

**PIONEER INSURANCE & SURETY CORPORATION, PETITIONER,
VS. THE HON. COURT OF APPEALS, WEAREVER TEXTILE MILLS, INC.,
AND VICENTE LIM, RESPONDENTS.**

G.R. No. 76509, December 15, 1989

Ponente: GUTIERREZ, JR., J.

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GUTIERREZ, JR., J.:

This is a petition for certiorari seeking to annul and set aside the decision of the Court of Appeals which affirmed the dismissal of the petitioner's complaint on the ground that compensation cannot take place between the petitioner and the private respondents as its requisites are not present.

In September, 1978, petitioner Pioneer Insurance and Surety Corporation issued general warehousing bonds in favor of the Bureau of Customs for importation of raw materials in the total amount of P6,500,000.00. The bonds were issued on behalf of the private respondents Wearever Textile Mills, Inc., and its president, Vicente T. Lim.

To secure the petitioner from and against any and all harm, damages and losses of whatever kind and nature which it may incur as a consequence of its becoming a surety upon the bonds, the respondents executed jointly and severally in favor of the petitioner indemnity agreements for said bonds each of which contain the following stipulations:

"INDEMNITY: - The undersigned, jointly and severally, agree and bind themselves to indemnify and hold and save harmless the Corporation from and against any and all damages, losses, costs, stamps, taxes, penalties, charges and expenses of whatsoever kind and nature which the Corporation shall or may at any time incur in consequence of having become surety upon the bond/note or any extension, renewal, substitution or alteration thereof made at the instance of the undersigned or executed on behalf of the undersigned or any of them; and to pay, reimburse and make good to the Corporation, its successors and assigns, all sums and amounts of money, which it or its representatives shall or may pay or cause to be paid or become liable to pay, on account of the undersigned or any of them, of whatsoever kind and nature including 20% of the amount involved in the litigation or other matters growing out of or connected therewith for attorney's fees but in no case to be less than P200.00. The undersigned further agree, jointly and severally, that in case of any extension or renewal of the bond/note, to bind ourselves for the payment thereof under the same terms and conditions, as above-mentioned, without the necessity of executing another Indemnity Agreement for the purpose and we hereby equally waive our right to be notified of any renewal or extension of the bond/note which may be granted under this Indemnity Agreement.

"MATURITY OF OUR OBLIGATIONS CONTRACTED HEREWITH: - The above indemnities shall be paid to the corporation as soon as demand is received from the creditor or as soon as it becomes liable to make payment of any sum under the terms of the above-mentioned bond/ note, its renewal, extensions or substitutions whether the said sum or sums or part thereof have been actually paid or not." (pp. 29-30, Rollo)

The private respondents failed to comply with their commitment under the warehousing bonds by reason whereof the Bureau of Customs demanded from the petitioner payment of the value of the said bonds in the amount of

P6,390,259.00. This amount eventually reached P9,031,000.00 in 1983.

In the meantime, in response to the petitioner's demand letter, the private respondents wrote petitioner promising that they will settle their obligations with the Bureau of Customs.

On representations by private respondents to the Bureau of Customs, the latter granted the request of respondents for staggered monthly installment payments of their obligation on condition that the respondents will make an initial payment of P500,000.00 and there-after shall amortize the balance at P400,000.00 monthly until fully paid pursuant to the first indorsement by the Bureau of Customs dated September 22, 1976. Other than the initial payment of P500,000.00, however, respondents have not made any other payments thereby violating the terms of the said agreement.

As a result of the foregoing, the Bureau of Customs again demanded from the petitioner payment of its bonds. No payment, however, has been made as yet.

Sometime in 1979, a fire gutted the respondents' factory destroying materials insured with the petitioner in the amount of P1,144,744.49. Respondents demanded from the petitioner payment of the proceeds of the insurance policy but the latter refused to pay claiming that said proceeds must be applied by way of partial compensation or set-off against its liability with the Bureau of Customs arising from the warehousing bonds.

The petitioner's efforts to protect itself from total loss in the much bigger amount of P6,390,259.00 which as of April 19, 1983 had already reached P9,031,000.00 having proved fruitless, the complaint for compensation was filed below.

The trial court rendered judgment in favor of the private respondents and ordered the petitioner to pay, among others, the insurance proceeds in the amount of P1,144,744.49 plus legal interest from November 19, 1979 until the whole amount is fully paid.

On appeal, the Court of Appeals affirmed the trial court's decision, holding that legal compensation can-not take place because the requisites thereof are not present, namely: that petitioner is not the creditor of private respondents; and that the former's claim against the latter is not due, demandable and liquidated because its liability on the warehousing bonds was extinguished when the textile goods covered by the same were destroyed by the fire. Therefore, according to the appellate court since the petitioner and private respondents are not mutually creditors and debtors to each other, the law on compensation is inapplicable.

In this petition, Pioneer Insurance alleges that legal compensation or set-off under Articles 1278 and 1279 can take place because there is due to private respondents from the petitioner the amount of P1,144,744.49 as proceeds of the fire insurance policy in the same manner that the private respondents are bound, jointly and severally, to reimburse petitioner what the latter is liable to pay the Bureau of Customs in the total amount of P6,390,259.00 and which, as of the date of the filing of the complaint, had already reached P9,031,000.00. The petitioner also stresses that even if it has not yet paid the Bureau of Customs any amount, the private respondents have already become indebted to the petitioner pursuant to the indemnity agreement which stands as the law between the parties.

On the other hand, the private respondents argue that the demands to pay made by the Bureau of Customs did not prove nor create any liability and even if they did, the liability under the warehousing bonds in favor of the Bureau of Customs was the liability of the petitioner; that petitioner did not pay and has never paid the Bureau of Customs under the warehousing bonds and, therefore, the private respondents have nothing to reimburse the petitioner for and that the approved staggered payment arrangement of the respondents with the Bureau of Customs released petitioner from liability under the warehousing bonds.

We rule for the petitioner.

In the case of *The International Corporate Bank, Inc. v. The Intermediate Appellate Court, et al.* (G.R. No. 69560, June 30, 1988), we reiterated the requisites of legal compensation. We said:

"Compensation shall take place when two persons, in their own right, are creditors and debtors of each other. (Art. 1278, Civil Code). 'When all the requisites mentioned in Art. 1279 of the Civil Code are present, compensation takes effect by operation of law, even without the consent or knowledge of the debtors.' (Art. 1290, Civil Code). Art. 1279 of the Civil Code requires among others, that in order that legal compensation shall take place, 'the two debts be due' and 'they be liquidated and demand-able.' Compensation is not proper where the claim of the person asserting the set-off against the other is not clear nor liquidated; compensation cannot extend to unliquidated, disputed claim arising from breach of contract. (*Compania General de Tabacos v. French and Unson*, 39 Phil. 34; *Lorenzo & Martinez v. Herrero*, 17 Phil. 29).

"There can be no doubt that petitioner is indebted to private respondent in the amount of P1,062,063.83 representing the proceeds of her money market investment. This is admitted. But whether private respondent is indebted to petitioner in the amount of P6.81 million representing the deficiency balance after the foreclosure of the mortgage executed to secure the loan extended to her, is vigorously disputed. This circumstance prevents legal compensation from taking place. (CA Decision, Rollo, pp. 112-113)."

There is no dispute that the petitioner owes the private respondents the amount representing the proceeds of the insurance policy. The private respondents, however, try to negate their liability by questioning the veracity and accuracy of the Bureau of Customs' demand letters to the petitioner and by claiming that they have no more liability because of the fortuitous event. At the same time, however, they admit liability when they argue that the petitioner was released from the same upon their agreement with the Bureau of Customs to make staggered payments. Finally, the private respondents argue that since the petitioner has not made any payment yet regarding the amount demanded by the Bureau of Customs, there is nothing for which the petitioner should be reimbursed.

It is needless to emphasize that at the time the fire occurred, the private respondents together with the petitioner had already incurred liability on the warehousing bonds with the Bureau of Customs because of the respondents' inability to comply with the provisions of their undertaking. It is, therefore, clear that as far as the amount of P9,031,000.00 is concerned, both the petitioner and respondents were already liable for said amount to the Bureau of Customs when the contingency for which compensation is sought, happened. Neither can the respondents claim that the petitioner was released from liability when they made arrangements with the Bureau of Customs for staggered payments since the facts will bear out that other than the P500,000.00 payment by respondents, no further payment was made by them thus leading the Bureau of Customs to go after the petitioner again. The private respondents, contend, however, that since the petitioner has not made any payment with the Bureau of Customs, it cannot demand reimbursement and, thus, petitioner cannot apply legal compensation or set-off against them because their liability has not yet become due and demandable.

In the recent case of *Mercantile Insurance Co., Inc. v. Felipe Ysmael, Jr., & Co., Inc.* (G. R. No. L-43962, January 13, 1989), we ruled:

"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)."

Clearly, the petitioner can demand reimbursement from the respondents even before it has actually paid its obligations to the Bureau of Customs. It can, in principle, be held liable under the warehouse bonds even before actual payment to the Bureau of Customs. The liability has been fixed. What remains is simply its liquidation. The respondents who defaulted on the agreement to make staggered payments thereby causing the petitioner's liability to the Bureau of Customs cannot refuse the set-off. Consequently, legal compensation can take place between the petitioner and the private respondents, that is, the petitioner can partially set off the insurance proceeds in the amount of P1,144,744.49 against its liability under the warehousing bonds which has been computed in the amount of P9,031,000.00 as of 1983.

From the records, it is seen that the last demand letter of the Bureau of Customs asking the petitioner to pay the value of the bonds was on March 27, 1981. The records are silent on whether or not the Bureau of Customs sued either of the parties to enforce liability under the warehousing bonds. It may be noted that the petitioner admits its liability under the warehousing bonds. Since the issue is legal compensation and in order to avoid any miscarriage of justice, the Court refers the issue on the enforcement of liability under the bonds to the Bureau of Customs.

WHEREFORE, the petition is GRANTED. The decision of the Court of Appeals dated September 23, 1986 is hereby ANNULLED and SET ASIDE. A copy of this decision is furnished the Commissioner of Customs for appropriate action to be taken under the warehousing bonds. Costs against the private respondents.

SO ORDERED.

Fernan, C.J., (Chairman), Feliciano, Bidin, and Cortes, JJ., concur.

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