

LA INSULAR, PLAINTIFF AND APPELLEE, VS. RAFAEL MACHUCA GO-TAUCO AND MANUEL NUBLA CO-SIONG, DEFENDANTS AND APPELLANTS.

G.R. No. 13307. February 03, 1919

Ponente: STREET, J.

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STREET, J.:

The plaintiff in this action, La Insular is a commercial partnership engaged in the manufacture of cigars and cigarettes in the city of Manila. On July 15, 1913, a contract was entered into between its general agent and the two defendants, Manuel Nubla Co-Siong and Rafael Machiica Go-Tauco, whereby the plaintiff became obliged to supply cigarettes daily to Manuel Nubla Co-Siong in a quantity of not less than two nor more than five boxes of two thousand packages each. The price was fixed at P172 per box, payment to be made within the first five days of the month next following the successive deliveries. Manuel Nubla Co-Siong obligated himself as principal to pay for the cigarettes within said five days, while Rafael Machuca GoTauco bound himself as surety, jointly and severally with Nubla, in the sum of P25,000, to satisfy an indebtedness contracted for cigarettes thus supplied.

Pursuant to the provisions of this agreement cigarettes were supplied by the plaintiff to Nubla Co-Siong during the year 1913 to 1916, amounting in value to nearly P350,000. For the cigarettes so supplied payment was from time to time made by the defendant Nubla Co-Siong upon bills presented by the plaintiff.

It appears that when the contract above-mentioned was executed cigarettes were subject to a specific tax of one peso for each thousand cigarettes. This tax was, under the law then prevailing, paid by the manufacturer, and the liability for said tax naturally fell in the present case upon the plaintiff. By Act No. 2432, enacted December 23, 1914, the Philippine Legislature increased the specific tax on cigarettes from P1 to P1.20 per thousand cigarettes, and by amendatory. Act No. 2445, effective from January 1, 1915, it was declared that, as regards contracts already made for future delivery, the burden of the increased tax should, unless the parties should have otherwise agreed, be borne by the person to whom the article taxed should be furnished.

After this provision became effective, the plaintiff continued, as before, to pay the internal-revenue taxes and in order to reimburse itself to the extent of the outlay incident to the increase in the tax added the amount of P10 per box to the price of the cigarettes. The monthly statements thereafter submitted to the purchaser by the plaintiff showed this increase; and as payments were from time to time made by Nubla, they were credited by the plaintiff upon account, with the result that, upon the showing of the plaintiff's books and assuming that Nubla had been properly charged with the increased tax, all cigarettes delivered prior to August 1, 1916, had been fully paid for. During the months of August and September, however, fifty-six cases of cigarettes were taken by Nubla, for which no payment has been made; and for the recovery of the amount alleged to be due for these cigarettes this action was instituted by the plaintiff in the Court of First Instance of the city of Manila. Judgment having been there rendered in favor of the plaintiff, both defendants have appealed.

The dispute is upon the point of liability for the increased tax imposed by Act No. 2432, and the amount which

the plaintiff is entitled to recover from the defendant Nubia Co-Siong, assuming that said defendant is liable for the tax at all, is P10,192—the amount for which judgment was rendered against him by the trial court. As to the defendant Rafael Machuca Go-Tauco, the trial court held that, being a surety, his liability was limited to the payment of the price stipulated in the original contract, or P172 per box, and that he was not liable for the additional amount of P10 per box representing the increase in the tax. Judgment was, therefore, rendered against this defendant, jointly and severally with his codefendant, for the sum of P9,632 only.

As regards the liability of the purchaser, Nubia CoSiong, the case is determined adversely to his contention by the decision of this court in Mitsui Bussan Kaisha vs. Manila Electric Railroad and Light Company (p. 624, post); and upon this branch of the present case we are content to refer to the opinion therein as embracing a sufficient statement of the grounds of the decision. As against the surety, Rafael Machuca Go-Tauco, the case presents one or two additional features which require discussion.

As already noted, the trial court held that the liability of the surety did not extend to the reimbursement of the plaintiff for the amount paid out by it in satisfaction of the increased internal-revenue tax on the fifty six cases of cigarettes bought in August and September 1916. This defendant was, therefore, absolved from liability for the sum of ^560, which the plaintiff had paid upon said cigarettes. As the plaintiff did not appeal from this judgment, the propriety of the action of the trial court upon this point is not now in question.

It is, however, here contended for the surety that the court erred in holding him liable for any part of the indebtedness which is the basis of this action. This contention is based upon two distinct arguments. The first is that, supposing Act No. 2445 to be valid, it increases from P172 to P182 per box the price which Manuel Nubia Co-Siong was obligated to pay for the cigarettes, which alteration in the contract has the effect of releasing the surety. The second is that the payments made by Nubia to the plaintiff in the entire period during which cigarettes were supplied under the contract in question, i.e., from July 15, 1913, to September 6, 1916, were sufficient fully to satisfy the price of P172 chargeable for the cigarettes under the contract, and that the obligation of the surety is therefore discharged. In other words this defendant insists that the application of the payments from time to time made by the principal debtor should be revised and that said payments should be reapplied exclusively to the stipulated price of the cigarettes, without reference to the additional P10 per case paid after January 1, 1915, in satisfaction of the increased internal-revenue tax. These propositions will be considered in turn.

It is undoubtedly true that the law looks upon the contract of suretyship with a jealous eye, and the rule is settled that the obligation of the surety cannot be extended by implication beyond its specified limits. Article 1827 of the Civil Code so declares (Uy Aloe vs. Cho Jan Ling, 27 Phil. Rep., 427); and with this doctrine the common law is accordant. As was said by Justice Story in *Miller vs. Stewart* (9 Wheat., 680; 3 L. ed., 189):

"Nothing can be clearer, both upon principle and authority, than the doctrine that the liability of a surety is not to be extended, by implication, beyond the terms of his contract. To the extent, and in the manner, and under the circumstances pointed out in his obligation, he is bound, and no farther."

It is, furthermore, a well-recognized rule of jurisprudence, applied in the case just cited, that if any material alteration or change in the obligation of the principal obligor is effected by the immediate parties to the contract, without the assent of the surety, the latter is discharged. Cases could be cited to this proposition without number, one of the most common illustrations being found in the situation where the creditor, or obligee, without the assent of the surety, by a valid and binding agreement gives further time to the principal debtor for payment or performance. As is well known, the surety is thereby discharged. (32 Cyc, 191.)

A statement is not infrequently found in the cases to the effect that it makes no difference whether the change in the obligation of the contract may be favorable to the surety; it is enough to release the surety that the contract

was changed without his assent. Speaking generally, this last observation may be accepted, but authorities are to be found which raise a doubt as to the universality of such rule. Thus, in *Preston vs. Huntington* (67 Mich., 139), it was held that a surety who had obligated himself to answer for the rent reserved in a lease at the rate of \$75 per month was not discharged from the obligation by the circumstance that, by a valid agreement between the landlord and his tenant (the principal obligor), the amount of the rent was reduced \$25 per month, though of course the liability of the surety was held to be reduced to the same extent. The court considered the reduction of rent as being in the nature of a release pro tanto only.

It is to be noted that in order to effect a release of the surety, the change in the contract must, as a general rule, be made by the principal parties to the contract. Indeed, no valid or effective change in the contract can, generally speaking, be made by any other person than the actual parties thereto. A recognized exception—more apparent than real—is found in cases where sureties on official bonds have been held to be released as a result of changes effected by the Legislature in the duration of the official term or in the duties of the officer whose fidelity is intended to be secured by the bond. A line of excisions, of which *Roman vs. Peters* (2 Rob. [La.], 479; 38 Am. Dec, 222), is an illustration, holds that the surety is discharged by such change in the law. It appeared in the case just cited, that, subsequent to the execution of the official bond of a sheriff, an Act of the Legislature was passed curtailing the duties and emoluments of the office. Said the court:

"The law is particularly watchful over the rights of sureties; and will not countenance any transactions between the parties, that shall lessen the ability of the principal to comply with his contract, or that shall alter the rights of the parties, or enlarge the demand to the prejudice of the sureties. To permit parties to alter and modify their contracts as they please, and to hold the sureties answerable for the performance of such parts as were not altered, would be transferring their responsibility, without their consent, from one contract to another. The contract, by the modification and alteration, becomes a new and different contract, and one for which the sureties never became responsible,

* * * * *

"These principles are not denied by the opposite party, but their application to official bonds given to the state by public officers is contested; and it is asserted that any change produced in the contract by the agency of a third person, causing an increased responsibility of the surety, will riot discharge the latter, if the creditor has merely been inactive or passive. But we cannot regard the state as a stranger to this contract,"

It is not necessary here to express an opinion upon the point whether the case referred to was or was not correctly decided. We observe, however, that the closing words of the passage quoted shows that the court placed the decision on the ground that the State—which entity, it should be noted, is named as the obligee in an official bond—was a party to the contract; and when the Legislature, as one of the arms of the State, intervened to change the obligation, such change was in fact effected by the State itself.

In the case at bar the Government of the Philippine Islands was in no sense a party to the contract of July 15, 1913, between the plaintiff and the defendants; and it is readily seen that when the Legislature of these Islands increased the internal revenue tax upon cigarettes, this was an act done by a stranger to the contract, and not by any person in privity therewith. The consequence is that, properly speaking¹, the legislative fiat, placing the burden of the tax on the purchaser, did not in any wise affect the obligation of the contract as between the parties. It was merely an external factor which, supervening upon the situation created by the contract, made it impossible for the purchaser to realize the benefit which would have accrued to him if the seller had been required to pay the tax. Nearly all changes in taxation affect existing contracts in some way or other, but this does not necessarily change such contracts in a legal sense.

The question of the constitutional validity of Acts Nos. 2432 and 2445 is not under discussion in this decision; for

as will be seen by reference to *Mitsui Bussan Kaisha vs. Manila Electric Railroad and Light Company*, already referred to, that question was effectually settled by the Act of Congress legalizing Acts Nos. 2432 and 2445. But it is insisted that the Legislative Acts last mentioned so altered the obligation of the contract in question as to release the surety, and in this connection we think it well to refer to some of the American cases in which the constitutionality of such Acts as these has been discussed, for it is evident that if the imposition of the increased tax on cigarettes in the case before us could not have had the effect, in the absence of any action by Congress, of impairing the contract in the constitutional sense, it must also follow that the contract was not changed in the sense necessary to release the surety. Upon this point we quote, as pertinent, the following language used by the Supreme Court of the United States:

"Authorities from numerous sources are cited by the plaintiffs, but none of them show that a lawful tax on a new subject, or an increased tax on an old one, interferes with a contract or impairs its obligation, within the meaning of the Constitution, even though such taxation may affect particular contracts, as it may increase the debt of one person and lessen the security of another, or may impose additional burdens upon one class and release the burdens of another, still the tax must be paid unless prohibited by the Constitution, nor can it be said that it impairs the obligation of any existing contract in its true legal sense" (*The North Missouri R. R. Co. vs. McGuire*, 87 U. S., 46; 22 L. ed., 294.)

It has been held by the same high Tribunal that the imposition of a license tax on the resident agent of a foreign manufacturing company does not impair the obligation of the contract between the agent and his principal, although its immediate consequence is to make that contract less profitable to the agent. (*Kehrer vs. Stewart*, 197 U. S., 60; 49 L. ed., 663.)

In *Clement National Bank vs. State of Vermont* (231 U. S., 120; 58 L. ed., 148), it was held that the obligations of existing contracts between a national bank and its depositors were not constitutionally impaired by a tax imposed by the legislature of the State of Vermont upon interest bearing deposits which the bank was authorized to pay and charge to the depositors. In this case it was held, at page 140:

"It cannot be doubted that the property being taxable, the state could provide, in order to secure the collection of a valid tax upon such credits, for garnishment or trustee process against the bank, or in effect constitute the bank its agent to collect the tax from the individual depositors."

The point was made in this case that the statute levying the tax interfered with existing contracts between the bank and its depositors, impairing their obligations. The court overruled this contention and held that the statute merely imposed a tax upon the property of the depositors in the exercise of a power subject to which the contracts of deposit were made. It is thus seen that all contracts are made subject to the taxing powers of the state and territorial governments.

In *Tanner vs. Little* (240 U. S., 369; 60 L. ed., 691), it was held that a state license tax on merchants using stamps, tickets, or coupons, redeemable in cash or merchandise, does not unconstitutionally impair the contract obligations of such merchants with their customers or with third parties with whom they had contracted for the use of such stamps or coupons before the Act levying the tax was passed.

In *Grand Trunk Western Railway Co. vs. Railroad Commission of Indiana* (221 U. S., 400; 55 L. ed., 786), it was held that a contract between two intersecting railway companies imposing upon the junior road the duty of constructing and properly maintaining the physical crossing of the two roads, and providing and maintaining semaphores, watchmen, etc., is not constitutionally impaired by an order of the state railroad commission prescribing other and additional duties such as the installation and use of an interlocking plant and apportioning between the two companies the expense of executing the order.

In *Chicago, Burlington & Quincy Railroad Co. vs. State of Nebraska* (170 U. S., 57; 42 L. ed., 948), it was held that a contract between a city and a railroad company to participate in the construction of a viaduct in view of their mutual duty to the public is not violated by a statute and ordinance compelling the railroad company to repair it. The court further held in this case that the maintenance of safe viaducts over railroad tracts at important street crossings cannot be taken out of the police power of the legislature by a contract between a city and a railroad company.

These authorities, we think, clearly show that the Acts of the Legislature by which the increased tax on cigarettes was imposed neither impaired, in a constitutional sense, the obligation of the contract which is the basis of this action nor changed that obligation in such sense as to occasion the discharge of the surety.

The point raised in behalf of the surety with respect to the application of the payments must in our opinion be likewise resolved adversely to him. The surety is clearly bound by the application of the payments made by the creditor with the assent of the principal debtor, and we entertain no doubt that when Manuel Nubia Co-Siong from time to time paid the bills submitted by the plaintiff, and which, after January 1, 1915, showed an increase of P10 per case in the price of the cigarettes, he very well knew that this additional amount was due to the inclusion of the new tax paid by the plaintiff. We are not impressed by the suggestion contained in the appellant's brief to the effect that as the bills appear to have been rendered only for cigarettes supplied, and not for cigarettes plus the amount paid upon account of internal-revenue tax, the payments must therefore be applied exclusively to the price of the cigarettes. The fundamental rights of the parties, which are sufficiently put in issue in the complaint and answer, are not in our opinion affected by the form in which the accounts were rendered nor by the circumstance that the plaintiff's cause of action, as stated in his complaint, purports to be based merely upon a claim for cigarettes sold.

Our conclusion is that there is no error in the judgment appealed from, and the same is accordingly affirmed, with costs against the appellants. So ordered.

Arellano, C.J., Torres, Carson, Malcolm, Avanceña, and Moir, JJ., concur.

Johnson, J., reserves his vote.

Judgment affirmed.

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