

## SECOND DIVISION

[ G.R. No. 182967, April 06, 2011 ]

**PHILIPPINE NATIONAL RAILWAYS, PETITIONER, VS. KANLAON  
CONSTRUCTION ENTERPRISES CO., INC., RESPONDENT.**

### D E C I S I O N

**CARPIO, J.:**

#### The Case

This is a petition for review<sup>[1]</sup> of the 26 February 2008 Decision<sup>[2]</sup> and 26 May 2008 Resolution<sup>[3]</sup> of the Court of Appeals in CA-G.R. CV No. 70205. In its 26 February 2008 Decision, the Court of Appeals affirmed the 12 December 2000 Decision,<sup>[4]</sup> as amended by the 22 February 2001 Order,<sup>[5]</sup> of the Regional Trial Court of Quezon City, Branch 221 (trial court), directing petitioner Philippine National Railways (PNR) to pay respondent Kanlaon Construction Enterprises Co., Inc. (Kanlaon) the remaining balance of the contracts and to release the retention money. In its 26 May 2008 Resolution, the Court of Appeals denied PNR's motion for reconsideration.

#### The Facts

In July 1990, PNR and Kanlaon entered into contracts for the repair of three PNR station buildings and passenger shelters, namely: 1) College Station for P2,316,568.41;<sup>[6]</sup> 2) Biñan Station for P2,547,978.63;<sup>[7]</sup> and 3) Buendia Station for P1,820,534.40.<sup>[8]</sup> The total cost of the three projects was P6,685,081.44. By November 1990, Kanlaon alleged that it had already completed the three projects.<sup>[9]</sup>

On 30 June 1994, Kanlaon sent a demand letter to PNR requesting for the release of the retention money in the amount of P333,894.07.<sup>[10]</sup>

In a letter dated 12 July 1994,<sup>[11]</sup> PNR denied Kanlaon's demand because of the 24 January 1994 Notices of Suspension<sup>[12]</sup> issued by the Commission on Audit (COA).

On 8 November 1994, Kanlaon filed a complaint for collection of sum of money plus damages against PNR.<sup>[13]</sup> Kanlaon sought to recover from PNR a total of P865,906.79 consisting of the remaining balance of the three projects in the amount of P531,652.72<sup>[14]</sup> and the retention money in the amount of P334,254.07. In its amended complaint dated 17 August 1995, Kanlaon impleaded the COA.<sup>[15]</sup>

In its answer, PNR admitted the existence of the three contracts but alleged that Kanlaon did not comply with the conditions of the contract. PNR also alleged that Kanlaon did not complete the projects and that PNR did not have any unpaid

balance. PNR added that it had a valid ground to refuse the release of the retention money because of the COA orders suspending the release of payment to Kanlaon.

In its 12 December 2000 Decision, the trial court ruled in favor of Kanlaon. The dispositive portion of the 12 December 2000 Decision reads:

WHEREFORE, premises considered, judgment is hereby rendered in favor of the plaintiff [Kanlaon] and against the herein defendants [PNR and COA]. Accordingly, defendant PNR is ordered to pay the plaintiff the following amount[s]:

1. P333,894.07 representing the unreleased retention money plus legal interest at 12% per annum computed from the date of the first written demand; [and]
2. P531,652.72 representing the unpaid contract price for the completed projects plus legal interest of 12% per annum computed from the date of the first written demand.

Defendant COA is absolved of any liability for actual damages or moral damages.

However, both defendant PNR and defendant COA are solidarily liable for reasonable attorney's fees in the amount of P50,000.00 and cost of suit.

SO ORDERED. <sup>[16]</sup>

On 28 December 2000, COA appealed. On 9 January 2001, PNR filed a motion for reconsideration.

In its 22 February 2001 Order, the trial court modified its 12 December 2000 Decision and fixed the interest rate from twelve percent to six percent per annum from the date of the first written demand.

PNR and COA appealed to the Court of Appeals.

In its 26 February 2008 Decision, the Court of Appeals affirmed the trial court's 12 December 2000 Decision, as amended by its 22 February 2001 Order.

PNR filed a motion for reconsideration.

In its 26 May 2008 Resolution, the Court of Appeals denied PNR's motion.

### **The Ruling of the Trial Court**

The trial court found that Kanlaon completed the projects and that it was entitled to payment in full of the contract price, as well as the release of the retention money. The trial court declared the PNR ledger, which was the only documentary evidence presented by PNR to show that the projects were not completed, to be self-serving and unverified. The trial court declared that PNR failed to present any credible and

substantial evidence that Kanlaon failed to complete the projects. Moreover, the trial court stated that COA suspended payment because PNR failed to comply with certain conditions and not because Kanlaon did not complete the projects. The trial court also took judicial notice of the fact that the PNR stations at College, Biñan and Buendia are fully operational and have been continuously used by PNR and the riding public. The trial court absolved COA from actual and moral damages because there was no contractual relations between COA and Kanlaon and it was not shown that COA acted in bad faith or with malice or gross negligence when it issued the Notices of Suspension.

### **The Ruling of the Court of Appeals**

The Court of Appeals sustained the trial court's ruling that PNR was liable for the remaining balance of the contract price and the retention money. The Court of Appeals agreed with the trial court that the preponderance of evidence leaned in favor of Kanlaon's claim against PNR and that there was nothing on record which supports PNR's allegation that Kanlaon failed to complete the project. The Court of Appeals said the only reason PNR refused to pay Kanlaon was because of COA's Notices of Suspension and not Kanlaon's non-completion of the projects. However, the Court of Appeals held that COA is not liable for attorney's fees and costs of the suit for lack of factual and legal bases.

### **The Issues**

PNR raises the following issues:

- I. The Court of Appeals erred in finding that the projects were completed.
- II. The Court of Appeals erred in affirming the 12 December 2000 Decision of the trial court, as modified by the Order dated February 22, 2001.
- III. The Court of Appeals erred in ruling that interest should be reckoned from the date of respondent's first written demand.<sup>[17]</sup>

### **The Ruling of the Court**

The petition is meritorious.

The Court notes that one of the reasons the COA issued the Notices of Suspension was because the contracts did not contain a Certificate of Availability of Funds as required under Sections 85 and 86 of Presidential Decree No. 1445.<sup>[18]</sup> Kanlaon does not dispute the absence of a Certificate of Availability of Funds.

The Administrative Code of 1987, a more recent law, also contains the same provisions. Sections 46, 47, and 48, Chapter 8, Subtitle B, Title I, Book V of the Administrative Code of 1987 provide:

SECTION 46. Appropriation Before Entering into Contract. --

1. No contract involving the expenditure of public funds shall be entered into unless there is an appropriation therefor, the unexpended balance of which, free of other obligations, is sufficient to cover the proposed expenditure; and

2. Notwithstanding this provision, contracts for the procurement of supplies and materials to be carried in stock may be entered into under regulations of the Commission provided that when issued, the supplies and materials shall be charged to the proper appropriations account.

SECTION 47. Certificate Showing Appropriation to Meet Contract. -- Except in the case of a contract for personal service, for supplies for current consumption or to be carried in stock not exceeding the estimated consumption for three (3) months, or banking transactions of government-owned or controlled banks, **no contract involving the expenditure of public funds by any government agency shall be entered into or authorized unless the proper accounting official of the agency concerned shall have certified to the officer entering into the obligation that funds have been duly appropriated for the purpose and that the amount necessary to cover the proposed contract for the current calendar year is available for expenditure on account thereof**, subject to verification by the auditor concerned. The certificate signed by the proper accounting official and the auditor who verified it, shall be attached to and become an integral part of the proposed contract, and the sum so certified shall not thereafter be available for expenditure for any other purpose until the obligation of the government agency concerned under the contract is fully extinguished.

SECTION 48. Void Contract and Liability of Officer. -- **Any contract entered into contrary to the requirements of the two (2) immediately preceding sections shall be void**, and the officer or officers entering into the contract shall be liable to the Government or other contracting party for any consequent damage to the same extent as if the transaction had been wholly between private parties. (Emphasis supplied)

Thus, the Administrative Code of 1987 expressly prohibits the entering into contracts involving the expenditure of public funds unless two prior requirements are satisfied. First, there must be an appropriation law authorizing the expenditure required in the contract. Second, there must be attached to the contract a certification by the proper accounting official and auditor that funds have been appropriated by law and such funds are available. Failure to comply with any of these two requirements renders the contract void.

In several cases,<sup>[19]</sup> the Court had the occasion to apply these provisions of the Administrative Code of 1987 and the Government Auditing Code of the Philippines. In these cases, the Court clearly ruled that the two requirements - the existence of appropriation and the attachment of the certification - are "*conditions sine qua non* for the execution of government contracts."