719 Phil. 205

THIRD DIVISION

[G.R. No. 162802, October 09, 2013]

EDS MANUFACTURING, INC., PETITIONER, VS. HEALTHCHECK INTERNATIONAL INC., RESPONDENT.

D E C I S I O N

PERALTA, J.:

This is a Petition for Review on *Certiorari* under Rule 45 of the Rules of Court seeking the reversal of the Decision[1] dated November 28, 2003 and Resolution[2] dated March 16, 2004 of the Court of Appeals (CA) in CA-G.R. CV No. 69420.

The facts, as found by the CA, are as follows:

> The plaintiff Healthcheck Inc. is a Health Maintenance Organization (HMO) that provides prepaid health and medical insurance coverage to its clients. To undergird its program, it maintains a network of accredited hospitals and medical clinics, one of which is the De La Salle University Medical Center located at Dasmariñas, Cavite. Being within the access of this medical facility, the defendant Eds Manufacturing Inc. with about 5,000 employees at Imus, Cavite saw fit in April 1998 to obtain insurance coverage from it. They entered into a one-year contract from May 1, 1998 to April 30, 1999 in which HCI was to provide the 4,191 employees of EMI and their 4,592 dependents as host of medical services and benefits. Attached to the Agreement was a *Service Program* which listed the services that HCI would provide and the responsibilities that EMI would undertake in order to avail of the services. Putting the Agreement into effect, EMI paid the full premium for the coverage in the staggering amount of P8,826,307.50.
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> Only two months into the program, problems began to loom in the horizon. On July 17, HCI notified EMI that its accreditation with DLSUMC was suspended and advised it to avail of the services of nearby accredited institutions. A more detailed communication to subscribers came out days later informing them of the problems of the HMO industry in the wake of the Asian regional financial crisis and proposing interim measures for the unexpired service contracts. In a quickly convened meeting, EMI and HCI hammered out this handwritten 5-point agreement:
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> > "1) Healthcheck to furnish EMI with list of procedural enhancements by 7/24 (FRI)-hospitals & professional fees payment.

2) Healthcheck to reduce no. of accredited hospitals to improve monitoring of bills for payment & other problems.

3) EMI to study the possibility of adding 'LIABILITY CLAUSE' to existing contract; to furnish HC copy for its review.

4) No renewal of contract w/ HC should there be another suspension of services in any hospitals to be chosen (w/ regard to item #2.) w/in the present contract period.

5) HC decision on APE provided by 7/24(FRI)."

Although HCI had yet to settle its accounts with it, DLSUMC resumed services on July 24. In another meeting with EMI on August 3, HCI undertook to settle all its accounts with DLSUMC in order to maintain its accreditation. Despite this commitment, HCI failed to preserve its credit standing with DLSUMC prompting the latter to suspend its accreditation for a second time from August 15 to 20. A third suspension was still to follow on September 9 and remained in force until the end of the contract period.

Until the difficulties between HCI and its client came to a head in September 1998, complaints from EMI employees and workers were pouring in that their HMO cards were not being honored by the DLSUMC and other hospitals and physicians. On September 3, EMI formally notified HCI that it was rescinding their April 1998 Agreement on account of HCI's *serious and repeated breach of its undertaking including but not limited to the unjustified non-availability of services*. It demanded a return of premium for the unused period after September 3, giving a ballpark figure of P6 million.

What went in the way of the rescission of the contract, the fly in the ointment so to speak, was the failure of EMI to collect all the HMO cards of the employees and surrender them to HCI as stipulated in the Agreement. HCI had to tell EMI on October 12, 1998 that its employees were still utilizing the cards even beyond the pretermination date set by EMI. It asked for the surrender of the cards so that it could process the pretermination of the contract and finalize the reconciliation of accounts. *Until we have received the IDs,* HCI said, *we will consider your account with us ongoing and existing, thus subject for inclusion to present billing and payment.*

Without responding to this reminder, EMI sent HCI two letters in January 1999 demanding for the payment of P5,884,205 as the 2/3 portion of the premium that remained unutilized after the Agreement was rescinded in the previous September. The computation was made on the basis of these observations:

- that EMI paid premium of P8,826,307.50

- Healthcheck's accreditation with DLSUMC was

suspended on July 17, August 15 and Sept. 9, 1998 by reason of Healthcheck's unjustified failure to pay its benefits to the hospital.

- That Healthcheck's accreditation with other hospitals and individual physicians was also suspended on various dates for the same reason.

- That, in effect Healthcheck managed to comply with its obligation only for the first 4 months of the year-long contract, or 1/3 thereof.

HCI pre-empted EMI's threat of legal action by instituting the present case before the Regional Trial Court of Pasig. The cause of action it presented was the unlawful pretermination of the contract and failure of EMI to submit to a joint reconciliation of accounts and deliver such assets as properly belonged to HCI. EMI responded with an answer alleging that HCI reneged on its duty to provide adequate medical coverage after EMI paid the premium in full. Having rescinded the contract, it claimed that it was entitled to the unutilized portion of the premium, and that the accounting required by HCI could not be undertaken until it submitted the monthly utilization reports mentioned in the Agreement. EMI asked for the dismissal of the complaint and interposed a counterclaim for damages and unutilized premium of P5,884,205.

In September 2000, after trial, the court ruled in favor of HCI. It found that EMI's rescission of the Agreement on September 3, 1998 was not done through court action or by a notarial act and was based on casual or slight breaches of the contract. Moreover, despite the announced rescission, the employees of EMI continued to avail of HCI's services until March 1999. The services rendered by HCI from May 1998 to March 1999 purportedly came to a total of P10,149,821.13. The court deducted from this figure the premium paid by EMI, leaving a net payable to HCI of P1,323,513.63, in addition to moral damages and attorney's fees. EMI's counterclaims, on the other hand, were dismissed for lack of merit.[3]

On appeal, the CA reversed the decision of the Regional Trial Court (*RTC*) of Pasig City and ruled that although Healthcheck International, Inc. (*HCI*) substantially breached their agreement, it also appears that Eds Manufacturing, Inc. (*EMI*) did not validly rescind the contract between them. Thus, the CA dismissed the complaint filed by HCI, while at the same time dismissing the counterclaim filed by EMI.

Undeterred, EMI filed a Motion for Partial Reconsideration against said decision. However, the same was denied in a Resolution dated March 16, 2004.

Hence, EMI filed the present petition raising the following issues for our resolution:

> THE COURT OF APPEALS, WHILE CORRECTLY OVERTURNING THE RTC'S DECISION BY DISMISSING THE COMPLAINT, COMMITTED A REVERSIBLE AND GROSS ERROR WHEN IT LIKEWISE DISMISSED THE COUNTERCLAIM ON THE GROUND THAT PETITIONER EMI DID NOT ACTUALLY RESCIND THE CONTRACT WHICH RULING BY THE APPELLATE COURT ALREADY WENT BEYOND THE AGREED/SUBMITTED ISSUES FOR ADJUDICATION.
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> THE COURT OF APPEALS COMMITTED SERIOUS ERROR OF LAW IN ADMITTING THE UTILIZATION REPORTS AS COMPETENT EVIDENCE OF THE PURPORTED NON-RESCISSION, WHEN SUCH EVIDENCE IS DOUBLE HEARSAY INASMUCH AS THE PERSON WHO PREPARED THE SAME DID NOT TESTIFY IN COURT AND HIS UNAVAILABILITY WAS UNEXPLAINED.
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> THE COURT OF APPEALS MADE A GRAVE ERROR WHEN IT DECLARED THAT PETITIONER, BY SUPPOSEDLY ALLOWING THE UTILIZATIONS AFTER THE RESCISSION, NEGATED ITS CLAIMED PRE-TERMINATION OF THE CONTRACT AND THEREFORE FORFEITED ITS P5.8M CLAIMS FOR UNUTILIZED PREMIUMS.[4]

Simply, the issue is whether or not there was a valid rescission of the Agreement between the parties.

We rule in the negative.

First, Article 1191 of the Civil Code states:

> The power to rescind obligations is implied in reciprocal ones, in case one of the obligors should not comply with what is incumbent upon him.
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> The injured party may choose between the fulfillment and the rescission of the obligation, with the payment of damages in either case. He may also seek rescission, even after he has chosen fulfillment, if the latter should become impossible.
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> **The court shall decree the rescission claimed, unless there be just cause authorizing the fixing of a period.**
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> This is understood to be without prejudice to the rights of third persons who have acquired the thing, in accordance with Articles 1385 and 1388 and the Mortgage Law.[5]

The general rule is that rescission (more appropriately, ***resolution***) of a contract will not be permitted for a slight or casual breach, but only for such substantial and

fundamental violations as would defeat the very object of the parties in making the agreement.[6]

In his concurring opinion in *Universal Food Corporation v. Court of Appeals*,[7] Justice J.B.L. Reyes clarifies:

> It is probable that the petitioner's confusion arose from the defective technique of the new Code that terms both instances as "rescission" without distinction between them; unlike the previous Spanish Code of 1889 that differentiated between "resolution" for breach of stipulations from "rescission" by reason of lesion or damage. But the terminological vagueness does not justify confusing one case with the other, considering the patent difference in causes and results of either action.[8]

Reiterating the aforementioned pronouncement, this Court in *Pryce Corporation v. Philippine Amusement Gaming Corporation*[9] held that:

> Relevantly, it has been pointed out that resolution was originally used in Article 1124 of the old Civil Code, and that the term became the basis for rescission under Article 1191 (and conformably, also Article 1659).[10]

Thus, the rescission referred to in Article 1191, more appropriately referred to as ***resolution***, is on the breach of faith by one of the parties which is violative of the reciprocity between them.[11]

In the present case, it is apparent that HCI violated its contract with EMI to provide medical service to its employees in a substantial way. As aptly found by the CA, the various reports made by the EMI employees from July to August 1998 are living testaments to the gross denial of services to them at a time when the delivery was crucial to their health and lives.

However, although a ground exists to validly rescind the contract between the parties, it appears that EMI failed to judicially rescind the same.

In *Iringan v. Court of Appeals*,[12] this Court reiterated the rule that in the absence of a stipulation, a party cannot unilaterally and extrajudicially rescind a contract. A judicial or notarial act is necessary before a valid rescission (or ***resolution***) can take place. Thus –

> Clearly, a judicial or notarial act is necessary before a valid rescission can take place, whether or not automatic rescission has been stipulated. It is to be noted that the law uses the phrase "even though" emphasizing that when no stipulation is found on automatic rescission, the judicial or notarial requirement still applies.
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