ASSET BUILDERS CORPORATION, PETITIONER, VS. STRONGHOLD INSURANCE COMPANY, INCORPORATED, RESPONDENT.

G.R. No. 187116. October 18, 2010

Ponente: MENDOZA, J.

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MENDOZA, J.:

This petition for review on certiorari under Rule 45 of the 1997 Rules of Civil Procedure assails the February 27, 2009 Decision[1] of the Regional Trial Court, Pasig City, Branch 71 (RTC), in Civil Case No. 71034, ordering defendant Lucky Star to pay petitioner Asset Builders Corporation the sum of P575,000.00 with damages, but absolving respondent Stronghold Insurance Company, Incorporated (Stronghold) of any liability on its Surety Bond and Performance Bond.

THE FACTS

On April 28, 2006, Asset Builders Corporation (ABC) entered into an agreement with Lucky Star Drilling & Construction Corporation (Lucky Star) as part of the completion of its project to construct the ACG Commercial Complex on "NHA Avenue corner Olalia Street, Barangay Dela Paz, Antipolo City."[2] As can be gleaned from the "Purchase Order,"[3] Lucky Star was to supply labor, materials, tools, and equipment including technical supervision to drill one (1) exploratory production well on the project site. The total contract price for the said project was P1,150,000.00. The salient terms and conditions of said agreement are as follows:

- Lump sum price--------PHP1,150,000.00;

- 50% downpayment---upon submission of surety bond in an equivalent amount and performance bond equivalent to 30 % of contract amount;

- Completion date-----60 calendar days;

- Penalty----2/10 of 1% of total contract amount for every day of delay;

- Terms---50% down payment to be released after submission of bonds;

- Retention--Subject to 10% retention to be released after the project is accepted by the owner;

To guarantee faithful compliance with their agreement, Lucky Star engaged respondent Stronghold which issued two (2) bonds in favor of petitioner. The first, SURETY BOND G(16) No. 141558, dated May 9, 2006, covers the sum of P575,000.00[4] or the required downpayment for the drilling work. The full text of the surety bond is herein quoted:

KNOW ALL MEN BY THESE PRESENTS:

That we, LUCKY STAR DRILLING & CONSTRUCTION CORP., 168 ACACIA St., Octagon Industrial Estate Subd., Pasig City as principal, and STRONGHOLD INSURANCE COMPANY, INC., a corporation duly organized and existing under and by virtue of laws of the Philippines, as surety, are held and firmly bound

> unto ASSET BUILDERS CORPORATION to the sum of Pesos FIVE HUNDRED SEVENTY FIVE THOUSAND ONLY (P575,000.00) Philippine Currency, for the payment of which, well and truly to be made, we bind ourselves, our heirs, executors, administrators, successors and assigns, jointly and severally, firmly by these presents.
>
> THE CONDITIONS OF THIS OBLIGATION ARE AS FOLLOWS:
>
> To fully and faithfully guarantee the repayment to be done through deductions from periodic billings of the advance payment made or to be made by the Obligee to the Principal in connection with the supply of labor, materials, tools and equipment including technical supervision to drill one (1) exploratory production well located at NIA Ave. cor. Olalia St., Brgy. dela Paz, Antipolo City. This bond is callable on demand.
>
> The liability of the surety company upon determination under this bond shall in no case exceed the penal sum of PESOS: FIVE HUNDRED SEVENTY FIVE THOUSAND (P575,000.00) only, Philippine Currency.

WHEREAS, the Obligee requires said principal to give a good and sufficient bond in the above stated sum to secure the full and faithful performance on his part of said undertakings.

NOW, THEREFORE, if the above bounden principal shall in all respects duly and fully observe and perform all and singular the aforesaid [co]-venants, conditions and agreements to the true intent and meaning thereof, then this obligation shall be null and void, otherwise to remain in full force and effect.

Liability of surety on this bond will expire on May 09, 2007 and said bond will be cancelled five DAYS after its expiration, unless surety is notified of and existing obligations hereunder.

x x x[5]

With respect to the second contract, PERFORMANCE BOND G(13) No. 115388, dated May 09, 2006, it covers the sum of P345,000.00.[6] Thus:

> KNOW ALL MEN BY THESE PRESENTS:
>
> That we, LUCKY STAR DRILLING & CONSTRUCTION of 168 Acacia St., Octagon Ind'l., contractor, of Estate, Sub., Pasig City Philippines, as principal and the STRONGHOLD INSURANCE COMPANY, INC. a corporation duly organized and existing under and by virtue of the laws of the Philippines, with head office at Makati, as Surety, are held and firmly bound unto the ASSET BUILDERS CORPORATION and to any individual, firm, partnership, corporation or association supplying the principal with labor or materials in the penal sum of THREE HUNDRED FORTY FIVE THOUSAND ONLY (P345,000.00), Philippine Currency, for the payment of which sum, well and truly to be made, we bind ourselves, our heirs, executors, administrators, successors and assigns, jointly and severally, firmly by these presents.
>
> The CONDITIONS OF THIS OBLIGATION are as follows;
>
> WHEREAS the above bounden principal on the ___ day of _____, 19__ entered into a contract with the ASSET BUILDERS CORPORATION represented by _____, to fully and faithfully.
>
> Comply with the supply of labor, materials, tools and equipment including technical supervision to drill one (1) exploratory production well located at NIA Ave. cor. Olalia St., Brgy. Dela Paz, Antipolo City. This bond is callable on demand.
>
> WHEREAS, the liability of the Surety Company under this bond shall in no case exceed the sum of PESOS THREE HUNDRED FORTY FIVE THOUSAND ONLY (P345,000.00) Philippine Currency, inclusive of interest, attorney's fee, and other damages, and shall not be liable for any advances of the obligee to the principal.

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> WHEREAS, said contract requires the said principal to give a good and sufficient bond in the above-stated sum to secure the full and faithfull performance on its part of said contract, and the satisfaction of obligations for materials used and labor employed upon the work;
>
> NOW THEREFORE, if the principal shall perform well and truly and fulfill all the undertakings, covenants, terms, conditions, and agreements of said contract during the original term of said contract and any extension thereof that may be granted by the obligee, with notice to the surety and during the life of any guaranty required under the contract, and shall also perform well and truly and fulfill all the undertakings, covenants, terms, conditions, and agreements of any and all duly authorized modifications of said contract that may hereinafter be made, without notice to the surety except when such modifications increase the contract price; and such principal contractor or his or its sub-contractors shall promptly make payment to any individual, firm, partnership, corporation or association supplying the principal of its sub-contractors with labor and materials in the prosecution of the work provided for in the said contract, then, this obligation shall be null and void; otherwise it shall remain in full force and effect. Any extension of the period of time which may be granted by the obligee to the contractor shall be considered as given, and any modifications of said contract shall be considered as authorized, with the express consent of the Surety.
>
> The right of any individual, firm, partnership, corporation or association supplying the contractor with labor or materials for the prosecution of the work hereinbefore stated, to institute action on the penal bond, pursuant to the provision of Act No. 3688, is hereby acknowledge and confirmed. x x x

On May 20, 2006, ABC paid Lucky Star P575,000.00 (with 2% withholding tax) as advance payment, representing 50% of the contract price.[7] Lucky Star, thereafter, commenced the drilling work. By July 18, 2006, just a few days before the agreed completion date of 60 calendar days, Lucky Star managed to accomplish only ten (10) % of the drilling work. On the same date, petitioner sent a demand letter to Lucky Star for the immediate completion of the drilling work[8] with a threat to cancel the agreement and forfeit the bonds should it still fail to complete said project within the agreed period.

On August 3, 2006, ABC sent a Notice of Rescission of Contract with Demand for Damages to Lucky Star.[9] Pertinent portions of said notice read:

> Pursuant to paragraph 1 of the Terms and Conditions of the service contract, notice is hereby made on you of the rescission of the contract and accordingly demand is hereby made on you, within seven (7) days from receipt hereof:
>
> (1) to refund the down payment of PHP563,500.00, plus legal interest thereon;
>
> (2) to pay liquidated damages equivalent to 2/10 of 1% of the contract price for every day of delay, or a total of PHP138,000.00;
>
> (3) to pay the amount guaranteed by your performance bond in the amount of PHP345,000.00;
>
> (4) to pay PHP150,000.00 in other consequential damages;
>
> (5) to pay exemplary damages in the amount of PHP150,000.00;
>
> (6) to vacate the project site, together with all your men and equipment.
>
> Should you refuse to comply with our demand within the above period, we shall be constrained to sue you in court, in which event we shall demand payment of attorney's fees in the amount of at least PHP100,000.00.

On August 16, 2006, ABC sent a Notice of Claim for payment to Stronghold to make good its obligation under its bonds.[10]

Despite notice, ABC did not receive any reply either from Lucky Star or Stronghold, prompting it to file its Complaint for Rescission with Damages against both before the RTC[11] on November 21, 2006.

In its "Answer (with Complusory Counterclaim and Cross-Claim)," dated January 24, 2007, Stronghold denied any liability arguing that ABC had not shown any proof that it made an advance payment of 50% of the contract price of the project. It further averred that ABC's rescission of its contract with Lucky Star virtually revoked the claims against the two bonds and absolved them from further liability.[12]

Lucky Star, on the other hand, failed to file a responsive pleading within the prescribed period and, thus, was declared in default by the RTC in its Order dated August 24, 2007.[13]

On February 27, 2009, the RTC rendered the assailed decision ordering Lucky Star to pay ABC but absolving Stronghold from liability.[14] Relevant parts of the decision, including the decretal portion, read:

> On the liability of defendant Stronghold Insurance, the Court rules on the negative.
>
> The surety bond and performance bond executed by defendants Lucky Star and Stronghold Insurance are in the nature of accessory contracts which depend for its existence upon another contract. Thus, when the agreement (Exhibit `A') between the plaintiff and defendant Asset Builders was rescinded, the surety and performance bond were automatically cancelled.
>
> WHEREFORE, in view of the foregoing, judgment is hereby rendered in favor of the plaintiff and against defendant Lucky Star Drilling & Construction, ordering the latter as follows:
>
> - to pay plaintiff in the amount of PHP575,000.00 as actual damages plus legal interest from the filing of the complaint;
>
> - to pay plaintiff in the amount of PHP100,000.00 as liquidated damages;
>
> - to pay plaintiff in the amount of PHP50,000.00 as exemplary damages;
>
> - to pay plaintiff in the amount of PHP 50,000.00 as attorney's fees;
>
> - to pay the costs of the suit.
>
> Defendant Stronghold Insurance Company, Inc.'s compulsory counterclaim and cross-claim are dismissed.[15]

Hence, this petition.

Petitioner ABC prays for the reversal of the challenged decision based on the following

> GROUNDS
>
> A. The Lower Court seriously erred and unjustly ACTED ARBITRARILY with manifest bias and grave abuse of discretion, CONTRARY to applicable laws and established jurisprudence in declaring the "automatic CANCELLATION" of respondent Stronghold's Surety Bond and Performance Bond, because:
>
> (a) Despite rescission, there exists a continuing VALID PRINCIPAL OBLIGATION guaranteed by Respondent's Bonds, arising out of the Contractor's DEFAULT and Non-performance.
>
> (b) Upon breach by its Principal/contractor, the LIABILITIES of Respondent's bonds had already ACCRUED, automatically attached, and had become already DIRECT, PRIMARY and ABSOLUTE, even before Petitioner's legitimate exercise of its option under Art. 1191 of the New Civil Code.
>
> (c) Rescission does NOT AFFECT the liabilities of the Respondent Stronghold as its LIABILITIES on its subject bonds have already become INTERWOVEN and INSEPARABLE with the liabilities of its Principal, the Contractor Lucky Star.

B. With the Lower Court's completely erroneous ruling on the liabilities of Respondent's bonds, the Lower Court equally ERRED with manifest bias and grave abuse, in its FAILURE to comply with the "duty of court" to make a finding of "unreasonable denial or withholding" by Respondent Stronghold or Petitioner's claims and impose upon the Respondent the penalties provided for under Section 241 and 244 of the Insurance Code.[16]

Essentially, the primary issue is whether or not respondent insurance company, as surety, can be held liable under its bonds.

The Court rules in the affirmative.

Respondent, along with its principal, Lucky Star, bound itself to the petitioner when it executed in its favor surety and performance bonds. The contents of the said contracts clearly establish that the parties entered into a surety agreement as defined under Article 2047 of the New Civil Code. Thus:

> Art. 2047. By guaranty a person, called the guarantor, binds himself to the creditor to fulfill the obligation of the principal debtor in case the latter should fail to do so.
>
> If a person binds himself solidarily with the principal debtor, the provisions of Section 4, Chapter 3, Title I of this Book shall be observed. In such case the contract is called a suretyship. [Emphasis supplied]

As provided in Article 2047, the surety undertakes to be bound solidarily with the principal obligor. That undertaking makes a surety agreement an ancillary contract as it presupposes the existence of a principal contract. Although the contract of a surety is in essence secondary only to a valid principal obligation, the surety becomes liable for the debt or duty of another although it possesses no direct or personal interest over the obligations nor does it receive any benefit therefrom.[17] Let it be stressed that notwithstanding the fact that the surety contract is secondary to the principal obligation, the surety assumes liability as a regular party to the undertaking.[18]

Stronghold Insurance Company, Inc. v. Republic-Asahi Glass Corporation,[19] reiterating the ruling in Garcia v. Court of Appeals,[20] expounds on the nature of the surety's liability:

> X x x. The surety's obligation is not an original and direct one for the performance of his own act, but merely accessory or collateral to the obligation contracted by the principal. Nevertheless, although the contract of a surety is in essence secondary only to a valid principal obligation, his liability to the creditor or promisee of the principal is said to be direct, primary and absolute; in other words, he is directly and equally bound with the principal.

Suretyship, in essence, contains two types of relationship - the principal relationship between the obligee (petitioner) and the obligor (Lucky Star), and the accessory surety relationship between the principal (Lucky Star) and the surety (respondent). In this arrangement, the obligee accepts the surety's solidary undertaking to pay if the obligor does not pay. Such acceptance, however, does not change in any material way the obligee's relationship with the principal obligor. Neither does it make the surety an active party to the principal obligee-obligor relationship. Thus, the acceptance does not give the surety the right to intervene in the principal contract. The surety's role arises only upon the obligor's default, at which time, it can be directly held liable by the obligee for payment as a solidary obligor.[21]

In the case at bench, when Lucky Star failed to finish the drilling work within the agreed time frame despite petitioner's demand for completion, it was already in delay. Due to this default, Lucky Star's liability attached and, as a necessary consequence, respondent's liability under the surety agreement arose.

Undeniably, when Lucky Star reneged on its undertaking with the petitioner and further failed to return the P575,000.00 downpayment that was already advanced to it, respondent, as surety, became solidarily bound with Lucky Star for the repayment of the said amount to petitioner. The clause, "this bond is callable on demand,"

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strongly speaks of respondent's primary and direct responsibility to the petitioner.

Accordingly, after liability has attached to the principal, the obligee or, in this case, the petitioner, can exercise the right to proceed against Lucky Star or respondent or both. Article 1216 of the New Civil Code states:

> The creditor may proceed against any one of the solidary debtors or some or all of them simultaneously. The demand made against one of them shall not be an obstacle to those which may subsequently be directed against the others, so long as the debt has not been fully collected.

Contrary to the trial court's ruling, respondent insurance company was not automatically released from any liability when petitioner resorted to the rescission of the principal contract for failure of the other party to perform its undertaking. Precisely, the liability of the surety arising from the surety contracts comes to life upon the solidary obligor's default. It should be emphasized that petitioner had to choose rescission in order to prevent further loss that may arise from the delay of the progress of the project. Without a doubt, Lucky Star's unsatisfactory progress in the drilling work and its failure to complete it in due time amount to non-performance of its obligation.

In fine, respondent should be answerable to petitioner on account of Lucky Star's non-performance of its obligation as guaranteed by the performance bond.

Finally, Article 1217[22] of the New Civil Code acknowledges the right of reimbursement from a co-debtor (the principal co-debtor, in case of suretyship) in favor of the one who paid (the surety). Thus, respondent is entitled to reimbursement from Lucky Star for the amount it may be required to pay petitioner arising from its bonds.

WHEREFORE, the February 27, 2009 Decision of the Regional Trial Court, Pasig City, Branch 71, is AFFIRMED with MODIFICATION. Respondent Stronghold Insurance is hereby declared jointly and severally liable with Lucky Star for the payment of P575,000.00 and the payment of P345,000.00 on the basis of its performance bond.

SO ORDERED.

Carpio, (Chairperson), Nachura, Leonardo-De Castro,[*] and Peralta, JJ., concur.

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[*] Designated as an additional member in lieu of Justice Roberto A. Abad, per Special Order No. 905 dated October 5, 2010.

[1] Rollo, pp. 8-12. Penned by RTC Judge Franco T. Falcon.

[2] Records, pp. 11-13.

[3] Id.

[4] Id. at 60-61.

[5] Id. at 60. See also Records, p. 17.

[6] Id. at 62-63.

[7] Id. at 64.

[8] Id. at 65.

[9] Id. at 66-67.

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[10] Id. at 68-69.

[11] Id. at 70-79.

[12] Id. at 92-101.

[13] Id. at 102.

[14] Id. at 45-49.

[15] Id. at 12.

[16] Id. at 26-27.

[17] Security Pacific Assurance Corporation v. Hon. Tria-Infante, 505 Phil. 609, 620 (2005).

[18] Philippine Bank of Communications v. Lim, 495 Phil. 645, 651 (2005).

[19] G.R. No. 147561, June 22, 2006, 492 SCRA 179, 190.

[20] G.R. No. 80201, November 20, 1990, 191 SCRA 493, 495-496.

[21] Intra-Strata Assurance Corporation v. Republic, G.R. No. 156571, July 9, 2008, 557 SCRA 363, 375-376.

[22] Art. 1217 reads in part: Payment made by one of the solidary debtors extinguishes the obligation. If two or more solidary debtors offer to pay, the creditor may choose which offer to accept.

He who made payment may claim from his co-debtors only on the share which corresponds to each, with the interest for the payment already made. If the payment is made before the debt is due, no interest for the intervening period may be demanded.

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