Republic of the Philippines
Supreme Court
Manila

FIRST DIVISION

GALILEO A. MAGLASANG, doing business under the name GL Enterprises, Petitioner,	**G.R. No. 188986**
	Present:
- versus -	SERENO, *CJ*, Chairperson, LEONARDO-DE CASTRO, BERSAMIN, VILLARAMA, JR., and *LEONEN, *JJ.*
NORTHWESTERN UNIVERSITY, INC., Respondent.	Promulgated: MAR 20 2013

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DECISION

SERENO, *CJ:*

Before this Court is a Rule 45 Petition, seeking a review of the 27 July 2009 Court of Appeals (CA) Decision in CA-G.R. CV No. 88989,[1] which modified the Regional Trial Court (RTC) Decision of 8 January 2007 in Civil Case No. Q-04-53660.[2] The CA held that petitioner substantially breached its contracts with respondent for the installation of an integrated bridge system (IBS).

The antecedent facts are as follows:[3]

On 10 June 2004, respondent Northwestern University (Northwestern), an educational institution offering maritime-related courses, engaged the services of a Quezon City-based firm, petitioner GL Enterprises, to install a new IBS in Laoag City. The installation of an IBS,

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* Additional member in lieu of Associate Justice Bienvenido L. Reyes due to his prior action in the Court of Appeals.

[1] CA Decision, penned by Associate Justice Isaias P. Dicdican, with Associate Justices Bienvenido L. Reyes (now a member of this Court) and Marlene B. Gonzales-Sison concurring.

[2] RTC Decision penned by Judge Hilario L. Laqui.

[3] *Rollo*, pp. 21-38.

used as the students' training laboratory, was required by the Commission on Higher Education (CHED) before a school could offer maritime transportation programs.[4]

Since its IBS was already obsolete, respondent required petitioner to supply and install specific components in order to form the most modern IBS that would be acceptable to CHED and would be compliant with the standards of the International Maritime Organization (IMO). For this purpose, the parties executed two contracts.

The first contract partly reads:[5]

> That in consideration of the payment herein mentioned to be made by the First Party (defendant), the Second Party agrees to furnish, supply, install and integrate the most modern **INTEGRATED BRIDGE SYSTEM** located at Northwestern University MOCK BOAT in accordance with the general conditions, plans and specifications of this contract.
>
> **SUPPLY & INSTALLATION OF THE FOLLOWING:**
>
> INTEGRATED BRIDGE SYSTEM
>
> A. 2-RADAR SYSTEM
> B. OVERHEAD CONSOLE MONITORING SYSTEM
> C. ENGINE TELEGRAPH SYSTEM
> D. ENGINE CONTROL SYSTEM
> E. WEATHER CONTROL SYSTEM
> F. ECDIS SYSTEM
> G. STEERING WHEEL SYSTEM
> H. BRIDGE CONSOLE
>
> | | | |
> |---|---|---|
> | TOTAL COST: | PhP | 3,800,000.00 |
> | LESS: OLD MARITIME EQUIPMENT TRADE-IN VALUE | | 1,000,000.00 |
> | DISCOUNT | | 100,000.00 |
> | **PROJECT COST (MATERIALS & INSTALLATION)** | **PhP** | **2,700,000.00** |
>
> (Emphasis in the original)

The second contract essentially contains the same terms and conditions as follows:[6]

> That in consideration of the payment herein mentioned to be made by the First Party (defendant), the Second Party agrees to furnish, supply, install & integrate the most modern **INTEGRATED BRIDGE SYSTEM located at Northwestern University MOCK BOAT** in accordance with the general conditions, plans and specifications of this contract.

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[4] Id. at 13; Petition for Review dated 13 September 2009.
[5] Id. at 43-44.
[6] Id. at 45-46.

SUPPLY & INSTALLATION OF THE FOLLOWING:

1. ARPA RADAR SIMULATION ROOM
x x x x
2. GMDSS SIMULATION ROOM
x x x x

TOTAL COST: PhP 270,000.00
(Emphasis in the original)

Common to both contracts are the following provisions: (1) the IBS and its components must be compliant with the IMO and CHED standard and with manuals for simulators/major equipment; (2) the contracts may be terminated if one party commits a substantial breach of its undertaking; and (3) any dispute under the agreement shall first be settled mutually between the parties, and if settlement is not obtained, resort shall be sought in the courts of law.

Subsequently, Northwestern paid ₱1 million as down payment to GL Enterprises. The former then assumed possession of Northwestern's old IBS as trade-in payment for its service. Thus, the balance of the contract price remained at ₱1.97 million.[7]

Two months after the execution of the contracts, GL Enterprises technicians delivered various materials to the project site. However, when they started installing the components, respondent halted the operations. GL Enterprises then asked for an explanation.[8]

Northwestern justified the work stoppage upon its finding that the delivered equipment were substandard.[9] It explained further that GL Enterprises violated the terms and conditions of the contracts, since the delivered components (1) were old; (2) did not have instruction manuals and warranty certificates; (3) contained indications of being reconditioned machines; and (4) did not meet the IMO and CHED standards. Thus, Northwestern demanded compliance with the agreement and suggested that GL Enterprises meet with the former's representatives to iron out the situation.

Instead of heeding this suggestion, GL Enterprises filed on 8 September 2004 a Complaint[10] for breach of contract and prayed for the following sums: ₱1.97 million, representing the amount that it would have

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[7] Id. at 85.
[8] Id. at 47; petitioner's letter dated 23 August 2004.
[9] Id. at 48; respondent's letter dated 30 August 2004.
[10] Id. at 39-42.

earned, had Northwestern not stopped it from performing its tasks under the two contracts; at least ₱100,000 as moral damages; at least ₱100,000 by way of exemplary damages; at least ₱100,000 as attorney's fees and litigation expenses; and cost of suit. Petitioner alleged that Northwestern breached the contracts by ordering the work stoppage and thus preventing the installation of the materials for the IBS.

Northwestern denied the allegation. In its defense, it asserted that since the equipment delivered were not in accordance with the specifications provided by the contracts, all succeeding works would be futile and would entail unnecessary expenses. Hence, it prayed for the rescission of the contracts and made a compulsory counterclaim for actual, moral, and exemplary damages, and attorney's fees.

The RTC held both parties at fault. It found that Northwestern unduly halted the operations, even if the contracts called for a completed project to be evaluated by the CHED. In turn, the breach committed by GL Enterprises consisted of the delivery of substandard equipment that were not compliant with IMO and CHED standards as required by the agreement.

Invoking the equitable principle that "each party must bear its own loss," the trial court treated the contracts as impossible of performance without the fault of either party or as having been dissolved by mutual consent. Consequently, it ordered mutual restitution, which would thereby restore the parties to their original positions as follows:[11]

> Accordingly, plaintiff is hereby ordered to restore to the defendant all the equipment obtained by reason of the First Contract and refund the downpayment of ₱1,000,000.00 to the defendant; and for the defendant to return to the plaintiff the equipment and materials it withheld by reason of the non-continuance of the installation and integration project. In the event that restoration of the old equipment taken from defendant's premises is no longer possible, plaintiff is hereby ordered to pay the appraised value of defendant's old equipment at ₱1,000,000.00. Likewise, in the event that restoration of the equipment and materials delivered by the plaintiff to the defendant is no longer possible, defendant is hereby ordered to pay its appraised value at ₱1,027,480.00.
>
> Moreover, plaintiff is likewise ordered to restore and return all the equipment obtained by reason of the Second Contract, or if restoration or return is not possible, plaintiff is ordered to pay the value thereof to the defendant.
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> SO ORDERED.

[11] Id. at 92.

Aggrieved, both parties appealed to the CA. With each of them pointing a finger at the other party as the violator of the contracts, the appellate court ultimately determined that GL Enterprises was the one guilty of substantial breach and liable for attorney's fees.

The CA appreciated that since the parties essentially sought to have an IBS compliant with the CHED and IMO standards, it was GL Enterprises' delivery of defective equipment that materially and substantially breached the contracts. Although the contracts contemplated a completed project to be evaluated by CHED, Northwestern could not just sit idly by when it was apparent that the components delivered were substandard.

The CA held that Northwestern only exercised ordinary prudence to prevent the inevitable rejection of the IBS delivered by GL Enterprises. Likewise, the appellate court disregarded petitioner's excuse that the equipment delivered might not have been the components intended to be installed, for it would be contrary to human experience to deliver equipment from Quezon City to Laoag City with no intention to use it.

This time, applying Article 1191 of the Civil Code, the CA declared the rescission of the contracts. It then proceeded to affirm the RTC's order of mutual restitution. Additionally, the appellate court granted ₱50,000 to Northwestern by way of attorney's fees.

Before this Court, petitioner rehashes all the arguments he had raised in the courts *a quo*.[12] He maintains his prayer for actual damages equivalent to the amount that he would have earned, had respondent not stopped him from performing his tasks under the two contracts; moral and exemplary damages; attorney's fees; litigation expenses; and cost of suit.

Hence, the pertinent issue to be resolved in the instant appeal is whether the CA gravely erred in (1) finding substantial breach on the part of GL Enterprises; (2) refusing petitioner's claims for damages, and (3) awarding attorney's fees to Northwestern.

RULING OF THE COURT

Substantial Breaches of the Contracts

Although the RTC and the CA concurred in ordering restitution, the courts *a quo*, however, differed on the basis thereof. The RTC applied the

[12] Id. at 12-16.

equitable principle of mutual fault, while the CA applied Article 1191 on rescission.

The power to rescind the obligations of the injured party is implied in reciprocal obligations, such as in this case. On this score, the CA correctly applied Article 1191, which provides thus:

> 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.
>
> 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.
>
> The court shall decree the rescission claimed, unless there be just cause authorizing the fixing of a period.

The two contracts require no less than substantial breach before they can be rescinded. Since the contracts do not provide for a definition of substantial breach that would terminate the rights and obligations of the parties, we apply the definition found in our jurisprudence.

This Court defined in *Cannu v. Galang*[13] that substantial, unlike slight or casual breaches of contract, are fundamental breaches that defeat the object of the parties in entering into an agreement, since the law is not concerned with trifles.[14]

The question of whether a breach of contract is substantial depends upon the attending circumstances.[15]

In the case at bar, the parties explicitly agreed that the materials to be delivered must be compliant with the CHED and IMO standards and must be complete with manuals. Aside from these clear provisions in the contracts, the courts *a quo* similarly found that the intent of the parties was to replace the old IBS in order to obtain CHED accreditation for Northwestern's maritime-related courses.

According to CHED Memorandum Order (CMO) No. 10, Series of 1999, as amended by CMO No. 13, Series of 2005, any simulator used for simulator-based training shall be capable of simulating the operating capabilities of the shipboard equipment concerned. The simulation must be achieved at a level of physical realism appropriate for training objectives;

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[13] 498 Phil. 128 (2005).
[14] 234 Phil. 523 (1987).
[15] *G.G. Sportswear Mfg. Corp. v. World Class Properties, Inc.*, G.R. No. 182720, 2 March 2010, 614 SCRA 75.

include the capabilities, limitations and possible errors of such equipment; and provide an interface through which a trainee can interact with the equipment, and the simulated environment.

Given these conditions, it was thus incumbent upon GL Enterprises to supply the components that would create an IBS that would effectively facilitate the learning of the students.

However, GL Enterprises miserably failed in meeting its responsibility. As contained in the findings of the CA and the RTC, petitioner supplied substandard equipment when it delivered components that (1) were old; (2) did not have instruction manuals and warranty certificates; (3) bore indications of being reconditioned machines; and, all told, (4) might not have met the IMO and CHED standards. Highlighting the defects of the delivered materials, the CA quoted respondent's testimonial evidence as follows:[16]

> Q: In particular which of these equipment of CHED requirements were not complied with?
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> A: The Radar Ma'am, because they delivered only 10-inch PPI, that is the monitor of the Radar. That is 16-inch and the gyrocompass with two (2) repeaters and the history card. The gyrocompass – there is no marker, there is no model, there is no serial number, no gimbal, no gyroscope and a bulb to work it properly to point the true North because it is very important to the Cadets to learn where is the true North being indicated by the Master Gyrocompass.
>
> x x x x
>
> Q: Mr. Witness, one of the defects you noted down in this history card is that the master gyrocompass had no gimbals, gyroscope and balls and was replaced with an ordinary electric motor. So what is the Implication of this?
> A: Because those gimbals, balls and the gyroscope it let the gyrocompass to work so it will point the true North but they being replaced with the ordinary motor used for toys so it will not indicate the true North.
>
> Q: So what happens if it will not indicate the true North?
> A: It is very big problem for my cadets because they must[,] to learn into school where is the true North and what is that equipment to be used on board.
>
> Q: One of the defects is that the steering wheel was that of an ordinary automobile. And what is the implication of this?
> A: Because on board Ma'am, we are using the real steering wheel and the cadets will be implicated if they will notice that the ship have the same steering wheel as the car so it is not advisable for them.
>
> Q: And another one is that the gyrocompass repeater was only refurbished and it has no serial number. What is wrong with that?

[16] TSN dated 7 April 2006, pp. 9-12.

> A: It should be original Ma'am because this gyro repeater, it must to repeat also the true [N]orth being indicated by the Master Gyro Compass so it will not work properly, I don't know it will work properly. (Underscoring supplied)

Evidently, the materials delivered were less likely to pass the CHED standards, because the navigation system to be installed might not accurately point to the true north; and the steering wheel delivered was one that came from an automobile, instead of one used in ships. Logically, by no stretch of the imagination could these form part of the most modern IBS compliant with the IMO and CHED standards.

Even in the instant appeal, GL Enterprises does not refute that the equipment it delivered was substandard. However, it reiterates its rejected excuse that Northwestern should have made an assessment only after the completion of the IBS.[17] Thus, petitioner stresses that it was Northwestern that breached the agreement when the latter halted the installation of the materials for the IBS, even if the parties had contemplated a completed project to be evaluated by CHED. However, as aptly considered by the CA, respondent could not just "sit still and wait for such day that its accreditation may not be granted by CHED due to the apparent substandard equipment installed in the bridge system."[18] The appellate court correctly emphasized that, by that time, both parties would have incurred more costs for nothing.

Additionally, GL Enterprises reasons that, based on the contracts, the materials that were hauled all the way from Quezon City to Laoag City under the custody of the four designated installers might not have been the components to be used.[19] Without belaboring the point, we affirm the conclusion of the CA and the RTC that the excuse is untenable for being contrary to human experience.[20]

Given that petitioner, without justification, supplied substandard components for the new IBS, it is thus clear that its violation was not merely incidental, but directly related to the essence of the agreement pertaining to the installation of an IBS compliant with the CHED and IMO standards. Consequently, the CA correctly found substantial breach on the part of petitioner.

In contrast, Northwestern's breach, if any, was characterized by the appellate court as slight or casual.[21] By way of negative definition, a breach is considered casual if it does not fundamentally defeat the object of the parties in entering into an agreement. Furthermore, for there to be a breach

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[17] *Rollo*, p. 13; Petition for Review dated 13 September 2009.
[18] Id. at 37; CA Decision dated 27 July 2009.
[19] Id. at 12-13; Petition for Review dated 13 September 2009.
[20] Id. at 91, RTC Decision dated 8 January 2007; id. at 36, CA Decision dated 27 July 2009.
[21] Id.

to begin with, there must be a "failure, without legal excuse, to perform any promise which forms the whole or part of the contract."[22]

Here, as discussed, the stoppage of the installation was justified. The action of Northwestern constituted a legal excuse to prevent the highly possible rejection of the IBS. Hence, just as the CA concluded, we find that Northwestern exercised ordinary prudence to avert a possible wastage of time, effort, resources and also of the ₱2.9 million representing the value of the new IBS.

Actual Damages, Moral and Exemplary Damages, and Attorney's Fees

As between the parties, substantial breach can clearly be attributed to GL Enterprises. Consequently, it is not the injured party who can claim damages under Article 1170 of the Civil Code. For this reason, we concur in the result of the CA's Decision denying petitioner actual damages in the form of lost earnings, as well as moral and exemplary damages.

With respect to attorney's fees, Article 2208 of the Civil Code allows the grant thereof when the court deems it just and equitable that attorney's fees should be recovered. An award of attorney's fees is proper if one was forced to litigate and incur expenses to protect one's rights and interest by reason of an unjustified act or omission on the part of the party from whom the award is sought.[23]

Since we affirm the CA's finding that it was not Northwestern but GL Enterprises that breached the contracts without justification, it follows that the appellate court correctly awarded attorney's fees to respondent. Notably, this litigation could have altogether been avoided if petitioner heeded respondent's suggestion to amicably settle; or, better yet, if in the first place petitioner delivered the right materials as required by the contracts.

IN VIEW THEREOF, the assailed 27 July 2009 Decision of the Court of Appeals in CA-G.R. CV No. 88989 is hereby **AFFIRMED**.

SO ORDERED.

MARIA LOURDES P. A. SERENO
Chief Justice, Chairperson

[22] *Omengan v. Philippine National Bank*, G.R. No. 161319, 23 January 2007, 512 SCRA 305.
[23] *Asian Center for Career and Employment System and Services, Inc. v. NLRC*, 358 Phil. 380 (1998).

WE CONCUR:

TERESITA J. LEONARDO-DE CASTRO
Associate Justice

LUCAS P. BERSAMIN
Associate Justice

MARTIN S. VILLARAMA, JR.
Associate Justice

MARVIC MARIO VICTOR F. LEONEN
Associate Justice

CERTIFICATION

Pursuant to Section 13, Article VIII of the Constitution, I certify that the conclusions in the above Decision had been reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

MARIA LOURDES P. A. SERENO
Chief Justice