Republic of the Philippines
SUPREME COURT
Manila

THIRD DIVISION

G.R. No. 76787 December 14, 1987

BAYLEN CORPORATION, REYNALDO M. REYES, EDNA L. REYES and EMMANUEL I. ASTILLERO petitioners,
vs.
HON. COURT OF APPEALS (14th Division) and JOSE RIZAL COLLEGE, respondents.

FELICIANO, *J.:*

In anticipation of an increase in student enrollment for the academic year 1970-1971, respondent Jose Rizal College, sometime in August of 1969, issued invitations to bid for the construction of a five-storey school building (Building H, Phase 11) within the College's compound in Mandaluyong, Metro Manila. Of the four bids submitted, respondent College accepted that of petitioner Baylen Corporation (hereafter Baylen which, for the amount of Pl,196,000.00, proposed to complete the project within a period of two hundred (200) working days.

On 16 September 1969, prior to the execution of a formal written agreement between the parties, petitioner Baylen mobilized its labor force and began delivery of construction materials and equipment to the project site. When petitioner Baylen commenced excavation work on the project site, it discovered that the ground at the site was not solid and stable enough to support the foundation of the proposed building. A depression in the soil surface was also discovered which likewise posed some technical difficulties. These matters were immediately brought to the attention of respondent College, which subsequently agreed to conduct sub-surface exploration tests at the project site and to have the costs of the same amounting to P80,000.00 — added on to petitioner Baylen's original bid price.

On 30 October 1969, a Building Contract with a contract price of Pl,276,000.00 was formally executed by the parties, Subsequently, in November of 1969, petitioner Baylen posted Surety Bond No. G(16) 0068 issued by the Imperial Insurance Company, Inc. in the amount of P255,200.00 to serve as its performance bond.

As work on the project progressed, petitioner Baylen was able to overcome the problems posed by the condition of the sub-soil and completed its excavation work in mid-December of 1969. It was at this point in time that the costs of construction materials dramatically increased as a result of the devaluation of the Philippine peso due to the adoption of a floating rate of exchange between the Philippine peso and the United States dollar. Notwithstanding this development, petitioner Baylen proceeded with the project, billing respondent College

periodically for the work accomplished with respect thereto in accordance with petitioner's view of paragraph 8 of the Building Contract.

From each of the billings sent by petitioner Baylen, however, Mr. Fernando Abad, the Supervising Architect of respondent College, deducted certain substantial amounts before certifying the same for payment. The result was that after four billings, only the amount of P210,716.00 had been approved for payment — allegedly P92,681.40 less than what had been originally billed. Petitioner Baylen requested respondent College to explain the deductions made by Architect Abad and to promptly pay the amounts deducted but, Baylen said, no response was forthcoming. In April of 1970, petitioner Baylen unilaterally ceased all work on the project.

Letters were exchanged between the parties but to no avail. The inability of petitioner Baylen and respondent College amicably to settle their differences led to the mutual filing of civil suits against each other on 29 July 1970 with Branch 26 of the then Court of First Instance of Rizal. The separate complaints filed by petitioner Baylen and respondent College were docketed as Civil Case No. 13698 and Civil Case No. 13697, respectively. (Civil Case No. 13698 was subsequently dismissed and incorporated as a counterclaim in Civil Case No. 13697.) The surety company, upon being impleaded, filed a third-party complaint against the officers of petitioner Baylen who had apparently signed the indemnity agreement in their personal capacities.

Believing that the substantial aspects of the dispute involved technical matters, the parties agreed during pre-trial to refer such matters to an independent Commissioner for determination. Hence, on 2 October 1971, upon nomination by respondent College and with the consent of petitioner Baylen, Appraisers (Philippines), Inc. was appointed by the trial court to serve as Commissioner in this case and asked to carry out the following tasks:

> 1. To determine what portion of the whole structure of the building as provided and described in the plans and specifications (Exhibits J, J-1 to J- 3) has been finished;
>
> 2. To determine the cost of completing the building from that point in accordance with the said plans and specifications at present condition;
>
> 3. To determine what is the value of the work already finished by Baylen Corporation when they stopped working in April, 1970 in relation to the stipulated contract price of P1,276,006.00; but this is subject to the plaintiff's objection for being immaterial. **1**

On 1 June 1973, the Commissioner submitted its report, which contained the following findings:

> Portion of the whole structure of the building as provided and described in the plans and specifications finished-

(a) Reinforced concrete foundation resting on natural adobe base.

(b) Approximately 1/2 of ground floor framing concreted, the other half having only structural reinforcing bars laid in place.

(c) Vertical steel bar reinforcements for all columns extending up to the second floor level installed.

(d) Reinforcing steel bars of the six (6) main beams along bays at the stalk room partially installed.

Estimated cost to complete the building in accordance with said plans and specifications at present condition-

(As of May 30, 1973) P1,879,160

Value of work already finished by Baylen Corporation —

(As of April 1970) P341,330 [2]

Neither party having objected to the contends of the Commissioner's report, the same was adopted as a common exhibit.

On 30 June 1976, upon the conclusion of the trial on the merits, the trial court rendered a Decision, the dispositive portion of which reads:

WHEREFORE, on the main complaint, judgment is hereby rendered in favor of the plaintiff and against the defendants, to wit:

1. ordering the defendant Baylen Corporation to pay the plaintiff liquidated damages at the rate of P200.00 a day from June 6, 1970 with legal rate of interest until fully paid;

2. ordering defendant Baylen Corp. to pay the plaintiff the sum of Pl,879.160.00, representing the estimated costs for the completion of the project, with legal rate of interest from June 6, 1970, until fully paid;

3. ordering the defendant Baylen Corporation to pay the plaintiff the sum of P25,000.00 for and as attorney's fees; and,

4. ordering the defendant Imperial Insurance, Inc. to pay the plaintiff, jointly and severally with the defendant Baylen Corporation to the extent of P255,200.00 of the aforementioned amounts.

> On the third-party complaint, the third-party defendants are hereby ordered to pay the third-party plaintiff, jointly and severally, for whatever amount the third-party plaintiff shall finally pay the plaintiff.
>
> With costs against the defendant Baylen Corporation.
>
> The counterclaims of the defendants are hereby ordered dismissed.
>
> SO ORDERED.

Both petitioner Baylen (defendant below) and the surety company (third- party plaintiff below) appealed the above decision to the Court of Appeals. The appeal was docketed as CA G.R. CV No. 61134.

In a Decision dated 30 October 1986, the Court of Appeals affirmed the judgment of the lower court in the following manner: [3]

> WHEREFORE, the judgment appealed from is AFFIRMED with the modification that the defendant Baylen Corporation and defendant Imperial Insurance Company, Inc., are ordered to pay, jointly and severally, the plaintiff:
>
> (a) the sum of P472,546.00, with interest at the legal rate from June 27, 1970 until fully paid;
>
> (b) the sum of P40,000.00, representing the penalty of P200.00 a day for a period of 200 days, with legal interest from June 27, 1970 until fully paid;
>
> (c) the sum of P l 0,000.00 as and for attorney's fees.
>
> The liability of defendant Imperial Insurance Company, Inc., to pay the aforementioned sums of money is limited, however, to P255,200.00, the extent of its liability under the performance bond it issued.
>
> Proportionate costs against both defendants.
>
> SO ORDERED.

On 10 December 1986, The Motion for Reconsideration filed by petitioner Baylen was denied.

In its Petition for Review before this Court, petitioner Baylen urges the following grounds for grant of the Petition:

a) that the respondent appellate court erroneously interpreted stipulations of the parties set out in the Building Contract between them, more particularly Section 8 thereof;

b) that the respondent appellate court committed a grave abuse of discretion in disregarding the Commissioner's report notwithstanding the failure of both parties to object to such report and its adoption as a common exhibit of the parties; and

c) the conclusion of the respondent appellate court relating to the percentage of completion of the project achieved by petitioner, is grounded entirely on conjecture or misapprehension of facts.

Considering their interlocking nature, we shall consider the grounds so urged by petitioner together.

The stipulations of the Building Contract which the respondent appellate court, the petitioner urges, misinterpreted, are those found in Section 8 of the Building Contract, which are:

> 8. TERMS OF PAYMENT: The OWNER shall pay to the CONTRACTOR in *installments* of not less than thirty (30) days each, until the whole consideration of this contract has been fully paid, *in amounts not to exceed, and proportionate to, the value of the work done and materials placed or used in said work*. The final payment shall be subject to additions and deductions in accordance with this contract. No payment to the CONTRACTOR shall be made except upon a certificate issued by the Architect as to the work done or completed. No payment made or any certificate issued by the Architect shall in any way be construed as an acceptance by the OWNER of any part of the work, nor will the same in any way lessen the total and final responsibility of then CONTRACTOR. [4] (Emphasis supplied)

Baylen is unable to see any uncertainty or ambiguity in the phrase "in amounts not to exceed, and proportionate to, the value of the work done and materials placed or used in said work." Baylen contends that the project owner, respondent College, should pay the contract price in monthly installments equivalent to the "*actual value* of work it had accomplished and materials placed or used in the project every month." [5] It points to the report of the Commissioner where the "value of work already finished by Baylen corporation [as of April 1970]" is set out as "P341,330.00." It does not appear to us possible to clarify "the value of the work done etc." by merely referring to the "*actual* value of the work done etc. " Baylen appears to assume that the reference of this contract phrase is to the "value" of the *labor* component and of the *materials* component of the "work done." The thrust of Baylen's interpretation is that, thereunder, it is entitled to be paid (or reimbursed?) the "value" ("cost?" or "cost plus profit?") of the *labor* and *materials* put into the project during the preceding month. One difficulty (and it is not the only difficulty, as win be seen later) with Baylen's interpretation is that it disregards

totally the words "*and proportionate to*" in the clause under consideration. Baylen seeks to explain away the words "and proportionate to" by invoking the maxim *noscitur a sociis;* here, Baylen does not persuade.

Upon the other hand, the project owner, respondent college, urges vigorously that the monthly installments of the contract price, which it is obligated by Section 8 to pay, must be proportionate to the *percentage of completion* of the total project achieved during the preceding month by petitioner Baylen In other words, the project owner contends that the petitioner contractor is generally entitled to be paid only the same percentage of the total contract price as the percentage of completion of the total project work actually achieved by Baylen; the contractor is not entitled to be paid faster than its rate of progress in completing the project. Thus, if at any given time, the petitioner contractor shall have completed x% of the total project, it shall be entitled to have been paid x% of the total contract price. In the view of project owner, such is the intent which underlies the words "*Proportionate to*." If one were to look merely at the underscored portion of Section 8, quoted above, one must concede that project owner's view places a heavy burden upon such a slender phrase as "and proportionate to." Fortunately, as pointed out by the respondent appellate court, the project owner's view is reinforced by the fact that the Architect's Certificate without which no installment payment could be made under the Building Contract, must specify "*the work done or completed*" and by the nature of the contractor's undertaking under the Building Contract. The point is adequately summarized in the decision of the trial court "fully subscribe(d) to by the Court of Appeals." [6]

> Indeed, as maintained by the plaintiff, *the contract calls for such a ratio between the contract price and the work accomplished.* This is so as *the building*, as per plans and specification, Exhibits I, J, J-1 to J-36, *has to be delivered to the plaintiff complete and ready for use and occupancy nat later than June 15, 1970, at the stipulated contract price of P1,276,000.00, irrespective of the decrease and increase in the price of the materials and cost of labor during the period of construction.*
>
> *To compute the payment in accordance with the contention of Baylen Corporation, with the increase in the cost of labor and materials, it (sic) will lead to a situation where the plaintiff will have to pay the whole stipulated contract price of Pl,276,000.00 even though the work accomplished is only half through Thus, the plaintiff would be left without sufficient security*. Although the plaintiff could retain 10% of the contract price until after the delivery of the building and there is a surety bond for P225,200.00, the total of the same is only P382,800.00. It should be further noted that Baylen Corporation's total billings amounted to about P 400,000.00 for a 14.5% work accomplished.
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> As aptly testified to by Architect Abad:
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> > I based my recommendation in proportion to the contract price, *otherwise the owner would have paid the Contractor in*

> *excess of what was accomplished knowing that the contract price was different compared to the actual cost price of materials and labor at the time.* In other words, had I computed it based on actual costs of labor and materials, then there will be time when the Contractor would have been paid more than the Percentage of work accomplished. In other words, there would be a time when all the payments perhaps would have been paid to the Contractor and almost only 1/2 of the project is
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> xxx xxx xxx (Emphasis supplied)

Petitioner contractor argued long and hard about the *installment payments* which it claims should have been made by the respondent project owner, possibly because it was necessary for petitioner contractor to make out a case of prior breach of the Building Contract on the part of respondent project owner in order that the walk-out or abandonment by petitioner contractor of the project might itself be justified. It win be seen, however, that the real dispute between petitioner and private respondent relates not so much to the amounts of the installment payments properly payable under the Building Contract but rather to *who, under that Contract, must bear the increased costs of constructing and completing the project work.* The answer to this issue must, of course, be looked for in the provisions of the Building Contract itself.

The Building Contract opens with the following terms:

> That *for and in consideration of the total amount of ONE MILLION TWO HUNDRED SEVENTY SIX THOUSAND PESOS, (Pl,276,000.00), Philippine Currency*, to be paid by the OWNER to the CONTRACTOR, his successors, heirs and assigns, in the manner hereinafter set forth and specified, the *CONTRACTOR agrees to undertake the complete construction of a FIVE-STORY (sic) building*known as Building H Phase 11 in the compound of the Jose Rizal College at Shaw Boulevard, Mandaluyong, Rizal for the OWNER, *in accordance with the general conditions, plans, and specifications prepared by the Owner's A architect which are made integral parts of this contract;* and the parties hereby agree and stipulate to be bound by the following terms and conditions.
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> xxx xxx xxx (Emphasis supplied)

Thus, for the stated contract price of P1,276,000.00, petitioner contractor was obligated to construct and complete a five-storey building in accordance with agreed plans and specifications, furnishing in that connection "all the necessary work, labor, constructions (sic), equipments, tools and materials needed for the construction of the above-mentioned building — ." [7] Moreover, the building contracted for was required to be completed and

> *ready for use and occupancy not later than June 15, 1970*, unless prevented by weather, accident or unavoidable cause. The failure of the CONTRACTOR to

> complete the erection and construction of said Project, and to deliver the said building to the OWNER for use and occupancy within the date given, shall entitle the OWNER to deduct from the contract price herein stipulated as part of the liquidated damages the sum of P200.00 for each day of delay. It is understood by the parties that the completion and delivery to the OWNER of the said building within the stipulated time is imperative in view of the purpose and use intended for said building, namely, for the holding of classes beginning the 1970-1971 school year. [8] (Emphasis supplied)

The Building Contract was, in fact, one for the supply, erection and construction of a building on a *turn key basis*, on a specified completion date. It is especially important to note that the Building Contract does *not* contain an escalation clause. Escalation clauses in construction contracts commonly provide for increases in the contract price under certain specified circumstances, e.g., as the cost of selected commodities (cement, fuel, steel bars) or the cost of living in the general community (as measured by, for instance, the Consumer Price Index officially published regularly by the Central Bank) move up beyond specified levels. [9] It is, thus, clear that the Building Contract is a *fixed price, lump sum contract*. The contract price is a *fixed price*, i.e., not subject to escalation. The contract price is, furthermore, a *lump sum* price and is not based upon the specified cost of a defined unit of work. Neither is the contract one on a "cost reimbursement" or "cost reimbursement plus supervision fee" basis, which is what petitioner contractor *impliedly* contended. It follows that any increase in the cost of constructing and completing the project work must, under the Building Contract, be borne by petitioner contractor. Put a little differently, petitioner contractor assumed the risk that the cost of constructing the building might change before the building was completed and turned over to the project owner.

It is also important to note that the above result is grounded not only the provisions of the Building Contract, but also upon the provisions of applicable law which is Article 1724 of the Civil Code:

> ART. 1724. *The contractor who undertakes to build a structure or any other work fora stipulated price, in conformity with plans and specifications agreed upon with the landowner, can neither withdraw from the contract nor demand an increase in the price on account of the higher cost of labor or materials*, save when there has been a change in the plans and specifications, provided:
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> (1) Such change has been authorized by the proprietor in writing; and
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> (2) The additional price to be paid to the contractor has been determined in writing by both parties. (Emphasis supplied)

It is also perhaps wen to note that there is nothing exotic about a contractor assuming the risk of the costs of construction moving up before completion of a project. Fixed priced, lump sum contracts are quite common in the construction industry. **10** The contractor can, in the first

place, and commonly does, build into its bid or negotiated price a realistic contingency factor to protect its expected profit from erosion by drastic cost increases. In the second place, the well-organized, credit-worthy contractor should be able substantially to mitigate the impact of expected or possible increases in construction costs. It is open to such a contractor to take advantage of economies of scale by buying construction materials in bulk and thus availing of bulk discounts, and to anticipate price increases by buying such materials forward. The contractor can, furthermore, reduce its effective costs by increasing the productivity and efficiency of its work force and by keeping its administrative and other overhead costs down. There is thus nothing unfair about holding a contractor to its fixed price, lump sum contract even in an environment of rising prices.

We turn to the question of the appropriate measure of damages that respondent project owner is entitled, to recover from petitioner Baylen. The trial court ordered petitioner Baylen to pay to the project owner the sum of P1,879,160.00 which, per the report of the Commissioner, was "the estimated cost to complete the building in accordance with the said plans and specifications at present condition (as of May 30, 1973)." The Court of Appeals correctly held the trial court to be in error here. The appropriate measure of direct damages which a contractor, like petitioner Baylen, must pay for abandoning a project under a fixed price, lump sum contract is not the cost of constructing or completing the building under conditions of increased costs, but rather merely the*increase over the original contract price* which the project owner would have to pay if the project is to be completed. The trial court's decision would in effect have required Baylen to give the project owner the building practically free of charge. The Court of Appeals said, on this point:

> What the defendant must be liable for, however, are the damages which the plaintiff had suffered as a consequence of its unjustified refusal to continue the construction. One of these is *the increase in construction cost which is the difference between what it would cost to finish the building and the contract price. Thus, deducting the contract price of Pl,276,000.00 from the sum of P1,879,160.00, the cost to complete the building* as found by the Commissioner; the plaintiff must be adjudged to have suffered *actual damages in the sum of P603,160.00.* **11** (Emphasis supplied)

The Court of Appeals thus correctly determined the appropriate measure of damages. It went on, however, to state:

> That the evidence shows that *for the work the defendant had accomplished, which was valued by the Commissioner at P341,330.00, it was paid only the sum of P210,716.00. In other words, plaintiff still owed the defendant the sum of P130,614.00 at the time the defendant stopped working in 1970. Such being the case, we believe that this indebtedness of the plaintiff should be taken into account reducing defendant's liability to the plaintiff (to) the sum of P472,546*. (Emphasis supplied)

The respondent appellate court here fell into error. Both the trial court and the Court of Appeals **12** found that at the time of Baylen's abandonment of the project, Baylen had accomplished *only 14.5%* of the whole project. Baylen, at that time, had been paid by respondent project owner P210,716.00 which represented 16.51% of the contract price of P1,276,000.00. Petitioner has failed to adduce any compelling reason why we should overturn these findings of facts. The difference of P130,614.00 between P341,330.00 (the "value" of the work actually accomplished as found by the Commissioner) and P210,716.00 (the amount already paid by the project owner) must have represented the increase of the cost of reaching the percentage (14.5%) of completion of the project actually reached by Baylen as of *April 1970*. As such, that increase of 130,614..00 could not have been included in the total increase of the costs of completing the project, i.e., P603,160.00, since that total increase of costs of completion was arrived at (correctly) by taking the Commissioner's figure of Pl,879,160,00 which was the cost of carrying forward to completion the project *from where petitioner Baylen left off in April 1970*. This is clear from the terms of reference given to the Commissioner by the trial court:

> 1. To determine what portion of the whole structure of the building as provided and described in the plans and specifications (Exhibits J, J-1 to J- 3) has been finished
>
> 2. To determine the cost of completing the building from that point in accordance with the said plans and specifications at present
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> xxx xxx xxx (Emphasis supplied)

It follows that respondent project owner did not owe to petitioner Baylen the amount of P130,614.00 and that amount should not be deducted from the total increase of costs for which Baylen is responsible.

Respondent project owner estimated the adjusted cost of the completed building as P3,863,600.00. **13** This estimate of cost, however, was made *as of 21 April 1978*. **14** We believe that this adjusted 1978 estimated cost cannot be used for determining the damages petitioner Baylen is liable for, having been made too long after the actual abandonment of the project by Baylen. Upon the other hand, it appears to us reasonable to use in this connection the *30 May 1973* figure given by the Commissioner in his report, P1,879,160.00.

The other element of damages for which the respondent appellate court held petitioner liable, was the penalty of liquidated damages in the amount of P200.00 stipulated in the Building Contract for each day of delay. **15** The trial court would have held petitioner liable for P200.00 per day until (apparently) the building was actually constructed and completed. The Court of Appeals, on the other hand, limited the maximum period of the delay for which petitioner contractor could be held liable to 200 days. It may be noted that the Building Contract itself did not put a limit upon the length of the delay for which the contractor could be held liable. More importantly, however, the terms of the relevant section of the Building Contract indicate that

the liquidated-damages-for-delay clause was intended to be operative *where the contractor actually completed the project, though beyond the stipulated completion date in other words, where the contractor in delay did not abandon the project uncompleted.* Section 7 read in part:

> ... The failure of the CONTRACTOR to complete the erection and construction of said Project, *and deliver* the said building to the OWNER for use and occupancy *within the date given* shall entitle the OWNER *to deduct from the contract price herein stipulated as part of the liquidated damages* the sum of P200.00 for each day of delay. It is understood by the parties that the completion and delivery to the OWNER of the said building within the stipulated time is imperative in view of the purpose and use intended for said building, namely, for the holding of classes beginning the 1970-1971 school year.
>
> Since the OWNER is an educational institution and time is of the essence of this contract, the OWNER shall have the right to take possession of and use any completed or partially completed portions of the work after the expiration of the Contract Time; but said taking possession and use shall not be deemed an acceptance of any work not completed in accordance with the contract. Neither shall it be deemed a waiver by the OWNER of its right to claim for damages due to *delays in the completion of the work.* (Emphasis supplied)

In this case, however, Baylen did not merely incur delay in completing the project. Baylen abandoned the project which therefore had to be taken over by either the project owner or another contractor and completed. Accordingly, we do not believe that here, the liquidated damages for delay should be awarded to respondent College on top of the award of the total increase in costs of completing the project, *there being no contract stipulation to that specific effect.* We do not believe that a penalty clause may casually be extended beyond its natural and ordinary import.

WHEREFORE, the Petition for Review is DENIED. The decision of the Court of Appeals dated 30 October 1986 is MODIFIED to the following extent:

1) Paragraph (a) of the dispositive portion is amended so as to read as follows: "The sum of P603,160.00 with interest at the legal rate from June 27, 1970 until fully paid;"

2) Paragraph (b) of the dispositive portion is deleted;

As so modified, the decision of the Court of Appeals is AFFIRMED. No pronouncement as to costs.

SO ORDERED.

Fernan (Chairman), Gutierrez, Jr., Bidin and Cortes, JJ., concur.

Footnotes

1 Joint Record on Appeal, p. 122.

2 Joint Record on Appeal, pp. 138-139.

3 The decision was penned by Pronove, J., and concurred in by Pascual and Javellana, JJ.

4 Joint Record on Appeal, p. 33.

5 Petition, pp. 13-14.

6 Decision of the Court of Appeals, pp. 10-11.

7 Section 1, Building Contract; Joint Record on Appeal, pp. 2728.

8 Section 7, *Ibid*, p. 32.

9 See e.g., Regulations and instructions on International Competitive Bidding for Major Industrial Projects and Uniform General Contract Terms and Conditions Applicable thereto (To Implement P.D. No. 1764 dated 11 January 1981) Appendix V "Cost Escalation Formula for Local Civil Works," p. 45.

10 See e.g., the Regulations and Instructions, supra note 9, p. 1, which require contracts for the supply, construction and installation of industrial plants, or any part thereof (for instance, the civil works component thereof) to be submitted to bidding and awarded on "a turnkey fixed price, lump sum basis." (Sec. 1.2.1. [b]). The same Regulations and Instructions permit the parties to provide, "on an exceptional basis subject to approval of the Board of Investments, " for an escalation formula for the local costs of an industrial plant project

11 Rollo, pp. 43-44.

12 See trial court's decision, Joint Record on Appeal, p. 195; Court of Appeals' decision, pp. 12-13. Rollo, pp. 41-42.

13 Brief for the plaintiff-appellee Jose Rizal College, p. 28.

14 The date of respondent's Brief before the Court of Appeals.

15 Section 7, Building Contract, Joint Record on Appeal, p. 32.