingo Gonzalo (Gonzalo) subcontracted to respondent John Tarnate, Jr. (Tarnate) on October 15, 1997, the supply of materials and labor for the project under the latter's business known as JNT Aggregates. Their agreement stipulated, among others, that Tarnate would pay to Gonzalo eight percent and four percent of the contract price, respectively, upon Tarnate's first and second billing in the project.<sup>[2]</sup>

In furtherance of their agreement, Gonzalo executed on April 6, 1999 a *deed of assignment* whereby he, as the contractor, was assigning to Tarnate an amount equivalent to 10% of the total collection from the DPWH for the project. This 10% retention fee (equivalent to P233,526.13) was the rent for Tarnate's equipment that had been utilized in the project. In the *deed of assignment*, Gonzalo further authorized Tarnate to use the official receipt of Gonzalo Construction in the processing of the documents relative to the collection of the 10% retention fee and in encashing the check to be issued by the DPWH for that purpose.<sup>[3]</sup> The *deed of assignment* was submitted to the DPWH on April 15, 1999. During the processing of the documents for the retention fee, however, Tarnate learned that Gonzalo had unilaterally rescinded the *deed of assignment* by means of an *affidavit of cancellation of deed of assignment* dated April 19, 1999 filed in the DPWH on April 22, 1999;<sup>[4]</sup> and that the disbursement voucher for the 10% retention fee had then been issued in the name of Gonzalo, and the retention fee released to him.<sup>[5]</sup>

Tarnate demanded the payment of the retention fee from Gonzalo, but to no avail. Thus, he brought this suit against Gonzalo on September 13, 1999 in the Regional Trial Court (RTC) in Mountain Province to recover the retention fee of P233,526.13, moral and exemplary damages for breach of contract, and attorney's fees.<sup>[6]</sup>

In his answer, Gonzalo admitted the *deed of assignment* and the authority given therein to Tarnate, but averred that the project had not been fully implemented

because of its cancellation by the DPWH, and that he had then revoked the *deed of assignment*. He insisted that the assignment could not stand independently due to its being a mere product of the subcontract that had been based on his contract with the DPWH; and that Tarnate, having been fully aware of the illegality and ineffectuality of the *deed of assignment* from the time of its execution, could not go to court with unclean hands to invoke any right based on the invalid *deed of assignment* or on the product of such *deed of assignment*.<sup>[7]</sup>

### **Ruling of the RTC**

On January 26, 2001, the RTC, opining that the *deed of assignment* was a valid and binding contract, and that Gonzalo must comply with his obligations under the *deed of assignment*, rendered judgment in favor of Tarnate as follows:

WHEREFORE, premises considered and as prayed for by the plaintiff, John Tarnate, Jr. in his Complaint for Sum of Money, Breach of Contract With Damages is hereby RENDERED in his favor and against the above-named defendant Domingo Gonzalo, the Court now hereby orders as follows:

1. Defendant Domingo Gonzalo to pay the Plaintiff, John Tarnate, Jr., the amount of TWO HUNDRED THIRTY THREE THOUSAND FIVE HUNDRED TWENTY SIX and 13/100 PESOS (P233,526.13) representing the rental of equipment;
2. Defendant to pay Plaintiff the sum of THIRTY THOUSAND (P30,000.00) PESOS by way of reasonable Attorney's Fees for having forced/compelled the plaintiff to litigate and engage the services of a lawyer in order to protect his interest and to enforce his right. The claim of the plaintiff for attorney's fees in the amount of FIFTY THOUSAND PESOS (P50,000.00) plus THREE THOUSAND PESOS (P3,000.00) clearly appears to be unconscionable and therefore reduced to Thirty Thousand Pesos (P30,000.00) as aforestated making the same to be reasonable;
3. Defendant to pay Plaintiff the sum of FIFTEEN THOUSAND PESOS (P15,000.00) by way of litigation expenses;
4. Defendant to pay Plaintiff the sum of TWENTY THOUSAND PESOS (P20,000.00) for moral damages and for the breach of contract; and
5. To pay the cost of this suit.

Award of exemplary damages in the instant case is not warranted for there is no showing that the defendant acted in a wanton, fraudulent, reckless, oppressive or malevolent manner analogous to the case of Xentrex Automotive, Inc. vs. Court of Appeals, 291 SCRA 66.<sup>[8]</sup>

Gonzalo appealed to the Court of Appeals (CA).

### **Decision of the CA**

On February 18, 2003, the CA affirmed the RTC.<sup>[9]</sup>

Although holding that the subcontract was an illegal agreement due to its object being specifically prohibited by Section 6 of Presidential Decree No. 1594; that Gonzalo and Tarnate were guilty of entering into the illegal contract in violation of Section 6 of Presidential Decree No. 1594; and that the *deed of assignment*, being a product of and dependent on the subcontract, was also illegal and unenforceable, the CA did not apply the doctrine of *in pari delicto*, explaining that the doctrine applied only if the fault of one party was more or less equivalent to the fault of the other party. It found Gonzalo to be more guilty than Tarnate, whose guilt had been limited to the execution of the two illegal contracts while Gonzalo had gone to the extent of violating the *deed of assignment*. It declared that the crediting of the 10% retention fee equivalent to P233,256.13 to his account had unjustly enriched Gonzalo; and ruled, accordingly, that Gonzalo should reimburse Tarnate in that amount because the latter's equipment had been utilized in the project.

Upon denial of his motion for reconsideration,<sup>[10]</sup> Gonzalo has now come to the Court to seek the review and reversal of the decision of the CA.

### **Issues**

Gonzalo contends that the CA erred in affirming the RTC because: (1) both parties were *in pari delicto*; (2) the *deed of assignment* was void; and (3) there was no compliance with the arbitration clause in the subcontract.

Gonzalo submits in support of his contentions that the subcontract and the *deed of assignment*, being specifically prohibited by law, had no force and effect; that upon finding both him and Tarnate guilty of violating the law for executing the subcontract, the RTC and the CA should have applied the rule of *in pari delicto*, to the effect that the law should not aid either party to enforce the illegal contract but should leave them where it found them; and that it was erroneous to accord to the parties relief from their predicament.<sup>[11]</sup>

### **Ruling**

We deny the petition for review, but we delete the grant of moral damages, attorney's fees and litigation expenses.

There is no question that every contractor is prohibited from subcontracting with or assigning to another person any contract or project that he has with the DPWH unless the DPWH Secretary has approved the subcontracting or assignment. This is pursuant to Section 6 of Presidential Decree No. 1594, which provides:

Section 6. *Assignment and Subcontract.* – The contractor shall not assign, transfer, pledge, subcontract or make any other disposition of the contract or any part or interest therein except with the approval of the Minister of Public Works, Transportation and Communications, the Minister of Public Highways, or the Minister of Energy, as the case may be. Approval of the subcontract shall not relieve the main contractor from any liability or obligation under his contract with the Government nor shall it create any contractual relation between the subcontractor and the Government.

Gonzalo, who was the sole contractor of the project in question, subcontracted the implementation of the project to Tarnate in violation of the statutory prohibition. Their subcontract was illegal, therefore, because it did not bear the approval of the