

**GENERAL INSURANCE AND SURETY CORPORATION, PETITIONER,
VS. REPUBLIC OF THE PHILIPPINES AND CENTRAL LUZON
EDUCATION FOUNDATION, INC., RESPONDENTS.**

G.R. No. L-13873. January 31, 1963

Ponente: REGALA, J.

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REGALA, J.:

On May 15, 1954, the Central Luzon Educational Foundation, Inc. and the General Insurance and Surety Corporation posted in favor of the Department of Education a bond, the terms of which read as follows:

"KNOW ALL MEN' BY THESE PRESENTS: "

WHEREAS, the Department of Education has required the Central Luzon Educational Foundation, Inc., operating the Sison & Aruego Colleges, of Urdaneta, Pangasinan, Philippines an institution of learning to file a bond to guarantee the adequate and efficient administration of said school or college and the observance of all regulations prescribed by the Secretary of Education and compliance with all obligations,' including the payment of the salaries of all its teachers and employees, past, present, and future, and the payment of all other obligations incurred by, or in behalf of said school;

Now, THEREFORE, in compliance with said requirement, we, ,CENTRAL LUZON EDUCATIONAL FOUNDATION, INC, operating the Sison and Aruego Colleges, represented by Dr. Jose Aruego, its Vice-Chairman, as principal, and the GENERAL INSURANCE AND SURETY CORPORATION, a corporation duly organized and existing under and by virtue of the laws of the Philippines, as surety, are held and firmly bound, jointly and firmly, unto the Department of Education of the Republic of the Philippines in the sum of TEN THOUSAND PESOS (P10,000.00) Philippine currency, for the payment thereof we bind ourselves, our heirs, executors, administrators, successors, and assigns, jointly and severally firmly by these presents;

WHEN the Secretary of Education is satisfied that said institution of learning had defaulted in any of the foregoing particulars, this bond may immediately thereafter be declared forfeited and for the payment of the amount above-specified, we bind ourselves, our heirs, executors, successors, administrators, and assigns, jointly and severally.

WE further bind ourselves, by these presents, to give the Department of Education at least sixty (60) days notice of the intended withdrawal or cancellation of this bond, in order that the Department can take such action as may be necessary to protect the interests of such teachers, employees or creditors of the school and of the Government.

LIABILITY of Surety under this bond will expire on June 15, 1955, unless sooner revoked.

IN WITNESS WHEREOF, we signed this present guaranty at the City of Manila, Philippines, this 15th day of May, 1954."

On the same day, May 15, 1954, the Central Luzon Educational Foundation, Inc., Teofilo Sison and Jose M.

Aruego executed an indemnity agreement binding themselves jointly and severally to indemnify the surety of "any damages, prejudices, loss, costs, payments, advances and expenses of whatever kind and nature, including attorney's fees and legal costs, which the COMPANY may, at any time sustain or incur, as well as to reimburse to said COMPANY all sums and amounts of money which the COMPANY or its representatives shall or may pay or cause to be paid or become liable to pay, on account of or arising from the execution of the above mentioned Bond." On June 25, 1954, the surety advised the Secretary of Education that it was withdrawing and cancelling its bond.

Copies of the letter were sent to the Bureau of Private Schools and to the Central Luzon Educational Foundation, Inc.

It appears that on the date of execution of the bond, the Foundation was indebted to two of its teachers for salaries, to wit: to Remedios Laoag, in the sum of P685.64, and to H.B. Arandia, in the sum of P820.00, or a total of P1,505.64.

Demand for the above amount having been refused, the Solicitor General, in behalf of the Republic of the Philippines, filed a complaint for the forfeiture of the bond, in the Court of First Instance of Manila on July 11, 1956.

In due time, the surety filed its answer in which it set up special defenses and a cross-claim against the Foundation and prayed that the complaint be dismissed and that it be indemnified by the Foundation of any amount it might be required to pay the Government, plus attorney's fees.

For its part, the Foundation denied the cross-claim and contended that, because Remedios Laoag owed Fr. Cinense the amount of P820.65, there was no basis for the action; that the bond is illegal and that the Government has no capacity to sue. The surety also filed a third-party complaint against Teofilo Sison and Jose M. Arucgo on the basis of the indemnity agreement. While admitting the allegations of the third-party complaint, Sison and Aruego claimed that because of the cancellation and withdrawal of the bond, the indemnity agreement ceased to be of force and effect.

Hearing was held and on December 18, 1956, the Court of First Instance rendered judgment holding the principal and the surety jointly and severally liable to the Government in the sum of P10,000.00 with legal interest from the date of filing of the complaint, until the sum is fully paid; and ordering the principal to reimburse the surety whatever amount it may be compelled to pay to the Government by reason of the judgment, with costs against both principal and the surety.

The surety filed a motion for reconsideration and a request to decide the third party complaint which the trial court denied.

On appeal, the Court of Appeals rendered a decision, the dispositive portion of which reads:

"WHEREFORE, the appealed judgment is hereby modified in the following manner:

"(a) Ordering Central Luzon Educational Foundation, Inc., and General Insurance and Surety Corporation to pay jointly and severally the Republic of the Philippines the sum of P10,000.00, plus costs and legal interests from July 11, 1956 until fully paid; and

"(b) Ordering Central Luzon Educational Foundation, Inc., Teofilo Sison and Jose M. Aruego to reimburse, jointly and severally, the General Insurance and Surety Corporation of all amounts it may be forced to pay the Republic of the Philippines by virtue of this judgment, plus costs and P2,000 for counsel's fees."

From this decision, the surety appealed to this Court by way of certiorari, raising questions of law.[1]

In its first four assignments of error, the surety contends that it was no longer liable on its bond after August 24, 1954 (when the 60-day notice of cancellation and withdrawal ended) or, at the latest, after June 15, 1955. For support, the surety invokes the following provisions of the bond:

"WE further bind ourselves, by these presents to give the Department of Education at least sixty (60) days notice of the intended withdrawal or cancellation of this bond, in order that the Department can take such action as may be necessary to protect the interest of such teacher, employees Creditor to the government. LIABILITY of the Surety under this bond will expire on June 15, 1955, unless sooner revoked."

On the other hand, the Government contends that since the salaries of the teachers were due and payable when the bond was still in force, the surety has become liable on its bond from the moment of its execution on May 15, 1954.

We agree with this contention of the Government.

It must be remembered that, by the terms of the bond, the surety guaranteed to the Government "compliance (by the Foundation) with all obligations, including the payment of the salaries of its teachers and employees, past, present and future, and the payment of all other, obligations incurred by, or in behalf of said school." Now, it is not 'disputed that even before the execution of the bond, the Foundation was already indebted to two of its teachers for ' past salaries. From the moment, therefore, the bond was executed, the right of the Government to proceed against the bond accrued because since then, there has been violation of the terms of the bond regarding payment of past salaries of teachers at the Sison and Aruego Colleges. The fact that the action was filed only on July 11, 1956 does not militate against this position because actions based on written contracts prescribe in ten years. (Art. 1144, par. 1, Civil Code).

The surety also cites our decision in the cases of Jollye vs. Barcelon and Luzon Surety Co., Inc., 68 Phil. 164 and National Rice and Corn Corp. (NARIC) vs. Rivera, et al., G. R. No. L-4023, February 29, 1952. But there is nothing in these cases that supports the proposition that the liability of a surety for obligations arising during the life of a bond ceases upon the expiration of the bond.

In the Jollye case, the bond provided;

"Whereas, the above bounded principal, on 13th day of February, 1933 entered into an agreement with H. P. L. Jollye of Manila, P.I., to fully and faithfully refund to said Mr. H.P.L. Jollye the above stated sum of P7,500 representing the purchase price of the 75 shares of the capital stock of the North Electric Company (certificate No. 38) paid by said Mr. H.P.L. Jollye to the undersigned principal, Mr. Emeterio Barcelon, in the event the title thereto of said Mr. Barcelon is invalidated by any judgment which may be rendered by the court of Cavite against Vicente Diosomito or in the event that any of the warranties contained in that certain deed of sale executed by the undersigned principal on this 13th day of February, 1933, be invalidated, a copy of which is hereto attached and made an integral part hereof, marked Exhibit A."

According to the bond, "the liability of Luzon Surety Company, Inc., under this bond will expire twelve (12) months from date hereof." The date referred to was February 13, 1933. This Court absolved the surety of liability because the acts for which the bond was posted happened after its expiration. Thus, We held in that case:

"* * * The acts provided therein by reason of which the contract of suretyship was executed could have taken place within the stipulated period of twelve months. Hence, the parties fixed that period exactly at twelve months, limiting: thereby the obligation of the appellee to answer for the payment to the appellant of the aforesaid sum of P7,500 to not more than the stipulated period. * * *"

Here, on the other hand, the right of the Government to collect on the bond arose while the bond was in force, because, as earlier noted, even before the execution of the bond, the principal had already been in debt to its

teachers. Neither does the NARIC case support the surety's position. In that case, the bond provided that—

"This bond expires on March 20th, 1949 and will be cancelled TEN DAYS after the expiration, unless the surety is notified of any existing obligation thereunder, or unless the surety renews or extends it in writing for another term."

and We held that giving notice of existing obligation was a condition precedent to further liability of the surety and that in default of such notice, liability on the bond automatically ceased.

Similarly, in the case of Santos, et al. vs. Mejia, et al., G. R. No. L-6388, December 29, 1953, the bond provided that—

"Liability of the surety on this bond will expire on THIRTY DAYS and said bond will be cancelled 10 DAYS after its expiration unless surety is notified of any existing obligation thereunder."

and We held that the surety could not be held liable because the bond was cancelled when no notice of existing obligations was given within ten days.

In the present case, there is no provision that the bond will be cancelled unless the surety is notified of any claim and so no condition precedent has to be complied with by the Government before it can bring an action. Indeed, the provision of the bond in the NARIC and Santos cases that it would be cancelled ten days after its expiration unless notice of claim was given was inserted precisely because, without such a provision, the surety's liability for obligations arising while the bond was in force would subsist even after its expiration.

Thus, in Pao Chuan Wek vs. Nomorosa, 54 Off. Gaz., No. 11, 3490, We held that under a provision that the surety "will not be liable for any claim not discovered and presented to the company within three months from the expiration of this bond and that the obligee hereby waives his right to file any court action against the surety after the termination of the period of three months above mentioned," the giving of notice is a condition precedent to be complied with.

And suppose this action were filed while the bond was in force, as the surety would have the Government do, but the same remained pending after June 15, 1955, would the surety suggest that the judgment that may be rendered in such action could not longer be enforced against it because the bond says that its liability under it has expired ?

And what of the provision on 60-day notice? The surety urges that all actions on the bond must be brought within that period or they would all be barred. The surety misread the provision. The 60-day notice is not a period of prescription of action. The provision merely means that the surety can withdraw—as in fact it did in this case—even before June 15, 1955 provided it gave notice of its intention to do so at least 60 days in advance. If at all, the condition is a limitation on the right of the surety to withdraw rather than a limitation of action on the bond. This is clear also from the Manual of Information of Private Schools[2] which states that "The bond furnished by a school may not be withdrawn by either or both of the bondsmen except by giving the Director of private Schools sixty days notice."

In its fifth assignment of error, the surety contends:

1. That the bond is void for being contrary to public policy insofar as it requires the surety to pay ₱10,000.00 regardless of the amount of the salaries of the teachers.[3] It is claimed that to enforce forfeiture of the bond for the full amount would be to allow the Government to enrich itself since the unpaid salaries of the teachers amount to P1,318.84 only.
2. That, under Article 1311 of the Civil Code,[4] since teachers of Sison and Aruego Colleges are not parties to the bond, "the bond is not effective and binding upon the obligors (principal and surety) as far as it guarantees

payment of the 'past salaries' of the teachers of said school." This is the same as saying that the surety is not liable to teachers of Sison and Aruego Colleges because the latter are not parties to the bond nor are they the beneficiaries of a stipulation pour autrui. But this argument is based on the false premise that the teachers are trying to enforce the obligation of the bond, which is not the case here. This is not an action filed by the teachers against the surety. This is an action brought by the Government, of which the Department of Education is an instrumentality, to hold the surety liable on its bond for the same has been violated when the principal failed to comply "with all obligations, including the payment of salaries of its teachers, past, present and future."

There is nothing against public policy in forfeiting the bond for the full amount. The bond is penal in nature. Article 1226 of the Code states that in obligation with a penal clause, the penalty shall substitute the indemnity for damages and the payment of interests in case of non-compliance, if there is no stipulation to the contrary, and the party to whom payment is to be made is entitled to recover the sum stipulated without need of proving damages because one of the primary purposes of a penalty clause is to avoid such necessity. (Art. 1228, Civil Code. *Lambert vs. Fox*, 26 Phil. 588; *Palacios vs. Municipality of Cavite*, 12 Phil. 140; *Manila Racing Club vs. Manila Jockey Club*, 69 Phil. 55). The mere non-performance of the principal obligation gives rise to the right to the penalty (IV Tolentino, Civil Code of the Philippines 247.)

In its first and second "alternative assignments of error," the surety contends that it was released from its obligation under the bond when on February 4, 1955, Remedios Laoag and the Foundation agreed that the latter would pay the former's salaries, which were then already due, on March 1, 1955. In support of this proposition, the surety cites Article 2079 of the Code which provides as follows:

"An extension granted to the debtor by the creditor without the consent of the guarantor extinguishes the guaranty. * * *"

But the above provision does not apply to this case. The supposed extension of time was granted not by the

Department of Education or the Government but by the teachers. As already stated, the creditors on the bond are not the teachers but the Department of Education or the Government.

Even granting that an extension of time was granted without the consent of the surety, still that fact would not help the surety, because as earlier pointed out, the Foundation was also in arrears in the payment of the salaries of H. B. Arandia. The case of Arandia alone would be enough basis for the Government to proceed against the bond.

Lastly, in its third and fourth "alternative assignments of error," the surety contends that it cannot be made to answer for more than the unpaid salaries of H. B. Arandia, which it claimed amounted to P720.00 only, because Article 2054 states that—

"A guarantor may bind himself for less, but not for more than the principal debtor, both as regards the amount and the onerous nature of the conditions.

"Should he have bound himself for more, his obligations shall be reduced to the limits of that of the debtor."

What We said about the penal nature of the bond would suffice to dispose of this claim. For whatever may be the amount of salaries due the teachers, the fact remains that the condition of the bond was violated and so the surety became liable for the penalty provided for therein.

Wherefore, the decision of the Court of Appeals is hereby affirmed, with costs against the surety.

Padilla, Bautista, Angelo, Labrador, Concepcion, Reyes, J. B. L., Barrera, Paredes, Dizon, and Makalintal, JJ., concur.

[1] Central Luzon Educational Foundation, Inc., Teofilo Sison and Jose M. Aruego also appealed to this Court but we dismissed their appeal in G. R. No. L-14119 for having, been filed out of time.

[2] Prepared by the Department of Education pursuant to Act No. 2706.

[3] Article 1183 states that impossible conditions, those contrary to good customs or public policy and those prohibited by law shall annul the obligation which depends upon them.

[4] Contracts take effect only between the parties, their assigns and heirs, except in case where the rights and obligations arising from the contract are not transmissible by their nature, or by stipulation or by provision of law. The heir is not liable beyond the value of the property he received from the decedent.

If a contract should contain some stipulation in favor of a third person, he may demand its fulfillment provided he communicated his acceptance to the obligor before its revocation. A mere incidental benefit or interest of a person is not sufficient. The contracting Parties must have clearly and deliberately conferred a favor upon a third person.

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