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[G. R. No. L-9981. October 31, 1957]

PHILIPPINE SURETY & INSURANCE COMPANY, INC., PETITIONER, VS. ROYAL OIL PRODUCTS, INC., AND THE COURT OF APFEALS, RESPONDENTS.

D E C I S I O N

MONTEMAYOR, J.:

In the Court of First Instance of Manila, judgment was rendered in favor of the Royal Oil Products, Inc., later referred to as the Royal Oil, against the Philippine Surety and Insurance Company, Inc., later referred to as the Philippine Surety, and its co-defendants, as follows:

> "IN VIEW OF THE FOREGOING, this Court renders judgment sentencing the Philippine Surety & Insurance Co., to pay to plaintiff Royal Oil Products, Inc. the sum. of P10,000,00 with interest to be computed at the rate of 12 per cent per annum from the date of the filing of the complaint, plus attorney's fee in the amount equivalent to 25 per cent of the sum. due, plus exemplary damages in the amount of P3,000, and costs. The cross-defendants Monico Perfecto, Lino Castillejo and Luis Santiago shall, upon proof of payment being made, reimburse jointly and severally the Philippine Surety & Insurance Co., all sums paid under this judgment."

On appeal by the Philippine Surety to the Court of Appeals, said court affirmed the appealed judgment, with a slight modification, thus:

> "WHEREFORE, the appealed decision should be modified, and we hereby reduce the attorney's fees to which the plaintiff is entitled from twenty-five (25%) to twenty percent (20%) of the sum due and the exemplary damages from Three Thousand Pesos (P3,000) to One Thousand Pesos (P 1,000). Thus modified, the decision is affirmed in all other respects, at appellant's costs."

It will be observed that the only change or modification made by the appellate court is in reducing attorney's fees from 25 per cent to 20 per cent of the sum due and the exemplary damages from P3,000 to P1,000. From said judgment, the Philippine Surety comes to us on appeal by certiorarij imiking the following assignment of errors:

> "ASSIGNMENT OF ERRORS
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> "I. The Court of Appeals committed a grave error of law in not holding that the petitioner was released from liability under its bond by Royal Oil's continued employment of Monico Perfecto despite his defaults and defalcations and said Royal Oil's failure to notify petitioner thereof.
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> "II. The Court of Appeals committed a grave error of law in not holding that Royal Oil's assignment to the Associated Insurance of more than P4,000 of Perfecto's accounts discharged petitioner from liability under its bond.
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> "III. The Court of Appeals committed a grave error of law in applying Section 2, Republic Act 487, to the instant litigation involving a mere surety bond of petitioner.
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> "IV. The Court of Appeals committed a grave error of law in holding that petitioner was liable for exemplary damages, despite the undisputed evidence that Royal Oil had not dealt with petitioner fairly and in good faith."

The facts and issues involved in the appeal are well and correctly narrated in the decision of the Court of Appeals, the pertinent portion of which we reproduce with approval:

> "It appears uncontested that on October 25, 1952, the Royal Oil Products and Monico Perfecto entered into a contract of employment whereby the latter was hired by the former as salesman for its products in the provinces of Laguna, Quezon and Batangas (Exh. "A"). Said contract was for one year's duration subject to termination without cause by the Royal Oil Products.
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> "The contract bound Monico Perfecto, among other things to sell the products of the Royal Oil within the assigned territory, for cash or on credit, provided that in

case of sales on credit, Perfecto was to be entirely and exclusively responsible for the value thereof; to collect ail accounts due from customers and deliver all such, collections and proceeds of cash sales forthwith or as soon as he reports to the company office at the end of each business day; and to collect within 30 days from the respective dates of sale all such sales on credit and to be responsible for all accounts on credit. On the other hand, Perfecto was to receive no salary save a commission of five per cent (5%) on his gross sales fully paid, to be computed and paid to him at the end of each month. Perfecto, moreover, was provided with a truck or delivery car hut the operational maintenance and repair expenses including the salary of the driver thereof was to be borne by Perfecto.

"As a security for the faithful performance of his obligations, Perfecto was required, as in fact he bound himself, to furnish the Royal Oil Products a bond of P10,000 which would remain in force for as long as the contract (Exh. "A") subsisted, it being agreed upon further, tlhat said bond could be increased upon demand by the "Royal Oil Products if in its opinion, such additional protection would be called for. Perfecto filed a bond dated October 27, 1952 (Exhs. "B" and "4") for P10,000 executed on his behalf by the Philippine Surety. In addition, Perfecto filed another bond underwritten by the Associated Insurance and Surety Co., Inc. on April 30, 1S53 to guaranty any liability arising under the contract (Exh. "A") in excess of the P10,000 obligation guaranteed by the Philippine Surety.

"The appellant Philippine Surety interposes as its first assignment of error the fact that the lower court erred in not finding that Royal Oil's continued employment of Monico Perfecto, without notice to and conformity of Philippine Surety, despite his defaults and defalcations, released said Philippine Surety from liability under its bond.

"The record evinces that consonant with the contract of employment (Exh. "A"), Monico Perfecto began working for the Royal Oil Products in his assigned territory under the following arrangement: usually a day or two before a trip to the provinces, Perfecto would submit to Vicente Lim, Vice-President, treasurer and in charge of the company warehouse at Makati, Rizal, a list of the merchandise needed for sale in his territory; Perfecto would be supplied with said merchandise and after his trip, he would surrender to the company office the delivery receipts representing the merchandise disposed of or sold by him."

"Sometime in June 1953, a statement of the accounts of Perfecto as of May, 1958 was made by the company and the same was found to contain an outstanding account of P2,492.80 (Exh. "C") This statement (Exh. "C") was later revised and as of July 2, 1953, the outstanding accountof Perfecto stood at a reduced figure of P12,275.10, (Exh. "E"—appendix). According to this statement of account, the last delivery of merchandise to Perfecto occurred on April 28, 1953 but inasmuch as Perfecto failed to show up in the company office during the entire month of May, 1953, the Royal Oil Products through its president and manager, Bienvenido Lim, sent a letter dated June 5, 1953 to the Associated Insurance and Suraty Co. which issued the second bond, demanding payment from the latter in the amount of P2,275.10. On the same date, Royal Oil Products addressed another letter of similar import to the defendant Philippine Surety (Exh. "B") demanding the payment of P10,000, Said letter (Exh. "D") was received by the defendant company on June 8, 1958.

"As aforestated, the appellant now claims that despite Perfecto's failure to live up to the terms of the contract (Exh. "A") particularly as regards his numerous sales on credit and failure to collect the same within the specified period, the plaintiff company continued to give Perfecto merchandise without due notice of Perfecto's defalcations to the appellant company. Such failure of the Royal Oil Products to notify the Philippine Surety of the defaults and defalcations of Perfecto, so the appellant claims, released the Philippine Surety from its obligations under the terms of the suraty bond (Exhs. "E" and "A").

"A careful perusal of the statement of Perfecto's outstanding accounts appended to Exhibit "E", reveals that the same includes sales on credit made by Perfecto from November 1952 to April 1953. Notably, the amount collectible for the month of November 1952 and December 1952 reach only to a total of P99.30 and P383.00, respectively. Vicente Lim, testifying for the plaintiff company attributed the delay in the settlement of said account to Perfecto's requests for extension of time to collect the proceeds of such sales on credit. Lim further stated that Perfecto purportedly explained that the customers on credit could not be expected to pay their accounts on time and besides, Perfecto assured that the plaintiff was well protected by his fidelity bond; that the plaintiff company granted Perfecto further consideration on the strength of Pcrfecto's assurances,

"Appellant, however, insists that the plaintiff company materially altered the

contract of employment which constituted as a reference if not a basis of the surety bond (Exh, “B”), when on April 28, 1953, the plaintiff company turned over to Perfecto merchandise worth P4,000 in spite of the plaintiff’s discovery of April 21, 1953 that Perfecto had appropriated the sum of P1,107 for his personal use which amount he had collected from Yao Bun Chuan for merchandise sold to the latter on March 2 and 14, 1953.

“To better understand and resolve tine issue clearly, it is well to examine the provisions of the surety bond between the plaintiff and Perfecto (Exh. “A”).

“Paragraph 10 of the Employment Contract reads as follows:

> ’10. That the failure on the part of the AGENT to comply fully with any of his duties and obligations herein above provided, shall give the COMPANY the right to immediately rescind this contract and take appropriate action in the premises, while the failure on the part of tlie Company to strictly enforce any of its rights herein granted, shall not be construed as a -waiver of such rights under this contract and under the law.’

and the pertinent provision of the surety bond (Exh. “B”) treating1 particularly on the liability of the defendant company states:

‘NOW THEREFORE, if the above bounden principal shall in all respects duly and fully observe and perform all and singular the aforesaid covenants conditions and agreement to the true intent and meaning thereof, then this obligation shall be null and void, otherwise to remain in full force and effect.'(Exh. “B”).

“It is abundantly clear from the above-quoted portion of the contract (Exh. “A”) which, by the terms of the surety bond itself (Exhs. “4” and “B”) was made a part of the latter, that the failure of the plaintiff to strictly enforce its rights under said contract, could not work nor be construed as a waiver of the plaintiff’s rights under the same. There is no question that the plaintiff could have outrightly dismissed Perfecto from its employ upon its discovery on December, 1952 of Perfecto’s failure to pay within 30 days the value of merchandise sold on credit by said agent. Rut ostensibly, the plaintiff chose to keep faith with Perfecto by

> retaining the latter and in continuing to deliver merchandise to him for sale on the strength of his many assurances. Such indulgence of the plaintiff company, to our mind, is impliedly sanctioned by the contract. Moreover, we find no stipulation in the contract which imposes upon the Royal Oil Products the duty to give notice to the Surety of any delay in payment or of defalcation committed by Perfecto. This surety bond clearly stipulates that the defendant's liability thereon would expire on October 27, 1953 and there seems to be no dispute that the instant action was filed on time."

Under the first assignment of error, appellant contends that the act of the Royal Oil in not notifying it of the alleged misappropriation by Perfecto of the total sum of P1,107, representing his collections from one Yao Bun Chuan, and in retaining Perfecto in its employ, as well as in thereafter turning over to Perfecto merchandise valued at P4,000 for sale, released it from its liability under its bond. This same question was passed upon by the Court of Appeals, saying that the surety bond contained no stipulations about the obligation of the Royal Oil to give notice to the Philippine Surety of any delay in payment or defalcation committed by Perfecto; and as to the granting of extension to Perfecto for the settlement of his account, the same was done by the Royal Oil upon its expectation based on Perfecto's own assurance that he would eventually settle his accounts and thereby avoid liability of the Philippine Surety upon its bond. We are inclined to agree with the Court of Appeals on this point. For its security, Philippine Surety should have included in its bond a stipulation to the effect that it should be apprised immediately of any default or defalcation on the part of its principal debtor, so that it could take the necessary measures for its protection, either to aid the Royal Oil in seeing to it that Perfeeto made good his liability and settled his accounts, or stop further deliveries to Perfecto of merchandise for sale. And from the standpoint of Royal Oil, it is a matter of common knowledge that despite rules and regulations about sales agents accounting for their sales within a fixed period of say one month, not infrequently, said agents make sales on credit and their buyers fail to pay on time, thereby resulting in the failure of the agents to deliver or remit in cash the price of sales made within such period; and that in case of failure to account for the price on cash sales, sometimes, companies give their agents periods of grace within which to settle their financial obligations, relying on the assurances made by said sales agents and in the hope that by giving them sufficient time, much unnecessary trouble and resort to the courts in which the surety company would naturally be involved, could be avoided.

Under the second error assigned, the Court of Appeals found that the Associated Insurance

Company, upon receiving a letter of demand of the Royal Oil for payment of the amount of P2,275.10, the excess of Perfecto's liability over P10,000, had paid said amount to the Royal Oil, the latter assigned to it some of "Perfecto's accounts, amounting to about P4,000, but with the understanding that the Associated Insurance Company should collect thereon not more than P2,275.10, and that the assignment of the said accounts under the condition above-stated, did not prejudice the Philippine Surety on its liability upon its bond. We agree with the Court of Appeals that the action of the Royal Oil did not materially prejudice the interests of the Philippine Surety. As a matter of fact, according to the unrefuted statement of counsel for respondents on page 35 of his brief, the Associated Insurance Company actually collected only P50 on the accounts assigned to it by the Royal Oil, while the Royal Oil itself could collect P1,056.78, which it turned over to the Associated Insurance, and it is to be presumed that the rest of the said accounts were returned to the Royal Oil and placed at the disposal of the Philippine Surety. Furthermore, it is to be presumed that the reason said accounts, worth about P4,000, were assigned to the Associated Insurance was to give it an opportunity to reimburse itself of the amount of P2,275.10, which it had promptly paid to the Royal Oil. Had the Philippine Surety acted in the same way and promptly paid the amount of its bond, it would have also been assigned the accounts of Perfecto and even given perhaps preference as to the amounts easily collectible, since it was the entity first and mainly called upon to answer for Perfecto's default. But unfortunately, it unduly delayed, even refused, to honor its bond.

To us, the most important issue involved in the present appeal is that included and discussed in the third assignment of error, namely, whether Republic Act No. 487, particularly, Section 2 thereof, is applicable to the Philippine Surety that filed the surety bond in this case. For purposes of reference, we reproduce said Section 2 of Republic Act No. 487:

> "SEC. 2. In case of any litigation for the enforcement of any policy other than a life insurance policy, it shall be the duty of the court to make a finding' as to whether the payment of the claim of the insured has been unreasonably denied or withheld, and la the affirmative cases the insurance company shall be adjudged to pay damages which shall consist of attorney's fees and other expenses incurred by the insured person by reason of such unreasonable denial or withholding of payment plus twelve per centum of the amount of the claim due the insured, from the date of the filing of the case in court until the claim is fully satisfied. The lapse of two months from the occurrence of the insured risk will be

> considered prima facie evidence of unreasonable delay in payment, unless satisfactorily explained."

This legal provision is relatively new in this jurisdiction and to our knowledge, has not yet been interpreted, much less applied, by the courts. The Court of Appeals itself has the same impression, and referring to Section 2, says that:

> "The application of said provision seems to us a case of first impression having' found no local precedents on the matter. Resort therefore is made to Anglo-American cases wherein it has been generally ruled that the law a of the nature of a regulatory legislation and considers fidelity insurance as a specie of Insurance contracts and a risk-shifting device."'***

And in support of its opinion that Section 2 is applicable to surety companies, makes the following citation:

> *** "It is now fairly well settled, by at least the decided weight of authority, that bonds or contracts which guarantee the fidelity of employees, fiduciaries, officials, etc., if written for profit and in the course of business undertaken therefore, are essentially insurance coil tracts rather than contracts of strict or pure suretyship, and should be construed as insurance contracts, so that the rights and liabilities of the parties are governed, in case of uncertainty or ambiguity as to meaning, by the insurance rule of liberal construction in favor of the insured and the indemnity contracted for, rather than by the rule *strictissimi juris*, which determines the rights of ordinary guarantors or sureties who have become such without pecuniary consideration; * * * (United States.—American Sur. Co. vs. Paely, 170 U.S. 133, 42 L. ed. 877, 18 Sup. Ct. Rep. 552)" (and other authorities)

We have carefully examined the authorities cited and our impression is that fidelity and surety contracts issued for profit have been held and considered as instruments or contracts of insurance in some courts of the United States only for purposes of construction and interpretation of the provision of said contracts, in case of uncertainty or ambiguity, and not for the purpose of holding fidelity and surety companies answerable for all the obligations

imposed by law on insurance companies. To aid us in ascertaining the purpose of Republic Act No. 487, we have read the explanatory note signed by Senator Quintin Paredes on the occasion of the consideration of Senate Bill No. 20, which was later approved as Republic Act No. 487. We reproduce said explanatory note:

> "EXPLANATORY NOTE
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> "It is observed by the undersigned that many insurance companies, especially the foreign ones, have adopted a practice of appointing' several general agents, but empowering only one of them to receive summons or notices required by law. In many instances, the general agent empowered to receive summons and notices are comparatively unknown individuals whose whereabouts are difficult to locate. This practice often leads to the defeat of a suit in law by the simple technicality of improper service of summons. It is obviously unfair and unjust, not to say immoral, to countenance the perpetuation of this practice which defeats an otherwise meritorious case by plain technicality.
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> "In several instances that have occurred, the insurance companies have taken advantage of the plight of the insured to delay, avoid, or reduce the claim or otherwise force the insured to unconscionable compromise in the settlement of their claims.
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> "The present insurance laws afford ample protection to the insurer against frauds. On the other hand, the said laws arc wanting in the protection of the insured.
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> "It is primarily to plug this loop-hole in the insurance Jaw that the approval of this measure is earnestly recommended.
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> (Sgd.) QUINTIN PAEEDES
> *Senator*"

It will be observed that according to said explanatory note, the legislation was directed against and intended for regular insurance companies, specially the foreign ones, in connection with the service of summons in court actions filed by the insured or their beneficiaries. Nothing is said either in the explanatory note or in the law itself about

surety and fidelity companies. Furthermore, Section 2 speaks of insurance policy, insured, and insurance companies, giving ground to the belief that the law contemplated contracts in the form of insurance policies issued by insurance companies and not to bonds issued by surety companies. Besides, as well observed by counsel for petitioner, the provisions of Section 2 regarding the payment of 12 per cent interest on the amount of the claim, as well as attorney's fees, are penal In character and should therefore be strictly construed and ma5′ not be interpreted to include matters not expressly enumerated in said section. For these reasons, we are not prepared to hold that Republic Act No. 487, particularly, Section 2 thereof, may be applied to strictly and purely surety bonds, like the bond in question. Had the Legislature intended Section 2 otherwise, it should have expressed such intention clearly and unequivocally. Consequently, petitioner Philippine Surety may be sentenced to pay only the legal interest on the claim. However, the attorney's fees awarded to respondent Royal Oil may be sustained under the provisions of the New Civil Code, providing for attorney's fees, particularly, Article 2208, thereof.

As regards the exemplary damages and attorney's fees awarded by the Court of Appeals, considering the conduct of petitioner Philippine Surety in failing, even refusing, to pay a valid claim, we are satisfied that the said award is fully justified, and that if the Court of Appeals erred at all on this point, it was in favor of the Philippine Surety by reducing said damages and attorney's fees.

During the pendency of the present appeal, counsel for petitioner Philippine Surety filed a petition to strike from the record certain supposedly unwarranted and derogatory statements contained on pages 6 and 46 of respondent's brief, and that counsel for respondent be admonished and/ or dealt with for contempt by this Court. Counsel for respondent filed a reply to said petition. By resolution of this Court of March 15, 1956, it was resolved to act upon said petition when the case is decided on the merits. Said statements objected to are to the effect and amount to an accusation of petitioner Philippine Surety of dilatory tactics and of using the courts as instruments for its purposes for delay. We have examined with care the said statements, and although we find the same to be quite strong and naturally objectionable from the point of view of the petitioner, we equally find that judging from the record, said statements, if not wholly, are at least in part justified. We can well understand the stats of mind of counsel for respondent when he included those statements in his brief. He was merely giving vent to his pent up feelings of irritation and disgust at the attitude taken and the conduct of petitioner and its officials in their seeming indifference and failure to take prompt action upon a valid claim of respondent entrusted to him for collection. This indifference and failure to act on the part of petitioner Philippine

Surety is reflected in the decision of the trial court, the pertinent portion of which we reproduce below:

> * * * "Accordingly, the plaintiff addressed two letters of demand which have been marked respectively as Exhibits D and E, to the Philippine Surety & Insurance Co. demanding full payment, Exhibit D being dated June 5, 1958 and Exhibit E being dated July 7, 1958. There is no showing that the Philippine Surety ever took any action upon receipt of these letters in order to verify the claim.
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> "By reason of this inaction on the part of the Philippine Surety & Insurance Co., the Royal Oil Products, Inc. was compelled to retain counsel Atty. Alfonso Felix, Jr. This attorney has testified that ho went, on several occasions in the months of August and September, to the offices of the Philippine Surety & Insurance Co., in order to demand payment. He was repeatedly asked to return and despite the fact that he showed them the admission of Monico Perfecto contained in Exhibit C, no action was forthcoming from the Philippine Surety & Insurance Co. These facts are admitted by defendant Philippine Surety & Insurance Co. in an answer to Bequest for Admission dated January 2, 1954. Plaintiff thereupon filed the present action which as to be expected, has been characterised by numerous postponements and requests for postponements."
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> * * * * * * *"
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> "From what has already been said, it may be gathered that, in the opinion of the court, defendant has acted in a wanton, reckless and oppressive manner, by withholding payment on its bond, despite a clear obligation on its part. It has sought to delay plaintiff by compelling plaintiff to resort to long and harassing judicial proceedings. In short, defendant Philippine Surety &, Insurance Co. has attempted to use the courts as an instrument of its own purposes. This should not be encouraged." * * *

The Court of Appeals would appear to have been equally impressed by this attitude of indifference of the Philippine Surety and its refusal to accept and pay the valid claim of respondent Royal Oil. We quote:

> "Remarkably in plaintiff's first letter of demand upon the defendant dated June 5, 1953 (Exh. "B") which "was followed up with another dated July 7, 1953 (Exh. "E") which later letter was accompanied by a statement of Perfccto's outstanding account as of July 2, 1953, no reply was made or action taken by the defendant Philippine Surety until the latter part of September when tho defendant sent Isidro Bernarbe, chief of its Bond and Credit Department to examine the vouchers referred to in Exhibits "1" and "3". When the case was filed in court, hearings were postponed six times; on several grounds, among which was that counsel for the defendant tried to convince his client to pay the plaintiff's demand plus 15 per cent as attorney's fees. On appeal, the defendant company neglected to pay the docket fee and the cost of printing the record on appeal but this Tribunal, notwithstanding a motion to dismiss the appeal allowed the same to take its due course; again, the defendant failed to file its brief on time but was given additional time therefor."
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> * * * * * * *"
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> * * * "Article 2232 of the Civil Code empowers the court to award exemplary damages in cases of contracts or quasi-contracts, should the defendant have acted as a wanton, fraudulent, reckless, oppressive or malevolent manner. The conduct of the defendant in initially ignoring the plaintiff's insistent demands and in deliberately refusing to honor its bond by purposely withholding payment thereof, has compelled and driven the latter to resort to a long, tedious and costly judicial remedy. To this extent, such conduct may be aptly considered oppressive." * * *

Evidently, the attitude and conduct of petitioner Philippine Surety failed to strike a responsive chord of sympathy either in the trial court or in the Court of Appeals. Considering all that has been said on this point, we are constrained to deny the petition to strike from the record and to admonish and/or deal with counsel for respondent for contempt.

In view of the foregoing, with the modification that Republic Act No. 487, particularly, Section 2 thereof, may not be applied in assessing damages against the Philippine Surety, and with the reduction of the interest payable by it from twelve per cent (12%) to six per

cent (6%), the appealed decision is hereby affirmed, with costs against the Philippine Surety.

Padilla, Bautista Angelo, Concepcion and *Endencia, JJ.,* concur.

CONCURRING

REYES, J. B. L., :

I fully agree with the learned opinion of Mr. Justice Montemayor. I would only add that the conduct of the surety in this case points out the necessity of revising previous ideas on the matter and indicates that it is time to abandon the application of the *strictissimi juris* rule to contracts of professional or compensated guarantors, as it is now being done by many courts of the United States. The rule of strict interpretation of contracts of guaranty was born out of the sympathy elicited by the situation of a gratuitous guarantor who ran all the risks and received no advantages whatever from his guaranty, which was almost always given out of friendship.

But the rule loses all *raison d'etre* in the case of guarantors that make a profession or trade out of their practice of undertaking to answer for the debt or default of others, for a price and who, in addition, protect themselves against all loss by requiring counterbonds. In these cases, the guarantors practically run no risk, because the amounts they may be required to pay are later collected from the counter-guarantors, who are also made responsible for the corresponding premiums. Surely the law could not have intended that these guarantors should receive the same treatment as that 'accorded to the lone individual who answers gratuitously for the debt of another, at no profit to himself.

Paras, C. J., concurs.

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