

## SPECIAL FIRST DIVISION

[ G.R. No. 189563, December 07, 2016 ]

**GILAT SATELLITE NETWORKS, LTD., PETITIONER, V. UNITED  
COCONUT PLANTERS BANK GENERAL INSURANCE CO., INC.,  
RESPONDENT.**

### RESOLUTION

**SERENO, C.J.:**

Before this Court is petitioner's Motion for Partial Reconsideration and/or For Clarification<sup>[1]</sup> and respondent's Motion for Reconsideration<sup>[2]</sup> of this Court's Decision dated 7 April 2014.<sup>[3]</sup> The Court reversed the Decision<sup>[4]</sup> and Resolution<sup>[5]</sup> of the Court of Appeals (CA) in CA-G.R. CV No. 89263, ordering petitioner and One Virtual Inc., to proceed to arbitration, the outcome of which shall bind the parties herein.

In Our Decision dated 7 April 2014, We held that as a surety to the principal contract between petitioner (seller) and One Virtual (buyer), respondent was liable to petitioner for the failure of One Virtual to pay for the equipment delivered to the latter as buyer under the Purchase Agreement.<sup>[6]</sup>

We stressed that respondent cannot invoke as a defense the arbitration clause in the Purchase Agreement, because the existence of a suretyship agreement does not give the surety (herein respondent) the right to intervene in the principal contract. The liability of the surety is direct, primary and absolute, and it may in fact be sued separately or together with the principal debtor.<sup>[7]</sup>

Consequently, We found respondent liable to petitioner for payment of the debt under the Surety Bond in the amount of one million two hundred thousand dollars (USD 1.2 million), and interest at the rate of 6% per annum from 5 June 2000 until satisfaction of the obligation under the Suretyship Contract and Purchase Agreement.<sup>[8]</sup>

In its **Motion for Reconsideration**, respondent argues that while the liability of a surety is principal and direct, such liability presupposes the existence of a valid principal obligation.<sup>[9]</sup> In this case, there is a principal contract, but the obligations stated therein have not been complied with. There is allegedly no sufficient evidence on record to prove that petitioner was able to install and commission the equipment and deliver the software under the Purchase Agreement.<sup>[10]</sup> The fulfilment of petitioner's obligation under the Purchase Agreement would have given rise to the concomitant obligation of the debtor or surety to pay.<sup>[11]</sup> Petitioner, therefore, cannot demand payment if it has not complied with its obligations.<sup>[12]</sup>

Respondent also believes that the surety agreement must be applied and interpreted together with the principal contract, because the surety is bound by the

terms and conditions thereof. Necessarily therefore, the surety — herein respondent — can invoke the arbitration clause found in the principal contract.<sup>[13]</sup>

Anent the awarded interest, respondent avers that the Court erred, because there is no evidence to prove that the delay caused by respondent in the payment of the supposed obligation to petitioner is inexcusable. Had the latter completed the delivery, installation and commissioning of the equipment and software, One Virtual would have made the proper payments, and respondent would not have incurred any delay.<sup>[14]</sup>

Likewise, respondent contests the award of attorney's fees, in that the "mere fact that a party was compelled to litigate to protect its rights will not justify an award of attorney's fees under Article 2208 of the Civil Code when no sufficient showing of bad faith would be reflected in the other party's persistence in a case other than an erroneous conviction of righteousness of his cause."<sup>[15]</sup> Here, petitioner allegedly failed to present even "a shred of evidence to prove that respondent acted in gross and evident bad faith in denying the claim of petitioner under the Surety Agreement."<sup>[16]</sup> In fact, the lower court ruled that the delay incurred by respondent was excusable, because the latter received advice from One Virtual that petitioner had breached its obligation under the Purchase Agreement and should therefore not be paid.<sup>[17]</sup>

On the other hand, in its **Motion for Partial Reconsideration and/or for Clarification**, petitioner prays for the "reconsideration and/or clarification of the Decision with respect to: (i) the rate of legal interest due on the principal debt of US\$1.2 Million; (ii) legal interest due on the accrued interest on the principal debt as of the filing of the Complaint; and (iii) the legal interest due on the total award (i.e., principal, interest, interest on interest, and the attorney's fees and litigation expenses) from finality of the Decision until full payment thereof."<sup>[18]</sup>

In particular, petitioner insists that while the Court correctly held that respondent's obligation started to run from 5 June 2000 (the date of the extrajudicial demand), the imposed legal interest of 6%, by virtue of *Bangko Sentral* Circular No. 799 (effective 30 June 2013, series of 2013), must be imposed prospectively. Accordingly, the legal interest of 12% per annum must be applied from 5 June 2000 up to 30 June 2013, and 6% per annum from 1 July 2013 until full payment.<sup>[19]</sup>

Petitioner also points out that whatever interest is due shall itself earn legal interest from the time it is judicially demanded, in accordance with Article 2210 of the Civil Code.<sup>[20]</sup> It then claims "interest on the accrued interest on the principal debt as of the filing of the Complaint on [23 April 2002] when Gilat judicially demanded payment of interest due on the principal debt,"<sup>[21]</sup> as follows:

13. As of [23 April 2002], the accrued interest on the principal debt of US\$1.2 Million (computed from 5 June 2000) is US\$270,270. This is computed as follows: US\$1.2 Million x 12% x 1.88 years = US\$270.270.

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(a) 12% per annum from [23 April 2002] up to 30 June 2013 (i.e., US\$270,270 x 12% x 11.19 years US\$363,522.82); and

(b) 6% per annum on US\$270270 from 1 July 2013 until finality of judgment.<sup>[22]</sup>

Moreover, petitioner insists that when a monetary judgment becomes final and executory, it shall earn legal interest from the date of its finality until its satisfaction. Gilat prays that the "Decision expressly state the legal interest of 6% shall be due from finality until satisfaction, not only on the principal debt but also on the accrued interest, interest on interests, and on the award of attorney's fees and litigation expenses."<sup>[23]</sup>

Overall, the Court is being asked to modify the Decision by ordering respondent to pay petitioner the following amounts:

(a) US\$1.2 Million representing the principal debt under the Surety Bond;

(b) US\$1,882,080 representing legal interest on the principal debt of US\$1.2 Million computed at 12% per annum from June 5, 2000 up to June 30, 2013;

(c) Legal interest on the principal debt of US\$1.2 Million computed at 6% per annum from July 1, 2013 until finality of judgment;

(d) US\$363,522.82 representing legal interest on the accrued interest of US\$270,270 (i.e., the accrued interest on the principal debt as of the date of the filing of the Complaint on April 23, 2002) computed at 12% per annum from April 12, 2002 up to June 30, 2013:

(e) Legal interest on US\$270,270 (i.e., the accrued interest on the principal debt as of the date of the filing of the Complaint on April 23, 2002) computed at 6% per annum from July 1, 2014 until finality of judgment;

(f) US\$44,004.04 representing attorney's fees and litigation expenses; and

(g) Legal interest on the total amount due (i.e., the sum of all the foregoing) as of the date of finality of judgment computed at 6% per annum from the date of finality until full satisfaction of the total amount due.<sup>[24]</sup>

### **We agree with petitioner on all points.**

*First*, We reiterate our ruling that although the contract of a surety is in essence secondary only to a valid principal obligation, the surety's liability to the creditor or the "promise" of the principal is direct, primary and absolute.<sup>[25]</sup> The surety becomes liable for the debt and duty of the principal obligor, even without possessing a direct or personal interest in the obligations constituted by the latter.<sup>[26]</sup>

It bears stressing that petitioner did in fact deliver the equipment and licensing, but that the commissioning was not completed because One Virtual was already in default at that time.<sup>[27]</sup> Had the latter paid its obligation on time, then petitioner would not have been forced to stop the commissioning.<sup>[28]</sup> Unfortunately, respondent miserably failed to debunk this argument when it presented witnesses

who had no personal knowledge of petitioner's alleged breach of contract.<sup>[29]</sup> The trial court rightly treated these testimonies as hearsay.<sup>[30]</sup>

Accordingly, respondent cannot invoke the arbitration clause, because it is not a party to the principal contract: the Purchase Agreement.<sup>[31]</sup> An arbitration agreement, being contractual in nature, is binding only on the parties thereto, as well as their assigns and heirs.<sup>[32]</sup> We have explained this exhaustively in Our Decision dated 7 April 2014, but we deem it necessary to reiterate the relevant portions, to wit:

*First*, we have held in *Stronghold Insurance Co. Inc. v. Tokyu Construction Co. Ltd.*, that "[the] acceptance [of a surety agreement], 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." Hence, the surety remains a stranger to the Purchase Agreement. We agree with petitioner that respondent cannot invoke in its favor the arbitration clause in the Purchase Agreement, because it is not a party to that contract. An arbitration agreement being contractual in nature, it is binding only on the parties thereto, as well as their assigns and heirs.

*Second*, Section 24 of Republic Act No. 9285 is clear in stating that a referral to arbitration may only take place "if at least one party so requests not later than the pre-trial conference, or upon the request of both parties thereafter." Respondent has not presented even an iota of evidence to show that either petitioner or One Virtual submitted its contesting claim for arbitration. In no way can respondent be allowed to hide behind the cloak of the arbitration agreement, because it is not a party thereto, and there is no referral to arbitrate.

*Third*, sureties do not insure the solvency of the debtor, but rather the debt itself. They are contracted precisely to mitigate risks of non-performance on the part of the obligor. This responsibility necessarily places a surety on the same level as that of the principal debtor. The effect is that the creditor is given the right to directly proceed to either principal debtor or surety. This is the reason why excussion cannot be invoked. To require the creditor to proceed to arbitration would render the very essence of suretyship nugatory and diminish its value in commerce. At any rate, as we have held in *Palmares v. Court of Appeals*, "if the surety is dissatisfied with the degree of activity displayed by the creditor in the pursuit of his principal, he may pay the debt himself and become subrogated to all the rights and remedies of the creditor."<sup>[33]</sup> [Emphasis and citation omitted]

*Second*, on the issue of whether or not there is inexcusable delay, We have already pointed out that petitioner presented sufficient evidence to prove that it had complied with the terms and conditions under the Purchase Agreement.<sup>[34]</sup> The deposition of Mr. Erez Antebi, vice president of Gilat, repeatedly stated that