

FIRST DIVISION

[G.R. No. 140047, July 13, 2004]

PHILIPPINE EXPORT AND FOREIGN LOAN GUARANTEE CORPORATION, PETITIONER, VS. V.P. EUSEBIO CONSTRUCTION, INC.; 3-PLEX INTERNATIONAL, INC.; VICENTE P. EUSEBIO; SOLEDAD C. EUSEBIO; EDUARDO E. SANTOS; ILUMINADA SANTOS; AND FIRST INTEGRATED BONDING AND INSURANCE COMPANY, INC., RESPONDENTS.

DECISION

DAVIDE JR., J.:

This case is an offshoot of a service contract entered into by a Filipino construction firm with the Iraqi Government for the construction of the Institute of Physical Therapy-Medical Center, Phase II, in Baghdad, Iraq, at a time when the Iran-Iraq war was ongoing.

In a complaint filed with the Regional Trial Court of Makati City, docketed as Civil Case No. 91-1906 and assigned to Branch 58, petitioner Philippine Export and Foreign Loan Guarantee Corporation^[1] (hereinafter Philguarantee) sought reimbursement from the respondents of the sum of money it paid to Al Ahli Bank of Kuwait pursuant to a guarantee it issued for respondent V.P. Eusebio Construction, Inc. (VPECI).

The factual and procedural antecedents in this case are as follows:

On 8 November 1980, the State Organization of Buildings (SOB), Ministry of Housing and Construction, Baghdad, Iraq, awarded the construction of the Institute of Physical Therapy-Medical Rehabilitation Center, Phase II, in Baghdad, Iraq, (hereinafter the Project) to Ajyal Trading and Contracting Company (hereinafter Ajyal), a firm duly licensed with the Kuwait Chamber of Commerce for a total contract price of ID5,416,089/046 (or about US\$18,739,668).^[2]

On 7 March 1981, respondent spouses Eduardo and Iluminada Santos, in behalf of respondent 3-Plex International, Inc. (hereinafter 3-Plex), a local contractor engaged in construction business, entered into a joint venture agreement with Ajyal wherein the former undertook the execution of the entire Project, while the latter would be entitled to a commission of 4% of the contract price.^[3] Later, or on 8 April 1981, respondent 3-Plex, not being accredited by or registered with the Philippine Overseas Construction Board (POCB), assigned and transferred all its rights and interests under the joint venture agreement to VPECI, a construction and engineering firm duly registered with the POCB.^[4] However, on 2 May 1981, 3-Plex and VPECI entered into an agreement

that the execution of the Project would be under their joint management.^[5]

The SOB required the contractors to submit (1) a performance bond of ID271,808/610 representing 5% of the total contract price and (2) an advance payment bond of ID541,608/901 representing 10% of the advance payment to be released upon signing of the contract.^[6] To comply with these requirements, respondents 3-Plex and VPECI applied for the issuance of a guarantee with petitioner Philguarantee, a government financial institution empowered to issue guarantees for qualified Filipino contractors to secure the performance of approved service contracts abroad.^[7]

Petitioner Philguarantee approved respondents' application. Subsequently, letters of guarantee^[8] were issued by Philguarantee to the Rafidain Bank of Baghdad covering 100% of the performance and advance payment bonds, but they were not accepted by SOB. What SOB required was a letter-guarantee from Rafidain Bank, the government bank of Iraq. Rafidain Bank then issued a performance bond in favor of SOB on the condition that another foreign bank, not Philguarantee, would issue a counter-guarantee to cover its exposure. Al Ahli Bank of Kuwait was, therefore, engaged to provide a counter-guarantee to Rafidain Bank, but it required a similar counter-guarantee in its favor from the petitioner. Thus, three layers of guarantees had to be arranged.^[9]

Upon the application of respondents 3-Plex and VPECI, petitioner Philguarantee issued in favor of Al Ahli Bank of Kuwait Letter of Guarantee No. 81-194-F ^[10] (Performance Bond Guarantee) in the amount of ID271,808/610 and Letter of Guarantee No. 81-195-F^[11] (Advance Payment Guarantee) in the amount of ID541,608/901, both for a term of eighteen months from 25 May 1981. These letters of guarantee were secured by (1) a Deed of Undertaking^[12] executed by respondents VPECI, Spouses Vicente P. Eusebio and Soledad C. Eusebio, 3-Plex, and Spouses Eduardo E. Santos and Iluminada Santos; and (2) a surety bond^[13] issued by respondent First Integrated Bonding and Insurance Company, Inc. (FIBICI). The Surety Bond was later amended on 23 June 1981 to increase the amount of coverage from P6.4 million to P6.967 million and to change the bank in whose favor the petitioner's guarantee was issued, from Rafidain Bank to Al Ahli Bank of Kuwait.^[14]

On 11 June 1981, SOB and the joint venture VPECI and Ajyal executed the service contract^[15] for the construction of the Institute of Physical Therapy – Medical Rehabilitation Center, Phase II, in Baghdad, Iraq, wherein the joint venture contractor undertook to complete the Project within a period of 547 days or 18 months. Under the Contract, the Joint Venture would supply manpower and materials, and SOB would refund to the former 25% of the project cost in Iraqi Dinar and the 75% in US dollars at the exchange rate of 1 Dinar to 3.37777 US Dollars.^[16]

The construction, which was supposed to start on 2 June 1981, commenced only on the last week of August 1981. Because of this delay and the slow progress of the construction work due to some setbacks and difficulties, the Project was not completed on 15 November 1982 as scheduled. But in October 1982, upon foreseeing the

impossibility of meeting the deadline and upon the request of Al Ahli Bank, the joint venture contractor worked for the renewal or extension of the Performance Bond and Advance Payment Guarantee. Petitioner's Letters of Guarantee Nos. 81-194-F (Performance Bond) and 81-195-F (Advance Payment Bond) with expiry date of 25 November 1982 were then renewed or extended to 9 February 1983 and 9 March 1983, respectively.^[17] The surety bond was also extended for another period of one year, from 12 May 1982 to 12 May 1983.^[18] The Performance Bond was further extended twelve times with validity of up to 8 December 1986,^[19] while the Advance Payment Guarantee was extended three times more up to 24 May 1984 when the latter was cancelled after full refund or reimbursement by the joint venture contractor.^[20] The surety bond was likewise extended to 8 May 1987.^[21]

As of March 1986, the status of the Project was 51% accomplished, meaning the structures were already finished. The remaining 47% consisted in electro-mechanical works and the 2%, sanitary works, which both required importation of equipment and materials.^[22]

On 26 October 1986, Al Ahli Bank of Kuwait sent a telex call to the petitioner demanding full payment of its performance bond counter-guarantee.

Upon receiving a copy of that telex message on 27 October 1986, respondent VPECI requested Iraq Trade and Economic Development Minister Mohammad Fadhi Hussein to recall the telex call on the performance guarantee for being a drastic action in contravention of its mutual agreement with the latter that (1) the imposition of penalty would be held in abeyance until the completion of the project; and (2) the time extension would be open, depending on the developments on the negotiations for a foreign loan to finance the completion of the project.^[23] It also wrote SOB protesting the call for lack of factual or legal basis, since the failure to complete the Project was due to (1) the Iraqi government's lack of foreign exchange with which to pay its (VPECI's) accomplishments and (2) SOB's noncompliance for the past several years with the provision in the contract that 75% of the billings would be paid in US dollars.^[24] Subsequently, or on 19 November 1986, respondent VPECI advised the petitioner not to pay yet Al Ahli Bank because efforts were being exerted for the amicable settlement of the Project.^[25]

On 14 April 1987, the petitioner received another telex message from Al Ahli Bank stating that it had already paid to Rafidain Bank the sum of US\$876,564 under its letter of guarantee, and demanding reimbursement by the petitioner of what it paid to the latter bank plus interest thereon and related expenses.^[26]

Both petitioner Philguarantee and respondent VPECI sought the assistance of some government agencies of the Philippines. On 10 August 1987, VPECI requested the Central Bank to hold in abeyance the payment by the petitioner "to allow the diplomatic machinery to take its course, for otherwise, the Philippine government, through the Philguarantee and the Central Bank, would become instruments of the Iraqi Government in consummating a clear act of injustice and inequity committed against a

Filipino contractor.”^[27]

On 27 August 1987, the Central Bank authorized the remittance for its account of the amount of US\$876,564 (equivalent to ID271, 808/610) to Al Ahli Bank representing full payment of the performance counter-guarantee for VPECI’s project in Iraq. ^[28]

On 6 November 1987, Philguarantee informed VPECI that it would remit US\$876,564 to Al Ahli Bank, and reiterated the joint and solidary obligation of the respondents to reimburse the petitioner for the advances made on its counter-guarantee. ^[29]

The petitioner thus paid the amount of US\$876,564 to Al Ahli Bank of Kuwait on 21 January 1988. ^[30] Then, on 6 May 1988, the petitioner paid to Al Ahli Bank of Kuwait US\$59,129.83 representing interest and penalty charges demanded by the latter bank. ^[31]

On 19 June 1991, the petitioner sent to the respondents separate letters demanding full payment of the amount of P47,872,373.98 plus accruing interest, penalty charges, and 10% attorney’s fees pursuant to their joint and solidary obligations under the deed of undertaking and surety bond. ^[32] When the respondents failed to pay, the petitioner filed on 9 July 1991 a civil case for collection of a sum of money against the respondents before the RTC of Makati City.

After due trial, the trial court ruled against Philguarantee and held that the latter had no valid cause of action against the respondents. It opined that at the time the call was made on the guarantee which was executed for a specific period, the guarantee had already lapsed or expired. There was no valid renewal or extension of the guarantee for failure of the petitioner to secure respondents’ express consent thereto. The trial court also found that the joint venture contractor incurred no delay in the execution of the Project. Considering the Project owner’s violations of the contract which rendered impossible the joint venture contractor’s performance of its undertaking, no valid call on the guarantee could be made. Furthermore, the trial court held that no valid notice was first made by the Project owner SOB to the joint venture contractor before the call on the guarantee. Accordingly, it dismissed the complaint, as well as the counterclaims and cross-claim, and ordered the petitioner to pay attorney’s fees of P100,000 to respondents VPECI and Eusebio Spouses and P100,000 to 3-Plex and the Santos Spouses, plus costs. ^[33]

In its 14 June 1999 Decision, ^[34] the Court of Appeals affirmed the trial court’s decision, ratiocinating as follows:

First, appellant cannot deny the fact that it was fully aware of the status of project implementation as well as the problems besetting the contractors, between 1982 to 1985, having sent some of its people to Baghdad during that period. The successive renewals/extensions of the guarantees in fact, was prompted by delays, not solely attributable to the contractors, and such extension understandably allowed by the SOB (project owner) which had not anyway complied with its contractual commitment to tender 75% of

payment in US Dollars, and which still retained overdue amounts collectible by VPECI.

...

Second, appellant was very much aware of the violations committed by the SOB of its contractual undertakings with VPECI, principally, the payment of foreign currency (US\$) for 75% of the total contract price, as well as of the complications and injustice that will result from its payment of the full amount of the performance guarantee, as evident in PHILGUARANTEE's letter dated 13 May 1987 ...

...

Third, appellant was fully aware that SOB was in fact still obligated to the Joint Venture and there was still an amount collectible from and still being retained by the project owner, which amount can be set-off with the sum covered by the performance guarantee.

...

Fourth, well-apprised of the above conditions obtaining at the Project site and cognizant of the war situation at the time in Iraq, appellant, though earlier has made representations with the SOB regarding a possible amicable termination of the Project as suggested by VPECI, made a complete turn-around and insisted on acting in favor of the unjustified "call" by the foreign banks.^[35]

The petitioner then came to this Court via Rule 45 of the Rules of Court claiming that the Court of Appeals erred in affirming the trial court's ruling that

I

...RESPONDENTS ARE NOT LIABLE UNDER THE DEED OF UNDERTAKING THEY EXECUTED IN FAVOR OF PETITIONER IN CONSIDERATION FOR THE ISSUANCE OF ITS COUNTER-GUARANTEE AND THAT PETITIONER CANNOT PASS ON TO RESPONDENTS WHAT IT HAD PAID UNDER THE SAID COUNTER-GUARANTEE.

II

...PETITIONER CANNOT CLAIM SUBROGATION.

III

...IT IS INIQUITOUS AND UNJUST FOR PETITIONER TO HOLD RESPONDENTS LIABLE UNDER THEIR DEED OF UNDERTAKING.^[36]

The main issue in this case is whether the petitioner is entitled to reimbursement of what it paid under Letter of Guarantee No. 81-194-F it issued to Al Ahli Bank of Kuwait based on the deed of undertaking and surety bond from the respondents.

The petitioner asserts that since the guarantee it issued was absolute, unconditional, and irrevocable the nature and extent of its liability are analogous to those of suretyship. Its liability accrued upon the failure of the respondents to finish the construction of the Institute of Physical Therapy Buildings in Baghdad.

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 contract is called suretyship. [37]

Strictly speaking, guaranty and surety are nearly related, and many of the principles are common to both. In both contracts, there is a promise to answer for the debt or default of another. However, in this jurisdiction, they may be distinguished thus:

1. A surety is usually bound with his principal by the same instrument executed at the same time and on the same consideration. On the other hand, the contract of guaranty is the guarantor's own separate undertaking often supported by a consideration separate from that supporting the contract of the principal; the original contract of his principal is not his contract.
2. A surety assumes liability as a regular party to the undertaking; while the liability of a guarantor is conditional depending on the failure of the primary debtor to pay the obligation.
3. The obligation of a surety is primary, while that of a guarantor is secondary.
4. A surety is an original promisor and debtor from the beginning, while a guarantor is charged on his own undertaking.
5. A surety is, ordinarily, held to know every default of his principal; whereas a guarantor is not bound to take notice of the non-performance of his principal.
6. Usually, a surety will not be discharged either by the mere indulgence of the creditor to the principal or by want of notice of the default of the principal, no matter how much he may be injured thereby. A guarantor is often discharged by the mere indulgence of the creditor to the principal, and is usually not liable unless notified of the default of the principal. [38]

In determining petitioner's status, it is necessary to read Letter of Guarantee No. 81-194-F, which provides in part as follows:

In consideration of your issuing the above performance guarantee/counter-guarantee, we hereby unconditionally and irrevocably guarantee, under our Ref. No. LG-81-194 F to pay you on your first written or telex demand Iraq Dinars Two Hundred Seventy One Thousand Eight Hundred Eight and six hundred ten (ID271,808/610) representing 100% of the performance bond required of V.P. EUSEBIO for the construction of the Physical Therapy Institute, Phase II, Baghdad, Iraq, plus interest and other incidental expenses related thereto.

In the event of default by V.P. EUSEBIO, we shall pay you 100% of the obligation unpaid but in no case shall such amount exceed Iraq Dinars (ID) 271,808/610 plus interest and other incidental expenses.... (Emphasis supplied)^[39]

Guided by the abovementioned distinctions between a surety and a guaranty, as well as the factual milieu of this case, we find that the Court of Appeals and the trial court were correct in ruling that the petitioner is a guarantor and not a surety. That the guarantee issued by the petitioner is unconditional and irrevocable does not make the petitioner a surety. As a guaranty, it is still characterized by its subsidiary and conditional quality because it does not take effect until the fulfillment of the condition, namely, that the principal obligor should fail in his obligation at the time and in the form he bound himself.^[40] In other words, an unconditional guarantee is still subject to the condition that the principal debtor should default in his obligation first before resort to the guarantor could be had. A conditional guaranty, as opposed to an unconditional guaranty, is one which depends upon some extraneous event, beyond the mere default of the principal, and generally upon notice of the principal's default and reasonable diligence in exhausting proper remedies against the principal.^[41]

It appearing that Letter of Guarantee No. 81-194-F merely stated that in the event of default by respondent VPECI the petitioner shall pay, the obligation assumed by the petitioner was simply that of an unconditional guaranty, not conditional guaranty. But as earlier ruled the fact that petitioner's guaranty is unconditional does not make it a surety. Besides, surety is never presumed. A party should not be considered a surety where the contract itself stipulates that he is acting only as a guarantor. It is only when the guarantor binds himself solidarily with the principal debtor that the contract becomes one of suretyship.^[42]

Having determined petitioner's liability as guarantor, the next question we have to grapple with is whether the respondent contractor has **defaulted** in its obligations that would justify resort to the guaranty. This is a mixed question of fact and law that is better addressed by the lower courts, since this Court is not a trier of facts.

It is a fundamental and settled rule that the findings of fact of the trial court and the Court of Appeals are binding or conclusive upon this Court unless they are not supported by the evidence or unless strong and cogent reasons dictate otherwise.^[43] The factual findings of the Court of Appeals are normally not reviewable by us under Rule 45 of the Rules of Court except when they are at variance with those of the trial court.^[44] The trial court and the Court of Appeals were in unison that the respondent

contractor cannot be considered to have defaulted in its obligations because the cause of the delay was not primarily attributable to it.

A corollary issue is what law should be applied in determining whether the respondent contractor has **defaulted** in the performance of its obligations under the service contract. The question of whether there is a breach of an agreement, which includes **default** or *mora*,^[45] pertains to the essential or intrinsic validity of a contract.^[46]

No conflicts rule on essential validity of contracts is expressly provided for in our laws. The rule followed by most legal systems, however, is that the intrinsic validity of a contract must be governed by the *lex contractus* or "proper law of the contract." This is the law voluntarily agreed upon by the parties (the *lex loci voluntatis*) or the law intended by them either expressly or implicitly (the *lex loci intentionis*). The law selected may be implied from such factors as substantial connection with the transaction, or the nationality or domicile of the parties.^[47] Philippine courts would do well to adopt the first and most basic rule in most legal systems, namely, *to allow the parties to select the law applicable to their contract, subject to the limitation that it is not against the law, morals, or public policy of the forum and that the chosen law must bear a substantive relationship to the transaction.*^[48]

It must be noted that the service contract between SOB and VPECI contains no express choice of the law that would govern it. In the United States and Europe, the two rules that now seem to have emerged as "kings of the hill" are (1) the parties may choose the governing law; and (2) in the absence of such a choice, the applicable law is that of the State that "has the most significant relationship to the transaction and the parties."^[49] Another authority proposed that all matters relating to the time, place, and manner of performance and valid excuses for non-performance are determined by the law of the place of performance or *lex loci solutionis*, which is useful because it is undoubtedly always connected to the contract in a significant way.^[50]

In this case, the laws of Iraq bear substantial connection to the transaction, since one of the parties is the Iraqi Government and the place of performance is in Iraq. Hence, the issue of whether respondent VPECI defaulted in its obligations may be determined by the laws of Iraq. However, since that foreign law was not properly pleaded or proved, the presumption of identity or similarity, otherwise known as the *processual presumption*, comes into play. Where foreign law is not pleaded or, even if pleaded, is not proved, the presumption is that foreign law is the same as ours.^[51]

Our law, specifically Article 1169, last paragraph, of the Civil Code, provides: "In reciprocal obligations, neither party incurs in delay if the other party does not comply or is not ready to comply in a proper manner with what is incumbent upon him."

Default or *mora* on the part of the debtor is the delay in the fulfillment of the prestation by reason of a cause imputable to the former.^[52] It is the non-fulfillment of an obligation with respect to time.^[53]

It is undisputed that only 51.7% of the total work had been accomplished. The 48.3%

unfinished portion consisted in the purchase and installation of electro-mechanical equipment and materials, which were available from foreign suppliers, thus requiring US Dollars for their importation. The monthly billings and payments made by SOB^[54] reveal that the agreement between the parties was a periodic payment by the Project owner to the contractor depending on the percentage of accomplishment within the period. ^[55] The payments were, in turn, to be used by the contractor to finance the subsequent phase of the work. ^[56] However, as explained by VPECI in its letter to the Department of Foreign Affairs (DFA), the payment by SOB purely in Dinars adversely affected the completion of the project; thus:

4. Despite protests from the plaintiff, SOB continued paying the accomplishment billings of the Contractor purely in Iraqi Dinars and which payment came only after some delays.

5. SOB is fully aware of the following:

...

- 5.2 That Plaintiff is a foreign contractor in Iraq and as such, would need

foreign currency (US\$), to finance the purchase of various equipment, materials, supplies, tools and to pay for the cost of project management, supervision and skilled labor not available in Iraq and therefore have to be imported and or obtained from the Philippines and other sources outside Iraq.

- 5.3 That the Ministry of Labor and Employment of the Philippines

requires the remittance into the Philippines of 70% of the salaries of Filipino workers working abroad in US Dollars;

...

- 5.5 That the Iraqi Dinar is not a freely convertible currency such that the

same cannot be used to purchase equipment, materials, supplies, etc. outside of Iraq;

- 5.6 That most of the materials specified by SOB in the CONTRACT are

not available in Iraq and therefore have to be imported;

- 5.7 That the government of Iraq prohibits the bringing of local currency

(Iraqi Dinars) out of Iraq and hence, imported materials, equipment, etc., cannot be purchased or obtained using

Iraqi Dinars as medium of acquisition.

...

8. Following the approved construction program of the CONTRACT, upon completion of the civil works portion of the installation of equipment for the building, should immediately follow, however, the CONTRACT specified that these equipment which are to be installed and to form part of the PROJECT have to be procured outside Iraq since these are not being locally manufactured. Copy of the relevant portion of the Technical Specification is hereto attached as Annex "C" and made an integral part hereof;

...

10. Due to the lack of Foreign currency in Iraq for this purpose, and if only to assist the

Iraqi government in completing the PROJECT, the Contractor without any obligation on its part to do so but with the knowledge and consent of SOB and the Ministry of Housing & Construction of Iraq, offered to arrange on behalf of SOB, a foreign currency loan, through the facilities of Circle International S.A., the Contractor's Sub-contractor and SACE MEDIO CREDITO which will act as the guarantor for this foreign currency loan.

Arrangements were first made with Banco di Roma. Negotiation started in June 1985. SOB is informed of the developments of this negotiation, attached is a copy of the draft of the loan Agreement between SOB as the Borrower and Agent. The Several Banks, as Lender, and counter-guaranteed by Istituto Centrale Per II Credito A Medio Termine (Mediocredito) Sezione Speciale Per L'Assicurazione Del Credito All'Esportazione (Sace). Negotiations went on and continued until it suddenly collapsed due to the reported default by Iraq in the payment of its obligations with Italian government, copy of the news clipping dated June 18, 1986 is hereto attached as Annex "D" to form an integral part hereof;

15. On September 15, 1986, Contractor received information from Circle International

S.A. that because of the news report that Iraq defaulted in its obligations with European banks, the approval by Banco di Roma of the loan to SOB shall be deferred indefinitely, a copy of the letter of Circle International together with the news clippings are hereto attached as Annexes "F" and "F-1", respectively.^[57]

As found by both the Court of Appeals and the trial court, the delay or the non-completion of the Project was caused by factors not imputable to the respondent contractor. It was rather due mainly to the persistent violations by SOB of the terms and conditions of the contract, particularly its failure to pay 75% of the accomplished work **in US Dollars**. Indeed, where one of the parties to a contract does not perform

in a proper manner the prestation which he is bound to perform under the contract, he is not entitled to demand the performance of the other party. A party does not incur in delay if the other party fails to perform the obligation incumbent upon him.

The petitioner, however, maintains that the payments by SOB of the monthly billings in purely Iraqi Dinars did not render impossible the performance of the Project by VPECI. Such posture is quite contrary to its previous representations. In his 26 March 1987 letter to the Office of the Middle Eastern and African Affairs (OMEAA), DFA, Manila, petitioner's Executive Vice-President Jesus M. Tañedo stated that while VPECI had taken every possible measure to complete the Project, the war situation in Iraq, particularly the lack of foreign exchange, was proving to be a great obstacle; thus:

VPECI has taken every possible measure for the completion of the project but the war situation in Iraq particularly the lack of foreign exchange is proving to be a great obstacle. Our performance counter guarantee was called last 26 October 1986 when the negotiations for a foreign currency loan with the Italian government through Banco de Roma bogged down following news report that Iraq has defaulted in its obligation with major European banks. Unless the situation in Iraq is improved as to allay the bank's apprehension, there is no assurance that the project will ever be completed. [58]

In order that the debtor may be in default it is necessary that the following requisites be present: (1) that the obligation be demandable and already liquidated; (2) that the debtor delays performance; and (3) that the creditor requires the performance because it must appear that the tolerance or benevolence of the creditor must have ended. [59]

As stated earlier, SOB cannot yet demand complete performance from VPECI because it has not yet itself performed its obligation in a proper manner, particularly the payment of the 75% of the cost of the Project in US Dollars. The VPECI cannot yet be said to have incurred in delay. Even assuming that there was delay and that the delay was attributable to VPECI, still the effects of that delay ceased upon the renunciation by the creditor, SOB, which could be implied when the latter granted several extensions of time to the former. [60] Besides, no demand has yet been made by SOB against the respondent contractor. Demand is generally necessary even if a period has been fixed in the obligation. And default generally begins from the moment the creditor demands judicially or extra-judicially the performance of the obligation. Without such demand, the effects of default will not arise. [61]

Moreover, the petitioner as a guarantor is entitled to the benefit of excussion, that is, it cannot be compelled to pay the creditor SOB unless the property of the debtor VPECI has been exhausted and all legal remedies against the said debtor have been resorted to by the creditor. [62] It could also set up compensation as regards what the creditor SOB may owe the principal debtor VPECI. [63] In this case, however, the petitioner has clearly waived these rights and remedies by making the payment of an obligation that was yet to be shown to be rightfully due the creditor and demandable of the principal debtor.

As found by the Court of Appeals, the petitioner fully knew that the joint venture contractor had collectibles from SOB which could be set off with the amount covered by the performance guarantee. In February 1987, the OMEAA transmitted to the petitioner a copy of a telex dated 10 February 1987 of the Philippine Ambassador in Baghdad, Iraq, informing it of the *note verbale* sent by the Iraqi Ministry of Foreign Affairs stating that the past due obligations of the joint venture contractor from the petitioner would "be deducted from the dues of the two contractors."^[64]

Also, in the *project situationer* attached to the letter to the OMEAA dated 26 March 1987, the petitioner raised as among the arguments to be presented in support of the cancellation of the counter-guarantee the fact that the amount of ID281,414/066 retained by SOB from the Project was more than enough to cover the counter-guarantee of ID271,808/610; thus:

6.1 Present the following arguments in cancelling the counterguarantee:

- The Iraqi Government does not have the foreign exchange to fulfill its contractual obligations of paying 75% of progress billings in US dollars.

...

- It could also be argued that the amount of ID281,414/066 retained by SOB from the proposed project is more than the amount of the outstanding counterguarantee.

^[65]

In a nutshell, since the petitioner was aware of the contractor's outstanding receivables from SOB, it should have set up compensation as was proposed in its *project situationer*.

Moreover, the petitioner was very much aware of the predicament of the respondents. In fact, in its 13 May 1987 letter to the OMEAA, DFA, Manila, it stated:

VPECI also maintains that the delay in the completion of the project was mainly due to SOB's violation of contract terms and as such, call on the guarantee has no basis.

While PHILGUARANTEE is prepared to honor its commitment under the guarantee, PHILGUARANTEE does not want to be an instrument in any case of inequity committed against a Filipino contractor. It is for this reason that we are constrained to seek your assistance not only in ascertaining the veracity of Al Ahli Bank's claim that it has paid Rafidain Bank but possibly averting such an event. As any payment effected by the banks will complicate matters, we cannot help underscore the urgency of VPECI's bid for government intervention for the amicable termination of the contract and release of the performance guarantee. ^[66]

But surprisingly, though fully cognizant of SOB's violations of the service contract and VPECI's outstanding receivables from SOB, as well as the situation obtaining in the

Project site compounded by the Iran-Iraq war, the petitioner opted to pay the second layer guarantor not only the full amount of the performance bond counter-guarantee but also interests and penalty charges.

This brings us to the next question: May the petitioner as a guarantor secure reimbursement from the respondents for what it has paid under Letter of Guarantee No. 81-194-F?

As a rule, a guarantor who pays for a debtor should be indemnified by the latter^[67] and would be legally subrogated to the rights which the creditor has against the debtor.^[68] However, a person who makes payment without the knowledge or against the will of the debtor has the right to recover only insofar as the payment has been beneficial to the debtor.^[69] If the obligation was subject to defenses on the part of the debtor, the same defenses which could have been set up against the creditor can be set up against the paying guarantor.^[70]

From the findings of the Court of Appeals and the trial court, it is clear that the payment made by the petitioner guarantor did not in any way benefit the principal debtor, given the project status and the conditions obtaining at the Project site at that time. Moreover, the respondent contractor was found to have valid defenses against SOB, which are fully supported by evidence and which have been meritoriously set up against the paying guarantor, the petitioner in this case. And even if the deed of undertaking and the surety bond secured petitioner's guaranty, the petitioner is precluded from enforcing the same by reason of the petitioner's undue payment on the guaranty. Rights under the deed of undertaking and the surety bond do not arise because these contracts depend on the validity of the enforcement of the guaranty.

The petitioner guarantor should have waited for the natural course of guaranty: the debtor VPECI should have, in the first place, defaulted in its obligation and that the creditor SOB should have first made a demand from the principal debtor. It is only when the debtor does not or cannot pay, in whole or in part, that the guarantor should pay.^[71] When the petitioner guarantor in this case paid against the will of the debtor VPECI, the debtor VPECI may set up against it defenses available against the creditor SOB at the time of payment. This is the hard lesson that the petitioner must learn.

As the government arm in pursuing its objective of providing "the necessary support and assistance in order to enable ... [Filipino exporters and contractors to operate viably under the prevailing economic and business conditions,"^[72] the petitioner should have exercised prudence and caution under the circumstances. As aptly put by the Court of Appeals, it would be the height of inequity to allow the petitioner to pass on its losses to the Filipino contractor VPECI which had sternly warned against paying the Al Ahli Bank and constantly apprised it of the developments in the Project implementation.

WHEREFORE, the petition for review on *certiorari* is hereby DENIED for lack of merit, and the decision of the Court of appeals in CA-G.R. CV No. 39302 is AFFIRMED.

No pronouncement as to costs.

SO ORDERED.

Panganiban, Ynares-Santiago, Carpio, and Azcuna, JJ., concur.

[1] Now known as the Trade Investment Development Corporation of the Philippines.

[2] Exhibit "V" and "2-3," Original Record, vol. III (hereinafter OR III), 395.

[3] Exh. 12-E," OR III, 433.

[4] Exh. 12-E," OR III, 433.

[5] Exh. "9-A," OR III, 416.

[6] Exh. "12-G," OR III, 435.

[7] Exh. "V," OR III, 395.

[8] Exh. "13-V," OR III, 447.

[9] CA Decision, 3.

[10] Exh. "A," OR III, 49.

[11] Exh. "B," OR III, 64.

[12] Exh. "11," OR III, 421.

[13] Exh. "12," OR III, 81.

[14] Exh. "E-1," OR III, 83.

[15] Exh. "1," OR III, 276.

[16] Exh. "1-J," OR III, 282.

[17] Exh. "A-1," OR III, 51.

[18] Exh. "E-2," OR III, 84.

[19] Exhs. "A-2" to "A-13," OR III, 51-63.

[20] Exhs. "B-2" to "B-4," OR III, 67-69.

[21] Exhs. "E" to "E-12," OR III, 84.

[22] TSN, 10 April 1992, 41-44.

[23] Exh. "22," OR III, 344-345.

[24] Exh."40," OR III, 366.

[25] Exh. "16," OR III, 220.

[26] Exh. "G-12-a," OR III, 207.

[27] Exh. 7-A," OR III, 306.

[28] Exh. "G-12-g," OR III, 213.

[29] Exh. "I," OR III, 230.

[30] Exh."G-12-h," OR III, 214.

[31] Exhs. "G-13-d" to "G-13-f," OR III, 220-222; Exh."G-12-h," OR III, 214.

[32] Exhs. "Q" to "T," OR III, 254-263.

[33] Per Judge Zosimo Z. Angeles. *Rollo*, 72-79.

[34] Per Associate Justice Martin S. Villarama, Jr. with Associate Justices Angelina Sandoval-Gutierrez (now Supreme Court Associate Justice) and Romeo A. Brawner concurring. *Rollo*, 48-71.

[35] *Rollo*, 61-68.

[36] *Id.*, 293-294.

[37] Article 2047, Civil Code.

[38] E. Zobel Inc. v. CA, G.R. No. 113931, 6 May 1998, 290 SCRA 1; VI Ambrosio Padilla, Civil Law 497-498 (5th ed. 1969)(hereinafter Padilla) .

[39] Exh. "A," OR III, 49-50.

[40] VI Padilla 494.

[41] Black's Law Dictionary 635 (5th ed. 1979).

[42] Art. 2047, Civil Code.

[43] Alba v. Court of Appeals, G.R. No. 120066, 9 September 1999, 314 SCRA 36.

[44] Development Bank of the Philippines v. Court of Appeals, G.R. No. 119712, 29 January 1999, 302 SCRA 362.

[45] DISEDERIO P. JURADO, COMMENTS AND JURISPRUDENCE ON OBLIGATIONS AND CONTRACTS 49 (7TH Revised ed. 1980) (hereinafter JURADO).

[46] JOVITO R. SALONGA, PRIVATE INTERNATIONAL LAW 350 (1995 ed.) (hereinafter SALONGA).

[47] EDGARDO L. PARAS, PHILIPPINE CONFLICT OF LAWS 414 (6th ed. 1984).

[48] SALONGA, 356.

[49] *Id.*, 355.

[50] JORGE R. COQUIA & ELIZABETH A. PANGALANGAN, CONFLICT OF LAWS 418 (1995 ed.).

[51] Lim v. Collector of Customs, 36 Phil. 472 (1917); International Harvester Co. v. Hamburg-American Line, 42 Phil. 845; Miciano v. Brimo, 50 Phil. 867 (1924).

[52] IV ARTURO M. TOLENTINO, COMMENTARIES AND JURISPRUDENCE ON THE CIVIL CODE OF THE PHILIPPINES 101 (hereinafter TOLENTINO).

[53] JURADO, 50.

[54] Exhs. "16" to "16-O," OR III, 454-469.

[55] See Court of Appeals' Decision, 19, *Rollo*, 66; RTC's Decision, 22, *Rollo*, 93.

[56] RTC's Decision, 22; *Rollo*, 93.

[57] Exhs. "4-A" to "4-D," OR III, 296-298.

[58] Exh. "25," OR III, 352.

[59] IV Tolentino 110.

[60] *Id.*,102.

[61] *Id.*,110.

[62] Art. 2058, Civil Code.

[63] Art.1280, Civil Code.

[64] Exh. "23," OR III, 348-349.

[65] Exh. "25-E," OR III, 355.

[66] Exh. "5," OR III, 303-304.

[67] Art. 2066, Civil Code.

[68] Arts. 1302(3) and 2067, Civil Code.

[69] Art. 1236, second par., Civil Code.

[70] VI PADILLA, 545.

[71] V TOLENTINO, 521.

[72] 4th Whereas Clause of Executive Order No. 185, which took effect on 5 June 1987.



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