THIRD DIVISION

[G.R. No. 180898, April 18, 2012]

PHILIPPINE CHARTER INSURANCE CORPORATION, PETITIONER, VS. PETROLEUM DISTRIBUTORS & SERVICE CORPORATION RESPONDENT.

D E C I S I O N

MENDOZA, J.:

Before the Court is a petition for review under Rule 45 of the Rules of Court seeking the reversal of the July 31, 2007 Decision[1] and the December 28, 2007 Resolution[2] of the Court of Appeals *(CA)* in CA-G.R. CV No. 82417, which affirmed with modification the January 12, 2004 Decision of the Regional Trial Court, Branch 111, Pasay City *(RTC)*.

The Facts:

On January 27, 1999, respondent Petroleum Distributors and Services Corporation *(PDSC)*, through its president, Conrado P. Limcaco, entered into a building contract[3] with N.C. Francia Construction Corporation *(FCC)*, represented by its president and chief executive officer, Emmanuel T. Francia, for the construction of a four-story commercial and parking complex located at MIA Road corner Domestic Road, Pasay City, known as Park 'N Fly Building *(Park 'N Fly)*. Under the contract, FCC agreed to undertake the construction of Park 'N Fly for the price of P45,522,197.72.

The parties agreed that the construction work would begin on February 1, 1999. Under the Project Evaluation and Review Technique Critical Path Method *(PERT-CPM)*, the project was divided into two stages: Phase 1[4] of the construction work would be finished on May 17, 1999 and Phase 2[5] would begin on May 18, 1999 and finish on October 20, 1999. The project should be turned over by October 21, 1999.[6] It was further stipulated that in the event FCC failed to finish the project within the period specified, liquidated damages equivalent to 1/10 of 1% of the contract price for every day of delay shall accrue in favor of PDSC.[7]

To ensure compliance with its obligation, FCC's individual officers, namely, Natividad Francia, Emmanuel C. Francia, Jr., Anna Sheila C. Francia, San Diego Felipe G. Bermudez, Emmanuel T. Francia, Charlemagne C. Francia, and Ruben G. Caperiña, signed the Undertaking of Surety[8] holding themselves personally liable for the accountabilities of FCC.

Also, FCC procured Performance Bond No. 31915 amounting to P6,828,329.00 from petitioner Philippine Charter Insurance Corporation *(PCIC)* to secure full and faithful performance of its obligation under the Building Contract.[9]

The construction of the Park 'N Fly started on February 1, 1999.

Pursuant to the Building Contract, PDSC sourced out construction materials and subcontracted various phases of the work to help obtain the lowest cost of the construction and speed up the work of the project. These resulted in the reduction of the contract price.[10]

During the Phase 1 of the project, PDSC noticed that FCC was sixteen (16) days behind schedule. In a Letter[11] dated March 25, 1999, it reminded FCC to catch up with the schedule of the projected work path, or it would impose the penalty of 1/10 of the 1% of the contract price. The problem, however, was not addressed, as the delay increased to 30 days[12] and ballooned to 60 days.[13]

Consequently, on September 10, 1999, FCC executed a deed of assignment,[14] assigning a portion of its receivables from Caltex Philippines, Inc. (*Caltex*), and a chattel mortgage,[15] conveying some of its construction equipment to PDSC as additional security for the faithful compliance with its obligation.

On even date, PDSC and FCC likewise executed a memorandum of agreement (*MOA*),[16] wherein the parties agreed to revise the work schedule of the project. As a consequence, Performance Bond No. 31915 was extended up to March 2, 2000.[17]

For failure of FCC to accomplish the project within the agreed completion period, PDSC, in a letter[18] dated December 3, 1999, informed FCC that it was terminating their contract based on Article 12, Paragraph 12.1 of the Building Contract. Subsequently, PDSC sent demand letters[19] to FCC and its officers for the payment of liquidated damages amounting to ?9,149,962.02 for the delay. In the same manner, PDSC wrote PCIC asking for remuneration pursuant to Performance Bond No. 31915.[20]

Despite notice, PDSC did not receive any reply from either FCC or PCIC, constraining it to file a complaint[21] for damages, recovery of possession of personal property and/or foreclosure of mortgage with prayer for the issuance of a writ of replevin and writ of attachment, against FCC and its officers before the RTC. PDSC later filed a supplemental complaint[22] impleading PCIC, claiming coverage under Performance Bond No. 31915 in the amount of P6,828,329.66.

In its Amended Answer with affirmative defense and counterclaim,[23] FCC admitted that it entered into a contract with PDSC for the construction of the Park 'N Fly building. It, however, asserted that due to outsourcing of different materials and subcontracting of various phases of works made by PDSC, the contract price was invariably reduced to P19,809,822.12.

FCC denied any liability to PDSC claiming that any such claim by the latter had been waived, abandoned or otherwise extinguished by the execution of the September 10, 1999 MOA. FCC claimed that in the said MOA, PDSC assumed all the obligations originally reposed upon it. FCC further explained that the PERT-CPM agreed upon by the parties covering the first phase of the work project was severely affected when PDSC deleted several scopes of work and undertook to perform the same. In fact, the PERT-CPM was evaluated and it was concluded that the delay was attributable to both of them. FCC added that after Phase I of the project, it sent a progress billing in the amount of P939,165.00 but PDSC approved the amount of P639,165.00 only after deducting the cost of the attributable delay with the agreement that from then on, PDSC should shoulder all expenses in the construction of the building until completion; that FCC would provide the workers on the condition that they would be paid by PDSC; and that it would allow PDSC free use of the construction equipments that were in the project site.

For its part, PCIC averred that as a surety, it was not liable as a principal obligor; that its liability under the bond was conditional and subsidiary and that it could be made liable only upon FCC's default of its obligation in the Building Contract up to the extent of the terms and conditions of the bond. PCIC also alleged that its obligation under the performance bond was terminated when it expired on October 15, 1999 and the extension of the performance bond until March 2, 2000 was not binding as it was made without its knowledge and consent.

PCIC added that PDSC's claim against it had been waived, abandoned or extinguished by the September 10, 1999 MOA. It also argued that its obligation was indeed extinguished when PDSC terminated the contract on December 3, 1999 and took over the construction and it failed to file its claim within ten (10) days from the expiry date or from the alleged default of FCC.[24]

Nonetheless, in the event that PCIC would be made liable, its liability should be in proportion to the liabilities of the other sureties.

On January 12, 2004, the RTC rendered its Decision[25] in favor of PDSC. The RTC found FCC guilty of delay when it failed to finish and turn over the project on October 15, 1999. It pronounced FCC and PCIC jointly and severally liable and ordered them to pay PDSC the amount of P9,000,000.00 as damages and P50,000.00 as attorney's fees plus interest.

FCC and PCIC filed their respective notice of appeal[26] with the RTC. On February 12, 2004, the RTC issued its Order[27] giving due course to the notice of appeal.

On July 31, 2007, the CA modified the RTC's decision.[28] The CA agreed that FCC incurred delay in the construction of the project. It, however, found that the computation of the liquidated damages should be based on the reduced contract price of P19,809,822.12. The dispositive portion reads:

> WHEREFORE, the Decision dated 12 January 2004 of the Regional Trial Court of Pasay City, Branch 111 is AFFIRMED with MODIFICATION in that appellants N.C. Francia Construction Corporation, Natividad Francia, Emmanuel Francia, Jr., Anna Sheila Francia San Diego, Felipe Bermudez, Emmanuel Francia, Charlemagne Francia, Ruben Caperiña, and Philippine Charter Insurance Corporation are hereby held solidarily liable to pay appellee Petroleum Distributors & Services Corporation (1) liquidated damages in the sum of P3,882,725.13, which shall earn legal interest at

the rate of 6% per annum from 10 January 2000 until finality of this judgment; (2) attorney's fees amounting to P50,000.00; and (3) cost of suit. Pursuant to Performance Bond No. 31915, the liability of appellant Philippine Charter Insurance Corporation should not exceed P6,828,329.66.

Appellants N.C Francia Construction Corporation, Emmanuel Francia and Natividad Francia are adjudged liable to pay appellant Philippine Charter Insurance Corporation for the amount the latter may have paid under Performance Bond No. 31915.

SO ORDERED.[29]

FCC and PCIC filed their separate motions for reconsideration[30] but the CA denied them in its December 28, 2007 Resolution.[31]

Hence, this petition.

It is well to note that only PCIC appealed the CA's decision. It became final and executory with regard to FCC and the other parties in the case. Hence, the Court shall limit its discussion to the liability of PCIC.

In its Memorandum,[32] PCIC anchored its petition on the following issues:

1. Whether or not the Court of Appeals, in adjudging Petitioner liable for liquidated damages, expanded liability under Performance Bond No. 31915 which on its face answers only for actual and compensatory damages, not liquidated damages.

Assuming *arguendo* liability for liquidated damages under the performance bond, whether or not the Court of Appeals erred in not declaring that the award of liquidated damages is iniquitous and unconscionable and in not applying the provisions of Article 2227, Civil Code, and Palmares v. Court of Appeals, 288 SCRA 422.

2. Whether or not the Memorandum of Agreement dated Sept. 10, 1999 entered into by respondent and Francia Construction, confirmed in a letter dated Sept. 20, 1999, --- without Petitioner's knowledge or consent---, the effect that all costs, expenses, payments and obligations shall be deemed paid, performed and fully settled as of Sept. 10, 1999, discharged Petitioner from liability under the performance bond under Article 2079, Civil Code.

3. Whether or not the Court of Appeals, having made the finding of fact that the sums of Php2,793,000.00 and Php662,836.50 should be deducted from Php3,882,725.13, erred in not deducting the amounts in the dispositive portion of the decision.[33]

In sum, the issues before the Court are (1) whether or not PCIC is liable for liquidated damages under the performance bond; (2) whether or not the September 10, 1999 MOA executed by PDSC and FCC extinguished PCIC's liability under the performance bond; and (3) whether or not the amounts of P2,793,000.00 and P662,836.50 are deductible from the liquidated damages awarded by the CA.

PCIC argues that in case of a breach of contract, the performance bond is answerable only for actual or compensatory, not for liquidated damages. The terms of the bond are clear that the liability of the surety is determined by the contract of suretyship and cannot be extended by implication beyond the terms of the contract. Nonetheless, even assuming that it is liable under the performance bond, the liability should be based on equity. It claims that it is unlawful and iniquitous to hold FCC responsible for the delay of the subcontractor commissioned by PDSC.

PCIC adds that the act of PDSC of subcontracting the various stages of the project resulted in a revision of work schedule and extension of the completion date that ultimately released both FCC and PCIC of whatever claims PDSC may have against them. PCIC is of the impression that since the subcontracting made by PDSC was made without its consent and knowledge, its liability under the performance bond should be extinguished.

PCIC also pointed out that the receivable in the amount of P2,793,000.00 acquired by PDSC from Caltex and the proceeds from the auction sale in the sum of P662,836.50 should be deducted from the award of P3,882,725.13.

The Court finds no merit in the petition.

The Building Contract entered into by PDSC and FCC provides that:

> Art. 2 ESSENCE OF THE CONTRACT
>
> 2.1 It is understood that time, quality of work in accordance with the OWNER's requirements, and reduced construction costs are the essence of this Contract.
>
> 2.2 The CONTRACTOR shall commence the construction for the first two (2) levels not later than five (5) days immediately after the date of execution of this Contract and shall regularly proceed and complete the construction within Two Hundred Fifty-Nine (259) calendar days reckoned from the date of signing of this Contract or not later than October 15, 1999, whichever is earlier. To ensure completion of the work within the time given herein, construction work shall be conducted at least twenty hours each day with at least two (2) work shift for every day actually worked.
>
> **2.3 In the event that the construction is not completed within the aforesaid period of time, the OWNER is entitled and shall have the right to deduct from any amount that may be due to the CONTRACTOR the sum of one-tenth (1/10) of one percent (1%) of the contract price for every day of delay in whatever stage of the project as liquidated damages, and not**