

**LIRAG TEXTILE MILLS, INC., AND BASILIO L. LIRAG, PETITIONERS,
VS. SOCIAL SECURITY SYSTEM, AND HON. PACIFICO DE CASTRO,
RESPONDENTS.**

G.R. No. L-33205. August 31, 1987

Ponente: FERNAN, J.

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FERNAN, J.:

This is an appeal by certiorari involving purely questions of law from the decision rendered by respondent judge in Civil Case No. Q-12275 entitled "Social Security System versus Lirag Textile Mills, Inc. and Basilio L. Lirag."

The antecedent facts, as stipulated by the parties during the trial, are as follows:

"1. That on September 4, 1961, the plaintiff [herein respondent Social Security System] and the defendants [herein petitioners] Lirag Textile Mills, Inc. and Basilio Lirag entered into a Purchase Agreement under which the plaintiff agreed to purchase from the said defendant preferred shares of stock worth ONE MILLION PESOS [P1,000,000.00] subject to the conditions set forth in such agreement; x x x

"2. That pursuant to the Purchase Agreement of September 4, 1961, the plaintiff, on January 31, 1962, paid the defendant Lirag Textile Mills, Inc. the sum of FIVE HUNDRED THOUSAND PESOS [P500,000.00] for which the said defendant issued to plaintiff 5,000 preferred shares with a par value of one hundred pesos [P100.00] per share as evidenced by Stock Certificate No. 128, x x x

"3. That further in pursuance of the Purchase Agreement of September 4, 1961, the plaintiff paid to the Lirag Textile Mills, Inc. the sum of FIVE HUNDRED THOUSAND PESOS [P500,000.00] for which the said defendant issued to plaintiff 5,000 preferred shares with a par value of one hundred pesos [P100.00] per share as evidenced by Stock Certificate No. 139, x x x

"4. That in accordance with paragraph 3 of the Purchase Agreement of September 4, 1961 which provides for the repurchase by the Lirag Textile Mills, Inc. of the shares of stock at regular intervals of one year beginning with the 4th year following the date of issue, Stock Certificates Nos. 128 and 139 were to be repurchased by the Lirag Textile Mills, Inc. thus:

CERT. NO.

AMOUNT

DATE OF REDEMPTION

128

P100,000.00

100,000:00

100,000.00

100,000.00

100,000.00

February 14, 1965

February 14, 1966

February 14, 1967

February 14, 1968

February 14, 1969

139

P100,000.00

100,000.00

100,000.00

100,000.00

100,000.00

July 3, 1966

July 3, 1967

July 3, 1968

July 3, 1969

July 3, 1970

"5. That to guarantee the redemption of the stocks purchased by the plaintiff, the payment dividends, as well as the other obligations of the Lirag textile Mills, Inc., defendants Basilio L. Lirag signed the Purchase Agreement of September 4, 1961 not only as president of the defendant corporation, but also as surety so that should the Lirag Textile Mills, Inc. fail to perform any of its obligations in the said Purchase Agreement, the surety shall immediately pay to the vendee the amounts then outstanding pursuant to Condition No. 4, to wit:

'To guarantee the redemption of the stocks herein purchased, the payment of the dividends, as well as other obligations of the VENDOR herein, the SURETY hereby binds himself jointly and severally liable with the VENDOR so that should the VENDOR fail to perform any of its obligations hereunder, the SURETY shall immediately pay to the VENDEE the amounts then outstanding.'

"6. That defendant corporation failed to redeem Certificates of Stock Nos. 128 and 139 by payment of the amounts mentioned in paragraph 4 above;

"7. That the Lirag Textile Mills, Inc. has not paid dividends in the amounts and within the period set forth in paragraph 10 of the complaint;*

"8. That letters of demands have been sent by the plaintiff to the defendant to redeem the foregoing stock certificates and pay the dividends set forth in paragraph 10 of the complaint, but the Lirag Textile Mills, Inc. has not made such redemption nor made such dividend payments;

"9. That defendant Basilio L. Lirag likewise received letters of demand from the plaintiff requiring him to make good his obligation as surety;

"10. That notwithstanding such letters of demand to the defendant Basilio L. Lirag, Stock Certificates Nos. 128 and 139 issued to plaintiff are still unredeemed and no dividends have been paid on said stock certificates;

"11. That paragraph 5 of the Purchase Agreement provides that should the Lirag Textile Mills, Inc., fail to effect any of the redemptions stipulated therein, the entire obligation shall immediately become due and demandable and the Lirag Textile Mills, Inc., shall, furthermore, be liable to the plaintiff in an amount equivalent to twelve per cent [12%] of the amount then outstanding as liquidated damages;

"12. That the failure of the Lirag Textile Mills, Inc. to redeem the foregoing certificates of stock and pay dividends thereon were due to financial reverses, to wit:

[a] Unrestrained smuggling into the country textiles from the United States and other countries;

[b] Unrestricted entry of supposed remnants which competed with textiles of domestic produce to the disadvantage and economic prejudice of the latter;

[c] Scarcity of money and the unavailability financing facilities;

[d] Payment of interest on matured loans extended to defendant corporation;

[e] Construction of the Montalban plant of the defendant corporation financed largely through reparation benefits;

[f] Labor problems occasioned by the fact that the defendant company is financial (sic) unable to improve, in a substantial way, the economic plight of its workers as a result of which two costly strikes had occurred, one in 1965 and another in 1968; and

[g] The occurrence of a fire which destroyed more than P1 million worth of raw cotton, paralyzed operations partially, increased overhead costs and wiped out any expected profits that year;

"13. That it has been the policy of the plaintiff to be represented in the board of directors of the corporation or entity which has obtained financial assistance from the System be it in terms of loans, mortgages or equity investments. Thus, pursuant to paragraph 6 of the Purchase Agreement September 4, 1961 which provides as follows:

'The VENDEE shall be allowed to have a representative in the Board of Directors of the VENDOR with the right to participate in the discussions and to vote therein;'

"14. That Messrs. Rene Espina, Bernardino Abes and Heber Catalan were each issued one common share of stock as a qualifying share to their election to the Board of Directors of the Lirag Textile Mills, Inc.;

"15. That Messrs. Rene Espina, Bernardino Abes and Heber Catalan, their respective tenure as member of the Board of Directors of the Lirag Textile Mills, Inc. attended the meetings of the said Board, received per diems for their attendance therein in the same manner and in the same amount as any other member of the Board of Directors, participated in the deliberations therein and freely exercised their right to vote in such meetings. However, the per diems received by the SSS representative do not go to the coffers of the System but personally to the representative in the said board of directors." [1]

For failure of Lirag Textile Mills, Inc. and Basilio L. Lirag to comply with the terms of the Purchase Agreement, the SSS filed an action for specific performance and damages before the then Court of First Instance of Rizal, Quezon City, praying that therein defendants Lirag Textile Mills, Inc. and Basilio L. Lirag be adjudged liable for [1] the entire obligation of P1 M which became due and demandable upon defendants' failure to repurchase the stocks as scheduled; [2] dividends in the amount of P220,000.00; [3] liquidated damages in an amount equivalent

to twelve percent (12%) of the amount then outstanding; [4] exemplary damages in the amount of P100,000.00 and [5] attorney's fees of P20,000.00.

Lirag Textile Mills, Inc. and Basilio L. Lirag moved for the dismissal of the complaint, but were denied the relief sought. Thus, they filed their answer with counterclaim, denying the existence of any obligation on their part to redeem the preferred stocks, on the ground that the SSS became and still is a preferred stockholder of the corporation so that redemption of the shares purchased depended upon the financial ability of said corporation. Insofar as defendant Basilio Lirag is concerned, it was alleged that his liability arises only if the corporation is liable and does not perform its obligations under the Purchase Agreement. They further contended that no liability on their part has arisen because of the financial condition of the corporation upon which such liability was made to depend, particularly the non-realization of any profit or earned surplus. Thus, the other claims for dividends, liqui-dated damages and exemplary damages are allegedly without basis.

After entering into the Stipulation of Facts above-quoted, the parties filed their respective memoranda and submitted the case for decision.

The lower court, ruling that the purchase agreement was a debt instrument, decided in favor of SSS and sentenced Lirag Textile Mills, Inc. and Basilio L. Lirag to pay SSS jointly and severally P1,000,000.00 plus legal interest until the said amount is fully paid; P220,000.00 representing the 8% per annum dividends on the preferred shares plus legal interest up to the time of actual pay-ment; P146,400.00 as liquidated damages; and P10,000.00 as attorney's fees. The counterclaim of Lirag Textile Mills, Inc. and Basilio L. Lirag was dismissed. Hence, this petition.

Petitioners assign the following errors:

1. The trial court erred in decid-ing that the Purchase Agree-ment is a debt instrument;
2. Respondent judge erred in hold-ing petitioner corporation lia-ble for the payment of the 8% preferred and cumulative divi-dends on the preferred shares since the purchase agreement provides that said dividends shall be paid from the net profits and earned surplus of petitioner corporation and respondent SSS has admitted that due to losses sustained since 1964, no dividends had been and can be declared by petitioner corporation;
3. Respondent judge erred in sen-tencing petitioners to pay P146,400.00 in liquidated da-mages;
4. Respondent judge erred in sen-tencing petitioners to pay P10,000.00 by way of attorney's fees;
5. Respondent judge erred in sen-tencing petitioners to pay in-terest from the time of filing the complaint up to the time of full payment both on the P1,000,000.00 invested by res-pondent SSS in petitioner's corporation and on the P220,000.00 which the SSS claims as divi-dends due on its investments;
6. Respondent judge erred in holding that petitioner Lirag is liable to redeem the P1,000,000.00 worth of preferred shares purchased by respondent SSS from petitioner corporation and the 8% cumulative dividend, it appear-ing that Lirag was merely a surety and not an insurer of the obligation;
7. Respondent judge erred in dismissing the counterclaim of petitioners.

The fundamental issue in this case is whe-ther or not the Purchase Agreement entered into by petitioners and respondent SSS is a debt instrument.

Petitioners claim that respondent SSS merely became and still is a preferred stockholder of the petitioner corporation, the redemption of the shares purchased by said respondent being dependent upon the financial ability of petitioner corporation. Petitioner corporation, thus, has no obligation to redeem the preferred stocks.

On the other hand, respondent SSS claims that the Purchase Agreement is a debt instrument, imposing upon the petitioners the obligation to pay the amount owed, and creating as between them the relation of creditor and debtor, not that of a stock-holder and a corporation.

We uphold the lower court's finding that the Purchase Agreement is, indeed, a debt instrument. Its terms and conditions unmistakably show that the parties intended the repurchase of the preferred shares on the respective scheduled dates to be an absolute obligation which does not de-pend upon the financial ability of petitioner corporation. This absolute obligation on the part of petitioner corporation is made manifest by the fact that a surety was required to see to it that the obligation is fulfilled in the event of the principal debtor's inability to do so. The uncon-ditional undertaking of petitioner corporation to redeem the preferred shares at the specified dates constitutes a debt which is defined "as an obli-gation to pay money at some fixed future time, or at a time which becomes definite and fixed by acts of either party and which they expressly or impliedly, agree to perform in the contract.[2]

A stockholder sinks or swims with the cor-poration and there is no obligation to return the value of his shares by means of repurchase if the corporation incurs losses and financial reverses, much less guarantee such repurchase through a surety.

As private respondent rightly contends, if the parties intended it [SSS] to be merely a stockholder of petitioner corporation, it would have been sufficient that Preferred Certificates Nos. 128 and 139 were issued in its name as the preferred certificates contained all the rights of a stockholder as well as certain obligations on the part of petitioner corporation. However, the parties did in fact execute the Purchase Agreement, at the same time that the peti-tioner corporation issued its preferred stock to the respondent SSS. The Purchase Agree-ment serves to define the rights and obliga-tions of the parties and to establish firmly the liability of petitioners in case of breach of contract. The Certificates of Preferred Stock serve as additional evidence of the agreement between the parties, though the pre-cise terms and conditions thereof must be read together with, and regarded as qualified by, the terms and conditions of the Purchase Agree-ment.

The rights given by the Purchase Agree-ment to respondent SSS are rights not en-joyed by ordinary stockholders. This fact could only lead to the conclusion made by the trial court that:

"The aforementioned rights specially stipulated for the benefit of the plaintiff [respondent SSS] suggest eloquently an intention on the part of the plaintiff [respondent SSS] to facilitate a loan to the defendant corporation upon the latter's request. In order to afford protection to the plaintiff which otherwise is provided by means collaterals, as the plaintiff exacts in its grants of loans in its ordinary transactions of this kind, as it is looked upon more as a lending institution rather than as an investing agency, the purchase agreement supplied these protective rights which would otherwise be furnished by collaterals to the loan. Thus, the membership in the board is to have a watchdog in the operation of the business of the corporation, so as to insure against mismanagement which may result in losses not entirety unavoidable since payment for purposes of redemption as well as the dividends is expressly stipulated to come from profits and/or surplus. Such a right is never exacted by an ordinary stockholder merely investing in the corporation."[3]

Moreover, the Purchase Agreement provided that failure on the part of petitioner to repur-chase the preferred shares on the scheduled due dates renders the entire obligation due and demandable, with petitioner in such eventuality lia-ble to pay 12% of the then outstanding obligation as liquidated damages. These features of the Purchase Agreement, taken collectively, clearly show the intent of the parties to be bound therein as debtor and creditor, and not as corporation and stockholder.

Petitioners' contention that it is beyond the power and competence of petitioner corporation to redeem the preferred shares or pay the accrued dividends due to financial reverses can not serve as legal justification for their

failure to perform under the Purchase Agreement. The Purchase Agreement constitutes the law between the parties and obligations arising ex contractu must be fulfilled in accordance with the stipulations.[4] Besides, it was precisely this eventuality that was sought to be avoided when respondent SSS re-required a surety for the obligation.

Thus, it follows that petitioner Basilio L. Lirag cannot deny liability for petitioner corporation's default. As surety, Basilio L. Lirag is bound immediately to pay respondent SSS the amount then outstanding.

"The obligation of a surety differs from that of a guarantor in that the surety insures the debt, whereas the guarantor merely insures solvency of the debtor; and the surety undertakes to pay if the principal does not pay, whereas a guarantor merely binds itself to pay if the principal is unable to pay.[5]

On the liability of petitioners to pay 8% cumulative dividend, We agree with the observation of the lower court that the dividends stipulated by the parties served evidently as interests.[6] The amount thereof was fixed at 8% per annum and was not made to depend upon or to fluctuate with the amount of profits or surplus realized, a clear indication that the parties intended to give a sure and fixed earnings on the principal loan. The fact that the dividends were supposed to be paid out of net profits and earned surplus, of which there were none, does not excuse petitioners from the payment thereof, again for the reason that the undertaking of petitioner Basilio L. Lirag as surety, included the payment of dividends and other obligations then outstanding.

The award of the sum of P146,400.00 in liquidated damages representing 12% of the amount then outstanding is correct, considering that petitioners in the stipulation of facts admitted having failed to fulfill their obligations under the Purchase Agreement. The grant of liquidated damages in the amount stated is expressly provided for in the Purchase Agreement in case of contractual breach.

The pronouncement of the lower court for the payment of interests on both the unredeemed shares and unpaid dividends is also in order. Per stipulation of facts, petitioners did not deny the fact of non-payment of dividends nor their failure to purchase the preferred shares. Since these involve sums of money which are overdue, they are bound to earn legal interest from the time of demand, in this case, judicial, i.e., the time of filing the action.

Petitioner Basilio L. Lirag is precluded from denying his liability under the Purchase Agreement. After his firm representation to "pay immediately to the VENDEE the amounts then outstanding" evidencing his commitment as SURETY, he is estopped from denying the same. His signature in the agreement carries with it the official imprimatur as petitioner corporation's president, in his personal capacity as majority stockholder, as surety and as solidary obligor. The essence of his obligation as surety is to pay immediately without qualification whatsoever if petitioner corporation does not pay. To have another interpretation of petitioner Lirag's liability as surety would violate the integrity of the Purchase Agreement as well as the clear and unmistakable intent of the parties to the same.

WHEREFORE, the decision in Civil Case No. Q-12275 entitled "Social Security System vs. Lirag Textile Mills, Inc. and Basilio L. Lirag" is hereby affirmed in toto. Costs against petitioners.

SO ORDERED.

Gutierrez, Jr., Feliciano, Bidin, and Cortes, JJ., concur.

* Defendants Lirag Textile Mills, Inc. and Basilio Lirag under Condition 2 of the Purchase Agreement obligated themselves to pay on the ONE MILLION PESOS [P1,000,000.00] Preferred Shares cumulative dividends of Eight Percent [8%] thereon per annum out of the net profits and earned surplus of the defendant corporation, to

wit:

"2. The shares of stock shall earn pre-ferred cumulative dividend of EIGHT PERCENT [8%] per annum out of the net profits and earned surplus of the VENDOR before any dividend is declared upon the common shares of stock of the VENDOR. x x x"

Thus, under paragraph 10 of the complaint, it was alleged that "defendants as of July 3, 1966 had an overdue account with the plaintiff in the amount of TWO HUNDRED TWENTY THOUSAND PESOS [P220,000.00] representing dividends on the preferred shares x x x" [p. 28, Rollo].

[1] Annex "D", Petition, pp. 53-57, Rollo

[2] Eliot v. Fiscal Court of Pike County, 36 S.W. (2d) 619, 621, 237 Ky 797, underscoring supplied

[3] pp. 66-67, Rollo

[4] Art. 1159, Civil Code

[5] Manila Surety and Fidelity Co., v. Batu Construction Co., 53 O.G. 8836

[6] p. 62, Rollo

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