

ANTONIO GARCIA, JR., PETITIONER, VS. COURT OF APPEALS, LASAL DEVELOPMENT CORPORATION, RESPONDENTS.

G.R. No. 80201. November 20, 1990

Ponente: CRUZ, J.

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CRUZ, J.:

On April 15, 1977, the Western Minolco Corporation (WMC) obtained from the Philippine Investments Systems Organization (PISO) two loans for P2,500,000.00 and P1,000,000.00 for which it issued the corresponding promissory notes payable on May 30, 1977. On the same date, Antonio Garcia and Ernest Kahn executed a surety agreement binding themselves jointly and severally for the payment of the loan of P2,500,000.00 on due date.

Upon failure of WMC to pay after repeated demands, demand was made on Garcia pursuant to the surety agreement. Garcia also failed to pay. Hence, on April 5, 1983, Lasal Development Corporation (to which the credit had been assigned earlier by PISO) sued Garcia for recovery of the debt in the Regional Trial Court of Makati.

On May 18, 1983, Garcia moved to dismiss on the grounds that: (a) the complaint stated no cause of action; (b) the suit would result in unjust enrichment of the plaintiff because he had not received any consideration from PISO; (c) the surety agreement violated the doctrine of the limited liability of corporations; and (d) the principal obligation had been novated.

After considering the arguments and evidence of the parties, the trial court granted the motion and dismissed the complaint on the ground that the surety agreement was invalid for absence of consideration.

The plaintiff moved for reconsideration and when this was denied elevated the matter to the Court of Appeals. In a decision dated June 23, 1987, the respondent court reversed Judge Jesus M. Elbinias and remanded the records of the case for trial on the merits. Garcia then came to this Court in this petition for review on certiorari, pleading the same arguments raised in the trial court.

The petitioner's first ground is that, as found by the trial court, the surety agreement was invalid because no consideration had been paid to him by PISO for executing the contract and that the amount of the entire loan had been received and enjoyed by WMC. He cites the following articles of the Civil Code in support of his contention that lack of consideration was a personal defense available to him as surety:

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 solidarity 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.

Art. 1222. A solidary debtor may, in actions filed by the creditor, avail himself of all defenses which are derived from the nature of the obligation and of those which are personal to him, or pertain to his own share. With respect to those which personally belong to the others, he may avail himself thereof only as regards that

part of the debt for which the latter are responsible.

The point is not well taken in view of the nature and purpose of a surety agreement.

Suretyship is a contractual relation resulting from an agreement whereby one person, the surety, engages to be answerable for the debt, default or miscarriage of another, known as the principal. 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; [1] in other words, he is directly and equally bound with the principal. The surety therefore becomes liable for the debt or duty of another although he possesses no direct or personal interest over the obligations nor does he receive any benefit therefrom.[2]

The peculiar nature of a surety agreement is that it is regarded as valid despite the absence of any direct consideration received by the surety either from the principal obligor or from the creditor. A contract of surety, like any other contract, must generally be supported by a sufficient consideration. However, the consideration necessary to support a surety obligation need not pass directly to the surety; a consideration moving to the principal alone will suffice.

It has been held that if the delivery of the original contract is contemporaneous with the delivery of the surety's obligation, each contract becomes completed at the same time, and the consideration which supports the principal contract likewise supports the subsidiary one.[3] And this is the kind of surety contract to which the rule of strict construction applies as opposed to a compensated surety contract undertaken by surety corporations which are organized for the purpose of conducting an indemnity business at established rates and compensation unlike an ordinary surety agreement where the surety binds his name through motives of friendship and accommodation.[4]

It follows from the above principles that Lasal would not be unjustly enriched if the petitioner were to be held liable for the obligation contracted by WMC. The creditor would only be recovering the amount of its loan plus its increments. The petitioner, for his part, can still go against WMC for the amount he may have to pay Lasal as assignee of the PISO credit.

Regarding the petitioner's claim that he is liable only as a corporate officer of WMC, the surety agreement shows that he signed the same not in representation of WMC or as its president but in his personal capacity. He is therefore personally bound. There is no law that prohibits a corporate officer from binding himself personally to answer for a corporate debt. While the limited liability doctrine is intended to protect the stockholder by immunizing him from personal liability for the corporate debts, he may nevertheless divest himself of this protection by voluntarily binding himself to the payment of the corporate debts. The petitioner cannot therefore take refuge in this doctrine that he has by his own acts effectively waived.

Concerning the issue of novation, we note first the following provisions of the memorandum of agreement supposedly entered into by WMC and its creditors which the petitioner argues had the effect of releasing him from the surety agreement:

IV. Release of JSS

The CREDITORS expressly agree to release and hereby release the Joint and Several Signatories (JSS) of MINOLCO's officers from any liability whatsoever on the obligations which they have personally guaranteed or secured. Any action therefore against all the aforesaid signatories are waived in view of the promissory notes to be issued by NDC which are fully and unconditionally guaranteed by the Philippine Government, in payment of MINOLCO's obligations to said CREDITORS.

x x x

VI. The CREDITORS who have filed cases in court against MINOLCO and who are signatories to this Agreement agree to dismiss the case with prejudice, accepting the repayment scheme set fourth in paragraph II as a just and equitable procedure for collecting their credits.

Significantly, however, the agreement (Annex 5) was signed only by Don M. Ferry as chairman of the board of directors of WMC and does not carry the signature of any of the creditors.[5] Hence, it has no binding force whatsoever on such creditors.

The petitioner cites other developments or transactions between the parties to the original loans that he contends had the effect of novating the said contracts and consequently extinguished the surety agreement. Among these are the extension of the original period of payment and the compounding of the interest on the principal obligations, both of which operated to the prejudice of the petitioner.

The petitioner invokes Article 2079 of the Civil Code, which provides:

Art. 2079. An extension granted to the debtor by the creditor without the consent of the guarantor extinguishes the guaranty. The mere failure on the part of the creditor to demand payment after the debt has become due does not of itself constitute any extension of time referred to herein.

However, Paragraphs 5 of the surety agreement clearly stipulated as follows:

The sureties expressly waive all rights to demand payment and notice of non-payment and protest, and agree that the securities of every kind, that now or may hereafter be left with the lender, its successors, indorsees or assigns, as collateral, for the said loan, or any evidence of debt or obligations, or upon which a lien may exist may be withdrawn or surrendered at any time, and the time of payment thereof extended, without notice to or consent by the sureties, and the liability on this suretyship shall be solidary, direct and immediate and not contingent upon any pursuit by the lender, its successors, indorsees or assigns, of whatever remedies the lender may have against the principal or the securities or liens it may possess. (Emphasis supplied.)

Since in the surety contract, the petitioner not only consented to an extension in the payment of the obligation but even waived his right to be notified of such extension, he cannot now claim that he has been released from his undertaking because of the extension granted to the principal.

As for the compounded interest, we apply by analogy the case of *Bank of the Philippine Islands v. Gooch and Redfern*,[6] which was affirmed in the later case of *Bank of the Philippine Islands v. Albaladejo & Cia*[7] In the said cases, the respective sureties claimed that since the creditor changed the rate of interest in the principal obligation without their knowledge or consent, they were relieved from liability under their contract. It was held, however, that the change in the rate of interest was merely a collateral agreement between the creditor bank and the principal debtor that did not affect the surety. When the debtor promised to pay the extra rate of interest on demand of the plaintiff, the liability he assumed was his alone and was separate and apart from the original contract. His agreement to pay the additional rate of interest was an additional burden upon him and him only. That obligation in no way affected the original contract of the surety, whose liability remained unchanged.[8]

Thus, despite the compounding of the interest, the liability of the surety remains only up to the original uncompounded interest, as stipulated in the promissory note, that is, 17% per annum, with a penalty charge of 2 1/2% per month until full payment.

The petitioner cites other supposed agreements in support of his theory of novation such as the prepayment of the restructured loans of WMC before the distribution of dividends to the common stockholders, the proposed sale on installments of its assets to Negros Occidental Copperfield Mines, and the preference given to other creditors of

WMC over PISO. But we do not think these are material as, to be so the alteration must change the legal effects of the original contract. The alleged alterations do not have that effect.

It is axiomatic, and only fair, that the creditors of a corporation must be paid first before dividends may be distributed among the stockholders. Unsecured creditors are given preference in bankruptcy or insolvency proceedings because secured creditors can after all go against the security given by the debtor. As for the installment sale of WMC's assets to Negros Occidental Copperfield Mines, which might make it difficult for the petitioner to recover any amount it may have to pay on the loan of WMC, this was a risk he took when he signed the surety agreement. As it did not prohibit the alienation of the properties of the principal debtor, the sale to Negros cannot be considered a novation of the original agreement. In fact, the proposed sale was intended precisely to enable WMC to meet its pending obligations.

The most important argument against the alleged novation is the failure of the petitioner to establish the validity of the new contract, an essential requisite for the novation of a previous valid obligation. Petitioner insists that the various communications made by WMC with DBP, together with the memorandum of agreement (Annexes 1 to 7), are sufficient to establish the new undertaking made by WMC with all its creditors, including DBP. We do not think so.

It is true that as a general rule no form of words or writing is necessary to give effect to a novation.[9] Nevertheless, since the parties involved here are corporations, it must first be proved that the contracts, assuming they were made, were executed by the persons possessing the proper authority to bind their respective principals. Annexes 1-4 are a mere exchange of correspondence between the officers of WMC and DBP. Although they contain the provisions and proposals that, according to petitioner, should suffice to establish that the original contract between WMC and PISO has been materially altered, they cannot be considered per se sufficient to give rise to a valid new obligation. WMC was in fact directed by Joseph W. Edralin, the Assistant Executive Officer of the DBP, to communicate with Atty. Hilario Oraolino of the Office of the Chief Legal Counsel for the preparation and execution of the necessary legal documents to cover the approval and confirmation of the several proposals made. No such documents, as duly signed by the parties, were ever presented in court. Annexes 5 to 7[10] are also incomplete documents and not binding without the signatures of the supposed contracting parties.

The argument of subrogation cannot be considered at this stage as it is being invoked only now. It is settled that an issue not raised in the court a quo cannot be raised for the first time on appeal because this would be offensive to the basic rules of fair play.[11]

As for the alleged substitution of debtors, nowhere in the record can we find evidence of this claim. The commitment made by DBP to the creditors of WMC was that, although they had a first mortgage lien over substantially all the assets of WMC (which if foreclosed would leave most of its creditors without recourse), they would nevertheless defer proceedings against those assets and instead allow their sale to NDC (with better terms) to enable WMC to meet the obligations.[12] In effect, what DBP did was merely to restructure its credit with WMC and make additional accommodations in the form of investments on preferred and common shares of stock of WMC. It was clearly an effort to assist WMC perform its obligations with its creditors. But not more than that.

Concerning the promissory notes supposedly issued by NDC to the creditors of WMC and with the full and unconditional guaranty of the Philippine Government as contained in Annex 5, suffice it to repeat that such Annex 5 (memorandum of agreement between WMC and DBP), as well as Annex 6 (addendum to Annex 5, making NOCOMIN, instead of NDC as the buyer) and Annex 7 (contract of sale between WMC and NOCOMIN), are all not signed by the contracting parties and therefore have no evidentiary weight or binding force.

We approve the following observations made by the Court of Appeals:

Novation of contract cannot be presumed. In order that an obligation may be extinguished by another which substitutes the same, it is imperative that it be so declared in unequivocal terms, or that the old and the new obligations be on every point incompatible with each other (Art. 1292, Civil Code). In every novation there are four essential requisites: (1) a previous valid obligation; (2) the agreement of all the parties to the new contract; (3) the extinguishment of the old contract; and (4) validity of the new one. Novation requires the creation of new contractual relations as well as the extinguishment of the old. There must be a consent of all the parties to the substitution, resulting in the extinction of the old obligation and the creation of a valid new one (*Tiu Siuco v. Habana*, 45 Phil. 707). The acceptance of the promissory note by the plaintiff is not novation of the contract. The legal doctrine is that an obligation to pay a sum of money is not novated in a new instrument by changing the term of payment and adding other obligations not incompatible with the old one (*Inchausti & Co. v. Yulo*, 34 Phil. 978). It is not proper to consider an obligation novated as in the case at bar by the mere granting of extension of payment which did not even alter its essence. To sustain novation necessitates that the same be so declared in unequivocal terms or that there is complete and substantial incompatibility between the two obligations (*Sandico v. Paquing*, 42 SCRA 322). An obligation to pay a sum of money is not novated in a new instrument wherein the old is ratified by changing only the terms of payment and adding other obligations not incompatible with the old one or wherein the old contract is merely supplementing the new one (*Dungo v. Lopeña*, L-19377, Dec. 29, 1962, 6 SCRA 1007; *Magdalena Estates, Inc. v. Rodriguez*, 18 SCRA 967; *Rizal Commercial Banking Corp. v. Militante*, AC GR CV 04077, Sept. 20, 1985; *Investors Finance Corp. v. Cruz*, AC GR CV 04710, Nov. 27, 1985).

WHEREFORE, the petition is DENIED and the challenged decision of the respondent court AFFIRMED, with costs against the petitioner.

SO ORDERED.

Narvasa, (Chairman), Gancayco, Griño-Aquino, and Medialdea, JJ., concur.

[1] *Sykes v. Everett*, 167 NC 600.

[2] *Miner's Merchants Bank v. Gidley*, 150 WV 229, 144 SE 2d 711.

[3] *Faust v. Rodelheim*, 77 NJL 740, 73 A 491; *Ballard v. Burton*, 64 Vt 387, 24 A 769.

[4] *Pastoral v. Mutual Security Insurance Corp.*, 14 SCRA 1011.

[5] Original Records, pp. 208-214.

[6] 45 Phil. 514.

[7] 53 Phil. 141.

[8] *Keene's Admr. v. Miller*, 103 Ky. 628; *Parson on Bills and Notes*, 571, *Chitty on Bills*, 212; *Malteson v. Ellsworth*, 33 Wis 488.

[9] *Re Dissolution of F. Yeager Bridge Culvert Co.*, 150 Mich. App. 386, NW 2d 99.

[10] Original Records, pp. 208-214, 224 and 225-243.

[11] *Filipino Merchants v. Court of Appeals*, G.R. No. 85141, November 28, 1989; *Ramos v. IAC*, 175 SCRA 70.

[12] Original Records, p. 209.

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