Republic of the Philippines
Supreme Court
Manila

SUPREME COURT OF THE PHILIPPINES PUBLIC INFORMATION OFFICE RECEIVED AUG 14 2015 BY: TIME: 2:17

FIRST DIVISION

CCC INSURANCE CORPORATION,
Petitioner,

- *versus* -

KAWASAKI STEEL CORPORATION, F.F. MAÑACOP CONSTRUCTION CO., INC., and FLORANTE F. MAÑACOP,
Respondents.

G.R. No. 156162

Present:

SERENO, *C.J.,*
Chairperson,
LEONARDO-DE CASTRO,
BERSAMIN,
PEREZ, and
PERLAS-BERNABE, *JJ.*

Promulgated:

JUN 22 2015

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DECISION

LEONARDO-DE CASTRO, *J.*:

Assailed in this Petition for Review on *Certiorari* are: (1) the Decision[1] dated May 30, 2002 of the Court of Appeals in CA-G.R. CV No. 54066, which reversed and set aside the Decision[2] dated May 2, 1996 of the Regional Trial Court (RTC), Makati City, Branch 66, and held petitioner CCC Insurance Corporation (CCCIC) liable under its Surety and Performance Bonds to respondent Kawasaki Steel Corporation (Kawasaki); and (2) the Resolution[3] dated November 14, 2002 of the appellate court in the same case which denied the Motion for Reconsideration of CCCIC.

The antecedents of this case are as follows:

On August 16, 1988, Kawasaki, represented by its Manager, Yoshimitsu Hosoya, and F.F. Mañacop Construction Company, Inc. (FFMCCI), represented by its President, Florante F. Mañacop (Mañacop), executed a Consortium Agreement for Pangasinan Fishing Port Network

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1 *Rollo,* pp. 37-49; penned by Associate Justice Perlita J. Tria Tirona with Associate Justices Buenaventura J. Guerrero and Rodrigo V. Cosico, concurring.

2 CA *rollo*, pp. 71-79; penned by Judge Eriberto U. Rosario, Jr.

3 *Rollo*, pp. 51-54.

Project (Consortium Agreement).[4] Kawasaki and FFMCCI formed a consortium (Kawasaki-FFMCCI Consortium) for the purpose of contracting with the Philippine Government for the construction of a fishing port network in Pangasinan (Project). According to their Consortium Agreement, Kawasaki and FFMCCI undertook to perform and accomplish their respective and specific portions of work in the intended contract with the Philippine Government.[5]

The Project was awarded to the Kawasaki-FFMCCI Consortium for the contract price of ₱62,000,441.00, 33.37% of which or ₱20,692,026.00 was the price of work of FFMCCI. On October 4, 1988, the Republic of the Philippines (Republic), through the Department of Public Works and Highways (DPWH), represented by former Secretary Romulo M. del Rosario, as owner, and the Kawasaki-FFMCCI Consortium, represented by Shigeru Kohda, as contractor, entered into a Contract Agreement entitled Stage I-A Construction of Pangasinan Fishing Port Network (Construction Contract).[6]

In accordance with Article 10 of the Consortium Agreement,[7] "Consortium Leader" Kawasaki, on behalf of the Consortium, secured from the Philippine Commercial International Bank (PCIB) Letter of Credit No. 38-001-183617[8] in the amount of ₱6,200,044.10 in favor of DPWH, available from September 9, 1988 to November 19, 1990. Said Letter of Credit guaranteed the faithful performance by Kawasaki-FFMCCI Consortium of its obligation under the Construction Contract.

The Republic made an advance payment for the Project to the Kawasaki-FFMCCI Consortium in the amount of ₱9,300,066.15, representing 15% of the contract price of ₱62,000,441.00.

For the release of its share in the advance payment made by the Republic, and also pursuant to Article 10 of the Consortium Agreement, FFMCCI secured from CCCIC the following bonds in favor of Kawasaki: (a) Surety Bond No. B-88/11191[9] in the amount of ₱3,103,803.90

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4 Id. at 64-87.

5 Article 5, Consortium Agreement.

6 *Rollo*, pp. 95-98.

7 ARTICLE 10 – BONDS

10.1 The CONSORTIUM LEADER shall arrange, at their own cost, all necessary bonds or guarantees as required under the CONTRACT on behalf of the CONSORTIUM. MAÑACOP shall, at its own cost, furnish the CONSORTIUM LEADER with a suitable counter guarantees of its advance payment under the CONTRACT and the performance of its PORTION OF WORK in the amount of fifteen (15%) percent (in the case of the repayment guarantee for the advance) and ten (10%) percent (in the case of the performance guarantee) of the price of its PORTION OF THE WORK.

10.2 If the EMPLOYER exercises its right on the bonds or guarantees furnished by the CONSORTIUM LEADER, the PARTIES shall decide the respective responsibilities according to the provisions of this AGREEMENT and the necessary reimbursement or compensation shall be made also according to the provisions of this AGREEMENT. (*Rollo*, p. 79.)

8 Records (Vol. I), p. 130.

9 *Rollo*, pp. 99-100.

(equivalent to 15% of the price of work of FFMCCI), effective from October 26, 1988 to October 26, 1989, to counter-guarantee the amount of advance payment FFMCCI would receive from Kawasaki; and (b) Performance Bond B-88/11193[10] in the amount of ₱2,069,202.60 (equivalent to 10% of the price of work of FFMCCI), effective from October 27, 1988 to October 27, 1989, to guarantee completion by FFMCCI of its scope of work in the Project. In turn, FFMCCI and Mañacop executed two Indemnity Agreements[11] promising to compensate CCCIC for any damages the insurance company might incur from issuing the Surety and Performance Bonds.

In two letters dated October 27, 1998,[12] FFMCCI submitted the Surety and Performance Bonds to Kawasaki and requested Kawasaki to release the advance payment in the amount of ₱3,103,803.90. FFMCCI eventually received the amount of advance payment it requested on a staggered basis.[13]

The Project commenced in November 1988.[14] Sometime in April 1989, FFMCCI ceased performing its work in the Project after suffering financial problems and/or business reverses. After discussions, Kawasaki and FFMCCI then executed a new Agreement[15] on August 24, 1989 wherein Kawasaki recognized the "Completed Portion of Work" of FFMCCI as of April 25, 1989, and agreed to take over the unfinished portion of work of FFMCCI, referred to as "Transferred Portion of Work." Kawasaki and FFMCCI further agreed that "[a]ny profit or benefit arising from the performance by [Kawasaki] of the Transferred Portion of Work shall accrue to [Kawasaki]."

In a letter dated September 14, 1989,[16] Kawasaki informed CCCIC about the cessation of operations of FFMCCI, and the failure of FFMCCI to perform its obligations in the Project and repay the advance payment made by Kawasaki. Consequently, Kawasaki formally demanded that CCCIC, as surety, pay Kawasaki the amounts covered by the Surety and Performance Bonds. Because CCCIC did not act upon its demand, Kawasaki filed on November 6, 1989 before the RTC a Complaint[17] against CCCIC to collect on Surety Bond No. B-88/11191 and Performance Bond No. B-88/11193.

In its Answer with Counterclaims,[18] CCCIC denied any liability on its Surety and Performance Bonds on the following grounds: (a) the rights of Kawasaki under the Surety and Performance Bonds had not yet accrued since the said Bonds were mere counter-guarantees, for which CCCIC could only be held liable upon the filing of a claim by the Republic against the Kawasaki-FFMCCI Consortium; (b) Kawasaki and FFMCCI, without the

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10 Id. at 101-102.
11 Records (Vol. I), pp. 220-223.
12 Id. at 46-47.
13 Records (Vol. IV), pp. 59-60.
14 TSN, March 18, 1993, p. 32.
15 Records (Vol. I), pp. 165-167.
16 Id. at 50.
17 Id. at 1-9.
18 Id. at 157-164.

consent of CCCIC, executed a new Agreement dated August 24, 1989 novating the terms of the Consortium Agreement, which prevented CCCIC from being subrogated to the right of Kawasaki against FFMCCI; (c) Kawasaki, in completing the Transferred Portion of Work was correspondingly compensated, which negated any allegation of loss on the part of Kawasaki; and (d) the obligation of CCCIC was extinguished when the Republic granted the Kawasaki-FFMCCI Consortium an extension of time to complete the Project, without the consent of CCCIC.

CCCIC subsequently filed on August 19, 1991 before the RTC a Third-Party Complaint[19] against FFMCCI and its President Mañacop based on the two Indemnity Agreements which FFMCCI and Mañacop executed in favor of CCCIC. The RTC issued summonses but FFMCCI and Mañacop failed to file any responsive pleading to the Third-Party Complaint of CCCIC. Upon motion of CCCIC, the RTC issued an Order[20] dated December 2, 1991 declaring FFMCCI and Mañacop in default.

After trial, the RTC rendered a Decision on May 2, 1996 dismissing the Complaint of Kawasaki and the counterclaim of CCCIC. The RTC agreed with CCCIC that the Surety and Performance Bonds issued by the insurance company were mere counter-guarantees and the cause of action of Kawasaki based on said Bonds had not yet accrued. Since the Republic did not exercise its right to claim against the PCIB Letter of Credit No. 38-001-183617, nor compelled Kawasaki to perform the unfinished work of FFMCCI, Kawasaki could not claim indemnification from CCCIC. Moreover, the RTC, citing Article 2079 of the Civil Code, ruled that the obligations of CCCIC under the Surety and Performance Bonds were extinguished when the Republic granted the Kawasaki-FFMCCI Consortium a 43-day extension to finish the Project, absent the consent of CCCIC. The RTC found no deliberate intent on the part of Kawasaki to cause prejudice to CCCIC, so it did not grant the counterclaims for moral and exemplary damages and attorney's fees of CCCIC against Kawasaki.

Kawasaki appealed before the Court of Appeals assigning the following errors on the part of the RTC:

> I. THE COURT A QUO GROSSLY ERRED IN HOLDING THAT [CCCIC] CAN BE HELD LIABLE TO [Kawasaki] UNDER THE SUBJECT BONDS ONLY "IF THE GOVERNMENT EXERCISES ITS RIGHTS AGAINST THE GUARANTEE-BONDS ISSUED TO IT BY [Kawasaki]" ON THE THEORY ADVANCED BY [CCCIC], WHICH THE COURT A QUO FULLY EMBRACED AND ADOPTED, THAT THE BONDS ARE MERE "COUNTER-GUARANTEES."
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> II. THE COURT A QUO GROSSLY ERRED IN HOLDING THAT THE EXTENSION GRANTED BY THE GOVERNMENT TO THE CONSORTIUM FOR THE CONSTRUCTION OF THE

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19 Id. at 207-210.

20 Id. at 271.

PANGASINAN FISHING PORT NETWORK PROJECT EXTINGUISHED THE LIABILITY OF [CCCIC].

III. THE COURT A QUO GROSSLY ERRED IN HOLDING THAT ARTICLE 2079 OF THE CIVIL CODE OF THE PHILIPPINES APPLIES TO THE CASE AT BAR. IN A LONG LINE OF DECISIONS, THE SUPREME COURT HAS HELD THAT THE RULE OF "STRICTISSIMI JURIS" DOES NOT APPLY TO SURETY COMPANIES SUCH AS [CCCIC] HEREIN.

IV. THE SUBJECT BONDS ARE FIXED UNTIL OCTOBER 26 AND 27, 1989 RESPECTIVELY WHILE THE ORIGINAL PERIOD OF THE CONTRACT WITH THE GOVERNMENT, THE PERFORMANCE OF WHICH BY [CCCIC] ARE PRECISELY GUARANTEED BY THESE BONDS, IS UNTIL DECEMBER 30, 1989. ON THE OTHER HAND, THE DEFAULT BY [FFMCCI] WHICH THE BONDS GUARANTEED AGAINST OCCURRED ON [OR] ABOUT AUGUST 24, 1989. THEREFORE, IRRESPECTIVE OF WHETHER THERE WAS AN EXTENSION OR NOT AT THE END OF THE ORIGINAL CONTRACT PERIOD AND IRRESPECTIVE OF WHETHER THIS EXTENSION IS KNOWN OR UNKNOWN TO [CCCIC], THE LIABILITY THAT IT BOUND ITSELF UNTO UNDER THE BONDS IS VERY CLEARLY AND UNEQUIVOCALLY FIXED UNTIL OCTOBER 26 AND 27, 1989 RESPECTIVELY. THEREFORE, ARTICLE 2079 WILL NOT APPLY. HENCE, THE COURT A QUO GROSSLY ERRED IN HOLDING OTHERWISE.[21]

The Court of Appeals, in its Decision dated May 30, 2002, reversed the appealed RTC Decision, reasoning as follows:

From the language of the aforesaid bonds, it is clear that, in the case of the surety bond, the same was posted, jointly and severally, by [FFMCCI] and CCCIC "to fully and faithfully guarantee the repayment of the downpayment made by the principal ([FFMCCI]) to the obligee (KAWASAKI) in connection with the construction of the Pangasinan Fishing Port Network Project at Pangasinan" subject only to the condition that "the liability of the [herein] surety shall in no case exceed the amount of Pesos: THREE MILLION ONE HUNDRED THREE THOUSAND EIGHT HUNDRED THREE & 90/100 (₱3,103,803.90) Philippine currency; and in the case of the performance bond, the same was posted, jointly and severally by [FFMCCI] and CCCIC "to guarantee the full and faithful performance of the principal ([FFMCCI]) of its obligation in connection with the project for the construction of the Pangasinan Fishing Port Network located at Pangasinan in accordance with the plans and specifications of the contract" subject only to the condition that "the liability of the [herein] surety shall in no case exceed the amount of Pesos: TWO MILLION SIXTY-NINE THOUSAND TWO HUNDRED TWO & 60/100 (₱2,069,202.60) Philippine currency."

The right of KAWASAKI as the obligee/creditor of the said bonds was not made subject to any other condition expressly so provided in the Consortium Agreement, which was the reason for the bonds posted by [FFMCCI] and CCCIC, or in the subject bonds themselves.

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21 CA *rollo*, pp. 42-44.

It is not provided, neither in the Consortium Agreement nor in the subject bonds themselves that before KAWASAKI may proceed against the bonds posted by [FFMCCI] and CCCIC, the Philippine government as employer must first exercise its rights against the bond issued in its favor by the consortium.

Hence, this Court finds that the court *a quo* did err in ruling that "[u]nder the Consortium Agreement, the bonds are counter-guarantees which only guarantee the plaintiff KAWASAKI for reimbursement to the extent of the value of the bonds in case the employer (government) successfully exercised its rights under the bonds issued to it by plaintiff KAWASAKI;" and that "[c]onsidering that the government did not exercise its rights against the bond issued to it by the Consortium Leader, it follows that the Consortium Leader cannot collect from the counter-guarantees furnished by [FFMCCI]."

Time and again, the Supreme Court has stressed the rule that a contract is the law between the parties, and courts have no choice but to enforce such contract so long as they are not contrary to law, morals, good customs or public policy.

With respect to the second, third and fourth issues raised, suffice it to say that this Court finds Article 2079 of the Civil Code of the Philippines not applicable.

[Kawasaki] claims that since the issue in this case is the liability of CCCIC to KAWASAKI, the extension of forty-three (43) days within which to complete the Pangasinan Fishing Port Network Project granted by the Philippine government, who is not a party to the two (2) bonds posted by [FFMCCI] and CCCIC, to the consortium, does not absolve CCCIC's liabilities to KAWASAKI under the subject bonds.

We agree.

As stated earlier, the parties insofar as the surety bond and performance bond are concerned are: KAWASAKI, as obligee, [FFMCCI], as principal; and CCCIC, as surety.

Considering therefore that the extension of time within which to complete the construction of the Pangasinan Fishing Port Network Project was granted by the Philippine government, who is not the creditor of the bonds, this Court finds that Article 2079 of the Civil Code of the Philippines does not apply and the extension of time granted by the Philippine government, contrary to the ruling of the trial court, does not absolve the surety of its liabilities to KAWASAKI under the subject bonds.

The principle of relativity of contracts provides that contracts can only bind the parties who entered into it.

Finally, this Court finds the award of attorney's fees in favor of the appellant warranted under the circumstance, pursuant to paragraph (2) of Article 2208 of the Civil Code of the Philippines.[22]

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22 *Rollo*, pp. 46-48.

In the end, the Court of Appeals decreed:

> **WHEREFORE**, the instant appeal is hereby **GRANTED**. Accordingly, the assailed decision of the Regional Trial Court of Makati City, Branch 66, is hereby **REVERSED** and **SET ASIDE**.
>
> CCC Insurance Corporation is hereby ordered to pay KAWASAKI the following:
>
> 1. The amount of ₱3,103,803.90 representing its liability to Kawasaki Steel Corporation under Surety Bond No. B-88/11191, plus legal interest at the rate of 12% per annum computed from 15 September 1989, until fully paid;
>
> 2. The amount of ₱2,069,202.80 representing its liability to Kawasaki Steel Corporation under Performance Bond No. B-88/11193, plus legal interest at the rate of 12% per annum computed from 15 September 1989, until fully paid; and
>
> 3. 15% of the total amount due as and for attorney's fees.[23]

In its Resolution dated November 14, 2002, the Court of Appeals denied the Motion for Reconsideration of CCCIC. However, in the same Resolution, the appellate court partially granted the Third-Party Complaint of CCCIC by holding Mañacop liable under the Indemnity Agreements he executed in favor of the insurance company, while declaring the RTC was without jurisdiction over FFMCCI due to invalid service of summons. The Court of Appeals ultimately resolved:

> **WHEREFORE**, judgment is hereby rendered in favor of third-party plaintiff CCC Insurance Corporation and against third-party defendant Florante F. Mañacop, ordering the latter to indemnify the former the total amount paid by the former to Kawasaki Steel Corporation representing CCC Insurance Corporation's liabilities under Surety Bond No. B-88/11191 and Performance Bond No. B-88/11193 and to pay CCC Insurance Corporation 25% of the total amount due, as and for attorney's fees.[24]

In the instant Petition for Review on *Certiorari*, CCCIC assails the aforementioned Decision and Resolution of the Court of Appeals on six grounds, *viz.*:

> A.
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> THE COURT OF APPEALS, CONTRARY TO LAW, FAILED TO CONSIDER THE TRUE NATURE OF THE TRANSACTION BETWEEN THE PARTIES AND THE TRUE NATURE OF A COUNTER-GUARANTEE.

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23 Id. at 48.

24 Id. at 54.

B.

THE COURT OF APPEALS, CONTRARY TO LAW, FAILED TO APPRECIATE THE APPLICABILITY OF ARTICLE 2079 OF THE CIVIL CODE, WHICH PROVIDES THAT AN EXTENSION GRANTED TO THE DEBTOR BY THE CREDITOR WITHOUT THE CONSENT OF THE GUARANTOR EXTINGUISHES THE GUARANTY.

C.

THE COURT OF APPEALS, CONTRARY TO LAW, ERRONEOUSLY FAILED TO CONSIDER THE FACT THAT KAWASAKI AND FFMCCI HAVE NOVATED THEIR ORIGINAL AGREEMENT WITHOUT THE KNOWLEDGE AND CONSENT OF CCCIC, THEREBY RELEASING THE LATTER FROM ANY OBLIGATION UNDER THE BONDS IT ISSUED.

D.

THE COURT OF APPEALS, CONTRARY TO LAW, ERRONEOUSLY RENDERED CCCIC LIABLE TO PAY THE FULL AMOUNT OF THE SURETY AND PERFORMANCE BONDS DESPITE THE FACT THAT FFMCCI WAS ABLE TO PARTIALLY EXECUTE ITS PORTION OF THE WORK AND THAT KAWASAKI HAD BEEN FULLY COMPENSATED FOR TAKING OVER THE UNFINISHED PORTION.

E.

THE COURT OF APPEALS, CONTRARY TO LAW, ERRONEOUSLY AWARDED ATTORNEY'S FEES TO KAWASAKI UNDER PARAGRAPH 2 OF ARTICLE 2208 OF THE CIVIL CODE.

F.

THE COURT OF APPEALS, CONTRARY TO LAW, ERRONEOUSLY RULED THAT THERE WAS NO VALID SERVICE OF SUMMONS UPON FFMCCI.[25]

CCCIC avers that its liabilities under the Surety and Performance Bonds are directly linked with the obligation of the Kawasaki-FFMCCI Consortium to finish the Project for the Republic, so that its liability as surety of FFMCCI will only arise if the Republic made a claim on the PCIB Letter of Credit furnished by Kawasaki, on behalf of the Consortium. Since the Republic has not exercised its right against said Letter of Credit, Kawasaki does not have a cause of action against CCCIC.

CCCIC also maintains that its obligations under the Surety and Performance Bonds had been extinguished when (a) the Republic extended the completion period for the Project upon the request of Kawasaki but without the knowledge or consent of CCCIC, based on Article 2079 of the Civil Code; and (b) when Kawasaki and FFMCCI executed the Agreement

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[25] Id. at 17-18.

dated August 24, 1989, without the consent of CCCIC, there being a novation of the Consortium Agreement.

CCCIC further argues that when Kawasaki, under the Agreement dated August 24, 1989, voluntarily took over the Transferred Portion of Work from FFMCCI, it resulted in the reduction of revenue of FFMCCI on which CCCIC relied upon as a source of indemnification. CCCIC additionally posits that Kawasaki already received compensation for doing the Transferred Portion of Work, so the Court of Appeals had no basis for still ordering Kawasaki to pay the full value of the Surety and Performance Bonds, plus interest.

Moreover, CCCIC contends that the Court of Appeals erred in awarding attorney's fees in favor of Kawasaki based on paragraph 2 of Article 2208 of the Civil Code as it is not a sound policy to place a penalty on the right to litigate.

Lastly, CCCIC insists that there was proper service of summons upon FFMCCI, through one of its directors, as authorized by the Rules of Court.

The Petition is partly meritorious.

The liability of CCCIC under the Surety and Performance Bonds is dependent on the fulfillment and/or non-fulfillment of the obligation of FFMCCI to KAWASAKI under the Consortium Agreement.

The statutory definition of suretyship is found in Article 2047 of the 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.)

Jurisprudence also defines a contract of suretyship as "an agreement where a party called the surety guarantees the performance by another party called the principal or obligor of an obligation or undertaking in favor of a third person called the obligee. Specifically, 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." [26] The Court expounds that "a surety's liability is

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[26] *Visayan Surety & Insurance Corporation v. Court of Appeals*, 417 Phil. 110, 116-117 (2001).

joint and several, limited to the amount of the bond, and determined strictly by the terms of contract of suretyship in relation to the principal contract between the obligor and the obligee. It bears stressing, however, that although the contract of suretyship is secondary to the principal contract, the surety's liability to the obligee is nevertheless direct, primary, and absolute."[27]

At the outset, the Court ascertains that there are two principal contracts in this case: (1) the Consortium Agreement wherein Kawasaki and FFMCCI agreed to jointly enter into a contract with the Republic for the Project, each assuming the performance of specific scopes of work in said Project; and (2) the Construction Contract whereby the Republic awards the Project to the Kawasaki-FFMCCI Consortium. While there is a connection between these two contracts, they are each distinguishable from and enforceable independently of one another: the first governs the rights and obligations between Kawasaki and FFMCCI, while the second covers contractual relations between the Republic and the Kawasaki-FFMCCI Consortium. The Surety and Performance Bonds from CCCIC guaranteed the performance by FFMCCI of its obligations under the Consortium Agreement; whereas the Letter of Credit from PCIB warranted the completion of the Project by the Kawasaki-FFMCCI Consortium. At the crux of the instant controversy are the Surety and Performance Bonds issued by CCCIC in relation to the Consortium Agreement.

FFMCCI secured the Surety and Performance Bonds from CCCIC in compliance with Article 10 of the Consortium Agreement which provided:

> ARTICLE 10 – BONDS
>
> 10.1 The CONSORTIUM LEADER [Kawasaki] shall arrange, at [its] own cost, all necessary bonds or guarantees as required under the CONTRACT on behalf of the CONSORTIUM. [FFMCCI] shall, at its own cost, furnish the CONSORTIUM LEADER [Kawasaki] with a suitable counter guarantees of its advance payment under the CONTRACT and the performance of its PORTION OF WORK in the amount of fifteen (15%) percent (in the case of the repayment guarantee for the advance) and ten (10%) percent (in the case of the performance guarantee) of the price of its PORTION OF THE WORK.
>
> 10.2 If the EMPLOYER [Republic] exercises its right on the bonds or guarantees furnished by the CONSORTIUM LEADER, the PARTIES shall decide the respective responsibilities according to the provisions of this AGREEMENT and the necessary reimbursement or compensation shall be made also according to the provisions of this AGREEMENT.[28]

Pertinent portions of Surety Bond No. B-88/11191 read:

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27 *The Manila Insurance Company, Inc. v. Amurao*, G.R. No. 179628, January 16, 2013, 688 SCRA 616-617.

28 *Rollo*, p. 79.

SURETY BOND

KNOW ALL MEN BY THESE PRESENTS:

That we, F.F. MAÑACOP CONSTRUCTION CO., INC., x x x, as principal, and CCC Insurance Corporation, x x x, as SURETY, are held and firmly bound unto KAWASAKI STEEL CORPORATION, hereinafter referred to as the OBLIGEE: in the sum of PESOS: THREE MILLION ONE HUNDRED THREE THOUSAND EIGHT HUNDRED THREE & 90/100 ONLY (₱3,103,803.90), 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 bound from notice of acceptance, by these presents.

THE CONDITIONS OF THIS OBLIGATION ARE AS FOLLOWS:

TO FULLY AND FAITHFULLY GUARANTEE THE REPAYMENT OF THE DOWNPAYMENT MADE BY THE PRINCIPAL TO THE OBLIGEE IN CONNECTION WITH THE CONSTRUCTION OF THE PANGASINAN FISHING PORT NETWORK PROJECT AT PANGASINAN; AND

PROVIDED HOWEVER, THAT THE LIABILITY OF THE HEREIN SURETY SHALL IN NO CASE EXCEED THE AMOUNT OF PESOS: THREE MILLION ONE HUNDRED THREE THOUSAND EIGHT HUNDRED THREE & 90/100 ONLY (₱3,103,803.90) PHILIPPINE CURRENCY.

x x x x

WHEREAS, the said 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 UNDERTAKING.**

NOW, THEREFORE, if the above bounden principal shall in all respects duly and fully observe and perform all and singular the aforesaid covenants, 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.

The liability of the Surety under this bond shall expire on October 26, 1989 and the Surety does not assume responsibility for any liability incurred or created after said date. Any claims against this bond must be presented to the Surety in writing not later than ten (10) days after said expiry date; otherwise, failure to do so shall forthwith release the Surety from all liabilities under this bond and shall be a bar to any court action against it and which right to sue is hereby waived by the Obligee after the lapse of said period of ten (10) days above cited.[29] (Emphases supplied.)

Performance Bond No. B-88/11193 contains the following terms and conditions:

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29 Id. at 99.

PERFORMANCE BOND

KNOW ALL MEN BY THESE PRESENTS:

That we, F.F. MAÑACOP CONSTRUCTION CO., INC., x x x, as principal, and CCC Insurance Corporation, x x x, as SURETY, are held and firmly bound unto KAWASAKI STEEL CORPORATION, hereinafter referred to as the OBLIGEE: in the sum of PESOS: TWO MILLION SIXTY-NINE THOUSAND TWO HUNDRED TWO & 60/100 ONLY (₱2,069,202.60), 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 bound from notice of acceptance, by these presents.

THE CONDITIONS OF THIS OBLIGATION ARE AS FOLLOWS:

TO GUARANTEE THE FULL AND FAITHFUL PERFORMANCE OF THE PRINCIPAL OF ITS OBLIGATION IN CONNECTION WITH THE PROJECT FOR THE CONSTRUCTION OF PANGASINAN FISHING PORT NETWORK LOCATED AT PANGASINAN IN ACCORDANCE WITH THE PLANS AND SPECIFICATION OF THE CONTRACT, AND;

PROVIDED HOWEVER, THAT THE LIABILITY OF THE HEREIN SURETY SHALL IN NO CASE EXCEED THE AMOUNT OF PESOS: TWO MILLION SIXTY-NINE THOUSAND TWO HUNDRED TWO & 60/100 ONLY (₱2,069,202.60) PHILIPPINE CURRENCY.

x x x x

WHEREAS, the said 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 UNDERTAKING.**

NOW, THEREFORE, if the above bounden principal shall in all respects duly and fully observe and perform all and singular the aforesaid covenants, 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.

The liability of the Surety under this bond shall expire on October 27, 1989 and the Surety does not assume responsibility for any liability incurred or created after said date. Any claims against this bond must be presented to the Surety in writing not later than ten (10) days after said expiry date; otherwise, failure to do so shall forthwith release the Surety from all liabilities under this bond and shall be a bar to any court action against it and which right to sue is hereby waived by the Obligee after the lapse of said period of ten (10) days above cited.[30] (Emphasis supplied.)

The Court reiterates that a surety's liability is determined strictly by the terms of contract of suretyship, in relation to the principal contract

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30 Id. at 101.

between the obligor and the obligee. Hence, the Court looks at the Surety and Performance Bonds, in relation to the Consortium Agreement.

According to the principle of relativity of contracts in Article 1311 of the Civil Code,[31] a contract takes effect only between the parties, their assigns, and heirs; except when the contract contains a stipulation in favor of a third person, which gives said person the right to demand fulfillment of said stipulation. In this case, the Surety and Performance Bonds are enforceable by and against the parties FFMCCI (the obligor) and CCCIC (the surety), as well as the third person Kawasaki (the obligee) in whose favor said bonds had been explicitly constituted; while the related Consortium Agreement binds the parties Kawasaki and FFMCCI. Since the Republic is neither a party to the Surety and Performance Bonds nor the Consortium Agreement, any action or omission on its part has no effect on the liability of CCCIC under said bonds.

The Surety and Performance Bonds state that their purpose was "to secure the full and faithful performance on [FFMCCI's] part of said undertaking," particularly, the repayment by FFMCCI of the downpayment advanced to it by Kawasaki (in the case of the Surety Bond) and the full and faithful performance by FFMCCI of its portion of work in the Project (in the case of the Performance Bond). These are the only undertakings expressly guaranteed by the bonds, the fulfillment of which by FFMCCI would release CCCIC from its obligations as surety; or conversely, the non-performance of which would give rise to the liabilities of CCCIC as a surety.

The Surety and Performance Bonds do not contain any condition that CCCIC would be liable only if, in addition to the default on its undertakings by FFMCCI, the Republic also made a claim against the PCIB Letter of Credit furnished by Kawasaki, on behalf of the Kawasaki-FFMCCI Consortium. The Court agrees with the observation of the Court of Appeals that "it is not provided, neither in the Consortium Agreement nor in the subject bonds themselves that before KAWASAKI may proceed against the bonds posted by [FFMCCI] and CCCIC, the Philippine government as employer must first exercise its rights against the bond issued in its favor by the consortium."[32]

The Court cannot give any additional meaning to the plain language of the undertakings in the Surety and Performance Bonds. The extent of a surety's liability is determined by the language of the suretyship contract or bond itself. Article 1370 of the Civil Code provides that "[i]f the terms of a

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31 Art. 1311. Contracts take effect only between the parties, their assigns and heirs, except in case where the rights and obligations arising from the contract are not transmissible by their nature, or by stipulation or by provision of law. The heir is not liable beyond the value of the property he received from the decedent.

If a contract should contain some stipulation in favor of a third person, he may demand its fulfillment provided he communicated his acceptance to the obligor before its revocation. A mere incidental benefit or interest of a person is not sufficient. The contracting parties must have clearly and deliberately conferred a favor upon a third person.

32 *Rollo*, p. 46.

contract are clear and leave no doubt upon the intention of the contracting parties, the literal meaning of its stipulations shall control."[33]

There is no basis for the interpretation by CCCIC of the word "counter-guarantee" in Article 10 of the Consortium Agreement. The first paragraph of Article 10 of the Consortium Agreement provides that Kawasaki, as the Consortium Leader, shall arrange, at its own cost but on behalf of the Kawasaki-FFMCCI Consortium, for all necessary bonds and guarantees under the Construction Contract with the Republic. The same paragraph requires, in turn, that FFMCCI, at its own cost, to furnish Kawasaki with suitable counter-guarantees for the repayment by FFMCCI for the advance payment from Kawasaki and performance by FFMCCI of its portion of work in the Project. Clearly, the "guarantees" and "counter-guarantees" were securities for the fulfillment of the obligations of the Kawasaki-FFMCCI Consortium to the Republic under the Construction Contract and of FFMCCI to the Consortium Leader Kawasaki under the Consortium Agreement, respectively. The CCCIC Surety and Performance Bonds were not counter-guarantees to the PCIB Letter of Credit. In fact, in the event that the Republic did make a claim on the PCIB Letter of Credit, the second paragraph of Article 10 of the Consortium Agreement stipulates that Kawasaki and FFMCCI would still have to determine their respective responsibilities, reimbursements, and/or compensations according to the provisions of the Consortium Agreement, instead of simply allowing Kawasaki to recover on the "counter-guarantees" of FFMCCI.

It is not disputed that FFMCCI, due to financial difficulties, was unable to repay the advance payment it received from Kawasaki and to finish its scope of work in the Project, thus, FFMCCI defaulted on its obligations to Kawasaki. Given the default of FFMCCI, CCCIC as surety became directly, primarily, and absolutely liable to Kawasaki as the obligee under the Surety and Performance Bonds. The following pronouncements of the Court in *Asset Builders Corporation v. Stronghold Insurance Company, Inc.*[34] are relevant herein:

> 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.* x x x.
>
> x x x x
>
> 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

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33 *Molino v. Security Diners International Corporation*, 415 Phil. 587, 595 (2001).

34 647 Phil. 692, 702-704 (2010).

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. 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.

Stronghold Insurance Company, Inc. v. Republic-Asahi Glass Corporation, reiterating the ruling in *Garcia v. Court of Appeals*, 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.**

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 ₱575,000.00 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," 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.** x x x. (Emphases supplied, citations omitted.)

Article 2079 of the New Civil Code is not applicable to the instant case.

To free itself from its liabilities under the Surety and Performance Bonds, CCCIC cites Article 2079 of the Civil Code, which reads:

> 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.

The aforequoted provision clearly speaks of an extension for the payment of a debt granted by the creditor to a debtor without the consent of the surety. The theory behind Article 2079 was further explained by the Court in *Trade and Investment Development Corporation of the Philippines (Formerly Philippine Export and Foreign Loan Guarantee Corporation) v. Asia Paces Corporation*,[35] thus:

> Comparing a surety's obligations with that of a guarantor, the Court, in the case of *Palmares v. CA*, illumined that a surety is responsible for the debt's payment at once if the principal debtor makes default, whereas a guarantor pays only if the principal debtor is unable to pay, *viz.*:
>
> > A surety is an insurer of the debt, whereas a guarantor is an insurer of the solvency of the debtor. A suretyship is an undertaking that the debt shall be paid; a guaranty, an undertaking that the debtor shall pay. Stated differently, a surety promises to pay the principal's debt if the principal will not pay, while a guarantor agrees that the creditor, after proceeding against the principal, may proceed against the guarantor if the principal is unable to pay. A surety binds himself to perform if the principal does not, without regard to his ability to do so. A guarantor, on the other hand, does not contract that the principal will pay, but simply that he is able to do so. In other words, a surety undertakes directly for the payment and is so responsible at once if the principal debtor makes default, while a guarantor contracts to pay if, by the use of due diligence, the debt cannot be made out of the principal debtor. x x x.
>
> Despite these distinctions, the Court in *Cochingyan, Jr. v. R&B Surety & Insurance Co., Inc.*, and later in the case of *Security Bank*, held that Article 2079 of the Civil Code, which pertinently provides that "[a]n extension granted to the debtor by the creditor without the consent of the guarantor extinguishes the guaranty," equally applies to both contracts of guaranty and suretyship. The rationale therefor was explained by the Court as follows:
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> > **The theory behind Article 2079 is that an extension of time given to the principal debtor by the creditor without the surety's consent would deprive the surety of his right to pay the creditor and to be immediately subrogated to the creditor's**

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35 G.R. No. 187403, February 12, 2014, 716 SCRA 67, 78-83.

> **remedies against the principal debtor upon the maturity date. The surety is said to be entitled to protect himself against the contingency of the principal debtor or the indemnitors becoming insolvent during the extended period. x x x.**

Applying these principles, the Court finds that the payment extensions granted by Banque Indosuez and PCI Capital to TIDCORP under the Restructuring Agreement did not have the effect of extinguishing the bonding companies' obligations to TIDCORP under the Surety Bonds, notwithstanding the fact that said extensions were made without their consent. **This is because Article 2079 of the Civil Code refers to a payment extension granted by the creditor to the principal debtor without the consent of the guarantor or surety**. In this case, the Surety Bonds are suretyship contracts which secure the debt of ASPAC, the principal debtor, under the Deeds of Undertaking to pay TIDCORP, the creditor, the damages and liabilities it may incur under the Letters of Guarantee, within the bounds of the bonds' respective coverage periods and amounts. No payment extension was, however, granted by TIDCORP in favor of ASPAC in this regard; hence, Article 2079 of the Civil Code should not be applied with respect to the bonding companies' liabilities to TIDCORP under the Surety Bonds.

The payment extensions granted by Banque Indosuez and PCI Capital pertain to TIDCORP's own debt under the Letters of Guarantee wherein it (TIDCORP) irrevocably and unconditionally guaranteed full payment of ASPAC's loan obligations to the banks in the event of its (ASPAC) default. In other words, the Letters of Guarantee secured ASPAC's loan agreements to the banks. Under this arrangement, TIDCORP therefore acted as a guarantor, with ASPAC as the principal debtor, and the banks as creditors.

Proceeding from the foregoing discussion, **it is quite clear that there are two sets of transactions that should be treated separately and distinctly from one another following the civil law principle of relativity of contracts** "which provides that contracts can only bind the parties who entered into it, and it cannot favor or prejudice a third person, even if he is aware of such contract and has acted with knowledge thereof." **Verily, as the Surety Bonds concern ASPAC's debt to TIDCORP and not TIDCORP's debt to the banks, the payments extensions (which conversely concern TIDCORP's debt to the banks and not ASPAC's debt to TIDCORP) would not deprive the bonding companies of their right to pay their creditor (TIDCORP) and to be immediately subrogated to the latter's remedies against the principal debtor (ASPAC) upon the maturity date.** It must be stressed that these payment extensions did not modify the terms of the Letters of Guarantee but only provided for a new payment scheme covering TIDCORP's liability to the banks. In fine, considering the inoperability of Article 2079 of the Civil Code in this case, the bonding companies' liabilities to TIDCORP under the Surety Bonds – except those issued by Paramount and covered by its Compromise Agreement with TIDCORP – have not been extinguished. Since these obligations arose and have been duly demanded within the coverage periods of all the Surety Bonds, TIDCORP's claim is hereby granted. x x x. (Emphases supplied, citations omitted.)

Similarly, there are two sets of transactions in the present case covered by two different contracts: the Consortium Agreement between Kawasaki and FFMCCI and the Construction Contract between the Republic and the Kawasaki-FFMCCI Consortium. The Surety and Performance Bonds guaranteed the performance of the obligations of FFMCCI to Kawasaki under the Consortium Agreement. The Republic was not a party in either the Surety and Performance Bonds or the Consortium Agreement. Under these circumstances, there was no creditor-debtor relationship between the Republic and FFMCCI and Article 2079 of the Civil Code did not apply. The extension granted by the Republic to Kawasaki modified the deadline for the completion of the Project under the Construction Contract, but had no effect on the obligations of FFMCCI to Kawasaki under the Consortium Agreement, much less, on the liabilities of CCCIC under the Surety and Performance Bonds.

CCCIC failed to discharge the burden of proving the novation of the Consortium Agreement which would have extinguished its obligations under the Surety and Performance Bonds.

CCCIC argues that it was released from its obligations as surety under the Surety and Performance Bonds because of the novation of the Consortium Agreement by the subsequent Agreement dated August 24, 1989 executed between Kawasaki and FFMCCI, without the consent of CCCIC.

The Court first notes that the default of FFMCCI preceded the execution of the Agreement on August 24, 1989 which purportedly novated the Consortium Agreement and, in effect, extinguished the Surety and Performance Bonds. As early as his letter dated July 20, 1989, Mañacop, FFMCCI President, already admitted the inability of FFMCCI to continue with its portion of work in the Project and authorized Kawasaki to continue the same. It was precisely because FFMCCI defaulted on its obligations under the Consortium Agreement that necessitated the execution of the Agreement dated August 24, 1989 between Kawasaki and FFMCCI, and this is evident from one of the "whereas" clauses in the said Agreement which says that "due to some financial reverses[, FFMCCI] can no longer do its portion of the work under the Contract." The liabilities of CCCIC as surety to Kawasaki under the Surety and Performance Bonds had already attached upon the default of FFMCCI while the said bonds were still in effect and prior to the alleged novation of the Consortium Agreement by the Agreement dated August 24, 1989 which resulted in the extinguishment of the bonds.

The Court expounded on the concept of novation in *Reyes v. BPI Family Savings Bank, Inc.*[36]:

> Novation is defined as the extinguishment of an obligation by the substitution or change of the obligation by a subsequent one which terminates the first, either by changing the object or principal conditions, or by substituting the person of the debtor, or subrogating a third person in the rights of the creditor.
>
> Article 1292 of the Civil Code on novation further provides:
>
> > Article 1292. In order that an obligation may be extinguished by another which substitute 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.
>
> The cancellation of the old obligation by the new one is a necessary element of novation which may be effected either expressly or impliedly. While there is really no hard and fast rule to determine what might constitute sufficient change resulting in novation, the touchstone, however, is irreconcilable incompatibility between the old and the new obligations.
>
> In *Garcia, Jr. v. Court of Appeals*, we held that:
>
> > 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. There must be consent of all the parties to the substitution, resulting in the extinction of the old obligation and the creation of a valid new one. x x x. (Citations omitted.)

It is well-settled that novation is never presumed – *novatio non praesumitur*. As the party alleging novation, the *onus* of showing clearly and unequivocally that novation had indeed taken place rests on CCCIC.[37] The Court laid down guidelines in establishing novation, *viz.*:

> Novation is never presumed, and the *animus novandi*, whether totally or partially, must appear by express agreement of the parties, or by their acts that are too clear and unequivocal to be mistaken.
>
> The extinguishment of the old obligation by the new one is a necessary element of novation which may be effected either expressly or impliedly. The term "expressly" means that the contracting parties incontrovertibly disclose that their object in executing the new contract is to extinguish the old one. Upon the other hand, no specific form is required for an implied novation, and all that is prescribed by law would be an incompatibility between the two contracts. While there is really no hard and fast rule to determine what might constitute to be a sufficient change that can bring about novation, the touchstone for contrariety,

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36 520 Phil. 801, 806-807 (2006).

37 *St. James College of Parañaque v. Equitable PCI Bank*, 641 Phil. 452, 464 (2010).

> however, would be an irreconcilable incompatibility between the old and the new obligations.
>
> There are two ways which could indicate, in fine, the presence of novation and thereby produce the effect of extinguishing an obligation by another which substitutes the same. The *first* is when novation has been explicitly stated and declared in unequivocal terms. The *second* is when the old and the new obligations are incompatible on every point. The test of incompatibility is whether or not the two obligations can stand together, each one having its independent existence. If they cannot, they are incompatible and the latter obligation novates the first. Corollarily, changes that breed incompatibility must be essential in nature and not merely accidental. The incompatibility must take place in any of the essential elements of the obligation, such as its object, cause or principal conditions thereof; otherwise, the change would be merely modificatory in nature and insufficient to extinguish the original obligation.[38] (Citations omitted.)

CCCIC failed to discharge the burden of proving novation of the Consortium Agreement by the Agreement dated August 24, 1989. The Court failed to see the presence of the essential requisites for a novation of contract, specifically, the irreconcilable incompatibility between the old and new contracts. Indeed, Kawasaki and FFMCCI executed the Agreement dated August 24, 1989 pursuant to Article 8.3 of the Consortium Agreement:

> 8.3 If, for any reason, any PARTY should fail in the performance of its PORTION OF WORK or contractual obligations and if such defaulting PARTY refuses to cure or makes no remedial action, without presenting any valid cause, within fifteen (15) days following demand of rectification by registered letter sent by the other PARTY, the defaulting PARTY's PORTION OF WORK may be performed at the account and responsibility of the defaulting PARTY, by the non-defaulting PARTY or by any other contractor selected by the non-defaulting PARTY and approved by the EMPLOYER. In such event, the defaulting PARTY or its representative shall, in no way, interfere with the performance of the CONTRACT or impede the progress thereof, on any ground, and shall allow such performing PARTY or the said contractor to use the materials and equipment of such defaulting PARTY, for the purpose of remedial action.

FFMCCI was unable to finish its portion of work in the Project because of business reverses, and by the Agreement dated August 24, 1989, Kawasaki assumed the Transferred Portion of Work from FFMCCI and was accorded the right to receive the profits and benefits corresponding to said portion. Although the Agreement dated August 24, 1989 resulted in the reallocation of the respective portions of work of Kawasaki and FFMCCI, as well as their corresponding shares in the profits and benefits under the Consortium Agreement, such changes were not incompatible with the object, cause, and principal conditions of the Consortium Agreement. Consequently, the changes under the Agreement dated August 24, 1989

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[38] *Quinto v. People*, 365 Phil. 259, 267-268 (1999).

were only modificatory and did not extinguish the original obligations under the Consortium Agreement.

Even granting that there is novation, the Court in *Stronghold Insurance Company, Incorporated v. Tokyu Construction Company, Ltd.*,[39] held that to release the surety, the material change in the principal contract must make the obligation of the surety more onerous. The Court ratiocinated in *Stronghold* as follows:

> Petitioner's liability was not affected by the revision of the contract price, scope of work, and contract schedule. Neither was it extinguished because of the issuance of new bonds procured from Tico.
>
> As early as February 10, 1997, respondent already sent a letter to Gabriel informing the latter of the delay incurred in the performance of the work, and of the former's intention to terminate the subcontract agreement to prevent further losses. Apparently, Gabriel had already been in default even prior to the aforesaid letter; and demands had been previously made but to no avail. By reason of said default, Gabriel's liability had arisen; as a consequence, so also did the liability of petitioner as a surety arise.
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> x x x x
>
> By the language of the bonds issued by petitioner, it guaranteed the full and faithful compliance by Gabriel of its obligations in the construction of the SDS and STP specifically set forth in the subcontract agreement, and the repayment of the 15% advance payment given by respondent. These guarantees made by petitioner gave respondent the right to proceed against the former following Gabriel's non-compliance with her obligation.
>
> Confusion, however, transpired when Gabriel and respondent agreed, on February 26, 1997, to reduce the scope of work and, consequently, the contract price. Petitioner viewed such revision as novation of the original subcontract agreement; and since no notice was given to it as a surety, it resulted in the extinguishment of its obligation.
>
> We wish to stress herein the nature of suretyship, which actually involves two types of relationship --- the underlying principal relationship between the creditor (respondent) and the debtor (Gabriel), and the accessory surety relationship between the principal (Gabriel) and the surety (petitioner). The creditor accepts the surety's solidary undertaking to pay if the debtor does not pay. Such acceptance, however, does not change in any material way the creditor's relationship with the principal debtor nor does it make the surety an active party to the principal creditor-debtor relationship. In other words, the acceptance does not give the surety the right to intervene in the principal contract. The surety's role arises only upon the debtor's default, at which time, it can be directly held liable by the creditor for payment as a solidary obligor.
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> The surety is considered in law as possessed of the identity of the debtor in relation to whatever is adjudged touching upon the obligation of the latter. Their liabilities are so interwoven as to be inseparable. Although

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39 606 Phil. 400, 411-413 (2009).

> the contract of a surety is, in essence, secondary only to a valid principal obligation, the surety's liability to the creditor is direct, primary, and absolute; he becomes liable for the debt and duty of another although he possesses no direct or personal interest over the obligations nor does he receive any benefit therefrom.
>
> Indeed, a surety is released from its obligation when there is a material alteration of the principal contract in connection with which the bond is given, such as a change which imposes a new obligation on the promising party, or which takes away some obligation already imposed, or one which changes the legal effect of the original contract and not merely its form. However, **a surety is not released by a change in the contract, which does not have the effect of making its obligation more onerous**.
>
> In the instant case, the revision of the subcontract agreement did not in any way make the obligations of both the principal and the surety more onerous. To be sure, petitioner never assumed added obligations, nor were there any additional obligations imposed, due to the modification of the terms of the contract. Failure to receive any notice of such change did not, therefore, exonerate petitioner from its liabilities as surety. (Emphasis supplied, citations omitted.)

There is no showing herein that the obligations of CCCIC as surety had become more onerous with the execution of the Agreement dated August 24, 1989 between Kawasaki and FFMCCI. The Agreement dated August 24, 1989 did not alter in any way the original coverage and the terms and conditions of the Surety and Performance Bonds of CCCIC. If truth be told, the Agreement dated August 24, 1989 made it more onerous for Kawasaki which had to take over the Transferred Portion of Work from FFMCCI.

That Kawasaki was to receive the profits and benefits corresponding to the Transferred Portion of Work would not extinguish the liabilities of CCCIC under the Surety and Performance Bonds. The right of Kawasaki to the profits and benefits corresponding to the Transferred Portion of Work was granted under the Agreement dated August 24, 1989 because Kawasaki was the one that would actually perform the remaining portion of work and complete the Project and should be duly compensated for the same. It is separate and distinct from the right of Kawasaki to demand payment of the amounts guaranteed by CCCIC as surety upon the default of FFMCCI on its undertakings under the Surety and Performance Bonds. CCCIC cannot standby passively and be benefitted by payments made by the Republic, as owner of the Project, to Kawasaki, as contractor, for the Transferred Portion of Work. The only way CCCIC can extinguish its liabilities as surety, which already attached upon the default of FFMCCI, is to make its own payments to Kawasaki of the amounts guaranteed under the Surety and Performance Bonds.

Equally without merit is the averment of CCCIC that by executing the Agreement dated August 24, 1989, which gave Kawasaki the right to the profits and benefits corresponding to the Transferred Portion of Work,

Kawasaki and FFMCCI colluded or connived to deprive CCCIC of its source of indemnification. Other than its allegation, CCCIC failed to present any evidence of collusion or connivance between Kawasaki and FFMCCI to intentionally prejudice CCCIC. The Court reiterates that the execution of the Agreement dated August 24, 1989 was actually authorized under Article 8.3 of the Consortium Agreement. Kawasaki was given the right to the profits and benefits corresponding to the Transferred Portion of Work because it would be the one to perform the same. It would be the height of inequity to allow FFMCCI to continue collecting payments for work it was not able to do. Besides, there is utter lack of basis for the claim of CCCIC that without the compensation for the Transferred Portion of Work, FFMCCI would have no means to indemnify CCCIC for any payments the latter would have to make to Kawasaki under the Surety and Performance Bonds. As the succeeding discussion will show, it is premature for CCCIC to question the capacity of FFMCCI to indemnify it.

CCCIC must first pay its liabilities to Kawasaki under the Surety and Performance Bonds before it could be indemnified and subrogated to the rights of Kawasaki against FFMCCI.

The rights of a guarantor who pays for the debt of the debtor are governed by the following provisions of the Civil Code:

> Art. 2066. The guarantor who pays for a debtor must be indemnified by the latter.
>
> The indemnity comprises:
>
> (1) The total amount of the debt;
>
> (2) The legal interests thereon from the time the payment was made known to the debtor, even though it did not earn interest for the creditor;
>
> (3) The expenses incurred by the guarantor after having notified the debtor that payment had been demanded of him;
>
> (4) Damages, if they are due.
>
> Art. 2067. The guarantor who pays is subrogated by virtue thereof to all the rights which the creditor had against the debtor.
>
> If the guarantor has compromised with the creditor, he cannot demand of the debtor more than what he has really paid.

Although the foregoing provisions only speak of a guarantor, they also apply to a surety, as the Court held in *Escaño v. Ortigas, Jr.*[40]:

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[40] 553 Phil. 24, 43-44 (2007).

> What is the source of this right to full reimbursement by the surety? We find the right under Article 2066 of the Civil Code, which assures that "[t]he guarantor who pays for a debtor must be indemnified by the latter," such indemnity comprising of, among others, "the total amount of the debt." Further, Article 2067 of the Civil Code likewise establishes that "[t]he guarantor who pays is subrogated by virtue thereof to all the rights which the creditor had against the debtor."
>
> Articles 2066 and 2067 explicitly pertain to guarantors, and one might argue that the provisions should not extend to sureties, especially in light of the qualifier in Article 2047 that the provisions on joint and several obligations should apply to sureties. We reject that argument, and instead adopt Dr. Tolentino's observation that "[t]he reference in the second paragraph of [Article 2047] to the provisions of Section 4, Chapter 3, Title I, Book IV, on solidary or several obligations, however, does not mean that suretyship is withdrawn from the applicable provisions governing guaranty." For if that were not the implication, there would be no material difference between the surety as defined under Article 2047 and the joint and several debtors, for both classes of obligors would be governed by exactly the same rules and limitations.
>
> Accordingly, the rights to indemnification and subrogation as established and granted to the guarantor by Articles 2066 and 2067 extend as well to sureties as defined under Article 2047. x x x. (Citations omitted.)

Pursuant to Articles 2066 and 2067, the rights of CCCIC as surety to indemnification and subrogation will arise only after it has paid its obligations to Kawasaki as the debtor-obligee. In *Autocorp Group v. Intra Strata Assurance Corporation*,[41] the Court ruled that:

> **The benefit of subrogation**, an extinctive subjective novation by a change of creditor, which "transfers to the person subrogated, the credit and all the rights thereto appertaining, either against the debtor or against third persons," **is granted by the Article 2067 of the Civil Code only to the "guarantor (or surety) who pays**." (Emphases supplied, citations omitted.)

In the present case, CCCIC has yet to pay Kawasaki.

While summons was validly served upon FFMCCI, the Third-Party Complaint of CCCIC against FFMCCI is dismissed on the ground of lack of cause of action.

The Court disagrees with the ruling of the Court of Appeals that there was no proper service of summons upon FFMCCI. The appellate court overlooked the fact that the service of summons on FFMCCI at its principal address at #86 West Avenue, Quezon City failed because FFMCCI had already vacated said premises without notifying anyone as to where it

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41 578 Phil. 804, 822-823 (2008).

transferred. For this reason, the RTC, upon the motion of CCCIC, issued an Order[42] dated September 4, 1991, directing the issuance and service of Alias Summons to the individual directors of FFMCCI. Eventually, the Alias Summons was personally served upon FFMCCI director Vicente Concepcion on September 25, 1991.[43]

Rule 14, Section 13 of the 1964 Rules of Court, which was then in force, allowed the service of summons upon a director of a private domestic corporation:

> Sec. 13. *Service upon private domestic corporation or partnership.* – If the defendant is a corporation organized under the laws of the Philippines or a partnership duly registered, service may be made on the president, manager, secretary, cashier, agent, or any of its directors.

The aforementioned rule does not require that service on the private domestic corporation be served at its principal office in order for the court to acquire jurisdiction over the same. The Court, in *Talsan Enterprises, Inc. vs. Baliwag Transit, Inc.*,[44] citing *Baltazar v. Court of Appeals*,[45] affirmed that:

> [S]ervice on respondent's bus terminal at the address stated in the summons and not in its main office in Baliwag do not render the service of summons invalid. In *Artemio Baltazar v. Court of Appeals*, we held:
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> > "The regular mode, in other words, of serving summons upon a private Philippine Corporation is by personal service upon one of the officers of such corporation identified in Section 13. Ordinarily, such personal service may be expected to be made at the principal office of the corporation. **Section 13, does not, however, impose such requirement, and so personal service upon the corporation may be effected through service upon, for instance, the president of the corporation at his office or residential address.**" x x x.
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> In fine, the service of summons upon respondent Baliwag Transit is proper. Consequently, the trial court validly acquired jurisdiction over respondent Baliwag. (Citation omitted.)

Hence, the personal service of the Alias Summons on an FFMCCI director was sufficient for the RTC to acquire jurisdiction over FFMCCI itself.

Nevertheless, the Third-Party Complaint filed by CCCIC against FFMCCI and Mañacop must be dismissed on the ground of lack of cause of action.

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42 Records (Vol. I), p. 250.
43 Id. at 255.
44 369 Phil. 409, 419-420 (1999).
45 250 Phil. 349, 360-361 (1988).

A cause of action is defined as the act or omission by which a party violates a right of another. The essential elements of a cause of action are: (a) the existence of a legal right in favor of the plaintiff; (b) a correlative legal duty of the defendant to respect such right; and (c) an act or omission by such defendant in violation of the right of the plaintiff with a resulting injury or damage to the plaintiff for which the latter may maintain an action for the recovery of relief from the defendant.[46]

As discussed earlier, the rights to indemnification and subrogation of a surety only arise upon its payment of the obligation to the obligee. In the case at bar, since CCCIC up to this point refuses to acknowledge and pay its obligation to Kawasaki under the Surety and Performance Bonds, it has not yet acquired the rights to seek indemnification from FFMCCI and subrogation to Kawasaki as against FFMCCI. In the same vein, the corresponding obligation of FFMCCI to indemnify CCCIC under the Indemnity Agreements has yet to accrue. Thus far, there is no act or omission on the part of FFMCCI which violated the right of CCCIC and for which CCCIC may seek relief from the courts. In the absence of these elements, CCCIC has no cause of action against FFMCCI and/or FFMCCI President Mañacop. Resultantly, the Third-Party Complaint of CCCIC should be dismissed.

There is no basis for awarding attorney's fees in favor of Kawasaki. In addition, the rate of legal interest imposed shall conform with latest jurisprudence.

Article 2208(2) of the Civil Code allows the award of attorney's fees "[w]hen the defendant's act or omission has compelled the plaintiff to litigate with third persons or to incur expenses to protect his interest[.]" In *Servicewide Specialists, Incorporated v. Court of Appeals*,[47] the Court declared that:

> Article 2208 of the Civil Code allows attorney's fees to be awarded by a court when its claimant is compelled to litigate with third persons or to incur expenses to protect his interest by reason of an unjustified act or omission on the part of the party from whom it is sought. To be sure, private respondents were forced to litigate to protect their rights but as we have previously held: "where no sufficient showing of bad faith would be reflected in a party's persistence in a case other than an erroneous conviction of the righteousness of his cause, attorney's fee shall not be recovered as cost." (Citation omitted.)

Bad faith has been defined as "a breach of a known duty through some motive of interest or ill will. It must, however, be substantiated by evidence. Bad faith under the law cannot be presumed, it must be

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46 *Turner v. Lorenzo Shipping Corporation*, 650 Phil. 372, 388 (2010).

47 326 Phil. 660, 669 (1996).

established by clear and convincing evidence."[48] There is no evidence in this case to show bad faith on the part of CCCIC. CCCIC, in refusing the claim of Kawasaki, was merely acting based on its belief in the righteousness of its defense. Hence, even though Kawasaki was compelled to litigate to enforce its claim against CCCIC, the award of attorney's fees is not proper.

Finally, the Court, in *Nacar v. Gallery Frames,*[49] modified the guidelines in imposing interests, taking into account Bangko Sentral ng Pilipinas-Monetary Board Resolution No. 796 dated May 16, 2013 and Circular No. 799, series of 2013, which fixed the legal rate at 6% per annum effective July 1, 2013. In the absence of stipulated interest in the present case, the Court imposes upon the amounts covered by the Surety and Performance Bonds the legal rate of 12% per annum from September 15, 1989, the date of demand, until June 30, 2013; and then the legal rate of 6% per annum from July 1, 2013 until full payment of the same.

WHEREFORE, premises considered, the instant Petition for Review on *Certiorari* is **PARTLY GRANTED**. The Decision dated May 30, 2002 and Resolution dated November 14, 2002 of the Court of Appeals are **AFFIRMED** with the following **MODIFICATIONS**:

1) The Third-Party Complaint filed by CCC Insurance Corporation against F.F. Mañacop Construction Company, Inc. and Mr. Florante F. Mañacop is **DISMISSED** on the ground of lack of cause of action;

2) The award of attorney's fees in favor of Kawasaki Steel Corporation is **DELETED**; and

3) In addition to the amounts CCC Insurance Corporation is ordered to pay Kawasaki Steel Corporation under Surety Bond No. B-88/11191 and Performance Bond No. B-88/11193, CCC Insurance Corporation is further **ORDERED** to pay Kawasaki Steel Corporation legal interest on said amounts at the rates of 12% per annum from September 15, 1989 to June 30, 2013 and 6% per annum from July 1, 2013 until full payment thereof.

SO ORDERED.

Teresita Leonardo de Castro

TERESITA J. LEONARDO-DE CASTRO
Associate Justice

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48 *GF Equity, Inc. v. Valenzona*, 501 Phil. 153, 168 (2005).

49 G.R. No. 189871, August 13, 2013, 703 SCRA 439, 454-456.

WE CONCUR:

MARIA LOURDES P. A. SERENO
Chief Justice
Chairperson

LUCAS P. BERSAMIN
Associate Justice

JOSE PORTUGAL PEREZ
Associate Justice

ESTELA M. PERLAS-BERNABE
Associate Justice

CERTIFICATION

Pursuant to Section 13, Article VIII of the Constitution, I certify that the conclusions in the above Decision had been reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

MARIA LOURDES P. A. SERENO
Chief Justice