

## FIRST DIVISION

[ G.R. No. 189563, April 07, 2014 ]

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

### D E C I S I O N

**SERENO, C.J.:**

This is an appeal via a Petition for Review on Certiorari<sup>[1]</sup> filed 6 November 2009 assailing the Decision<sup>[2]</sup> and Resolution<sup>[3]</sup> of the Court of Appeals (CA) in CA-G.R. CV No. 89263, which reversed the Decision<sup>[4]</sup> of the Regional Trial Court (RTC), Branch 141, Makati City in Civil Case No. 02-461, ordering respondent to pay petitioner a sum of money.

The antecedent facts, as culled from the CA, are as follows:

On September 15, 1999, One Virtual placed with GILAT a purchase order for various telecommunications equipment (sic), accessories, spares, services and software, at a total purchase price of Two Million One Hundred Twenty Eight Thousand Two Hundred Fifty Dollars (US\$2,128,250.00). Of the said purchase price for the goods delivered, One Virtual promised to pay a portion thereof totalling US\$1.2 Million in accordance with the payment schedule dated 22 November 1999. To ensure the prompt payment of this amount, it obtained defendant UCPB General Insurance Co., Inc.'s surety bond dated 3 December 1999, in favor of GILAT.

During the period between [sic] September 1999 and June 2000, GILAT shipped and delivered to One Virtual the purchased products and equipment, as evidenced by airway bills/Bill of Lading (*Exhibits "F", "F-1" to "F-8"*). All of the equipment (including the software components for which payment was secured by the surety bond, was shipped by GILAT and duly received by One Virtual. Under an endorsement dated December 23, 1999 (*Exhibit "E"*), the surety issued, with One Virtual's conformity, an amendment to the surety bond, Annex "A" thereof, correcting its expiry date from May 30, 2001 to July 30, 2001.

One Virtual failed to pay GILAT the amount of Four Hundred Thousand Dollars (US\$400,000.00) on the due date of May 30, 2000 in accordance with the payment schedule attached as Annex "A" to the surety bond, prompting GILAT to write the surety defendant UCPB on June 5, 2000, a demand letter (*Exhibit "G"*) for payment of the said amount of US\$400,000.00. No part of the amount set forth in this demand has been

paid to date by either One Virtual or defendant UCPB. One Virtual likewise failed to pay on the succeeding payment instalment date of 30 November 2000 as set out in Annex "A" of the surety bond, prompting GILAT to send a second demand letter dated January 24, 2001, for the payment of the full amount of US\$1,200,000.00 guaranteed under the surety bond, plus interests and expenses (*Exhibits "H"*) and which letter was received by the defendant surety on January 25, 2001. However, defendant UCPB failed to settle the amount of US\$1,200,000.00 or a part thereof, hence, the instant complaint."<sup>[5]</sup> (Emphases in the original)

On 24 April 2002, petitioner Gilat Satellite Networks, Ltd., filed a Complaint<sup>[6]</sup> against respondent UCPB General Insurance Co., Inc., to recover the amounts supposedly covered by the surety bond, plus interests and expenses. After due hearing, the RTC rendered its Decision,<sup>[7]</sup> the dispositive portion of which is herein quoted:

WHEREFORE, premises considered, the Court hereby renders judgment for the plaintiff, and against the defendant, ordering, to wit:

1. The defendant surety to pay the plaintiff the amount of One Million Two Hundred Thousand Dollars (US\$1,200,000.00) representing the principal debt under the Surety Bond, with legal interest thereon at the rate of 12% per annum computed from the time the judgment becomes final and executory until the obligation is fully settled; and
2. The defendant surety to pay the plaintiff the amount of Forty Four Thousand Four Dollars and Four Cents (US\$44,004.04) representing attorney's fees and litigation expenses.

Accordingly, defendant's counterclaim is hereby **dismissed** for want of merit.

SO ORDERED. (Emphasis in the original)

In so ruling, the RTC reasoned that there is "no dispute that plaintiff [petitioner] delivered all the subject equipments [sic] and the same was installed. Even with the delivery and installation made, One Virtual failed to pay any of the payments agreed upon. Demand notwithstanding, defendant failed and refused and continued to fail and refused to settle the obligation."<sup>[8]</sup> Considering that its liability was indeed that of a surety, as "spelled out in the Surety Bond executed by and between One Virtual as Principal, UCPB as Surety and GILAT as Creditor/Bond Oblige,"<sup>[9]</sup> respondent agreed and bound itself to pay in accordance with the Payment Milestones. This obligation was not made dependent on any condition outside the terms and conditions of the Surety Bond and Payment Milestones.<sup>[10]</sup>

Insofar as the interests were concerned, the RTC denied petitioner's claim on the premise that while a surety can be held liable for interest even if it becomes more onerous than the principal obligation, the surety shall only accrue when the delay or refusal to pay the principal obligation is without any justifiable cause.<sup>[11]</sup> Here,

respondent failed to pay its surety obligation because of the advice of its principal (One Virtual) not to pay.<sup>[12]</sup> The RTC then obligated respondent to pay petitioner the amount of USD1,200,000.00 representing the principal debt under the Surety Bond, with legal interest at the rate of 12% per annum computed from the time the judgment becomes final and executory, and USD44,004.04 representing attorney's fees and litigation expenses.

On 18 October 2007, respondent appealed to the CA.<sup>[13]</sup> The appellate court rendered a Decision<sup>[14]</sup> in the following manner:

**WHEREFORE**, this appealed case is **DISMISSED** for lack of jurisdiction. The trial court's *Decision* dated December 28, 2006 is VACATED. Plaintiff-appellant Gilat Satellite Networks Ltd., and One Virtual are ordered to proceed to arbitration, the outcome of which shall necessary bind the parties, including the surety, defendant-appellant United Coconut Planters Bank General Insurance Co., Inc.

**SO ORDERED.** (Emphasis in the original)

The CA ruled that in "enforcing a surety contract, the 'complementary-contracts-construed-together' doctrine finds application." According to this doctrine, the accessory contract must be construed with the principal agreement.<sup>[15]</sup> In this case, the appellate court considered the Purchase Agreement entered into between petitioner and One Virtual as the principal contract,<sup>[16]</sup> whose stipulations are also binding on the parties to the suretyship.<sup>[17]</sup> Bearing in mind the arbitration clause contained in the Purchase Agreement<sup>[18]</sup> and pursuant to the policy of the courts to encourage alternative dispute resolution methods,<sup>[19]</sup> the trial court's Decision was vacated; petitioner and One Virtual were ordered to proceed to arbitration.

On 9 September 2008, petitioner filed a Motion for Reconsideration with Motion for Oral Argument. The motion was denied for lack of merit in a Resolution<sup>[20]</sup> issued by the CA on 16 September 2009.

Hence, the instant Petition.

On 31 August 2010, respondent filed a Comment<sup>[21]</sup> on the Petition for Review. On 24 November 2010, petitioner filed a Reply.<sup>[22]</sup>

## **ISSUES**

From the foregoing, we reduce the issues to the following:

1. Whether or not the CA erred in dismissing the case and ordering petitioner and One Virtual to arbitrate; and
2. Whether or not petitioner is entitled to legal interest due to the delay in the fulfilment by respondent of its obligation under the

## THE COURT'S RULING

***The existence of a suretyship agreement does not give the surety the right to intervene in the principal contract, nor can an arbitration clause between the buyer and the seller be invoked by a non-party such as the surety.***

Petitioner alleges that arbitration laws mandate that no court can compel arbitration, unless a party entitled to it applies for this relief.<sup>[23]</sup> This referral, however, can only be demanded by one who is a party to the arbitration agreement.<sup>[24]</sup> Considering that neither petitioner nor One Virtual has asked for a referral, there is no basis for the CA's order to arbitrate.

Moreover, Articles 1216 and 2047 of the Civil Code<sup>[25]</sup> clearly provide that the creditor may proceed against the surety without having first sued the principal debtor.<sup>[26]</sup> Even the Surety Agreement itself states that respondent becomes liable upon "mere failure of the Principal to make such prompt payment."<sup>[27]</sup> Thus, petitioner should not be ordered to make a separate claim against One Virtual (via arbitration) before proceeding against respondent.<sup>[28]</sup>

On the other hand, respondent maintains that a surety contract is merely an accessory contract, which cannot exist without a valid obligation.<sup>[29]</sup> Thus, the surety may avail itself of all the defenses available to the principal debtor and inherent in the debt<sup>[30]</sup> – that is, the right to invoke the arbitration clause in the Purchase Agreement.

### **We agree with petitioner.**

In suretyship, the oft-repeated rule is that a surety's liability is joint and solidary with that of the principal debtor. This undertaking makes a surety agreement an ancillary contract, as it presupposes the existence of a principal contract.<sup>[31]</sup> Nevertheless, although the contract of a surety is in essence secondary only to a valid principal obligation, its liability to the creditor or "promise" of the principal is said to be direct, primary and absolute; in other words, a surety is directly and equally bound with the principal.<sup>[32]</sup> He 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>[33]</sup> Thus, a surety is not entitled to a separate notice of default or to the benefit of excussion.<sup>[34]</sup> It may in fact be sued separately or together with the principal debtor.<sup>[35]</sup>

After a thorough examination of the pieces of evidence presented by both parties,

[36] the RTC found that petitioner had delivered all the goods to One Virtual and installed them. Despite these compliances, One Virtual still failed to pay its obligation, [37] triggering respondent's liability to petitioner as the former's surety. In other words, the failure of One Virtual, as the principal debtor, to fulfill its monetary obligation to petitioner gave the latter an immediate right to pursue respondent as the surety.

Consequently, we cannot sustain respondent's claim that the Purchase Agreement, being the principal contract to which the Suretyship Agreement is accessory, must take precedence over arbitration as the preferred mode of settling disputes.

*First*, we have held in *Stronghold Insurance Co. Inc. v. Tokyu Construction Co. Ltd.*, [38] 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. [39] An arbitration agreement being contractual in nature, [40] it is binding only on the parties thereto, as well as their assigns and heirs. [41]

*Second*, Section 24 of Republic Act No. 9285 [42] 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.

*Third*, sureties do not insure the solvency of the debtor, but rather the debt itself. [43] 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.** [44] The effect is that the creditor is given the right to directly proceed against either principal debtor or surety. This is the reason why excussion cannot be invoked. [45] 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*, [46] "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."

***Interest, as a form of indemnity, may be awarded to a creditor for the delay incurred by a debtor in the payment of the latter's obligation, provided that the delay is inexcusable.***

Anent the issue of interests, petitioner alleges that it deserves to be paid legal interest of 12% per annum from the time of its first demand on respondent on 5