Republic of the Philippines
SUPREME COURT
Baguio City

FIRST DIVISION

G.R. No. 189563 April 7, 2014

GILAT SATELLITE NETWORKS, LTD., Petitioner,
vs.
UNITED COCONUT PLANTERS BANK GENERAL INSURANCE CO., INC., Respondent.

D E C I S I O N

SERENO, *CJ:*

This is an appeal via a Petition for Review on Certiorari[1] filed 6 November 2009 assailing the Decision[2] and Resolution[3] of the Court of Appeals (CA) in CA-G.R. CV No. 89263, which reversed the Decision[4] of the Regional Trial Court (RTC), Branch 141, Makati City in Civil Case No. 02-461, ordering respondent to pay petitioner a sum of money.

The antecedent facts, as culled from the CA, are as follows:

On September 15, 1999, One Virtual placed with GILAT a purchase order for various telecommunications equipment (sic), accessories, spares, services and software, at a total purchase price of Two Million One Hundred Twenty Eight Thousand Two Hundred Fifty Dollars (US$2,128,250.00). Of the said purchase price for the goods delivered, One Virtual promised to pay a portion thereof totalling US$1.2 Million in accordance with the payment schedule dated 22 November 1999. To ensure the prompt payment of this amount, it obtained defendant UCPB General Insurance Co., Inc.'s surety bond dated 3 December 1999, in favor of GILAT.

During the period between [sic] September 1999 and June 2000, GILAT shipped and delivered to One Virtual the purchased products and equipment, as evidenced by airway bills/Bill of Lading (Exhibits "F", "F-1" to "F-8"). All of the equipment (including the software components for which payment was secured by the surety bond, was shipped by GILAT and duly received by One Virtual. Under an endorsement dated December 23, 1999 (Exhibit "E"), the surety issued, with One Virtual's conformity, an amendment to the surety bond, Annex "A" thereof, correcting its expiry date from May 30, 2001 to July 30, 2001.

One Virtual failed to pay GILAT the amount of Four Hundred Thousand Dollars (US$400,000.00) on the due date of May 30, 2000 in accordance with the payment schedule attached as Annex "A" to the surety bond, prompting GILAT to write the surety defendant UCPB on June 5, 2000, a demand letter (Exhibit "G") for payment of the said amount of US$400,000.00. No part of the amount set forth in this demand has been paid to date by either One Virtual or defendant UCPB. One Virtual likewise failed to pay on the succeeding payment instalment date of 30 November 2000 as set out in Annex "A" of the surety bond, prompting GILAT to send a second demand letter dated January 24, 2001, for the payment of the full amount of US$1,200,000.00 guaranteed under the surety bond, plus interests and expenses (Exhibits "H") and which letter was received by the defendant surety on January 25, 2001. However, defendant UCPB failed to settle the amount of US$1,200,000.00 or a part thereof, hence, the instant complaint."[5] (Emphases in the original)

On 24 April 2002, petitioner Gilat Satellite Networks, Ltd., filed a Complaint[6] against respondent UCPB General Insurance Co., Inc., to recover the amounts supposedly covered by the surety bond, plus interests and expenses. After due hearing, the RTC rendered its Decision,[7] the dispositive portion of which is herein quoted:

WHEREFORE, premises considered, the Court hereby renders judgment for the plaintiff, and against the defendant, ordering, to wit:

> 1. The defendant surety to pay the plaintiff the amount of One Million Two Hundred Thousand Dollars (US$1,200,000.00) representing the principal debt under the Surety Bond, with legal interest thereon at the rate of 12% per annum computed from the time the judgment becomes final and executory until the obligation is fully settled; and

2. The defendant surety to pay the plaintiff the amount of Forty Four Thousand Four Dollars and Four Cents (US$44,004.04) representing attorney's fees and litigation expenses.

Accordingly, defendant's counterclaim is hereby dismissed for want of merit.

SO ORDERED. (Emphasis in the original)

In so ruling, the RTC reasoned that there is "no dispute that plaintiff [petitioner] delivered all the subject equipments [sic] and the same was installed. Even with the delivery and installation made, One Virtual failed to pay any of the payments agreed upon. Demand notwithstanding, defendant failed and refused and continued to fail and refused to settle the obligation."[8]

Considering that its liability was indeed that of a surety, as "spelled out in the Surety Bond executed by and between One Virtual as Principal, UCPB as Surety and GILAT as Creditor/Bond Obligee,"[9] respondent agreed and bound itself to pay in accordance with the Payment Milestones. This obligation was not made dependent on any condition outside the terms and conditions of the Surety Bond and Payment Milestones.[10]

Insofar as the interests were concerned, the RTC denied petitioner's claim on the premise that while a surety can be held liable for interest even if it becomes more onerous than the principal obligation, the surety shall only accrue when the delay or refusal to pay the principal obligation is without any justifiable cause.[11] Here, respondent failed to pay its surety obligation because of the advice of its principal (One Virtual) not to pay.[12] The RTC then obligated respondent to pay petitioner the amount of USD1,200,000.00 representing the principal debt under the Surety Bond, with legal interest at the rate of 12% per annum computed from the time the judgment becomes final and executory, and USD44,004.04 representing attorney's fees and litigation expenses.

On 18 October 2007, respondent appealed to the CA.[13] The appellate court rendered a Decision[14] in the following manner:

WHEREFORE, this appealed case is DISMISSED for lack of jurisdiction. The trial court's Decision dated December 28, 2006 is VACATED. Plaintiff-appellant Gilat Satellite Networks Ltd., and One Virtual are ordered to proceed to arbitration, the outcome of which shall necessary bind the parties, including the surety, defendant-appellant United Coconut Planters Bank General Insurance Co., Inc.

SO ORDERED. (Emphasis in the original)

The CA ruled that in "enforcing a surety contract, the 'complementary-contracts-construed-together' doctrine finds application." According to this doctrine, the accessory contract must be construed with the principal agreement.[15] In this case, the appellate court considered the Purchase Agreement entered into between petitioner and One Virtual as the principal contract,[16] whose stipulations are also binding on the parties to the suretyship.[17] Bearing in mind the arbitration clause contained in the Purchase Agreement[18] and pursuant to the policy of the courts to encourage alternative dispute resolution methods,[19] the trial court's Decision was vacated; petitioner and One Virtual were ordered to proceed to arbitration.

On 9 September 2008, petitioner filed a Motion for Reconsideration with Motion for Oral Argument. The motion was denied for lack of merit in a Resolution[20] issued by the CA on 16 September 2009.

Hence, the instant Petition.

On 31 August 2010, respondent filed a Comment[21] on the Petition for Review. On 24 November 2010, petitioner filed a Reply.[22]

ISSUES

From the foregoing, we reduce the issues to the following:

1. Whether or not the CA erred in dismissing the case and ordering petitioner and One Virtual to arbitrate; and

2. Whether or not petitioner is entitled to legal interest due to the delay in the fulfilment by respondent of its obligation under the Suretyship Agreement.

THE COURT'S RULING

The existence of a suretyship agreement does not give the surety the right to intervene in the principal contract, nor can an arbitration clause between the buyer and the seller be invoked by a non-party such as the surety.

Petitioner alleges that arbitration laws mandate that no court can compel arbitration, unless a party entitled to it applies for this relief.[23] This referral, however, can only be demanded by one who is a party to the arbitration

agreement.[24] Considering that neither petitioner nor One Virtual has asked for a referral, there is no basis for the CA's order to arbitrate.

Moreover, Articles 1216 and 2047 of the Civil Code[25] clearly provide that the creditor may proceed against the surety without having first sued the principal debtor.[26] Even the Surety Agreement itself states that respondent becomes liable upon "mere failure of the Principal to make such prompt payment."[27] Thus, petitioner should not be ordered to make a separate claim against One Virtual (via arbitration) before proceeding against respondent.[28]

On the other hand, respondent maintains that a surety contract is merely an accessory contract, which cannot exist without a valid obligation.[29] Thus, the surety may avail itself of all the defenses available to the principal debtor and inherent in the debt[30] – that is, the right to invoke the arbitration clause in the Purchase Agreement.

We agree with petitioner.

In suretyship, the oft-repeated rule is that a surety's liability is joint and solidary with that of the principal debtor. This undertaking makes a surety agreement an ancillary contract, as it presupposes the existence of a principal contract.[31] Nevertheless, although the contract of a surety is in essence secondary only to a valid principal obligation, its liability to the creditor or "promise" of the principal is said to be direct, primary and absolute; in other words, a surety is directly and equally bound with the principal.[32] He becomes liable for the debt and duty of the principal obligor, even without possessing a direct or personal interest in the obligations constituted by the latter.[33] Thus, a surety is not entitled to a separate notice of default or to the benefit of excussion.[34] It may in fact be sued separately or together with the principal debtor.[35]

After a thorough examination of the pieces of evidence presented by both parties,[36] the RTC found that petitioner had delivered all the goods to One Virtual and installed them. Despite these compliances, One Virtual still failed to pay its obligation,[37] triggering respondent's liability to petitioner as the former's surety. In other words, the failure of One Virtual, as the principal debtor, to fulfill its monetary obligation to petitioner gave the latter an immediate right to pursue respondent as the surety.

Consequently, we cannot sustain respondent's claim that the Purchase Agreement, being the principal contract to which the Suretyship Agreement is accessory, must take precedence over arbitration as the preferred mode of settling disputes.

First, we have held in Stronghold Insurance Co. Inc. v. Tokyu Construction Co. Ltd.,[38] that "[the] acceptance [of a surety agreement], however, does not change in any material way the creditor's relationship with the principal debtor nor does it make the surety an active party to the principal creditor-debtor relationship. In other words, the acceptance does not give the surety the right to intervene in the principal contract. The surety's role arises only upon the debtor's default, at which time, it can be directly held liable by the creditor for payment as a solidary obligor." Hence, the surety remains a stranger to the Purchase Agreement. We agree with petitioner that respondent cannot invoke in its favor the arbitration clause in the Purchase Agreement, because it is not a party to that contract.[39] An arbitration agreement being contractual in nature,[40] it is binding only on the parties thereto, as well as their assigns and heirs.[41]

Second, Section 24 of Republic Act No. 9285[42] is clear in stating that a referral to arbitration may only take place "if at least one party so requests not later than the pre-trial conference, or upon the request of both parties thereafter." Respondent has not presented even an iota of evidence to show that either petitioner or One Virtual submitted its contesting claim for arbitration.

Third, sureties do not insure the solvency of the debtor, but rather the debt itself.[43] They are contracted precisely to mitigate risks of non-performance on the part of the obligor. This responsibility necessarily places a surety on the same level as that of the principal debtor.[44] The effect is that the creditor is given the right to directly proceed against either principal debtor or surety. This is the reason why excussion cannot be invoked.[45] To require the creditor to proceed to arbitration would render the very essence of suretyship nugatory and diminish its value in commerce. At any rate, as we have held in Palmares v. Court of Appeals,[46] "if the surety is dissatisfied with the degree of activity displayed by the creditor in the pursuit of his principal, he may pay the debt himself and become subrogated to all the rights and remedies of the creditor."

Interest, as a form of indemnity, may be awarded to a creditor for the delay incurred by a debtor in the payment of the latter's obligation, provided that the delay is inexcusable.

Anent the issue of interests, petitioner alleges that it deserves to be paid legal interest of 12% per annum from the time of its first demand on respondent on 5 June 2000 or at most, from the second demand on 24 January 2001 because of the latter's delay in discharging its monetary obligation.[47] Citing Article 1169 of the Civil Code, petitioner insists that the delay started to run from the time it demanded the fulfilment of respondent's obligation under the suretyship contract. Significantly, respondent does not contest this point, but instead argues that it is only liable for legal interest of 6% per annum from the date of petitioner's last demand on 24 January 2001.

In rejecting petitioner's position, the RTC stated that interests may only accrue when the delay or the refusal of a party to pay is without any justifiable cause.[48] In this case, respondent's failure to heed the demand was due to the advice of One Virtual that petitioner allegedly breached its undertakings as stated in the Purchase Agreement.[49] The CA, however, made no pronouncement on this matter.

We sustain petitioner.

Article 2209 of the Civil Code is clear: "[i]f an obligation consists in the payment of a sum of money, and the debtor incurs a delay, the indemnity for damages, there being no stipulation to the contrary, shall be the payment of the interest agreed upon, and in the absence of stipulation, the legal interest."

Delay arises from the time the obligee judicially or extrajudicially demands from the obligor the performance of the obligation, and the latter fails to comply.[50] Delay, as used in Article 1169, is synonymous with default or mora, which means delay in the fulfilment of obligations.[51] It is the nonfulfillment of an obligation with respect to time.[52] In order for the debtor (in this case, the surety) to be in default, it is necessary that the following requisites be present: (1) that the obligation be demandable and already liquidated; (2) that the debtor delays performance; and (3) that the creditor requires the performance judicially or extrajudicially.[53]

Having held that a surety upon demand fails to pay, it can be held liable for interest, even if in thus paying, its liability becomes more than the principal obligation.[54] The increased liability is not because of the contract, but because of the default and the necessity of judicial collection.[55]

However, for delay to merit interest, it must be inexcusable in nature. In Guanio v. Makati-Shangri-la Hotel,[56] citing RCPI v. Verchez,[57] we held thus:

In culpa contractual x x x the mere proof of the existence of the contract and the failure of its compliance justify, prima facie, a corresponding right of relief. The law, recognizing the obligatory force of contracts, will not permit a party to be set free from liability for any kind of misperformance of the contractual undertaking or a contravention of the tenor thereof. A breach upon the contract confers upon the injured party a valid cause for recovering that which may have been lost or suffered. The remedy serves to preserve the interests of the promissee that may include his "expectation interest," which is his interest in having the benefit of his bargain by being put in as good a position as he would have been in had the contract been performed, or his "reliance interest," which is his interest in being reimbursed for loss caused by reliance on the contract by being put in as good a position as he would have been in had the contract not been made; or his "restitution interest," which is his interest in having restored to him any benefit that he has conferred on the other party. Indeed, agreements can accomplish little, either for their makers or for society, unless they are made the basis for action. The effect of every infraction is to create a new duty, that is, to make RECOMPENSE to the one who has been injured by the failure of another to observe his contractual obligation unless he can show extenuating circumstances, like proof of his exercise of due diligence x x x or of the attendance of fortuitous event, to excuse him from his ensuing liability. (Emphasis ours)

We agree with petitioner that records are bereft of proof to show that respondent's delay was indeed justified by the circumstances – that is, One Virtual's advice regarding petitioner's alleged breach of obligations. The lower court's Decision itself belied this contention when it said that "plaintiff is not disputing that it did not complete commissioning work on one of the two systems because One Virtual at that time is already in default and has not paid GILAT."[58] Assuming arguendo that the commissioning work was not completed, respondent has no one to blame but its principal, One Virtual; if only it had paid its obligation on time, petitioner would not have been forced to stop operations. Moreover, the deposition of Mr. Erez Antebi, vice president of Gilat, repeatedly stated that petitioner had delivered all equipment, including the licensed software; and that the equipment had been installed and in fact, gone into operation.[59] Notwithstanding these compliances, respondent still failed to pay.

As to the issue of when interest must accrue, our Civil Code is explicit in stating that it accrues from the time judicial or extrajudicial demand is made on the surety. This ruling is in accordance with the provisions of Article 1169 of the Civil Code and of the settled rule that where there has been an extra-judicial demand before an action for performance was filed, interest on the amount due begins to run, not from the date of the filing of the complaint, but from the date of that extra-judicial demand.[60] Considering that respondent failed to pay its obligation on 30 May 2000 in accordance with the Purchase Agreement, and that the extrajudicial demand of petitioner was sent on 5 June 2000,[61] we agree with the latter that interest must start to run from the time petitioner sent its first demand letter (5 June 2000), because the obligation was already due and demandable at that time.

With regard to the interest rate to be imposed, we take cue from Nacar v. Gallery Frames,[62] which modified the guidelines established in Eastern Shipping Lines v. CA[63] in relation to Bangko Sentral-Monetary Board Circular No. 799 (Series of 2013), to wit:

1. When the obligation is breached, and it consists in the payment of a sum of money, i.e., a loan or forbearance of money, the interest due should be that which may have been stipulated in writing. Furthermore, the interest due shall itself earn legal interest from the time it is judicially demanded. In the absence of stipulation, the rate of

interest shall be 6% per annum to be computed from default, i.e., from judicial or extrajudicial demand under and subject to the provisions of Article 1169 of the Civil Code.

x x x x

3. When the judgment of the court awarding a sum of money becomes final and executory, the rate of legal interest, whether the case falls under paragraph 1 or paragraph 2, above, shall be 6% per annum from such finality until its satisfaction, this interim period being deemed to be by then an equivalent to a forbearance of credit.

Applying the above-discussed concepts and in the absence of an agreement as to interests, we are hereby compelled to award petitioner legal interest at the rate of 6% per annum from 5 June 2000, its first date of extra judicial demand, until the satisfaction of the debt in accordance with the revised guidelines enunciated in Nacar.

WHEREFORE, the Petition for Review on Certiorari is hereby GRANTED. The assailed Decision and Resolution of the Court of Appeals in CA-G.R. CV No. 89263 are REVERSED. The Decision of the Regional Trial Court, Branch 141, Makati City is REINSTATED, with MODIFICATION insofar as the award of legal interest is concerned. Respondent is hereby ordered to pay legal interest at the rate of 6% per annum from 5 June 2000 until the satisfaction of its obligation under the Suretyship Contract and Purchase Agreement.

SO ORDERED.

MARIA LOURDES P. A. SERENO
Chief Justice, Chairperson

WE CONCUR:

TERESITA J. LEONARDO-DE CASTRO
Associate Justice

LUCAS P. BERSAMIN
Associate Justice

MARTIN S. VILLARAMA, JR.
Associate Justice

BIENVENIDO L. REYES
Associate Justice

C E R T I F I C A T I O N

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

Footnotes

[1] Rollo, pp. 45-77.

[2] Id. at 12-21; CA Decision dated 6 October 2008, penned by Associate Justice Magdangal M. De Leon and concurred in by Associate Justices Josefina Guevara-Salonga and Ramon R. Garcia.

[3] Id. at 23-24; CA Resolution dated 16 September 2009.

[4] Id. at 151-156; RTC Decision dated 28 December 2006 penned by Pairing Judge Dina Pestano Teves.

[5] Id. at 14-15.

[6] Id. at 100-104.

[7] Supra note 4.

[8] Id. at 155.

[9] Id. at 154.

[10] Id. at 155.

[11] Id. at 156.

[12] Id.

[13] Id. at 176-191.

[14] Supra note 2.

[15] Rollo, p. 90.

[16] Id.

[17] Id. at 91.

[18] Id. at 92. The arbitration clause reads:

"20.1. In the event of a dispute between Buyer and Seller arising out of, or relating to this Agreement, its interpretation or performance hereunder, the parties shall exert their best efforts to resolve the dispute amicably through negotiations.

20.2. In the event that a dispute cannot be resolved amicably by the parties through negotiations within sixty (60) days of the commencement of such negotiations, the dispute shall be submitted to arbitration in accordance with the laws of the United States, with such arbitration to be held in New York, United States. Each party shall select one arbitrator and then those two arbitrators shall in good faith select a third arbitrator. The arbitration shall be conducted in English. Any decision resulting from such arbitration shall be final and binding upon the parties to this Agreement and on any other person participating in the arbitration. Judgment upon the award may be entered in any court having jurisdiction thereof."

[19] Id. at 92.

[20] Supra note 3.

[21] Rollo, pp. 400-421.

[22] Id. at 433-448.

[23] Id. at 60-62.

[24] Id.

[25] CIVIL CODE, Art. 1216. The creditor may proceed against any one of the solidary debtors or some or all of them simultaneously. The demand made against one of them shall not be an obstacle to those which may subsequently be directed against the others, so long as the debt has not been fully collected. CIVIL CODE, Art. 2047. x x x If a person binds himself solidarily with the principal debtor, the provisions of Section 4, Chapter 3, Title I of this Book shall be observed. In such case the contract is called a suretyship.

[26] Rollo, p. 54.

[27] Id. at 57.

[28] Id. at 59.

[29] Id. at 412.

[30] Id. at 413.

[31] Asset Builders Corporation, v. Stronghold Insurance Co., Inc., G.R. No. 187116, 18 October 2010, 633 SCRA 370, citing Security Pacific Assurance Corporation v. Hon. Tria-Infante, 505 Phil. 609, 620 (2005).

[32] Id., citing Stronghold Insurance Company, Inc. v. Republic-Asahi Glass Corporation, 525 Phil. 270 (2006).

[33] Totanes v. China Banking Corporation, G.R. No. 179880, 19 January 2009, 576 SCRA 323, citing Tiu Hiong Guan v. Metropolitan Bank and Trust Company, 530 Phil. 12 (2006).

[34] Intra-Strata Assurance Corporation & Philippine Home Assurance Corp. v. Republic of the Philippines, 579 Phil. 631 (2008), citing 74 Am. Jur. §35, and Manila Surety & Fidelity Co, Inc. v. Batu Construction & Co., 101 Phil. 494 (1957).

[35] Id., citing NASSCO v. Torrento, 126 Phil. 777 (1967); CIVIL CODE, Article 1216.

[36] Rollo, pp. 153-155.

[37] Id. at 155.

[38] G.R. Nos. 158820-21, 5 June 2009, 588 SCRA 410, 422.

[39] Rollo, p. 59.

[40] Gonzales v. Climax Mining Ltd., 541 Phil. 143 (2007). See also Manila Electric Company v. Pasay Transportation Co., 57 Phil. 600, 603 (1932).

[41] Heirs of Augusto L. Salas, Jr., v. Laperal Realty Corp., 378 Phil. 369 (1999), citing Civil Code, Art. 1311.

[42] "An Act to Institutionalize the Use of an Alternative Dispute Resolution System in the Philippines and to Establish the Office for Alternative Dispute Resolution, and for Other Purposes" or the "Alternative Dispute Resolution Act of 2004."

[43] Totanes v. China Banking Corporation, supra note 33.

[44] See International Finance Corporation v. Imperial Textile Mills, Inc., 511 Phil. 591 (2005).

[45] Intra-Strata Assurance Corp. v. Republic, 579 Phil. 631 (2008), citing Manila Surety & Fidelity Co, Inc. v. Batu Construction & Co., 101 Phil. 494 (1957).

[46] 351 Phil. 664, 686 (1998), citing 74 Am. Jur. 2d, Principal and Surety, § 68, 53.

[47] Rollo, pp. 69-75.

[48] Id. at 156.

[49] Id.

[50] Social Security System v. Moonwalk Development & Housing Corp., G.R. No. 73345, 7 April 1993, 221 SCRA 119.

[51] Santos Ventura Hocorma Foundation, Inc. v. Santos, 484 Phil. 447 (2004), citing IV Arturo M. Tolentino, Civil Code of the Philippines, 101 (1987 ed.).

[52] Id.

[53] Id. citing Tolentino at 102.

[54] Commonwealth Insurance Corporation v. Court of Appeals, 466 Phil. 104 (2004), citing Republic vs. Court of Appeals and R & B Surety and Insurance Company, Inc., 406 Phil. 745(year?).

[55] Id.

[56] G.R. No. 190601, 7 February 2011, 641 SCRA 591, 596-597.

[57] 516 Phil. 725, citing FGU Insurance Corp. v. G.P. Sarmiento Trucking Corp., 435 Phil. 333, 341-342 (2002).

[58] Rollo, p. 156.

[59] Id. at 461-481.

[60] Commonwealth Insurance Corporation v. Court of Appeals, supra note 54, citing Tolentino, Commentaries and Jurisprudence on the Civil Code of the Philippines, 1991 Reprint, Vol. IV, p. 103; Padilla, Civil Code Annotated, 1987 Edition, Vol. IV, p. 61.

[61] Rollo, pp. 48, 495.

[62] G.R.No.189871, 13 August 2013.

[63] G.R. No. 97412, 12 July 1994, 234 SCRA 78, 95-97.

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