

**MERCANTILE INSURANCE CO., INC., PLAINTIFF-APPELLEE, VS.
FELIPE YSMAEL, JR., & CO., INC., DEFENDANTS-APPELLANTS.***G.R. No. L-43862. January 13, 1989*

Ponente: BIDIN, J.

Read online (full-text search, related cases, audio case brief): <https://batas.org/library/764124bfc33b/>**BIDIN, J.:**

This is an appeal from the decision* dated October 30, 1971 of the Court of First Instance of Manila (now Regional Trial Court) in Civil Case No. 82168 entitled "Mercantile Insurance Co., Inc. (herein referred to as the plaintiff- appellee) vs. Felipe Ysmael, Jr. & Co., Inc., et al." (hereinafter referred to as the defendant-appellant), ordering defendants-appellants Felipe Ysmael, Jr. & Co., Inc. and Felipe Ysmael, Jr., to pay jointly and severally the plaintiff the sum of P100,000.00 plus 15% thereof as attorney's fees, and costs. On appeal to the Court of Appeals, this case which involves only a question of law, was certified to this Court.

The factual milieu of this case as found by the trial court is as follows:

"Felipe Ysmael, Jr. & Co., Inc., repre-sented by Felipe Ysmael filed an application for an overdraft line of P1,000,000.00 and credit line of P1,000,000.00 with the Philippine National Bank. The latter was willing to grant credit accommodation of P2,000,000.00 applied for provided that the applicant shall have filed a bond in the sum of P140,000.00 to guarantee the payment of the said amount. Accordingly, on March 6, 1967, Felipe Ysmael, Jr. & Co., Inc., represented by Felipe Ysmael filed surety bond No. G (16) 007 of Mercantile Insurance Co., Inc. in the sum of P100,000.00 (Exh. A). On December 4, 1967, Felipe Ysmael, Jr. & Co., Inc. as principal and the Mercantile Insurance Co., Inc. executed another surety bond MERICO Bond No. G (16) 0030 in the sum of P40,000.00. It is the condition in both bonds that if the principal Felipe Ysmael, Jr. & Co., Inc. shall perform and fulfill its under-takings with the Philippine National Bank, then these surety bonds shall be null and void (Exh. B).

"As security and in consideration of the execution of the surety bonds, exhibits A and B, Felipe Ysmael, Jr. & Co., Inc. and Magdalena Estate, Inc. represented by Felipe Ysmael, Jr. as president and in his personal capacity executed with the plaintiff Mercantile Insurance Co., Inc. an indemnity agreement (Exh. D) wherein the defendants Felipe Ysmael, Jr. & Co., Inc. and Felipe Ysmael, Jr. bound them-selves jointly and severally to indemnify the plaintiff, hold save it harmless from and against any and all payments, damages, costs, losses, penalties, charges and expenses which said company as surety (relative to MERICO Bond No. 0007) shall incur or become liable to pay plus an additional amount as attorney's fees equal to 20% of the amount due to the company. Paragraph 3 of the indemnity agreement ex-pressly provides:

'3) ACCRUAL OF ACTION: - Notwith-standing the provisions of the next preceding paragraph, where the obligation involves a liquidated amount for the payment of which the COMPANY has become legally liable under the terms of the obligation and its suretyship undertaking or by the demand of the obligee or otherwise and the latter has merely allowed the COMPANY a term or extension for payment of the latter's demand the full amount necessary to discharge the COMPANY's aforesaid liability irrespective of whether or not payment has actually been made by the COMPANY, the COMPANY for the protection of its interest may forthwith proceed against the undersigned or either of them by court action or otherwise to enforce payment even prior to making payment to the obligee which may hereafter be done by the COMPANY.'

"On September 6, 1967, Gabriel Daza, Jr., Edgardo L. Tordesillas and Augusto Torres in their official capacities and the defendants executed another indemnity agreement (Exh. E) with the plaintiff in consideration of the surety bond (referring to MERICO Bond No. G (16) 0030. In the indemnity agreement (Exh. E) the same provisions of paragraph 3 found in exhibit D is provided for.

"By agreement dated September 5, 1967 (Exh. C), the amount of the Bond was reduced by P40,000.00 so that the total liability of the plaintiff to the Philippine National Bank in view of the aforesaid reduction is P100,000.00 (Exh. C), P60,000.00 on Surety Bond No. 0007 plus P40,000.00 on Surety Bond No. 0030.

"In view of the failure of the defendants to pay the overdraft and credit line with the Philippine National Bank on July 15, 1970, the Philippine National Bank demanded from the Mercantile Insurance Co., Inc. settlement of its obligation under surety bonds No. (G-16) - 0007 for P60,000.00 which expired on March 6, 1970 and No. G (-16) - 0030 for P40,000.00 which expired since September 4, 1968 (Exh. P) otherwise drastic measures for collection to protect the interest of the bank would be taken. Attached to the demand letter is a statement of account.

"By letter of December 17, 1970, the Legal Department of plaintiff company wrote a letter of demand to the defendants (Exhs. G and H) in-viting their attention to the letter of demand of the Philippine National Bank sent to the plaintiff and demanding from the defendants the settlement of said account. These letters were received as shown by the registry return receipts (Exhs. G-2 and H-2). Since the de-fendants failed to settle their obligation with the Philippine National Bank, on February 10, 1971, plaintiff brought the present action."

Instead of filing their answer, the defendants (appellants herein) filed a motion to DISMISS, which motion was subsequently denied. Thereafter, the defendants filed their answer and the case was set for pre-trial. On the date scheduled for pre-trial, the defendants and their counsel failed to appear, thus on motion of the plaintiff, they were declared in default and plaintiff was allowed to present its evidence ex-parte. Upon motion for reconsideration filed by the defendants, the case was ordered re-opened and the case was scheduled for reception of defendants' evidence. Thereafter, the parties were required to submit their respective memoranda and the case was submitted for decision. On October 30, 1971, the trial court rendered its decision, the dispositive part of which reads:

"WHEREFORE, in view of the foregoing considerations, judgment is rendered for the plaintiff and the defendants are ordered to pay jointly and severally the plaintiff the sum of P100,000.00 plus the further sum of 15% thereof in the concept of reasonable attorney's fees and the costs.

"Plaintiff upon payment of this judgment, shall deliver the sum of P100,000.00 to the Philippine National Bank in partial satisfaction of the obligation of the defendants to said Bank.

"SO ORDERED." (Record on Appeal, p. 96)

Said decision was appealed to the Court of Appeals on question of facts and law. Acting on the appeal and finding that the only question raised therein involves a question of law, the Court of Appeals by resolution* dated April 29, 1976, certified the same to this Court, for proper disposition (Rollo, pp. 62-63).

This Court, thru its First Division by Resolution dated May 31, 1978, resolved to have the case docketed and declared the same submitted for decision (Rollo, p. 65).

The defendants-appellants raised the following assignment of errors in the Court of Appeals:

I

THE LOWER COURT ERRED IN NOT DISMISSING THE CASE FOR LACK OF CAUSE OF ACTION, THE COMPLAINT BEING PREMATURE BECAUSE THE PLAINTIFF HAS PAID NOTHING ON THE SURETY BONDS AND HAS SUFFERED NO ACTUAL DAMAGE.

II

"THE LOWER COURT ERRED IN NOT DECLARING THAT PARAGRAPH 3 OF THE INDEMNITY AGREEMENTS IS VOID.

III

CONSEQUENTLY, THE TRIAL COURT ERRED IN ORDERING THE DEFENDANTS-APPELLANTS TO PAY JOINTLY AND SEVERALLY TO THE PLAINTIFF THE SUM OF P100,000.00 PLUS THE FURTHER SUM OF 15% THEREOF IN THE CONCEPT OF REASONABLE ATTOR-NEY'S FEES AND THE COSTS." (Brief for Defendants-Appellants, CA, pp. 1-2).

The crux of the controversy is whether or not the surety can be allowed indemnification from the defendants-appellants, upon the latter's default even before the former has paid to the creditor.

There is no dispute that the overdraft line of 1,000,000.00 and the credit line of P1,000,000.00 applied for by the de-fendant was granted by the Philippine National Bank on the strength of the two surety bonds denominated as MERICO Bond No. G (16) 0007 for one hundred thousand pesos (Exh. A) and MERICO Bond No. G (16) 0030 for forty thousand pesos (Exh. B), later reduced as above stated on September 5, 1967 (Exh. C) by P40,000.00 or a total amount of P100,000.00. As security and in consideration of the execution of the surety bonds, the defendants executed with the plaintiff identical indemnity agreements (Exhs. D and E) which provide, among others, that payment of indemnity or compensation may be claimed irrespective of whether or not plaintiff company has actually paid the same.

Defendants-appellants maintain that the complaint is pre-mature and that paragraph 3 of the indemnity agreements is void for being contrary to law, public policy and good morals. They argued that to allow plaintiff surety (appellee herein) to receive indemnity or compensation for something it has not paid in its capacity as surety would constitute unjust enrichment at the expense of another. (Brief for Defendants-Appellants, CA, p. 6).

To bolster their contention, defendants-appellants argue that it is an indispensable requisite for an action to prosper, that the party bringing the action must have a cause of action against the other party; and that for a cause of action to be ripe for litigation, there must be both wrongful violation and damages; all of which are not present in the case at bar because plaintiff-appellee has not suffered any injury whatsoever, notwithstanding the demand sent to it by the Philippine National Bank, nor has plaintiff-appellee made a single actual payment to said bank. Hence, to allow plaintiff-appellee to recover from them something which it has not paid in its capacity as surety would violate the fundamental principle which states NEMO-CUM ALTERIUS DETRIMENTO LOCOPLETARI POTES (No person should unjustly enrich himself at the expense of another). [Defendants-Appellants' Brief, pp. 7-8; 49].

The question as to whether or not under the Indemnity Agreement of the parties, the Surety can demand indemnification from the principal, upon the latter's default, even before the former has paid to the creditor, has long been settled by this Court in the affirmative.

It has been held that:

"The stipulation in the indemnity agreement allowing the surety to recover even before it paid the creditor is enforceable. In accordance therewith, the surety may demand from the indemnitors even before paying the creditors." (Cosmopolitan Ins. Co. Inc. v. Reyes, 15 SCRA 528 [1965] citing: Security Bank v. Globe Assurance, 58 Off. Gaz. 3709 [April 30, 1962]; Alto Surety and Ins. Co., Inc. v. Aguilar, et al., G.R. No. L-5625, March 16, 1954).

Hence, appellants' contention that the action of the appellee (surety company) is premature or that the complaint

fails to state a cause of action because the surety has not paid anything to the bank, cannot be sustained (*Cosmopolitan Ins. Co., Inc. v. Reyes*, supra). In fact, such contention is belied not only by the allegations in the complaint but also by the agreement entered into between the appellants and the appellee in favor of the bank.

The records show that the cause of action is distinctly set forth in the complaint, the pertinent portion of which states:

"6. That defendants, by virtue of the two Surety Bonds (Annexes "A" and "B") were extended by the Philippine National Bank, a credit accommodation in the sum of TWO MILLION (P2,000,000.00) PESOS;

"7. That the Philippine National Bank is demanding and collecting from the plaintiff the sum of ONE HUNDRED THOUSAND (P100,000.00) PESOS which is the defendants' account with the said bank that is secured and covered by the above-mentioned bonds (Annexes "A" and "B");

"8. That under the terms of the Indemnity Agreements (Annexes "D" and "E") more particularly paragraph 3, plaintiff may forth-with proceed against the defendants to impose payment, even prior to making payment to the Philippine National Bank;

"9. That notwithstanding series of demands made by plaintiff, the defendants failed and refused to pay the Philippine National Bank the sum of ONE HUNDRED THOUSAND (P100,000.00) PESOS;

"10. That on account of defendants' default, plaintiff becomes liable to the Philippine National Bank in the sum of ONE HUNDRED THOUSAND (P100,000.00) PESOS;" (Record on Appeal, p. 2).

Correspondingly, it is readily apparent that said cause of action was derived from the terms of the Indemnity Agreement, paragraph 3 thereof, as above quoted. By virtue of the provisions of the Indemnity Agreement, defendants-appellants have undertaken to hold plaintiff-appellee free and harmless from any suit, damage or liability which may be incurred by reason of non-performance by the defendants-appellants of their obligation with the Philippine National Bank. The Indemnity Agreement is principally entered into as security of plaintiff-appellee in case of default of defendants-appellants; and the liability of the parties under the surety bonds is joint and several, so that the obligee PNB may proceed against either of them for the satisfaction of the obligation. (Brief for Plaintiff-Appellee, p. 7).

II

Defendants-appellants have, by virtue of the Indemnity Agreement, given the plaintiff-appellee the prerogative of filing an action even prior to the latter's making any payment to the Philippine National Bank.

Contracts are respected as the law between the contract-ing parties (*Henson v. IAC*, 148 SCRA 11 [1987], citing *Castro v. CA*, 99 SCRA 722 [1980] and *Escano v. CA*, 100 SCRA 197 [1980]). It is settled that the parties may establish such stipulations, clauses, terms and conditions as they may want to include, and as long as such agreements are not contrary to law, morals, good customs, public policy or public order, they shall have the force of law between them (*Herrera v. Petrophil Corp.*, 146 SCRA [1986]).

Contracts should be interpreted according to their literal meaning and should not be interpreted beyond their obvious intentment (*Ibid.*). It is a basic and fundamental rule in the interpretation of contracts that if the terms thereof are clear and leave no doubt as to the intention of the contracting parties, the literal meaning of the stipulation shall control.

In the case at bar, there is no dispute as to meaning of the terms of the Indemnity Agreement. The only bone of contention is whether or not such terms are null and void as defendants-appellants would have this Court declare.

A careful analysis of the contract in question will show that the provisions therein do not contravene any law or

public policy much less do the militate against the public good. In fact, as shown above, they are fully sanctioned by well-established jurisprudence. Having voluntarily entered into such contract, the appellants cannot now be heard to complain. Their indemnity agreement have the force and effect of law.

Elucidating further on the obligations of the parties in agreements of this nature, this Court ruled:

"x x x The indemnity agreement was not executed for the benefit of the creditors; it was rather for the benefit of the surety and if the latter thought it necessary in its own interest to impose this stipulation, and the indemnitors voluntarily agreed to the same, the court should respect the agreement of the parties and require them to abide by their contract." (Security Bank v. Globe Assurance, 107 Phil. 733 [1960]).

III

Finally, the trial court did not err in ordering defendants-appellants to pay jointly and severally the plaintiff the sum of P100,000.00 plus 15% as attorney's fees.

It must be stressed that in the case at bar, the principal debtors, defendants-appellants herein, are simultaneously the same persons who executed the Indemnity Agreement. Thus, the position occupied by them is that of a principal debtor and indemnitor at the same time, and their liability being joint and several with the plaintiff-appellee's, the Philippine National Bank may proceed against either for fulfillment of the obligation as covered by the Surety bonds. There is, therefore, no principle of guaranty involved and, therefore, the provision of Article 2071 of the Civil Code does not apply. Otherwise stated, there is no more need for the plaintiff-appellee to exhaust all the properties of the principal debtor before it may proceed against defendants-appellants.

As to the attorney's fees, it has been squarely ruled by this Court that the award of fifteen (15) per cent for cases of this nature is not unreasonable (Cosmopolitan Insurance Co., Inc. v. Reyes, supra).

WHEREFORE, the decision appealed from is hereby AFFIRMED.

SO ORDERED.

Fernan, C.J., Gutierrez, Jr., Feliciano, and Cortes, JJ., concur.

[*] Penned by Jose G. Bautista, Jr., Presiding Judge, CFI, Manila, Branch III.

[*] Penned by Justices Pacifico P. de Castro, Luis B. Reyes and Vicente G. Erica.

ABOUT BATAS.ORG

Study smarter at BATAS.org

The Philippine bar review and law-school companion built around how your brain actually remembers.

The complete Philippine law library - free for everyone.

More than 100,000 Supreme Court decisions, Republic Acts, and executive issuances - full-text searchable, browsable by category and year, and always free. No paywall, no login. This PDF came from it.

Audio case-brief lectures.

Any decision becomes a podcast-style lecture - facts, issues, ruling, and doctrine - with read-along highlighting and a hands-free presentation mode. Study while commuting, working out, or resting your eyes.

Bar review built on the science of memory.

Complete, sequenced courses for all eight bar subjects, narrated like podcasts and reinforced with retrieval practice and spaced review - the study techniques with the strongest evidence behind them.

The full law-school curriculum.

One subscription unlocks the entire J.D. curriculum - every subject, every lesson, with your progress tracked down to the paragraph so you can pick up exactly where you left off, on any device.

Mock exams that tell you where you stand.

Timed multiple-choice exams graded instantly, with per-subject score breakdowns and focus suggestions that point you at your weakest topics first.

A study planner that keeps you on pace.

Set your schedule and BATAS tells you every day whether you are on track for bar day - and exactly which lesson to take next.

Start free at <https://batas.org>

The law library is free forever - and your first lesson is one click away.

The text of this document is an official public record and remains in the public domain. Formatting, presentation, and compilation © 2026 batas.org.

Downloaded free from the batas.org Law Library. Share it freely - the library is free for every law student, bar reviewee, and practitioner.