608 Phil. 206

FIRST DIVISION

[G.R. No. 167017, June 22, 2009]

SERAFIN CHENG, PETITIONER, VS. SPOUSES VITTORIO AND MA. HELEN DONINI, RESPONDENTS.

D E C I S I O N

CORONA, J.:

The subject of this petition is an oral lease agreement that went sour. Petitioner Serafin Cheng agreed to lease his property located at 479 Shaw Blvd., Mandaluyong City to respondents, Spouses Vittorio and Ma. Helen Donini, who intended to put up a restaurant thereon. They agreed to a monthly rental of P17,000, to commence in December 1990.

Bearing an *Interim Grant of Authority* executed by petitioner, respondents proceeded to introduce improvements in the premises. The authority read:

> I, Serafin Cheng, of legal age and with office address at Room 310 Federation Center Building Muelle de Binondo, Manila, owner of the building/structure located at 479 Shaw Boulevard, Mandaluyong, Metro Manila, *pursuant to a lease agreement now being finalized and to take effect December 1, 1990*, hereby grants VITTORIO DONINI (Prospective Lessee) and all those acting under his orders to make all the necessary improvements on the prospective leased premises located at 479 Shaw Blvd., Mandaluyong, Metro Manila, and for this purpose, to enter said premises and perform, all such works and activities to make the leased premises operational as a restaurant or similar purpose.
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> Manila, 31 October 1990.[1]

However, before respondents' business could take off and before any final lease agreement could be drafted and signed, the parties began to have serious disagreements regarding its terms and conditions. Petitioner thus wrote respondents on January 28, 1991, demanding payment of the deposit and rentals, and signifying that he had no intention to continue with the agreement should respondents fail to pay. Respondents, however, ignoring petitioner's demand, continued to occupy the premises until April 17, 1991 when their caretaker voluntarily surrendered the property to petitioner.

Respondents then filed an action for specific performance and damages with a prayer for the issuance of a writ of preliminary injunction in the Regional Trial Court (RTC) of Pasig City, Branch 67, docketed as Civil Case No. 60769. Respondents prayed that petitioner be ordered to execute a written lease contract for five years, deducting from the deposit and rent the cost of repairs in the amount of P445,000, or to order petitioner to return their investment in the amount of P964,000 and compensate for their unearned net income of P200,000 with interest, plus attorney's

fees.[2]

Petitioner, in his answer, denied respondents' claims and sought the award of moral and exemplary damages, and attorney's fees.[3]

After trial, the RTC rendered its decision in favor of petitioner, the dispositive portion of which provided:

> WHEREFORE, in view of all the foregoing, this Court finds the preponderance of evidence in favor of the [petitioner] and hereby renders judgment as follows:
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> 1. The Complaint is dismissed.
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> 2. On the counterclaim, [respondents] are ordered, jointly and severally, to pay the [petitioner] P500,000.00 as moral damages; P100,000.00 as exemplary damages; and P50,000.00 as attorney's fees.
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> 3. [Respondents] are likewise ordered to pay the costs.
>
> SO ORDERED.[4]

Respondents appealed to the Court of Appeals (CA) which, in its decision[5] dated March 31, 2004, recalled and set aside the RTC decision, and entered a new one ordering petitioner to pay respondents the amount of P964,000 representing the latter's expenses incurred for the repairs and improvements of the premises.[6]

Petitioner filed a motion for reconsideration on the ground that the award of reimbursement had no factual and legal bases,[7] but this was denied by the CA in its resolution dated February 21, 2005.[8]

Hence, this petition for certiorari under Rule 45 of the Rules of Court, with petitioner arguing that:

> THE COURT OF APPEALS DECIDED THIS CASE NOT IN ACCORD WITH LAW AND WITH APPLICABLE DECISIONS OF THIS HONORABLE COURT. PUT OTHERWISE:
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> A. BY ORDERING PETITIONER TO REIMBURSE RESPONDENTS THE FULL VALUE OF EXPENSES FOR THEIR ALLEGED REPAIRS AND IMPROVEMENTS OF THE LEASED PREMISES, THE COURT OF APPEALS ERRONEOUSLY CONSIDERED RESPONDENTS NOT AS MERE LESSEES BUT POSSESSORS IN GOOD FAITH UNDER ARTICLES 448 AND 546 OF THE CIVIL CODE.
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> B. THE COURT OF APPEALS DECIDED THIS CASE NOT IN ACCORD WITH ARTICLE 1678 OF THE CIVIL CODE WHICH GIVES THE LESSOR THE OPTION TO REIMBURSE THE LESSEE ONE-HALF OF THE VALUE OF USEFUL IMPROVEMENTS OR, IF HE DOES NOT WANT TO, ALLOW

THE LESSEE TO REMOVE THE IMPROVEMENTS.

C. LIKEWISE, BY ORDERING PETITIONER TO REIMBURSE THE VALUE OF ORNAMENTAL EXPENSES, THE COURT OF APPEALS CONTRAVENED THE SECOND PARAGRAPH OF ARTICLE 1678.

D. THE COURT OF APPEALS ERRED IN APPLYING THE PRINCIPLE OF EQUITY IN FAVOR OF THE RESPONDENTS.

E. THE COURT OF APPEALS ERRED IN NOT AFFIRMING THE DECISION OF THE TRIAL COURT AWARDING DAMAGES TO PETITIONER.

F. THE COURT OF APPEALS SERIOUSLY ERRED AND/OR GRAVELY ABUSED ITS DISCRETION IN FIXING THE AMOUNT OF P961,000.00[9] CONTRARY TO RESPONDENTS' OWN REPRESENTATION AND EVIDENCE. [10]

Respondents were required to file their comment on the petition but their counsel manifested that he could not file one since his clients' whereabouts were unknown to him.[11] Counsel also urged the Court to render a decision on the basis of the available records and documents.[12] Per resolution dated August 30, 2006, copies of the resolutions requiring respondents to file their comment were sent to their last known address and were deemed served. The order requiring respondents' counsel to file a comment in their behalf was reiterated.[13]

In their comment, respondents argued that they were possessors in good faith, hence, Articles 448 and 546 of the Civil Code applied and they should be indemnified for the improvements introduced on the leased premises. Respondents bewailed the fact that petitioner was going to benefit from these improvements, the cost of which amounted to P1.409 million, in contrast to respondents' rental/deposit obligation amounting to only P34,000. Respondents also contended that petitioner's rescission of the agreement was in bad faith and they were thus entitled to a refund. [14]

In settling the appeal before it, the CA made the following findings and conclusions:

1. there was no agreement that the deposit and rentals accruing to petitioner would be deducted from the costs of repairs and renovation incurred by respondents;

2. respondents committed a breach in the terms and conditions of the agreement when they failed to pay the rentals;

3. there was no valid rescission on the part of petitioner;

4. respondents were entitled to reimbursement for the cost of improvements under the principle of equity and unjust enrichment;

and

5. the award of damages in favor of petitioner had no basis in fact and law.[15]

As the correctness of the CA's ruling regarding (1) the lack of agreement on the deposit and rentals; (2) respondents' breach of the terms of the verbal agreement and (3) the lack of valid rescission by petitioner was never put in issue, this decision will be confined only to the issues raised by petitioner, that is, the award of reimbursement and the deletion of the award of damages. It need not be stressed that an appellate court will not review errors that are not assigned before it, save in certain exceptional circumstances and those affecting jurisdiction over the subject matter as well as plain and clerical errors, none of which is present in this case.[16]

Remarkably, in ruling that respondents were entitled to reimbursement, the CA did not provide any statutory basis therefor and instead applied the principles of equity and unjust enrichment, stating:

> It would be inequitable to allow the defendant-appellee, as owner of the property to enjoy perpetually the improvements introduced by the plaintiffs-appellants without reimbursing them for the value of the said improvements. Well-settled is the rule that no one shall be unjustly enriched or benefitted at the expense of another.[17]

Petitioner, however, correctly argued that the principle of equity did not apply in this case. Equity, which has been aptly described as "justice outside legality," is applied only in the absence of, and never against, statutory law or judicial rules of procedure.[18] Positive rules prevail over all abstract arguments based on equity *contra legem*.[19] Neither is the principle of unjust enrichment applicable since petitioner (who was to benefit from it) had a valid claim.[20]

The relationship between petitioner and respondents was explicitly governed by the Civil Code provisions on lease, which clearly provide for the rule on reimbursement of useful improvements and ornamental expenses after termination of a lease agreement. Article 1678 states:

> If the lessee makes, in good faith, useful improvements which are suitable to the use for which the lease is intended, without altering the form or substance of the property leased, the lessor upon the termination of the lease shall pay the lessee one-half of the value of the improvements at that time. Should the lessor refuse to reimburse said amount, the lessee may remove the improvements, even though the principal thing may suffer damage thereby. He shall not, however, cause any more impairment upon the property leased than is necessary.
>
> With regard to ornamental expenses, the lessee shall not be entitled to any reimbursement, but he may remove the ornamental objects, provided no damage is caused to the principal thing, and the lessor does not choose to retain them by paying their value at the time the lease is extinguished.

Article 1678 modified the (old) Civil Code provision on reimbursement where the lessee had no right at all to be reimbursed for the improvements introduced on the leased property, he being entitled merely to the rights of a usufructuary - the right of removal and set-off but not to reimbursement.[21]

Contrary to respondents' position, Articles 448 and 546 of the Civil Code did not apply. Under these provisions, to be entitled to reimbursement for useful improvements introduced on the property, respondents must be considered builders in good faith. Articles 448 and 546, which allow full reimbursement of useful improvements and retention of the premises until reimbursement is made, apply only to a possessor in good faith or one who builds on land in the belief that he is the owner thereof. A builder in good faith is one who is unaware of any flaw in his title to the land at the time he builds on it.[22]

But respondents cannot be considered possessors or builders in good faith. As early as 1956, in *Lopez v. Philippine & Eastern Trading Co., Inc.*,[23] the Court clarified that a lessee is neither a builder nor a possessor in good faith -

> x x x This principle of possessor in good faith naturally cannot apply to a lessee because as such lessee he knows that he is not the owner of the leased property. Neither can he deny the ownership or title of his lessor. Knowing that his occupation of the premises continues only during the life of the lease contract and that he must vacate the property upon termination of the lease or upon the violation by him of any of its terms, **he introduces improvements on said property at his own risk in the sense that he cannot recover their value from the lessor, much less retain the premises until such reimbursement**. (Emphasis supplied)

Being mere lessees, respondents knew that their right to occupy the premises existed only for the duration of the lease.[24] *Cortez v. Manimbo*[25] went further to state that:

> If the rule were otherwise, it would always be in the power of the tenant to improve his landlord out of his property.

These principles have been consistently adhered to and applied by the Court in many cases.[26]

Under Article 1678 of the Civil Code, the lessor has the primary right (or the first move) to reimburse the lessee for 50% of the value of the improvements at the end of the lease. If the lessor refuses to make the reimbursement, the subsidiary right of the lessee to remove the improvements, even though the principal thing suffers damage, arises. Consequently, on petitioner rests the primary option to pay for one-half of the value of the useful improvements. It is only when petitioner as lessor refuses to make the reimbursement that respondents, as lessees, may remove the improvements. Should petitioner refuse to exercise the option of paying for one-half of the value of the improvements, he cannot be compelled to do so. It then lies on respondents to insist on their subsidiary right to remove the improvements even though the principal thing suffers damage but without causing any more impairment on the property leased than is necessary.